**FHB Mortgage Bank Plc.**

*CONSOLIDATED FINANCIAL STATEMENTS IN ACCORDANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS AS ADOPTED BY THE EUROPEAN UNION FOR THE YEAR ENDED DECEMBER 31, 2017*

# 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 2017

**Consolidated Financial Statements in Accordance with the International Financial Reporting Standards adopted by the European Union – 31 December 2017**

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# GENERAL INFORMATION

## 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

Dr. Gyula László Nagy
Edit Erika Tóth

## Chief Executive Officers

Dr. Gyula László Nagy (Chief Executive Officer from 26/04/2017)
Edit Erika Tóth (Deputy Chief Executive Officer from 26/04/2017)

## Large Shareholders Liaison Officer and Secretary

Rita Bozzai

## Small Shareholders Liaison Officer

Béla Kappéter

## Auditor

Deloitte Ltd.

## Seat of the Bank, central office

Budapest.
Üllői út 48.
1082

Deloitte.

Deloitte Auditing and Consulting Ltd.
H-1068 Budapest,
Dózsa György út 84/C, Hungary
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Registered by the Capital Court of Registration
Company Registration Number: 01-09-071057

# INDEPENDENT AUDITOR'S REPORT

To the Shareholders 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 2017 which comprise the consolidated statement of financial position as at December 31, 2017 – which shows a total assets of HUF 610,577 million –, and the related consolidated statement of recognized income, consolidated statement of comprehensive income – which shows a net loss for the year of HUF 8,188 million –, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended and notes to the consolidated 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 consolidated financial position of the Group as at December 31, 2017 and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union (the „EU IFRS"), and the consolidated financial statements were prepared in all material respects in accordance with the provisions of the effective Hungarian Act C of 2000 on Accounting (hereinafter: "the Accounting Act") relevant to the entities preparing consolidated financial statements in accordance with EU IFRS.

***Basis for 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 relevant effective Hungarian regulations and the "Rules of conduct (ethical rules) of the auditor profession and the disciplinary process" of the Chamber of Hungarian Auditors and, in respect of matters not regulated therein, the "Code of Ethics for Professional Accountants" (the IESBA Code) issued by the International Ethics Standards Board for Accountants, 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)<br><br>The net value of loans and advances to customers in an amount of HUF 310,632 million comprise 51% of the total assets (the gross book value of HUF 329,992 million), the relevant impairment charge recorded in the current year was HUF 5,708 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:<br><br>- valuation of collaterals<br><br>- probability of default<br><br>- estimate that future cash-flows expected to be realized.<br><br>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:<br><br>- evaluate internal controls relating to origination and monitoring of loans,<br><br>- 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<br><br>- evaluate of specific loan impairments with random sample, including the review of consideration and valuation of collaterals and estimations of expected future cash-flows,<br><br>- evaluating the underlying assumption of collective provisioning models,<br><br>- assess the balloon and bullet conditions of corporate loans and the review of consideration these conditions at individual provisioning,<br><br>- evaluating of appropriateness of related 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 the Group for 2017, 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 provisions of the effective Hungarian 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 the Group for 2017 corresponds to the consolidated financial statements of the Group for 2017 and the relevant provisions of the Accounting Act in all material respects. 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 consolidated business report, we have not formulated an opinion on this matter.

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 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 the 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 and the effective Hungarian laws and other regulations on audits 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 and the effective Hungarian laws and other regulations on audits, 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.

***Report on Other Legal and Regulatory Requirements***

In compliance with Article 10 (2) of Regulation (EU) No. 537/2014 of the European Parliament and the Council, we provide the following information in our independent auditor's report, which is required in addition to the requirements of International Standards on Auditing:

*Appointment of the Auditor and the Period of Engagement*
We were appointed as the auditors of the FHB Mortgage Bank Plc. by the General Meeting of Shareholders on April 28, 2016 and our uninterrupted engagement has lasted for 6 years.

*Consistence with the Additional Report to the Audit Committee*
We confirm that our audit opinion on the consolidated financial statements expressed herein is consistent with the additional report to the Audit Committee of the FHB Mortgage Bank Plc., which we issued on April 5, 2018 in accordance with Article 11 of Regulation (EU) No. 537/2014 of the European Parliament and the Council.

*Provision of Non-audit Services*
We declare that no prohibited non-audit services referred to in Article 5 (1) of Regulation (EU) No. 537/2014 of the European Parliament and the Council were provided by us to the Group. In addition, there are no other non-audit services which were provided by us to the FHB Mortgage Bank Plc. and its controlled undertakings and which have not been disclosed in the consolidated financial statements.

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

Budapest, April 5, 2018

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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 2017

| | Notes | 2017 | 2016 |
|---|---|---|---|
| Interest income | 4 | 22,684 | 28,225 |
| Interest expense | 4 | (9,839) | (16,469) |
| **Net interest income** | | **12,845** | **11,756** |
| Fee and commission income | 5 | 7,811 | 8,254 |
| Fee and commission expense | 5 | (2,236) | (2,187) |
| **Net fee and commission income** | | **5,575** | **6,067** |
| Profit/(loss) from foreign exchange transactions | | 446 | 279 |
| Change in fair value of financial instruments | 36 | 85 | 965 |
| Gains from securities | | 1,390 | 3,033 |
| Net result from investment services | | 192 | 262 |
| **Net trading result** | | **2,113** | **4,539** |
| Other operating income | 6 | 1,090 | 1,619 |
| Other operating expense | 7 | (11,528) | (7,707) |
| **Operating income, net** | | **10,095** | **16,274** |
| Provision for impairment losses on loans | 19 | (1,634) | (8,047) |
| General and administrative expenses | 8 | (17,783) | (17,799) |
| **Loss before tax** | | **(9,322)** | **(9,572)** |
| Income tax benefit/(expense) | 11 | (1,889) | (5,799) |
| Profit/(loss) from discontinued operations | 17 | 3,023 | (131) |
| **Loss for the year** | | **(8,188)** | **(15,502)** |
| Attributable to: loss of shareholders of the Bank | | (3,949) | (11,048) |
| Attributable to: non-controlling interests | | (4,239) | (4,454) |
| **Earnings per share (HUF 100 face value)** | 32 | | |
| *Basic earnings per share (HUF)* | | **(40.74)** | **(102.07)** |
| *Diluted earnings per share (HUF)* | | **(40.74)** | **(102.07)** |

*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 2017

| | Notes | 2017 | 2016 |
|---|---|---|---|
| Loss for the year | | (8,188) | (15,502) |
| Other comprehensive income | | | |
| Items that may be reclassified to profit or loss: | | | |
| Change in Cash-flow hedge reserve | | 5 | - |
| Change in fair value of financial assets available-for-sale | | 721 | 30 |
| Foreign currency translation reserve | | 2 | (18) |
| Deferred tax effect for other comprehensive income | | (65) | (1) |
| Other comprehensive income/(loss) for the period net of taxes | 12 | 663 | 11 |
| **Total comprehensive income for the year, net of income taxes** | | **(7,525)** | **(15,491)** |
| Attributable to: loss of shareholders of the Bank | | (3,286) | (11,037) |
| Attributable to: non-controlling interests | | (4,239) | (4,454) |

*All figures in tables are in HUF million except otherwise noted*

## Consolidated Statement of Financial Position as at 31 December 2017

| | Notes | 31 December 2017 | 31 December 2016 |
|---|---|---|---|
| **Assets** | | | |
| Cash on hand | | 3,135 | 4,327 |
| Balances with the National Bank of Hungary | 13 | 33,165 | 60,635 |
| Due from banks | 14 | 48,797 | 70,289 |
| Securities held for trading | 15 | 46,651 | 40,734 |
| Financial assets available-for-sale | 16 | 80,198 | 66,295 |
| Shares in associates and joint ventures | 29 | - | 4,816 |
| Derivative financial assets | 36 | 410 | 933 |
| Refinanced mortgage loans | 18 | 76,597 | 31,423 |
| Loans and advances to customers | 19 | 310,632 | 294,473 |
| Investment property | 21 | - | 780 |
| Tangible assets | 22 | 2,847 | 4,942 |
| Goodwill and other intangible assets | 20,23 | 1,128 | 2,042 |
| Deferred tax asset | 11 | 811 | 3,030 |
| Other assets | 24 | 6,206 | 8,685 |
| **Total assets** | | **610,577** | **593,404** |

*All figures in tables are in HUF million except otherwise noted*

## Consolidated Statement of Financial Position as at 31 December 2017

| | Notes | 31 December 2017 | 31 December 2016 |
|---|---|---|---|
| **Liabilities** | | | |
| Due to banks | 25 | 33,983 | 47,229 |
| Deposits from customers | 28 | 329,253 | 297,072 |
| Derivative financial liabilities | 36 | 1,078 | 1,579 |
| Issued securities | 26 | 176,947 | 170,283 |
| Financial liabilities at fair value through profit or loss, except for derivatives | 27 | 7,016 | 11,991 |
| Finance lease liabilities | | - | 3 |
| Current tax liability | | 21 | - |
| Deferred tax liability | 11 | - | - |
| Provisions | 30 | 6,251 | 1,546 |
| Other liabilities | 31 | 5,696 | 6,099 |
| **Total liabilities** | | **560,245** | **535,802** |
| **Shareholders' equity** | | | |
| Share capital | 32 | 10,849 | 10,849 |
| Treasury shares | 32 | (207) | (207) |
| Retained earnings | | (2,796) | 1,613 |
| Other reserve | 32 | 29,658 | 28,535 |
| Non-controlling interest | 32 | 12,828 | 16,812 |
| **Total shareholders' equity** | | **50,332** | **57,602** |
| **Total liabilities and shareholders' equity** | | **610,577** | **593,404** |

Budapest, 5 April 2018

***Dr. Gyula László Nagy***
CEO

***Edit Erika Tóth***
Deputy CEO

*All figures in tables are in HUF million except otherwise noted*

## Consolidated Statement of Cash Flows for the year ended 31 December 2017

| | Notes | 2017 | 2016 |
|---|---|---|---|
| Cash flow from operating activities | | | |
| Loss for the year | | (8,188) | (15,502) |
| Non-cash adjustments to net loss from: | | | |
| Depreciation and amortization | 22,23 | 409 | 475 |
| Impairment of tangible assets | 22,23 | 1,035 | 1,100 |
| (Release)/provision of provision for losses | | (1,125) | (569) |
| Gain/ (loss) on tangible assets derecognized | | 1,609 | (7) |
| Gain/ (loss) on intangible assets derecognized | | (28) | 45 |
| Capitalized interest on loans and advanced to customers | | 718 | 317 |
| Fair value adjustment of derivatives | 36 | 27 | (778) |
| Fair value adjustment on financial liabilities through profit or loss, except derivatives | | 59 | (987) |
| Change in foreign currency translation reserve | | 2 | (16) |
| Change in investment in associates | 29 | - | 2,939 |
| Finance lease liabilities | | (3) | (9) |
| **Operating loss before change in operating assets** | | **(5,485)** | **(12,992)** |
| Decrease/(Increase) in operating assets: | | | |
| Securities held for trading | | (5,917) | 11,179 |
| Financial assets available-for-sale | | (14,518) | 7,773 |
| Refinanced mortgage loans | | (45,174) | 51,367 |
| Loans and advances to customers | | (23,135) | (5,376) |
| Other assets | | 1,009 | 4,586 |
| Increase/(Decrease) in operating liabilities: | | | |
| Deposits from customers | | 32,181 | (31,976) |
| Due to banks | | (220,304) | (85,290) |
| Other liabilities | | 1,608 | (3,053) |
| **Net cash flow from operating activities** | | **(279,735)** | **(63,782)** |

*All figures in tables are in HUF million except otherwise noted*

## Consolidated Statement of Cash Flows for the year ended 31 December 2017 - continued

| | Notes | 2017 | 2016 |
|---|---|---|---|
| **Cash flow from investing activities** | | | |
| Proceeds from sales of tangible assets | | 119 | 35 |
| Purchase of tangible and intangible assets | | (871) | (549) |
| **Net cash outflow from investing activities** | | **(752)** | **(514)** |
| **Cash flow from financing activities** | | | |
| Proceed from issued securities | | 73,960 | 39,248 |
| Principal repayment on issued securities | | (72,330) | (110,981) |
| Repayment of long term loans | | 227,796 | 92,745 |
| Dividend payment to non-controlling interests | | 254 | (214) |
| Repayment of Capital Securities (additional tier1 capital) | | - | (35,225) |
| **Net cash outflow from financing activity** | | **229,680** | **(14,427)** |
| Net (decrease)/increase in cash and cash equivalents | | (50,807) | (78,723) |
| Net effect of the sale of subsidiaries and joint venture | 17 | 653 | - |
| Opening balance of cash and cash equivalents | | 135,251 | 213,974 |
| Closing balance of cash and cash equivalents | | **85,097** | **135,251** |
| **Breakdown of cash and cash equivalents:** | | | |
| Cash on hand | | 3,135 | 4,327 |
| Balances with the National Bank of Hungary | | 33,165 | 60,635 |
| Due from banks with a maturity of less than 90 days | | 48,797 | 70,289 |
| **Closing balance of cash and cash equivalents** | | **85,097** | **135,251** |
| *Supplementary data* | | | |
| *Income tax paid* | | *(803)* | *(1,451)* |
| *Interest received* | | *23,537* | *28,759* |
| *Interest paid* | | *(14,304)* | *(19,367)* |

*All figures in tables are in HUF million except otherwise noted*

## Consolidated Statement of Changes in Equity for the year ended 31 December 2017

| | Notes | Share capital | Treasury shares | Share premium | General reserve | Cash flow hedge 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 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) |
| **1 January 2017** | | **10,849** | **(207)** | **27,926** | **-** | **-** | **-** | **611** | **(2)** | **1,613** | **16,812** | **57,602** |
| Loss for the year | | | | | | | | | | (3,949) | (4,239) | (8,188) |
| Other comprehensive income | 12 | | | | | 5 | | 656 | 2 | | | 663 |
| Change in non-controlling interests | | | | | | | | | | | | - |
| Dividend payment to NCI | | | | | | | | | | | 255 | 255 |
| General reserve | | | | | 460 | | | | | (460) | | - |
| **31 December 2017** | | **10,849** | **(207)** | **27,926** | **460** | **5** | **-** | **1,267** | **-** | **(2,796)** | **12,828** | **50,332** |

**Subordinated loans*

*All figures in tables are in HUF million except otherwise noted*

## Notes to the Consolidated Financial Statements

### 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.

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 partnership program with Allianz was adopted by the Board of Directors of FHB Mortgage Bank, the plan included the acquisition of the Allianz Bank, which merged into the FHB Commercial Bank Ltd in 2011. The Board of Directors also approved “The bank of the families” concept, meaning a customer- and service-driven sales attitude.

In 2013, FHB Mortgage Bank managed several acquisitions, there through broadened the Banking Group and the range of activities. It included the acquisition of Diófa Alapkezelő Zrt. (Diófa Fund Management Ltd.), the purchase of the Díjbeszedő Operational and Service Limited Liability Company, hereinafter the “DÜSZ”), that come into being after a demerge from Díjbeszedő Holding Ltd. (DBH), the Díjbeszedő Faktorház Co. Plc. (“DBF”), DíjNET Ltd., Díjbeszedő Informatikai Lld (“DBIT”) and the portion of the ownership of the Magyar Posta (Hungarian Post).

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 some of their jointly controlled companies, furthermore in course of the harmonization of their business activities.

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. (hereinafter the Takarékbank).

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 under its qualifying holding and prudential supervisory FHB Commercial Bank Ltd. became a member of Integration Organisation of Cooperative Credit Institution (SZHISZ) in September 2015, and also the member of the Guarantee Group of Cooperative Credit Institutions, and a member of the country's fourth largest banking group.

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 not listed on the Budapest Stock Exchange, they were purchased by the members of the Integration.

As parent company of FHB Group, the Mortgage Bank exercised its rights over the Group companies until 2017, the rights were transferred to Takarékbank in 2017 according to the strategy of SZHISZ.

The satellite financial entities of the FHB Group, including the fund management, the leasing and factoring services and the centralized debt collection were taken over in December 2017 by the Takarékbank, the leader of the Integration. Takarékbank extended the provision of investment services also to the customers of the FHB Group from 2017, supported by the FHB Commercial Bank, as investment agent.

From the second quarter of 2018 the FHB Mortgage Banks continues its operations purely as a mortgage bank, the FHB Commercial Bank will provide retail mortgage lending services to customers. However, the existing loan portfolio remains at FHB Mortgage Bank until expiry.

The big commercial bank of the Integration represents the Takarék Group around the greater towns and Budapest, as a big bank competing, high prestige institution, however, the Takarék Group ceased to operate branches in smaller villages in 2017.

The consolidated financial statements for the year ended 31 December 2017 were authorized for issue in accordance with a resolution of the Board of Directors on 5 April 2018. 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 2017*

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 IAS 7 „Statement of Cash Flows"** - Disclosure Initiative (endorsed on 6 November 2017, 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 (endorsed on 6 November 2017, effective for annual periods beginning on or after 1 January 2017).

The adoption of these amendments to the existing standards and interpretation has not led to any changes in the Group's accounting policies.

### *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:

- **Amendments to IFRS 4 "Insurance Contracts"** - Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (endorsed on 3 November 2017, effective for annual periods beginning on or after 1 January 2018),
- **Clarifications to IFRS 15 "Revenue from Contracts with Customers"** (endorsed on 31 October 2017, effective for annual periods beginning on or after 1 January 2018),
- **IFRS 16 "Leases"** (endorsed on 31 October 2017, effective for annual periods beginning on or after 1 January 2019),
- **IFRS 9 "Financial Instruments"** (endorsed on 22 November 2016, effective for annual periods beginning on or after 1 January 2018),
- **IFRS 15 "Revenue from Contracts with Customers"** including amendments to IFRS 15: Effective date of IFRS 15 (endorsed on 22 September 2016, effective for annual periods beginning on or after 1 January 2018),

The Group is planning to analyse the impact IFRS 16 "Leases" standard after adequate test runs. After this work the Group to be able switch to IFRS based bookkeeping on 01. January 2019 and be able to provide high quality IFRS 16 information after the transition. The effects of IFRS 9 are presented in Note 53.

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

At present, IFRS as adopted by the EU do not significantly differ from regulations adopted by the International Accounting Standards Board (IASB) except from the following standards, amendments to the existing standards and interpretations, which were not endorsed for use in EU as at 31 December 2017 (the effective dates stated below is for IFRS in full):

- **IFRS 17 "Insurance Contracts"** (effective for annual periods beginning on or after 1 January 2021),
- **IFRIC 22 "Foreign Currency Transactions and Advance Consideration**" (effective for annual periods beginning on or after 1 January 2018),
- **IFRIC 23 "Uncertainty over Income Tax Treatments"** (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),
- **Annual Improvements to IFRS Standards 2014-2016 Cycle** (Amendments to IAS 28 effective for annual periods beginning on or after 1 January 2017, Amendments to IFRS 1 effective for annual periods beginning on or after 1 January 2018, )
- **Amendments to IAS 40 "Investment Property"** - Transfers of Investment Property (effective for annual periods beginning on or after 1 January 2018),
- **Amendments to IFRS 9 "Financial Instruments"** - Prepayment Features with Negative Compensation (effective for annual periods beginning on or after 1 January 2019),
- **Amendments to IAS 28 "Investment in Associates and Joint Ventures" -** Long-term Interests in Associates and Joint Ventures (effective for annual periods beginning on or after 1 January 2019),

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.
At the same time, hedge accounting regarding the portfolio of financial assets and liabilities, whose principles have not been adopted by the EU, is still 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 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 2017.
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, one branch in Germany (FHB Commercial Bank Ltd. Niederlassung Frankfurt) and one branch in Croatia (Central European Credit d.d.). 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"). In 2016 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 FHB Group has sold the satellite financial entities in December 2017 to the Takarékbank, the leader of the Integration and the Magyar Takarék Befektetési és Vagyongazdálkodási Ltd. has been sold to an external investor. The remaining subsidiaries at the end of 2017 are in the following table.

The list of the subsidiaries, the Bank as at 31 December 2017 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 |
| Magyar Kártya Szolgáltató Ltd. | FHB Commercial Bank Ltd. 99.18% | Providing services related to bank cards, and electronic payment systems | S |

** Relationship: "S"=subsidiary.*

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

*All figures in tables are in HUF million except otherwise noted*

### 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% |
| | |
| 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.
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.

*All figures in tables are in HUF million except otherwise noted*

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 33, 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 52). 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 is 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*

The credit institutions as financial institutions are taxable entities of the Act LIX of 2006 on the Introduction of Special Tax and Bankers' contribution intended to improve the Balance of Public Finances.
For tax year 2017 the tax base is the total assets of the second financial year preceding the tax year (2015), while for 2016 the basis and rates are 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 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.

The special tax for financial institutions will be paid in accordance with the amount of special tax for credit institutions paid by FHB Mortgage Bank Ltd in 2017.
In 2017 there was no tax liability because of the contribution payable by credit institutions.

### 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 36)

*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 33)

*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 2016 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

The Hungarian Central Bank (Central Bank) established the label of consumer friendly housing loan in order to increase the transparency and the comparability of the housing loans, which label can be obtained by loans meeting certain requirements. Members of the Takarék Group were first to meet these requirements set by Central Bank; FHB Bank Ltd. got the label on 23 June 2017, other members of the Integration on 5 July 2017, on the basis of which they are entitled to sell Qualified Consumer friendly Housing Loan. The sales of the Qualified Consumer friendly Housing Loan are increasing permanently; FHB Bank Ltd.'s loan disbursement in January 2018 was higher than HUF 2 billion, which came to half of the sales in January. The credit cooperatives have launched the new product successively after obtaining the label; increases in sales are expected in 2018. Based on the positive clients' feedback it can be stated that Qualified Consumer friendly Housing Loan is a good direction in responsible lending, strengthens the competition thanks to the transparent and comparable conditions, furthermore FHB Bank Ltd. and the credit cooperatives gained significant and increasing market share.

The modification of Act CXXXV of 2013 on the Integration of Cooperative Credit Institutions and on the Amendment of Certain Statutes Related to Matters of Economy came into force on 1st August 2017. The modification refined the relations among the members of the Integration, moreover the rights and obligations of the Integration Organization and the Savings Bank towards the credit cooperatives. The Integration Organization is the highest leading body with prudential control and institutional protection tasks. Therefore the modification gives certain rights to the Integration Organization, thus this organization supervises directly the credit institutions and the Savings Bank. To the contrary, Savings Bank – contributing to the performance of the central function of the Integration Organization – on one side pursues independent business management activities, and on the other hand provides central banking services to the credit cooperatives, and its tasks are regulated respectively and separately from the prudential control tasks of the Integration Organization. The modification modernizes and transforms the rules, which secure that credit cooperatives' and the Saving Bank's operation are in line with the relevant laws and the integrational aims. Hence the dismemberment from the Integration and the suspension of the membership as measures are repealed.

The modification contains detailed regulation regarding the set up and operation of a modern, economically operated IT system, meeting the needs of the credit institution sector, securing prudential compliance and supporting the common client service, which system is available for the members of the Integration Organization operating in joint responsibility. The unified IT system helps to meet the requirements defined by law, and the common database makes it possible for the leading institutions to expansively control the sector, to assess and handle the risks effectively. The legal requirement of switching to the unified IT system till 31 December 2017 was fulfilled by both FHB Mortgage Bank Co. Plc. and FHB Bank Ltd.

On 1st April 2017 Decree Nr. 20/2015 (VI.29.) of the Governor of the Central Bank on the regulation of the forint maturity mismatch of credit institutions became effective, which established the mortgage funding adequacy ratio. The aim of the ratio is to ensure the funding of the retail mortgage loans in the banking system by long term stabile mortgage bonds. As a result FHB Co. Plc.'s refinancing activity rose in 2017, and with 11 banking partners the refinanced loan stock grew to HUF134.972 billion by the end of the year.

## 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

| | 2017 | 2016 |
|---|---|---|
| ***Interest income*** | | |
| Loans and advances to customers | 17,542 | 18,979 |
| Refinanced mortgage loans | 2,644 | 4,878 |
| Due from banks | 396 | 1,137 |
| *Interest income on assets carried at amortised cost* | *20,582* | *24,994* |
| | | |
| Securities held for trading | 425 | 1,615 |
| Financial assets available-for-sale | 857 | 1,257 |
| Interest on derivative transactions | 820 | 359 |
| *Interest income on assets carried at fair value* | *2,102* | *3,231* |
| **Total** | **22,684** | **28,225** |

Accrued interest receivable on impaired loans amounted to HUF 36 million (2016: HUF 50 million).

| | 2017 | 2016 |
|---|---|---|
| ***Interest expense*** | | |
| Mortgage bonds | 6,811 | 9,673 |
| Due to banks | 46 | 98 |
| Interest paid on deposits | 1,008 | 2,369 |
| Interest on bonds | 769 | 2,906 |
| Interest expense on leases | - | - |
| *Interest expense on liabilities carried at amortised cost* | *8,634* | *15,046* |
| | | |
| Interest on derivative transactions | 867 | 949 |
| Mortgage bonds | 338 | 474 |
| Interest on bonds | - | - |
| *Interest expense on liabilities carried at fair value* | *1,205* | *1,423* |
| **Total** | **9,839** | **16,469** |

The interest income from loans and refinanced mortgage loans includes HUF 2,372 million interest subsidy in 2017 (2016: HUF 4,290 million).

*All figures in tables are in HUF million except otherwise noted*

## 5. FEE AND COMMISSION INCOME AND EXPENSE

| | 2017 | 2016 |
|---|---|---|
| ***Fee and commission income*** | | |
| Mortgage loans of the Bank | 566 | 588 |
| Refinanced mortgage loans* | 70 | 1,097 |
| Handling commission | 168 | 150 |
| Real estate appraisal fee | 84 | 59 |
| Deposit fee income | 3,587 | 3,375 |
| Agency fee income | 348 | 362 |
| Card business | 1,881 | 1,525 |
| Investment services | 301 | 183 |
| Postal giro (PEK) commission | 374 | 469 |
| Other | 432 | 446 |
| **Total** | **7,811** | **8,254** |

**Include one-off fees related to repayment of refinanced loans of AXA Bank in 2016.*

| | 2017 | 2016 |
|---|---|---|
| ***Fee and commission expense*** | | |
| Investment services | 593 | 847 |
| Agency fees and commissions | 601 | 470 |
| Card business | 779 | 651 |
| Fees and commissions to banks and to clearing house | 166 | 204 |
| Other | 97 | 15 |
| **Total** | **2,236** | **2,187** |

## 6. OTHER OPERATING INCOME

| | 2017 | 2016 |
|---|---|---|
| Income from damages compensations received | - | 426 |
| Income from sold inventory | 9 | 16 |
| Rental income on property | 65 | 71 |
| Invoiced expenses and services | 581 | 588 |
| Tax refunds for previous years | 160 | - |
| Other | 275 | 518 |
| **Total** | **1,090** | **1,619** |

*All figures in tables are in HUF million except otherwise noted*

## 7. OTHER OPERATING EXPENSE

| | 2017 | 2016 |
|---|---|---|
| Bank tax (detailed in a) below) | 3,503 | 4,154 |
| Other payable taxes and contributions* | 820 | - |
| Impairment of non-financial assets | 1,580 | 6 |
| Provision for expected liabilities (Note 30) | 3,988 | 667 |
| Donation | 5 | 32 |
| Tax penalty, late penalty | 72 | 214 |
| Supervisory and other fees | 1,246 | 1,147 |
| Loss on sold property | 35 | 7 |
| Loss on damages compensations paid | 13 | - |
| P&L effect of settlement and forint conversion in other operating expense | 9 | 633 |
| Other | 257 | 847 |
| **Total** | **11,528** | **7,707** |

*Include the local business tax and the innovation contribution in 2017, this tax and contribution are presented on the Income tax benefit/(expense) line in the Consolidated Statement of Profit or Loss in 2016.

### a) Bank tax

The amount of Bank tax booked for 2017 by group members is detailed in the following table:

| | 2017 | 2016 |
|---|---|---|
| FHB Mortgage Bank Plc. | 365 | 1,144 |
| FHB Commercial Bank Ltd.* | 3,138 | 3,010 |
| **Total** | **3,503** | **4,154** |

*Include 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 | 2017 | 2016 |
|---|---|---|---|
| Staff costs | 9 | 7,270 | 7,031 |
| Marketing and advertising | | 438 | 866 |
| General and administrative costs | | 1,748 | 1,760 |
| Rental fee | 10 | 1,136 | 1,045 |
| Depreciation | 22 | 273 | 309 |
| Amortisation | 23 | 136 | 124 |
| Consultancy fees | | 607 | 748 |
| Maintenance costs | | 5,513 | 5,254 |
| Other taxes | | 40 | 39 |
| Insurance fees | | 38 | 27 |
| Database system usage | | 178 | 199 |
| Other | | 406 | 397 |
| **Total** | | **17,783** | **17,799** |

## 9. STAFF COSTS

| | 2017 | 2016 |
|---|---|---|
| Wages and salaries | 5,262 | 4,920 |
| Social security contribution | 1,330 | 1,495 |
| Other personnel related payments | 679 | 616 |
| **Total** | **7,270** | **7,031** |

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 811 (2016: 908).

*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 2017<br>Minimum lease payments | 31 December 2016<br>Minimum lease payments |
|---|---|---|
| Within 12 month | 2,243 | 2,304 |
| Between 1 and 5 years | 1,414 | 1,846 |
| Over 5 years | 758 | 775 |
| **Total** | **4,415** | **4,925** |

| | Minimum lease payments | Contingent rents | Sublease payments | Total |
|---|---|---|---|---|
| Expense in the period 2017 | 1,155 | - | (16) | 1,139 |
| Expense in the period 2016 | 1,108 | - | (20) | 1,088 |

*All figures in tables are in HUF million except otherwise noted*

## 11. INCOME TAX

| | 31 December 2017 | 31 December 2016 |
|---|---|---|
| **Current income tax** | **-** | **924** |
| Corporate income tax | - | 112 |
| Local business tax* | - | 714 |
| Innovation contribution* | - | 98 |
| **Deferred tax expense/(benefit)** | **1,889** | **5,258** |
| **Total** | **1,889** | **6,182** |

*The local business tax and the innovation contribution are presented on the "Other operating expense" line in the Consolidated Statement of Profit or Loss in 2017.

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 January 2017).
Based on this information the Group calculated the deferred tax with the 9% tax rate in 2017 and in 2016.

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 2017 | 31 December 2016 |
|---|---|---|
| *Loss before tax* | *(9,322)* | *(9,320)* |
| Calculated corporate income tax (9%) | (839) | (1,771) |
| Local business tax and innovation contribution | - | 812 |
| Effect of local business tax and innovation contribution to the corporate income tax | - | (155) |
| Items modifying the Hungarian tax base | 635 | 3,451 |
| Items modifying because of investments accounted for using the equity method | - | (46) |
| Subsidiaries' tax losses not to be carried forward | - | 3 |
| Effect of deferred tax rate | - | 4,131 |
| Effect of the reduction of the available taxable profit | 2,220 | - |
| Effect of other modifications | (127) | (243) |
| **Total income tax expense/(benefit)** | **1,889** | **6,182** |

*All figures in tables are in HUF million except otherwise noted*

## Notes to the Consolidated Financial Statements

*Deferred tax position*

| | 31 December 2017 | | | | |
|---|---|---|---|---|---|
| | Deferred tax assets | Deferred tax liabilities | Deferred tax net position | Income statement effect | Deferred tax position in reserves |
| Disbursement fee | 25 | - | 25 | (346) | - |
| Derivatives | 120 | - | 120 | (42) | - |
| Impairment | (120) | - | (120) | 127 | - |
| Suspended interest | (157) | - | (157) | 244 | - |
| Acquisition | (38) | - | (38) | 3 | - |
| Tax loss carried forward | 1,264 | - | 1,264 | (2,477) | - |
| Effect of consolidation | (269) | - | (269) | 363 | - |
| AFS securities | (14) | - | (14) | 27 | (65) |
| Deferred tax of foreign subsidiaries | - | - | - | 212 | - |
| **Net deferred tax position** | **811** | **-** | **811** | **(1,889)** | **(65)** |

*All figures in tables are in HUF million except otherwise noted*

| | 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) | - |
| 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) |
| 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*

## 12. OTHER COMPREHENSIVE INCOME

### Components of other comprehensive income

| | 31 December 2017 | 31 December 2016 |
|---|---|---|
| **Other comprehensive income** | | |
| Cash-flow hedge reserve | 5 | - |
| including: change in fair value | 5 | - |
| including: reclassification to profit or loss | - | - |
| Financial asset available-for-sale | 721 | 30 |
| including: change in fair value | 614 | 45 |
| including: reclassification to profit or loss | 107 | (15) |
| Foreign currency translation | 2 | (18) |
| Deferred tax effect | (65) | (1) |
| **Total** | **663** | **11** |

### Deferred tax effects relating to other comprehensive income

| | 31 December 2017 | | | 31 December 2016 | | |
|---|---|---|---|---|---|---|
| | Before tax amount | Deferred tax | Net of tax amount | Before tax amount | Deferred tax | Net of tax amount |
| **Other comprehensive income** | | | | | | |
| Cash-flow hedge reserve | 5 | - | 5 | - | - | - |
| Financial assets available-for-sale | 721 | (65) | 656 | 30 | (3) | 27 |
| Foreign currency translation | 2 | - | 2 | (18) | 2 | 16 |
| **Total** | **728** | **(65)** | **663** | **12** | **(1)** | **11** |

*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 2017 | 31 December 2016 |
|---|---|---|
| Short term deposits | 28,235 | 45,252 |
| Nostro account at National Bank of Hungary | 4,925 | 15,358 |
| Accrued interest for the period | 5 | 25 |
| **Total** | **33,165** | **60,635** |

## 14. DUE FROM BANKS

| | 31 December 2017 | 31 December 2016 |
|---|---|---|
| Nostro accounts | 3,028 | 3,018 |
| Term deposits | 45,768 | 67,238 |
| Accrued interest for the period | 1 | 33 |
| **Total** | **48,797** | **70,289** |

## 15. SECURITIES HELD FOR TRADING

| | 31 December 2017 | 31 December 2016 |
|---|---|---|
| Hungarian Government bonds | 28,631 | 9,598 |
| Hungarian Treasury bills | 3,842 | 3,996 |
| Hungarian Development Bank bonds | 12,271 | 22,014 |
| Mortgage bonds | 1,138 | 602 |
| Investment notes | - | 188 |
| Student Loan Centre Ltd. bond | 97 | 1,014 |
| Bonds issued by MOL Plc. | - | 1,510 |
| Foreign bonds | 672 | 1,812 |
| **Total** | **46,651** | **40,734** |

*All figures in tables are in HUF million except otherwise noted*

## 16. FINANCIAL ASSETS AVAILABLE-FOR-SALE

| | 31 December 2017 | 31 December 2016 |
|---|---|---|
| Hungarian Government bonds | 29,849 | 11,488 |
| Hungarian Discount Treasury bills | 16,822 | 22,148 |
| Domestic issued bonds | 16,191 | 18,235 |
| Mortgage bonds | 8,799 | - |
| Investment funds | 449 | 455 |
| Foreign bank bonds | 7,857 | 11,489 |
| Equity investments | 231 | 2,480 |
| **Total** | **80,198** | **66,295** |

Equity investments include shares of SZHISZ for 20 million HUF (2016: HUF 20 million), shares of Garantiqa Creditgurantee Ltd. for HUF 30 million (2016: HUF 30 million) as well as SWIFT shares for HUF 1 million (2016: HUF 1 million) and VISA Europe shares for HUF 180 million (2016: HUF 130 million). The 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 2017 and in 2016.

### Sale of subsidiaries, discontinued operations

The institutions of the FHB Group, including the mutual fund management, factoring and leasing service suppliers have been directly subordinated to the Takarékbank in December of 2017. The function of Integration management has solely performed by Takarékbank.
From the end of December the Takarékbank is the 100 % owner of the Diófa Alapkezelő Ltd. (and its subsidiary: Diófa Ingatlankezelő Ltd.), Takarék Invest Befektetési és Ingatlankezelő Ltd. (and its subsidiary: FHB Lízing Ltd,; joint ventures companies Díjbeszedő Faktorház Ltd, Díjbeszedő Informatikai Ltd., Díjnet Ltd, Magyar Posta Befektetési Szolgáltató Ltd), FHB Ingatlan Ltd. (and its subsidiary: Káry-villa Ltd.).

*All figures in tables are in HUF million except otherwise noted*

| 31 December 2017 | Diófa Alapkezelő Ltd (and its subsidiary: Diófa Ingatlankezelő Ltd.)* | FHB Ingatlan Ltd. (and its subsidiary: Káry-villa Ltd.)* | Takarék Invest Befektetési és Ingatlankezelő Ltd. (and its subsidiary and joint ventures companies)* |
|---|---|---|---|
| | Net assets | Net assets | Net assets |
| *Assets* | *2,558* | *1,233* | *28,327* |
| Due from banks | 434 | 319 | 526 |
| Securities held for trading | - | - | 185 |
| Shares in associates and joint venture | - | - | 4,816 |
| Financial assets available-for-sale | - | - | 1,088 |
| Loans and advances | - | - | 19,847 |
| Investment Property | - | 780 | - |
| Tangible assets | 81 | - | 13 |
| Goodwill and other intangible assets | 181 | - | - |
| Deferred tax asset | - | - | 56 |
| Other asset | 1,862 | 134 | 1,796 |
| | | | |
| *Liabilities* | *256* | *970* | *21,729* |
| Due to banks | - | 700 | 20,038 |
| Current tax liabilities | - | 1 | 16 |
| Provision | - | 135 | 74 |
| Other liabilities | 256 | 134 | 1,601 |
| **Total** | **2,302** | **263** | **6,598** |

* Consolidated figures

*All figures in tables are in HUF million except otherwise noted*

| 31 December 2017 | Diófa Alapkezelő Ltd (and its subsidiary: Diófa Ingatlankezelő Ltd.)* | FHB Ingatlan Ltd. (and its subsidiary: Káry-villa Ltd.)* | Takarék Invest Befektetési és Ingatlankezelő Ltd. (and its subsidiary and joint ventures companies)* |
|---|---|---|---|
| | Net assets | Net assets | Net assets |
| Consideration received in cash | 3,063 | 407 | 6,965 |
| Consideration received in 2018 January | 234 | - | - |
| Net cash inflow on disposal of a subsidiary | | | |
| Net assets disposed of | 2,302 | 263 | 6,598 |
| Consideration received in cash | 3,063 | 407 | 6,965 |
| **Net cash inflow** | **761** | **144** | **367** |

* Consolidated figures

The combined result of the discontinued operations included in the profit for the year is set out below. The comparative profit and cash flows from the discontinued operations have been re-presented to include those operations classified as discontinued at the end of current year.

*All figures in tables are in HUF million except otherwise noted*

Profit for the year of discontinued operations 2017:

| 31 December 2017 | Diófa Alapkezelő Ltd (and its subsidiary: Diófa Ingatlankezelő Ltd.)* | FHB Ingatlan Ltd. (and its subsidiary: Káry-villa Ltd.)* | Takarék Invest Befektetési és Ingatlankezelő Ltd. (and its subsidiary and joint ventures companies)* |
|---|---|---|---|
| | Net assets | Net assets | Net assets |
| Net interest income | - | (15) | 475 |
| Net fee and commission income | 2,399 | 809 | 55 |
| Operating Income, net | 2,543 | 756 | 1,434 |
| Profit before tax | 1,380 | (22) | 525 |
| Attributable income tax expenses | (126) | (11) | (228) |
| Profit after tax | 1,254 | (33) | 297 |
| Gain/(loss) on disposal of operation | 995 | 144 | 366 |
| **Profit for the year from discontinued operations** | **2,249** | **111** | **663** |

* Consolidated figures

Profit for the year of discontinued operations 2016:

| 31 December 2016 | Diófa Alapkezelő Ltd (and its subsidiary: Diófa Ingatlankezelő Ltd.)* | FHB Ingatlan Ltd. (and its subsidiary: Káry-villa Ltd.)* | Takarék Invest Befektetési és Ingatlankezelő Ltd. (and its subsidiary and joint ventures companies)* |
|---|---|---|---|
| | Net assets | Net assets | Net assets |
| Net interest income | 5 | (23) | 298 |
| Net fee and commission income | 1,584 | 534 | 60 |
| Operating Income, net | 1,716 | 642 | (88) |
| Profit before tax | 879 | 50 | (676) |
| Attributable income tax expenses | (143) | (16) | (225) |
| **Profit for the year from discontinued operations** | **736** | **34** | **(901)** |

* Consolidated figures

*All figures in tables are in HUF million except otherwise noted*

## 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.

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 2017, the refinanced portfolio changed significantly due to the MFAR (Mortgage funding adequacy ratio) indicator coming into force on 1 April 2017 (20/2015 and 6/2016 NBH decrees), as a result the refinancing activity of FHB Mortgage Bank has been highly active. After come into the refinancing agreements, refinancing cooperation commenced with 4 new bank partners. By the end of the first quarter of 2017 the number of refinanced bank partners increased to 11 from 7 partner banks compared to the end of the last year. The refinanced loan portfolio of the Mortgage Bank increased by 134% because of this transaction and amounted to HUF 134.92 billion (with the refinanced loan portfolio of FHB Commercial Bank) at the end of the year. The balance as at 31 December 2017 includes loans disbursed to 31,017 customers (2016: 27,207).

## 19. LOANS AND ADVANCES TO CUSTOMERS

| | 31 December 2017 | 31 December 2016 |
|---|---|---|
| Housing loans | 113,034 | 110,464 |
| General purpose mortgage loans | 66,584 | 80,832 |
| Customer loans and overdrafts | 10,330 | 11,190 |
| Loans to employees | 1,159 | 1,299 |
| Finance lease to retail customers | 0 | 2,738 |
| Finance lease to companies | 0 | 2,120 |
| Finance lease for capital equipment | 0 | 4,550 |
| Loans to companies | 132,731 | 104,076 |
| Corporate capital equipment loan | 0 | 571 |
| **Loans gross subtotal** | **323,838** | **317,840** |
| Fair value adjustment of hedged items | 28 | 43 |
| *Accrued part of disbursed loans under Funding of Growth Scheme** | *2,768* | *3,898* |
| Derecognition | (1,300) | (3,784) |
| Accrued interest | 4,773 | 8,143 |
| Amortized origination cost | (115) | (3,916) |
| **Loans gross total** | **327,224** | **318,326** |
| Loan impairment | (16,592) | (23,853) |
| **Loan portfolio reported** | **310,632** | **294,473** |

*All figures in tables are in HUF million except otherwise noted*

*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 13,118 million (2016: HUF 14,258 million), based on portfolio rating: HUF 3,473 million (2016: HUF 9,595 million).

*Changes in impairment for credit losses:*

| | 31 December 2017 | 31 December 2016 |
|---|---|---|
| Impairment as at 1 January | 23,853 | 26,557 |
| Provision for impairment in the period | 5,708 | 10,318 |
| Exchange rate change of impairment | (36) | (104) |
| Reverse of impairment for the period | (10,234) | (7,919) |
| Derecognition due to foreign currency loans conversion to HUF at a fixed rate | - | (1,588) |
| Derecognition due to sale of assets | (2,389) | (3,411) |
| Derecognition due to disposal | (310) | - |
| **Impairment as at end of period** | **16,592** | **23,853** |

*Breakdown of the credit loss expense for the period*

| | 31 December 2017 | 31 December 2016 |
|---|---|---|
| Change of impairment in the period* | (4,525) | 2,447 |
| Entries due to consolidation | - | - |
| Losses from the repayment of the loans at a fixed rate | 34 | 11 |
| Written-off loans | 1,149 | 1,768 |
| Loss on loans sold | 4,017 | 3,817 |
| Loss on terminated loans | 75 | 94 |
| Charge for commitments | 884 | (90) |
| **Credit losses on loans and advances** | **1,634** | **8,047** |

* 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 22,878 million as of 31 December 2017 (31 December 2016: HUF 34,260 million).
Within the total balance of mortgage loans 99.78% have maturity over five years (2016: 99.04%), exceeding the minimum level of 80% that is required by the Section 5(1) of Act XXX of 1997 on Mortgage Loan companies.

*All figures in tables are in HUF million except otherwise noted*

## Notes to the Consolidated Financial Statements

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 2017, loan to value is 31.02% (31 December 2016: 29.83%).

In 2017, the Bank has sold the Takarék Invest Befektetési és Ingatlankezelő Ltd. and its subsidiary and joint ventures companies to the Takarékbank, as a result the leasing service suppliers will be directly subordinated to the Takarékbank.

*Finance Lease*

| | 31 December 2016 |
|---|---|
| Gross investment in the lease | 11,642 |
| Minimum lease payments | 11,642 |
| Net investment in the lease | 9,325 |
| **Unearned finance income** | **2,317** |
| Impairment on finance leases | (122) |

*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** |

*All figures in tables are in HUF million except otherwise noted*

## 20. GOODWILL

| | 31 December 2017 | 31 December 2016 |
|---|---|---|
| **Gross value** | | |
| Opening balance | 152 | 152 |
| Increase | - | - |
| Purchased through acquisition | - | - |
| Decrease due to disposal | (152) | - |
| **Closing balance** | **-** | **152** |
| **Impairment** | | |
| Opening balance | - | - |
| Increase | - | - |
| Closing balance | - | - |
| **Net value** | **-** | **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 Takarék Invest Ltd. is classified among shares in associates and joint ventures in 2016. (Notes 29).

## 21. INVESTMENT PROPERTY

| | 31 December 2017 | 31 December 2016 |
|---|---|---|
| **Gross value** | | |
| Opening balance | 780 | 780 |
| Increase | - | - |
| Decrease due to disposal | (780) | - |
| **Closing balance** | **-** | **780** |
| **Revaluation adjustment** | | |
| Opening balance | - | - |
| Increase | - | - |
| Decrease | - | - |
| Closing balance | - | - |
| **Net value** | **-** | **780** |

*All figures in tables are in HUF million except otherwise noted*

## 22. TANGIBLE ASSETS 31 December 2017

| | Property and Leasehold improvement | Office equipment | Total |
|---|---|---|---|
| ***Gross value*** | | | |
| Opening balance | 7,810 | 3,840 | 11,650 |
| Increase | 178 | 79 | 257 |
| Decrease | (2,993) | (129) | (3,122) |
| Derecognize of tangible assets due to disposal | (1,480) | (2,400) | (3,880) |
| Closing balance | **3,515** | **1,390** | **4,905** |
| ***Depreciation*** | | | |
| Opening balance | 1,722 | 3,428 | 5,150 |
| Annual depreciation | 168 | 105 | 273 |
| Annual depreciation from discontinued operations | 1 | 25 | 26 |
| Decrease | (263) | (60) | (323) |
| Derecognized depreciation of tangible assets due to disposal | (710) | (2,692) | (3,402) |
| Closing balance | **918** | **806** | **1,724** |
| ***Impairment*** | | | |
| Opening balance | 1,547 | 11 | 1,558 |
| Increase* | 210 | 124 | 334 |
| Decrease** | (1,100) | - | (1,100) |
| Derecognized impairment of tangible assets due to disposal | (447) | (11) | (458) |
| Closing balance | **210** | **124** | **334** |
| **Net value** | **2,387** | **460** | **2,847** |

*The Bank estimates the recoverable amount of the tangible 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. The impairment of this year connected to the branch building where the recoverable amount is lower than the net assets. The impairment is presented on the "Other operating expense" line in the Consolidated Statement of Profit or Loss in 2017.
** Takarék Invest Ltd. has sold the property in autumn of 2017, the decrease includes the impairment of this property.

*All figures in tables are in HUF million except otherwise noted*

## Notes to the Consolidated Financial Statements

### 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 |
| *Annual depreciation from discontinued operations* | - | *14* | *14* |
| 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** |

*All figures in tables are in HUF million except otherwise noted*

## 23. INTANGIBLE ASSETS 31 December 2017

| | Software | Other intangible assets | Agency cooperation | Total |
|---|---|---|---|---|
| ***Gross value*** | | | | |
| Opening balance | 4,005 | 917 | 645 | 5,567 |
| Increase | 426 | 7 | - | 433 |
| Decrease | - | - | - | - |
| Derecognize of intangible assets due to disposal | (1,693) | (495) | - | (2,188) |
| Closing balance | **2,738** | **429** | **645** | **3,812** |
| ***Amortisation*** | | | | |
| Opening balance | 2,977 | 501 | 199 | 3,677 |
| Annual amortisation | 81 | 23 | 32 | 136 |
| Annual amortisation from discontinued operations | - | 15 | - | 15 |
| Decrease | - | - | - | - |
| Derecognized amortisation of tangible assets due to disposal | (1,456) | (389) | - | (1,845) |
| Closing balance | **1,602** | **150** | **231** | **1,983** |
| ***Impairment*** | | | | |
| Opening balance | - | - | - | - |
| Increase | 579 | 122 | - | 701 |
| Reversal | - | - | - | - |
| Closing balance | **579** | **122** | **-** | **701** |
| **Net value** | **557** | **157** | **414** | **1,128** |

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 2017.

The Bank estimates the recoverable amount of the intangible asset. The impairment of this year connected to the intangible of Magyar Kártya Szolgáltató Ltd. where the recoverable amount is lower than the net assets. The impairment is presented on the “Other operating expense” line in the Consolidated Statement of Profit or Loss in 2017.

*All figures in tables are in HUF million except otherwise noted*

## 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 |
| *Annual amortisation from discontinued operations* | - | *10* | - | *10* |
| Decrease | - | - | - | - |
| Closing balance | **2,977** | **501** | **199** | **3,677** |
| ***Impairment*** | | | | |
| Opening balance | - | - | - | - |
| Increase | - | - | - | - |
| Reversal | - | - | - | - |
| Closing balance | **-** | **-** | **-** | **-** |
| **Net value** | **1,028** | **416** | **446** | **1,890** |

*All figures in tables are in HUF million except otherwise noted*

## 24. OTHER ASSETS

| | 31 December 2017 | 31 December 2016 |
|---|---|---|
| Prepaid expenses | 205 | 697 |
| Reclaimable taxes | 313 | 1,352 |
| Settlements with the Hungarian State | 149 | 284 |
| Repossessed collateral | 177 | 758 |
| Debtors | 547 | 710 |
| Deposits | 3,060 | 3,487 |
| Receivables from investment services | 10 | 331 |
| Other | 1,745 | 1,066 |
| **Total** | **6,206** | **8,685** |

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 2017 | 31 December 2016 |
|---|---|---|
| Long term loans received | 22,001 | 36,149 |
| Short term loans received | 9,120 | 6,886 |
| Accrued part of disbursed liabilities under Funding for Growth Scheme* | 2,861 | 4,177 |
| Accrued interest | 1 | 17 |
| **Total** | **33,983** | **47,229** |

* 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 2017 | | 31 December 2016 | |
|---|---|---|---|---|
| | Gross book value | Face value | Gross book value | Face value |
| ***Non-listed mortgage bonds*** | | | | |
| Fixed interest | 16,573 | 16,449 | 16,667 | 16,449 |
| Floating interest | - | - | - | - |
| ***Listed mortgage bonds*** | | | | |
| Fixed interest | 61,417 | 56,915 | 69,956 | 63,620 |
| Floating interest | 86,339 | 86,513 | 40,850 | 40,958 |
| **Total mortgage bonds** | **164,329** | **159,877** | **127,473** | **121,027** |
| ***Non-listed bonds*** | | | | |
| Fixed interest | 1,084 | 1,078 | 19,586 | 19,564 |
| Floating interest | - | - | - | - |
| ***Subordinated bonds*** | - | - | - | - |
| ***Listed bonds*** | | | | |
| Fixed interest | 7,371 | 7,261 | 14,912 | 14,955 |
| Floating interest | 275 | 275 | 1,883 | 1,885 |
| ***Total bonds*** | **8,730** | **8,614** | **36,381** | **36,404** |
| Accrued interest (*mortgage bonds*) | 3,588 | - | 3,667 | - |
| Accrued interest (*bonds*) | 300 | - | 2,762 | - |
| **Total issued securities** | **176,947** | **168,491** | **170,283** | **157,431** |

### Mortgage bonds

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.

*All figures in tables are in HUF million except otherwise noted*

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 2017 | | 31 December 2016 | |
|---|---|---|---|---|
| | Fair value | Face value | Fair value | Face value |
| ***Listed mortgage bonds*** | | | | |
| Fixed interest | 7,016 | 5,893 | 11,991 | 10,519 |
| Floating interest | - | - | - | - |
| **Total mortgage bonds** | **7,016** | **5,893** | **11,991** | **10,519** |
| **Total Financial liabilities at fair value through profit or loss, except derivatives** | **7,016** | **5,893** | **11,991** | **10,519** |

The total credit risk was HUF 68.8 million as of 31 December 2017 (31 December 2016: HUF 371.6 million).

## 28. DEPOSITS FROM CUSTOMERS

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

| | 31 December 2017 | 31 December 2016 |
|---|---|---|
| Current accounts | 166,453 | 139,874 |
| Term deposits | 162,594 | 156,604 |
| Accrued interest | 206 | 594 |
| **Total** | **329,253** | **297,072** |

*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*

## 29. SHARES IN ASSOCIATES AND JOINT VENTURES

| | 31 December 2017 | 31 December 2016 |
|---|---|---|
| Opening balance | 4,816 | 7,755 |
| Capital increase in joint ventures | - | 40 |
| Decrease from joint ventures and associates* | (4,816) | - |
| Share of profit of joint ventures and associates** | - | (2,979) |
| **Closing balance** | **-** | **4,816** |

*This decrease from joint ventures and associates include the disposal of Takarék Invest Befektetési és Ingatlankezelő Ltd. and its subsidiary and joint ventures to the Takarékbank.
**In 2016 share of profit of joint ventures and associates include dividend payment of HUF 3,570 million.

## 30. PROVISIONS

Provisions are set up mainly for current and contractual obligation. 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).

| 2017 | Credit risk provision | Contractual obligation | Other provision | Expected costs of legal cases | Total |
|---|---|---|---|---|---|
| Opening balance | 396 | 211 | 924 | 15 | 1,546 |
| Increase in the period | 1,012 | 4,905 | - | 31 | 5,948 |
| Utilization in the period | (733) | (61) | (278) | (4) | (1,076) |
| Provision of discontinued operations | (1) | (150) | (16) | - | (167) |
| **Closing balance** | **674** | **4,905** | **630** | **42** | **6,251** |

The credit risk provision in 2017 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 present HUF 630 million provision for the organizational changes related to the project in 31 December 2017.

In 2017, the Bank expressed its willingness to change of information systems, about this the IT software company was informed. For the contractual obligation, which is part of the existing contract, the Bank has set up provision of HUF 4,605 million.

*All figures in tables are in HUF million except otherwise noted*

| 2016 | Credit risk provision | Contractual obligation | 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.

## 31. OTHER LIABILITIES

| | 31 December 2017 | 31 December 2016 |
|---|---|---|
| Taxes payable | 1,424 | 822 |
| Creditors | 1,253 | 584 |
| Accrued expenses | 914 | 914 |
| Liability from investments services | 44 | 1,464 |
| Customer loan prepayments | 625 | 625 |
| Other | 1,436 | 1,690 |
| **Total** | **5,696** | **6,099** |

*All figures in tables are in HUF million except otherwise noted*

## 32. SHARE CAPITAL

In the year of 2017 the ownership structure of the Bank Group was significantly altered. On 21 April 2017 the Allianz Hungária Biztosító Ltd sold number of 6,462,005 from its shares, so its right to vote was decreased to 0.02%. On 22 June 2017 the Magyar Takarékszövetkezeti Bank Ltd. made a public bid to the owners of the Bank. As a result of this transaction the Magyar Takarékszövetkezeti Bank Ltd. bought number of 20,092,211 shares and its ownership increased to 40%.

As of 31 December 2017 the Bank's share capital consists of series "A", "B" and "C" shares. Domestic institutional investors have the majority of shares (89.61%).

The ownership structure of the Bank as at 31 December 2017 and 31 December 2016 was as follows:

| | 31 December 2017 | | 31 December 2016 | |
|---|---|---|---|---|
| **Shareholder** | **Holding %** | **Number of shares** | **Holding %** | **Number of shares** |
| ***Ordinary shares (Series "A")*** | | | | |
| Domestic institutional investors | 50.5 | 54,735,748 | 39.0 | 42,345,991 |
| Foreign institutional investors | 0.1 | 126,899 | 10.7 | 11,597,658 |
| Domestic private investors | 5.3 | 5,750,222 | 5.9 | 6,435,206 |
| Foreign private investors | 0.0 | 39,388 | 0.0 | 22,330 |
| Employees, directors and senior management | 0.0 | 11,517 | 0.1 | 87,963 |
| Government held owner | 4.5 | 4,832,225 | 4.5 | 4,832,225 |
| Treasury shares | 0.2 | 253,601 | 0.2 | 253,601 |
| Other | 0.2 | 250,410 | 0.4 | 425,036 |
| *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 2017 | 31 December 2016 |
|---|---|---|
| Loss of shareholders of the Bank | (3,949) | (11,048) |
| Change of general reserve | -460 | - |
| **Attributable profit** | **(4,409)** | **(11,048)** |
| Weighted average number of shares | 108 236 699 | 108 236 699 |

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. 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 2017 | 31 December 2016 |
|---|---|---|
| Opening balance | 207 | 207 |
| Purchase | - | - |
| **Closing balance** | **207** | **207** |

## c) Other reserves

| | Note | 31 December 2017 | 31 December 2016 |
|---|---|---|---|
| Share premium | | 27,926 | 27,926 |
| General reserve | 34 | 460 | - |
| Cash-flow hedge reserve | | 5 | |
| Change in fair value of financial assets available-for-sale | 32 | 1,267 | 611 |
| Foreign currency translation reserve | | - | (2) |
| **Total other reserves** | | **29,658** | **28,535** |

*All figures in tables are in HUF million except otherwise noted*

## d) Financial assets available-for-sale reserve

| | 31 December 2017 | 31 December 2016 |
|---|---|---|
| Opening balance | 611 | 584 |
| Net unrealised gains on available-for-sale assets | 721 | 30 |
| Net realised losses on available-for-sale assets | - | - |
| Deferred tax | (65) | (3) |
| **Closing balance** | **1,267** | **611** |

## e) Non-controlling interest

| | 31 December 2017 |
|---|---|
| Opening balance | 16,812 |
| Dividend payment to NCI | 255 |
| Share of profit/(loss) of the year | (4,239) |
| **Closing balance** | **12,828** |

*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% | (4,175) | 12,832 |
| Diófa Alapkezelő Ltd.* | 11% | (112) | - |
| Diófa Ingatlankezelő Ltd.* | 11% | - | - |
| Magyar Kártya Szolgáltató Ltd. | 1% | 48 | (4) |
| **Total** | **-** | **(4,239)** | **12,828** |

'* These subsidiaries were sold to Takarékbank before the end of 2017.

*All figures in tables are in HUF million except otherwise noted*

## 33. 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 expense recognised for share based payments during 2016 is zero, because the KPI doesn't exceed the minimum level.
The Group hasn't got approved share based incentive scheme in 2017.

## 34. 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 460 million as at 31 December 2017, it equals the 10% of the profit after tax for the year (General reserve was HUF zero as at 31 December 2016). The other reserves are presented in Note 32.

## 35. 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 2017 | 31 December 2016 |
|---|---:|---:|
| Guarantees | 5,405 | 11,649 |
| Loan commitments | 71,046 | 51,864 |
| **Total** | **76,451** | **63,513** |

*All figures in tables are in HUF million except otherwise noted*

## 36. 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., shares of SWIFT and shares of Integration of Savings Cooperatives the total value of these is HUF 51 million (2016: HUF 51 million). Visa shares are reported at fair value for HUF 180 million in 2017 (2016: HUF 130 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 2017 | | 31 December 2016 | |
|---|---|---|---|---|
| | Gross book value | Fair value | Gross book value | Fair value |
| Refinanced mortgage loans | 76,597 | 80,570 | 31,423 | 36,962 |
| Loans and advances to customers | 327,224 | 349,820 | 318,326 | 357,720 |

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 2017 | | 31 December 2016 | |
|---|---|---|---|---|
| | Net book value | Fair value | Net book value | Fair value |
| ***Non-listed mortgage bonds*** | | | | |
| Fixed interest | 17,621 | 19,281 | 17,715 | 20,199 |
| Floating interest | - | - | - | - |
| ***Listed mortgage bonds*** | | | | |
| Fixed interest | 63,836 | 68,560 | 72,505 | 91,786 |
| Floating interest | 86,460 | 87,125 | 40,920 | 70,808 |
| **Total mortgage bonds** | **167,917** | **174,966** | **131,140** | **182,793** |
| ***Non-listed bonds*** | | | | |
| Fixed interest | 1,153 | 1,165 | 21,371 | 25,709 |
| Floating interest | - | - | - | - |
| ***Listed bonds*** | | | | |
| Fixed interest | 7,601 | 7,930 | 15,886 | 25,600 |
| Floating interest | 276 | 276 | 1,886 | 3,143 |
| **Total bonds** | **9,030** | **9,371** | **39,143** | **54,452** |
| **Total issued security** | **176,947** | **184,337** | **170,283** | **237,245** |

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 2017 | 31 December 2016 | 31 December 2017 | 31 December 2016 |
| **Derivatives designated as cash-flow hedges** | | | | |
| Positive fair value of cash flow hedges | 14 | 3 | 909 | 376 |
| Including: CCIRS | 14 | 3 | 909 | 376 |
| **Swap deals classified as HFT** | | | | |
| Positive fair value of trading swaps | 339 | 867 | 33,249 | 83,141 |
| Including: CCIRS | - | 90 | - | 6,797 |
| Including: IRS | 261 | 446 | 21,829 | 53,354 |
| Including: FXS | 78 | 331 | 11,420 | 22,990 |
| **Fair value hedge** | | | | |
| Positive fair value of IRS fair value hedge | 2 | - | 620 | - |
| Including: CCIRS | - | - | - | - |
| Including: IRS | 2 | - | 620 | - |
| **Options** | | | | |
| Positive fair value of options | - | 6 | - | 730 |
| **Forward deals** | | | | |
| Positive fair value of forward deals | 55 | 57 | 1,828 | 5,440 |
| **Total derivative financial assets** | **410** | **933** | **36,606** | **89,687** |

*All figures in tables are in HUF million except otherwise noted*

| | 31 December 2017 | 31 December 2016 | 31 December 2017 | 31 December 2016 |
|---|---|---|---|---|
| **Derivatives designated as cash-flow hedges** | | | | |
| Negative fair value of cash flow hedges | (2) | (4) | 545 | 310 |
| Including: CCIRS | (2) | (4) | 545 | 310 |
| **Swap deals classified as HFT** | | | | |
| Negative fair value of trading swaps | (653) | (1,277) | 56,069 | 45,566 |
| Including: CCIRS | - | (318) | - | 6,165 |
| Including: IRS | (464) | (849) | 42,400 | 31,764 |
| Including: FXS | (189) | (110) | 13,669 | 7,637 |
| **Fair value hedge** | | | | |
| Negative fair value of fair value hedges | (375) | (115) | 17,561 | 7,931 |
| Including: CCIRS | - | - | - | - |
| Including: IRS | (375) | (115) | 17,561 | 7,931 |
| **Options** | | | | |
| Negative fair value of options | - | (6) | - | 730 |
| **Forward deals** | | | | |
| Negative fair value of forward deals | (47) | (177) | 6,559 | 16,274 |
| **Total derivative financial liabilities** | **(1,078)** | **(1,579)** | **80,735** | **70,811** |

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 2017**

| 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 | (33) | 4,497 | (28) | 28 |
| IRS | available-for-sale asset | (172) | 1,772 | 44 | (44) |

In 2017 two new IRS was designated as hedging instrument in fair value hedge connection.

**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.

*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 2017 | | |
|---|---|---|---|
| | Level 1 | Level 2 | Level 3 |
| **Assets** | | | |
| Securities held for trading | 46,651 | - | - |
| Financial assets available-for-sale | 79,748 | 449 | - |
| Derivative financial assets | - | 396 | 14 |
| **Total assets carried at fair value** | **126,399** | **845** | **14** |
| **Liabilities** | | | |
| Derivative financial liabilities | - | 1,076 | 2 |
| Financial liabilities at fair value through profit or loss, except derivatives | - | 7,016 | - |
| **Total liabilities carried at fair value** | **-** | **8,092** | **2** |

| | 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** |

*All figures in tables are in HUF million except otherwise noted*

## 37. RISK MANAGEMENT

### a) Overview

FHB Mortgage Bank Plc. and its subsidiary – FHB Commercial Bank Ltd. – are members of Integration Organisation of Cooperative Credit Institution (SZHISZ). Due to the membership of Integration the scope of the risk management policies of the Integration, as well as risk strategy have been extended to both FHB banks.

Risk Strategy – approved by the Board of Directors of Takarékbank Ltd. is mandatory for credit institutions and companies under consolidated supervision led by Takarékbank Ltd.– 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. The primary tools for creating a risk culture are internal policies, strategies, regulations and guidelines, communication and training of employees.

The risk capacity of FHB banks should be in line with the financial resources that are available to cover potential losses. In order to this the current and future economic, capital requirements and the capital requirements under Pillar 1 for quantifiable risk types are calculated.

Prudent risk taking is a fundamental value for FHB Mortgage Bank Plc. and FHB Commercial Bank Ltd. In order to this risk management identifies, evaluates and analyses the exposures. 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 positions and continuous monitoring
- consideration of the risks in business decisions
- separation the risk management organisation from the business division
- 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 exposure is basically credit-, liquidity-, market- and operation risks.

In 2017 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, and with the dynamic reduction of non-performing loans in the retail segment. In the corporate segment the FHB could increase the exposures by high quality portfolio beside low NPL ratio.

To maintain a diversified liability structure in 2017 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.

## 38. RISK MANAGEMENT STRUCTURE

### Board of Directors

The Boards of Directors of the banks are responsible for the FHB Mortgage Bank's and FHB Commercial Bank's risk management policy and strategy. The Boards of Directors develop the basic framework rules for risk management and guidelines of applicable methodologies. After the admission to the Integration the FHB Banks follow the risk strategy, apply the uniform risk management policies of the Integration and report about their risks to the central bodies of the Integration – to the Takarékbank Ltd., and the Integration Organisation of Cooperative Credit Institution (SZHISZ).

Based on regular risk exposure reports, the Boards of Directors evaluate the risk management activities and the level of exposure of the banks. If the level of exposure undertaken by the banks does not correspond to the strategy the Board takes measures to contain risks.

### Supervisory Board

The Supervisory Boards of the banks are responsible for monitoring the overall risk and risk management processes within the Bank. In this context they supervise and monitor the suitability of methods and systems applied by the Banks in order to ensure compliance with the statutory capital adequacy requirements.

### Assets and Liabilities Committee

The Assets and Liabilities Committee of the banks make decisions with respect to assets and liability management, risk management, liquidity management and pricing issues.

### Departments of Risk Management

Risk Management is responsible for determining the requirements necessary for the prudent operation. They develop the risk guidelines and manage lending, liquidity, market and operating risk.

### Treasury departments

Treasury departments are responsible for ensuring the short-term and long-term liquidity of the banks, 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 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 regularly 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 Boards and the Managements of the banks.

### 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 FHB Banks apply 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 willingness to undertake risks, and the market environment. The Banks collect and analyse data about events and losses related to risk from operation. As a result of risk assessment the Banks determine the level of capital justified by the level of acceptable exposure. The Assets and Liabilities Committees evaluate the report on credit risk on a monthly basis. They review 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 Boards of Directors evaluate the risk reports every quarter and exercise professional control over all components of the system through demanding reports from Management. The Supervisory Board evaluate the reports on risks on a quarterly basis, they exercise their function of ongoing control through the Internal Audit departments under its professional supervision.

## 39. RISK MITIGATION

*Interest rate and exchange rate risks*

To minimize the risk of interest- and foreign exchange rate risks the Banks manage their asset and liability structure – economical hedging deals – and also enter 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 Banks rates the creditworthiness of their clients and partners and classify them into client or partner categories. Risk is only accepted if the client's or partner's rating is appropriate. The Banks monitor 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 FHB Banks apply 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 FHB Mortgage Bank Plc. 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 2017 | 31 December 2016 |
|---|---|---|
| Balances with the National Bank of Hungary | 33,165 | 60,635 |
| Dues from banks | 48,797 | 70,289 |
| Securities held for trading | 46,651 | 40,734 |
| Financial assets available-for-sale | 80,198 | 66,295 |
| Shares in associated and joint venture companies | - | 4,816 |
| Derivative financial assets | 410 | 933 |
| Refinanced mortgage loans | 76,597 | 31,423 |
| Loans and advances to customers | 323,838 | 317,840 |
| Other assets | 6,206 | 8,685 |
| **Total** | **615,862** | **601,650** |
| Off-balance sheet commitments | 70,751 | 58,645 |
| **Total** | **70,751** | **58,645** |
| **Total credit risk exposure** | **683,613** | **660,295** |

## 40. 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 |
|---|---|---|---|---|
| | 31.12.2017 | 31.12.2017 | 31.12.2017 | 31.12.2017 |
| Dues from banks and refinanced mortgage loans | 81,168 | - | - | 81,168 |
| Loans, commitments and guarantees | 301,197 | 71,630 | 23,383 | 396,210 |
| To corporate customers | 149,819 | 47,522 | - | 197,341 |
| To retail customers | 151,378 | 24,108 | 23,383 | 198,869 |
| **Total** | **382,365** | **71,630** | **23,383** | **477,378** |

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.

*All figures in tables are in HUF million except otherwise noted*

| | 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** |

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

| Class | Historic default rate 31.12.2017 (%) | Uncovered 31.12.2017 HUF million | Total 31.12.2017 HUF million |
|---|---|---|---|
| Class 1 | 0.00 | 100,247 | 100,247 |
| Class 2 | 0.00 | 2,612 | 2,612 |
| Class 3 | 0.00 | 11,507 | 49,582 |
| Class 4 | 0.11 | 19,868 | 140,480 |
| Class 5-7 | 1.99 | 89,799 | 270,673 |
| **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 |

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 continuously by the Internal Audit as well as by the supervisory authorities.

The Bank applies different rating scales in different segments, but applies a standardized framework for external reporting, 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 |
|---|---|---|
| | 2017 | 2016 |
| Dues from banks and Refinanced mortgage loans | - | - |
| Loans | 2,318 | 3,492 |
| Corporate customers | 247 | 1,117 |
| Retail customers | 2,071 | 2,375 |
| **Total** | **2,318** | **3,492** |

As of 31 December 2017 the Company has HUF 9,382 million collateral value for loans past due unimpaired (2016: HUF 11,001 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.

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.

*All figures in tables are in HUF million except otherwise noted*

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 2017 and 2016*

| Loan type | 31 December 2017 | 31 December 2016 |
|---|---|---|
| Individual loans | 19,039 | 25,109 |
| *Fx rate protection scheme (original loan)* | 4,913 | 4,962 |
| *Fx rate protection scheme (buffer account)* | 263 | 306 |
| Corporate loans | 650 | 1,263 |
| **Total** | **19,689** | **26,372** |

*An analysis of impaired forborne loan portfolio by loan types as 31 December 2017 and 2016*

| Loan type | 31 December 2017 | 31 December 2016 |
|---|---|---|
| Individual loans | 17,986 | 23,735 |
| *Fx rate protection scheme (original loan)* | 3,902 | 4,024 |
| *Fx rate protection scheme (buffer account)* | 263 | 302 |
| Corporate loans | 650 | 1,082 |
| **Total** | **18,636** | **24,817** |

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

*All figures in tables are in HUF million except otherwise noted*

## Notes to the Consolidated Financial Statements

*An analysis of forborne loan portfolio by loan types and risk classes as 31 December 2017*

| Loan type | Not past due | 1-30 DPD | 31-60 DPD | 61-90 DPD | 91-360 DPD | 360+DPD | Total |
|---|---|---|---|---|---|---|---|
| Individual loans | 7,360 | 1,510 | 465 | 306 | 917 | 8,481 | 19,039 |
| *allowance* | *29* | *73* | *15* | *78* | *566* | *6,233* | *6,994* |
| Corporate loans | 147 | - | - | - | - | 503 | 650 |
| *allowance* | *7* | - | - | - | - | *151* | *158* |
| **Total capital of loans** | **7,507** | **1,510** | **465** | **306** | **917** | **8,984** | **19,689** |
| ***Total allowance*** | ***36*** | ***73*** | ***15*** | ***78*** | ***566*** | ***6,384*** | ***7,152*** |

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

*An analysis of forborne loan portfolio impaired and not impaired by loan types and risk classes as 31 December 2017*

| Loan type | Not past due | | | Past due | | | Total |
|---|---|---|---|---|---|---|---|
| | Impaired | Not impaired | Total | Impaired | Not impaired | Total | |
| Individual loans | 6,368 | 992 | 7,360 | 11,579 | 100 | 11,679 | 19,039 |
| *allowance* | *29* | - | *29* | *6,965* | - | *6,965* | *6,994* |
| *collateral* | *10,685* | *2,372* | *13,057* | *13,776* | *416* | *14,192* | *27,249* |
| Corporate loans | 147 | - | 147 | 503 | - | 503 | 650 |
| *allowance* | *7* | - | *7* | *151* | - | *151* | *158* |
| *collateral* | *459* | - | *459* | *781* | - | *781* | *1,240* |
| **Total capital of loans** | **6,515** | **992** | **7,507** | **12,082** | **100** | **12,182** | **19,689** |
| ***Total allowance*** | ***36*** | **-** | ***36*** | ***7,116*** | **-** | ***7,116*** | ***7,152*** |
| ***Total collateral*** | ***11,144*** | ***2,372*** | ***13,516*** | ***14,557*** | ***416*** | ***14,973*** | ***28,489*** |

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

*All figures in tables are in HUF million except otherwise noted*

*An analysis of forborne loan portfolio by type of forbearance as 31 December 2017 and 31 December 2016*

| | 31 December 2017 | | 31 December 2016 | |
|---|---|---|---|---|
| | capital | allowance | capital | allowance |
| Retail loans | 19,039 | 6,994 | 25,109 | 10,803 |
| *bridge loan* | 11,337 | 4,548 | 15,593 | 7,541 |
| *Fx rate protection scheme (original loan)* | 4,913 | 1,549 | 4,962 | 1,136 |
| *Fx rate protection scheme (buffer account)* | 263 | 125 | 306 | 159 |
| *Fx housing loan converted to HUF* | 436 | 200 | 955 | 583 |
| other | 2,090 | 572 | 3,293 | 1,384 |
| Corporate loans | 650 | 158 | 1,263 | 184 |
| **Total** | **19,689** | **7,152** | **26,372** | **10,987** |

*Changes in impairment of forborne loan portfolio*

| | 31 December 2017 |
|---|---|
| Impairment as at 1 January | 10,987 |
| Provision for impairment in the period | 1,782 |
| Reverse of impairment for the period | (1,287) |
| Derecognition due to sale of assets | (4,283) |
| Derecognition due to disposal | (47) |
| **Impairment as at end of period** | **7,152** |

*All figures in tables are in HUF million except otherwise noted*

## 41. COLLATERALS AND OTHER MEANS FOR IMPROVING THE LOANS PORTFOLIO

**Collaterals for lending risk applied by the Bank:**

**Real estate collateral**
The FHB Banks accepts as collateral mortgages, independent or separated liens established on such real estate that is registered in Hungary and have long live stable value.
Real estate is valued by independent appraisers who are not involved in decision-making regarding the loan and who establish the collateral value conservatively.

**State guarantee**
All instances of State guarantee accepted by the Banks 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 Banks also accept 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.

The table below shows the structure of the collaterals in 2017 and 2016:

| | 31 December 2017 | 31 December 2016 |
|---|---|---|
| Mortgage | 883,648 | 837,679 |
| Bail | 16,467 | 28,978 |
| Guarantee | 7,083 | 6,365 |
| Other collaterals | 1,938 | 2,058 |
| **Total** | **909,136** | **875,080** |

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.

*All figures in tables are in HUF million except otherwise noted*

## 42. MARKET RISK

Due to the nature of its business as a mortgage bank and to the special legal regulation relating to it, FHB Mortgage Bank Plc. has distinctive assets and liabilities structure within the Hungarian banking system as the significant part of the Bank's and its subsidiary's assets and liabilities are long-term and raise most of its funds in the capital market.
Both of the Banks maintain low the maturity-, interest rate- and foreign exchange rate risk derive from the asset, liability and off balance sheet commitments.

## 43. INTEREST RATE RISK

Interest rate risk derives from interest rate changes, which affect the value of financial instruments. A 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 Banks assess interest rate risk on a continuous basis with the help of Gap-analysis, VaR calculations and sensitivity analysis. The Banks manage 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.

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

| | 31 December 2017 | | 31 December 2016 | |
|---|---|---|---|---|
| | 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 | 109,772 | 1.09 | 115,948 | 1.30 |
| Securities held for trading and available-for-sale | 38,688 | 3.42 | 46,901 | 7.39 |
| Refinanced mortgage loans | 58,933 | 4.64 | 68,001 | 7.18 |
| Loans and advances to customers | 275,118 | 6.36 | 267,517 | 7.25 |
| **Total interest earning assets** | **482,512** | **4.71** | **498,367** | **5.87** |
| | | | | |
| **Interest bearing liabilities** | | | | |
| Due to banks | 25,940 | 0.09 | 79,225 | 0.09 |
| Deposits | 298,607 | 0.33 | 299,200 | 0.79 |
| Issued securities and Financial liabilities at fair value through profit or loss, except derivatives | 175,472 | 4.47 | 206,085 | 6.21 |
| Other loan | 4 | - | 5 | - |
| **Total interest bearing liabilities** | **500,022** | **1.77** | **584,515** | **2.60** |

*All figures in tables are in HUF million except otherwise noted*

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

| | Sensitivity of interest income 2017 | Sensitivity of equity (2017) | | | | |
|---|---|---|---|---|---|---|
| | | 0-6 months | 6-12 months | 1-5 years | Over 5 years | Total |
| HUF | 21.2 | (3.8) | (2.8) | (18.5) | 11.4 | (13.7) |
| EUR | 2 | 0.3 | 0.6 | (3.1) | (3.7) | (5.9) |
| CHF | - | - | - | - | - | - |

| | 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 2017 +10 bp | Sensitivity of interest income 2017 +25 bp | Sensitivity of equity (2017) +10 bp | Sensitivity of equity (2017) +25bp |
|---|---|---|---|---|
| HUF | 212 | 531 | (137) | (341) |
| EUR | 20 | 50 | (59) | (147) |
| 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 2017 net interest income would increase by HUF 21.2 million in case of HUF, it would increase by HUF 2 million in case of EUR and would increase by HUF 0.02 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 decrease of the capital by HUF 13.7 million in HUF, the decrease by HUF 5.9 million in EUR, the decrease by HUF 0.04 million in CHF.

## 44. 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 business policy of the Banks is to keep exchange rate risk at a low level.

The Banks strive to immediately hedge the exchange risks related to its core business 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.

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

| FX | Effect on earning before income tax (31 December 2017) | Effect on capital (31 December 2017) | Effect on earning before income tax (31 December 2016) | Effect on capital (31 December 2016) |
|---|---|---|---|---|
| EUR | 276.5 | 282.8 | 4.0 | 18.7 |
| CHF | 4.5 | 5.0 | (2.2) | 1.6 |

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 276.5 million HUF, in case of CHF items it could increase with 4.5 million HUF. The similar effect for the capital could mean an increase of 282.8 million in case of EUR items and 5.0 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 2017 | CHF | EUR | HUF | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash on hand | 51 | 298 | 2,786 | 3,135 |
| Balances with the National Bank of Hungary | - | - | 33,165 | 33,165 |
| Due from Banks | 150 | 7,140 | 41,507 | 48,797 |
| Securities held for trading | - | 4,239 | 42,412 | 46,651 |
| Financial assets available-for-sale | - | 15,307 | 64,891 | 80,198 |
| Shares in associated and joint venture | - | - | - | - |
| Derivative financial assets | - | - | 410 | 410 |
| Refinanced mortgage loans | - | - | 76,597 | 76,597 |
| Loans and advances to customers | 1,620 | 29,528 | 279,484 | 310,632 |
| Investment property | - | - | - | - |
| Tangible assets | - | - | 2,847 | 2,847 |
| Goodwill and other intangibles | - | - | 1,128 | 1,128 |
| Deferred tax asset | - | - | 811 | 811 |
| Other assets | 31 | 155 | 6,020 | 6,206 |
| **Total assets** | **1,852** | **56,667** | **552,058** | **610,577** |
| Nominal values of derivative assets | - | 23,428 | 13,974 | 37,402 |
| **Total assets incl. derivatives** | **1,852** | **80,095** | **566,032** | **647,979** |

| 31 December 2017 | CHF | EUR | HUF | Total |
|---|---|---|---|---|
| **Liabilities** | | | | |
| Due to banks | - | 695 | 33,288 | 33,983 |
| Deposits | 342 | 55,778 | 273,133 | 329,253 |
| Derivative financial liabilities | - | - | 1,078 | 1,078 |
| Issued securities | - | 5,183 | 171,764 | 176,947 |
| Financial liabilities at fair value through profit or loss, except | - | 7,016 | - | 7,016 |
| Leasing liability | - | - | - | - |
| Current tax liability | - | - | 21 | 21 |
| Deferred tax liability | - | - | - | - |
| Provisions | - | - | 6,251 | 6,251 |
| Other liabilities | 3 | 293 | 5,400 | 5,696 |
| **Total liabilities** | **345** | **68,965** | **490,935** | **560,245** |

*All figures in tables are in HUF million except otherwise noted*

| 31 December 2017 | CHF | EUR | HUF | Total |
|---|---|---|---|---|
| **Shareholders' equity** | **-** | **-** | **50,332** | **50,332** |
| **Total liabilities and shareholders' equity** | **345** | **68,965** | **541,267** | **610,577** |
| Nominal values of derivative liabilities | 1,463 | 11,401 | 24,471 | 37,335 |
| **Total liabilities incl. derivatives** | **1,808** | **80,366** | **565,738** | **647,912** |
| Position | (44) | 271 | (294) | (67) |

*Consolidated FX financial position of the group in terms of main currencies (31 December 2016):*

| 31 December 2016 | CHF | EUR | HUF | Total |
|---|---|---|---|---|
| **Total assets incl. derivatives** | **6,325** | **93,156** | **562,621** | **662,102** |
| **Total liabilities incl. derivatives** | **6,253** | **94,010** | **562,272** | **662,534** |
| **Shareholders' equity** | **-** | **-** | **57,602** | **57,602** |
| **Position** | (72) | 854 | (349) | 432 |

## 45. 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 |
|---|---|---|---|---|
| | 31.12.2017 | 31.12.2017 | 31.12.2016 | 31.12.2016 |
| | HUF million | HUF million | HUF million | HUF million |
| **Loans** | **(388)** | **(274)** | **(1,226)** | **(1,001)** |
| HUF | (390) | (278) | (1,182) | (959) |
| EUR | 2 | 4 | (39) | (37) |
| CHF | - | - | (5) | (5) |
| **Refinanced mortgage loans** | **(3)** | **120** | **(1,068)** | **(2)** |
| HUF | (3) | 113 | (1,068) | (2) |
| EUR | - | 7 | - | - |
| CHF | - | - | - | - |
| **Total** | **(391)** | **(154)** | **(2,294)** | **(1,003)** |

## 46. 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, which can be ensured by coordinating the maturity of receivables and payables. At the same time, the FHB 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 FHB Banks prepare their liquidity plans and financing position based on different scenarios, also including effects coming from stress tests. The Banks maintain 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.

*Contractual maturities of undiscounted cash flows of financial liabilities as of 31 December 2017*

| | On demand | Within 3 months | 3 - 12 months | 1 –5 years | 5 – 10 years | 10 – 15 years | Total |
|---|---|---|---|---|---|---|---|
| **Banking liabilities** | | | | | | | |
| Due to banks | 4,544 | 237 | 4,185 | 8,123 | 16,740 | - | 33,829 |
| Deposits | 166,725 | 117,159 | 39,658 | 5,768 | - | - | 329,310 |
| Derivative financial liabilities | - | 268 | - | 562 | 248 | - | 1,078 |
| Issued securities | - | 3,781 | 31,149 | 151,336 | 670 | - | 186,936 |
| Financial liabilities at fair value through profit or loss, except derivatives | - | 281 | - | 7,016 | - | - | 7,297 |
| Off balance sheet commitments | - | 19,528 | 34,568 | 29,448 | 38 | - | 83,582 |
| **Total banking liabilities** | **171,269** | **141,254** | **109,560** | **202,253** | **17,696** | **-** | **642,032** |

| | On demand | Within 3 months | 3 - 12 months | 1 –5 years | 5 – 10 years | 10 – 15 years | Total |
|---|---|---|---|---|---|---|---|
| Receivables from derivatives | - | 710 | 2,226 | 4,974 | 3,194 | 103 | 11,207 |
| Liabilities from derivatives | - | 555 | 2,425 | 5,111 | 2,478 | 75 | 10,644 |
| **Net value of derivatives** | **-** | **155** | **(199)** | **(137)** | **716** | **28** | **563** |

In the table, the undiscounted interest cash flows includes not only the accrued interest but also the interest payments in the given period.

*All figures in tables are in HUF million except otherwise noted*

*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*

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 2017*

| | Less than 12 months | Over 12 months |
|---|---|---|
| **Assets** | | |
| Cash on hand | 3,135 | - |
| Balances with the National Bank of Hungary | 33,165 | - |
| Due from banks | 20,691 | 28,106 |
| Securities held for trading | 8,994 | 37,657 |
| Financial assets available-for-sale | 33,241 | 46,957 |
| Derivative financial assets | 132 | 278 |
| Refinanced mortgage loans | 8,324 | 68,273 |
| Loans and advances to customers | 73,376 | 237,256 |
| Tangible assets | - | 2,847 |
| Goodwill and other intangible assets | - | 1,128 |
| Deferred tax assets | - | 811 |
| Other assets | 6,206 | - |
| **Total assets** | **187,264** | **423,313** |

*All figures in tables are in HUF million except otherwise noted*

| | Less than 12 months | Over 12 months |
|---|---|---|
| **Liabilities** | | |
| Due to banks | 9,120 | 24,863 |
| Deposits from customers | 323,485 | 5,768 |
| Derivative financial liabilities | 268 | 810 |
| Issued securities | 24,941 | 152,006 |
| Financial liabilities at fair value through profit or loss, except derivatives | - | 7,016 |
| Current tax liabilities | 21 | - |
| Provisions | 6,251 | - |
| Other liabilities | 5,696 | - |
| **Total liabilities** | **369,782** | **190,463** |

*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** |

## 47. 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 Bank 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.

## 48. TREATMENT OF RISK CONCENTRATION

The FHB Banks are 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 their 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*

## 49. CALCULATION OF REGULATORY CAPITAL, CAPITAL ADEQUACY AND ROAE

The calculation of regulatory capital based on the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 the 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.

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 members of Integration Organisation of Cooperative Credit Institution (SZHISZ) should – with regard to the several responsibility system of the Integration – examine the prudential requirements on consolidation bases. The exemption of individual compliance is ensured for the members of SZHISZ by the relevant statutory and resolution of the National Bank of Hungary. The FHB Mortgage Bank Ltd and the FHB Commercial Bank Ltd are members of the SZHISZ, as a result above exemption also applies to them.

According to this in the next table 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.

| | 31 December 2017 | 31 December 2016 |
|---|---|---|
| Own Funds | 43,603 | 45,612 |
| TIER 1 Capital | 43,598 | 42,606 |
| Common Equity TIER 1 Capital | 42,033 | 40,359 |
| Additional TIER 1 Capital | 1,565 | 2,247 |
| TIER 2 Capital | 5 | 3,006 |

| | 31 December 2017 | 31 December 2016 |
|---|---|---|
| ROAE (return on average equity %) | (15.2) | (18.7) |

*All figures in tables are in HUF million except otherwise noted*

## 50. 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% (from 14.10.2016. Fókusz Takarékszövetkezet, and from 09.12.2016. Magyar Takarékszövetkezeti Bank 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.

The satellite financial entities of the FHB Group, including the fund management, the leasing and factoring services and the centralized debt collection were taken over in December 2017 by the Takarékbank, see notes 17.

The list of the related parties, -including the subsidiaries and joint ventures (joint control with Hungarian Post Ltd.) and associates of the Takarekbank as at 31 December 2017 is the following:

| Companies included in the consolidation* | Main shareholder*** | Core business |
|---|---|---|
| FHB Real Estate Ltd. | Magyar Takarékszövetkezeti Bank Ltd. 100% | Real estate valuation services, real estate agency and sales |
| Takarék INVEST Befektetési és Ingatlankezelő Ltd. | Magyar Takarékszövetkezeti Bank Ltd. 100% | Own property management, leasing, and operating , facility management |
| Diófa Alapkezelő Ltd. | Magyar Takarékszövetkezeti Bank Ltd. 88,29% | Fund and property management |
| FHB Lízing Ltd. | Takarék INVEST Befektetési és Ingatlankezelő Ltd. 100% | Lending and leasing |
| Central European Credit d.d. (Croatia) | FHB Lízing Ltd. 100% | Lending |
| Diófa Ingatlankezelő Ltd. | Diófa Alapkezelő Ltd. Ltd. 100% | Real estate management |
| Kary-villa Real Estate Investment Ltd. | FHB Real Estate Ltd. 100% | Sale of own properties |
| Díjbeszedő Faktorház Ltd. | Takarék INVEST Befektetési és Ingatlankezelő Ltd. 51% | Purchasing, handling and collection receivables of retail customers |
| Díjbeszedő Informatikai Ltd. | Takarék INVEST Befektetési és Ingatlankezelő Ltd. 50%, Díjbeszedő Holding Ltd. 50 % | Providing IT services primarily to the members of Díjbeszedő Group |
| Magyar Posta Kártyaközpont Ltd. | Díjbeszedő Holding Ltd. 50,05% | Providing services related to bank cards, and electronic payment systems |
| DÍJNET Ltd. | Takarék INVEST Befektetési és Ingatlankezelő Ltd. 51% | Providing electronic bill payment services |

*All figures in tables are in HUF million except otherwise noted*

| | | |
|---|---|---|
| Mohácsi Takarékbank Zrt. | Magyar Takarék Befektetési és Vagyongazdálkodási Ltd. 100% | Credit institution |

| Companies included in the consolidation* | Main shareholder*** | Core business |
|---|---|---|
| Magyar Posta Befektetési Szolgáltató Ltd. | Takarék INVEST Befektetési és Ingatlankezelő Ltd. 50%, Magyar Posta Ltd. 50% | Selling investment products |
| Magyar Takarékszövetkezeti Bank Ltd. | Magyar Takarék Befektetési és Vagyongazdálkodási Ltd. 54,82% | Credit institution, the central bank of the integration of Savings Cooperatives |
| Takarék Faktorház Ltd. | Magyar Takarék-szövetkezeti Bank Ltd. 100% | Providing full factoring services |
| Takarékszövetkezeti Informatikai Ltd. | Magyar Takarék-szövetkezeti Bank Ltd. 52,38%<br>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 |
| Tak-Invest Zrt. | Magyar Takarék-szövetkezeti Bank Ltd. 85,09% | IT service provider |
| Takarék Központi Követeléskezelő Ltd. | Magyar Takarék-szövetkezeti Bank Ltd. 73,74% | Debt collection, debt recovery, intermediation of financial services |
| MTB Ingatlan Ltd. | Magyar Takarék-szövetkezeti Bank Ltd. 100% | Sale of properties |
| MA-TAK-EL Magyar Takarék Ellátó Ltd. | Magyar Takarék Befektetési és Vagyongazdálkodási Ltd. 59,09% | Providing bank security, facility management and other operating services excluding IT services |

** From the point of view of Takarékbank, as parent company of Takarék Group (including FHB Group).*

*** "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*

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 |
| B3 TAKARÉK Szövetkezet | owners outside the scope of consolidation | Savings Cooperative |
| Békés Takarék Szövetkezet | owners outside the scope of consolidation | Savings Cooperative |
| Bóly és Vidéke Takarékszövetkezet | owners outside the scope of consolidation | Savings Cooperative |
| CENTRÁL TAKARÉK Szövetkezet | owners outside the scope of consolidation | Savings Cooperative |
| Dél TAKARÉK Szövetkezet | owners outside the scope of consolidation | Savings Cooperative |
| Fókusz Takarékszövetkezet | owners outside the scope of consolidation | Savings Cooperative |
| Hungária Takarék Takarékszövetkezet | owners outside the scope of consolidation | Savings Cooperative |
| Kinizsi Bank Ltd. | owners outside the scope of consolidation | Savings Cooperative |
| Korona TAKARÉK Takarékszövetkezet | owners outside the scope of consolidation | Savings Cooperative |
| M7 Takarékszövetkezet | owners outside the scope of consolidation | Savings Cooperative |
| Nyugat Takarék Szövetkezet | owners outside the scope of consolidation | Savings Cooperative |
| Pannon Takarék Bank Zrt. | owners outside the scope of consolidation | Savings Cooperative |
| Pátria Takarékszövetkezet | owners outside the scope of consolidation | Savings Cooperative |
| TISZÁNTÚLI TAKARÉK Takarékszövetkezet | owners outside the scope of consolidation | Savings Cooperative |

** From the point of view of Takarékbank, as parent company of Takarék Group.*

| | 31 December 2017 | 31 December 2016 |
|---|---|---|
| Loans to executives, members of the Board of Directors and Supervisory Board | - | - |
| Gross remuneration | | |
| Salary | 19 | 81 |
| Bonus | - | 15 |
| Honorarium | 29 | 28 |
| **Total remuneration** | **48** | **124** |

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 2017 and 2016 between the Group and other related parties are disclosed on the next page.

*All figures in tables are in HUF million except otherwise noted*

*Details of transactions as of 31 December 2017*

| | Parent | Associates and joint ventures | Key management |
|---|---|---|---|
| Due from banks | 45,569 | - | - |
| Loans and advances to customers | - | - | 1 |
| Other assets | 179 | 156 | - |
| **Total assets** | **45,748** | **156** | **1** |
| Due to banks | - | 4,000 | - |
| Deposits from customers | - | 73 | 21 |
| Other liabilities | 178 | 55 | - |
| **Total liabilities** | **178** | **4,128** | **21** |
| Interest income | 336 | - | - |
| Interest expense | (337) | - | - |
| **Net interest income** | **(1)** | **0** | **0** |
| Fee and commission income | 73 | 3 | - |
| Fee and commission expense | (74) | (6) | - |
| **Net fee and commission income** | **(1)** | **(3)** | **0** |
| Other operating income | 145 | 291 | - |
| Other operating expense | - | (763) | - |
| **Operating income** | **143** | **(475)** | **0** |
| Operating expense | (1) | (439) | (48) |
| **Profit/loss on transactions with related parties** | **142** | **(914)** | **(48)** |

*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** | **0** | **9,878** | **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)** |

*All figures in tables are in HUF million except otherwise noted*

## 51. NET GAINS

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

| 2017 | 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 | 1,245 | 857 | 20,582 | - | - | - | 22,684 |
| Interest expense | - | - | - | (1,205) | (8,634) | - | (9,839) |
| **Net interest income** | **1,245** | **857** | **20,582** | **(1,205)** | **(8,634)** | **-** | **12,845** |
| Fee and commission income | - | - | 3,118 | - | 3,888 | 805 | 7,811 |
| Fee and commission expense | - | - | (1,380) | - | (593) | (263) | (2,236) |
| **Net fee and commission income** | **-** | **-** | **1,738** | **-** | **3,295** | **542** | **5,575** |
| Change in fair value of derivatives | (500) | - | - | 585 | - | - | 85 |
| Gains from securities | 72 | 47 | - | 232 | 5,856 | (4,817) | 1,390 |
| Other operating income | - | - | - | - | - | 1,090 | 1,090 |
| Other operating expense | - | - | - | - | - | (11,528) | (11,528) |
| **Operating income** | **817** | **904** | **22,320** | **(388)** | **517** | **(14,713)** | **9,457** |

*All figures in tables are in HUF million except otherwise noted*

| 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*

## 52. 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. Retail bank accounts, deposits, savings, loans of the FHB Mortgage Bank continue to be included as part of the retail segment.
- **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 has provided investment services to retail and corporate clients. Since 18 December 2017, FHB Group has provided investment services as an agent of the Takarékbank.
- **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
- **Other:** the Bank's core business is supported by subsidiary, which profitability's is reported in this category.
    - Magyar Kártyaszolgáltató Ltd.

In December 2017, the Bank has sold the subsidiaries – exception of Magyar Kártyaszolgáltató Ltd. – to the Takarékbank.

| Segment report, 31 December 2017 | Retail | Corporate | Investment services | Treasury | Refinancing | Other | Total |
|---|---|---|---|---|---|---|---|
| Net interest income | 10,999 | 1,669 | 348 | (2,039) | 1,872 | (4) | 12,845 |
| Other net income | (946) | 690 | 157 | 1,748 | (182) | (4,217) | (2,750) |
| Provision for impairment on loan losses | (1,445) | (264) | - | - | 75 | - | (1,634) |
| Direct expense | (13,712) | (1,979) | (1,125) | (449) | (758) | 240 | (17,783) |
| Operating result | (5,104) | 116 | (620) | (740) | 1,007 | (3,981) | (9,322) |
| Profit before tax | - | - | - | - | - | - | (9,322) |
| | | | | | | | |
| Segment assets | 189,810 | 120,822 | - | 198,319 | 87,499 | 14,127 | 610,577 |
| Segment liabilities and equity | 168,189 | 161,064 | - | 35,061 | 183,964 | 62,299 | 610,577 |

*All figures in tables are in HUF million except otherwise noted*

| Segment report, 31 December 2016 | Retail | Corporate | Investment services | Treasury | Refinancing | Other | Total |
|---|---|---|---|---|---|---|---|
| Net interest income | 12,073 | 2,057 | 308 | (4,623) | 2,689 | (248) | 12,256 |
| Other net income | (216) | 744 | 408 | 3,570 | (447) | 2,102 | 6,161 |
| Provision for impairment on loan losses | (7,546) | (344) | - | - | 27 | (329) | (8,192) |
| Direct expense | (12,728) | (1,650) | (566) | (537) | (525) | (3,791) | (19,797) |
| Operating result | (8,417) | 807 | 150 | (1,590) | 1,744 | (2,266) | (9,572) |
| Profit before tax | - | - | - | - | - | - | (9,572) |
| | | | | | | | |
| Segment assets | 188,082 | 98,717 | 9,753 | 226,221 | 31,423 | 25,630 | 579,826 |
| Segment liabilities and equity | 125,397 | 118,366 | 53,597 | 276,423 | - | 6,043 | 579,826 |

## 53. IMPACTS OF IMPLEMENTATION OF IFRS 9

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.
The summary data presented in this section is based on the Bank's best estimate. Due to the 2018 interim methodological clarifications and further National Bank of Hungary recommendations, we do not exclude the possibility of changing the estimate in the 2018 Consolidated Financial Statements. In this case, this fact will be presented in the 2018 Consolidated Financial Statements.

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 reviewed the classification requirements of IFRS 9 related to SPPI and business model tests.
The entity's business model refers to how an entity manages its financial assets in order to generate cash flows. That is, the entity's business model determines whether cash flows will result from collecting contractual cash flows, selling financial assets or both.
The entity needs to classify a financial asset on the basis of its contractual cash flow characteristics if the financial asset is held within a business model whose objective is to hold assets to collect contractual cash flows or within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets. Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding are consistent with a basic lending arrangement (where the interest is the consideration for the time value of money, credit risk associated with holding the financial asset for a particular period of time, basic lending risks and costs, and it can include the profit margin).

*All figures in tables are in HUF million except otherwise noted*

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. Based on IAS 39 the Bank examined the loans and receivables, financial assets at fair value through profit or loss, financial assets available-for-sale, and after preparing the two tests mentioned above, the Bank splits these assets into four categories. The four categories are followings: financial assets measured at amortised cost ( “amortised cost”), financial assets measured at fair value through profit or loss (“FVPL”) debt instrument financial assets measured at fair value through other comprehensive income (“FVOCI (debt instruments)”); equity instrument financial assets measured at fair value through other comprehensive income (“FVOCI (equity instruments)”). Adopting the IFRS 9 has no significant effect on determining the effective interest rate and the amount effective interest.

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

The Bank Group 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 changed the 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 staging classification methodology determines that the expected exposure is expected to be 12 months or a life-cycle expected loss of credit (ECL). This is accomplished in FHB primarily in an automated, group-based method based on the staging criteria that can be evaluated based on the data stored in the system, while over a limit the staging classification is supplemented by an individual test in addition to group criteria. The worst result of the group-based and the individual staging test determines the final classification of the given exposure.

FHB uses advanced methodology (IRB) for capital calculation. In the case of the IFRS 9 ECL group-based models, the categories used in the IRB primarily determine the segmentation. The parameters assigned to the categories are based on the IRB calibration databases and have been determined without using the Basel conservative reserves. Where appropriate number of observations allow, the PIT (instantaneous) and TTC (long-term average) parameter estimates are separated. These portfolios mainly come from retail portfolios, and in the case of non-retail portfolios, the separation of TTC-PIT takes place in PD estimation. In accordance to the said method above, when the number of observations is sufficient, the forward-looking nature of the short term PIT parameters is strengthened by an exponential smoothing state space model.

In case of the Stage2 exposures, the ECL calculation requires conditional, over a year PIT parameters. In the long term, all conditional PIT parameter converges to its respective TTC value and the convergence rate is controlled by a so-called convergence factor. With the help of the calculated parameter matrices, the required ECL level is defined for each staging category.

In order to carry out the individual impairment calculation basically based on the information identified during the monitoring process (early warning signs), the handling of the transaction may induce the administrator. In the case of corporate transactions, an individual calculation is required for stage3 transactions based on the staging classification. In addition, achieving certain exposure limits may also involve the need for an individual calculation, which is necessary for stage2 and stage1 classes for different limitaires.

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.

## a) Classification of financial assets and liabilities from IAS 39 to IFRS 9

| Financial assets | IAS 39 | | IFRS 9 | |
|---|---|---|---|---|
| | Measurement category | Carrying amount as of 31 December 2017 | Measurement category | Carrying amount as of 1 January 2018 |
| Cash on hand | Amortised cost (Loans and receivables) | 3,135 | Amortised cost | 3,120 |
| Balances with the National Bank of Hungary | Amortised cost (Loans and receivables) | 33,165 | Amortised cost | 33,160 |
| Due from banks | Amortised cost (Loans and receivables) | 48,797 | Amortised cost | 48,784 |
| Securities held for trading | FVPL (Held for trading) | 46,651 | FVPL (Mandatory) | 12,484 |
| Financial assets available-for-sale | FVOCI (Available for sale) | 80,198 | FVOCI<br>FVPL (Mandatory) | 112,005<br>2,343 |
| Derivative financial assets | FVPL (Derivatives held for trading) | 410 | FVPL (Mandatory) | 410 |
| Refinanced mortgage loans | Amortised cost (Loans and receivables) | 76,597 | Amortised cost | 76,596 |
| Loans and advances to customers | Amortised cost (Loans and receivables) | 310,632 | Amortised cost<br>FVPL (Mandatory) | 309,263<br>209 |

*All figures in tables are in HUF million except otherwise noted*

## b) Reconciliation of carrying amounts of financial assets and liabilities from IAS 39 to IFRS 9

| Financial assets measured at amortised cost | IAS 39 carrying amount 31 December 2017 | Reclassi-fications | Remeasu-rements | IFRS 9 carrying amount 1 January 2018 |
|---|---|---|---|---|
| **Cash on hand** | | | | |
| Opening balances under IAS 39 | 3,135 | - | - | 3,135 |
| Remeasurement: ECL allowance | - | - | (15) | (15) |
| Closing balance under IFRS 9 | - | - | - | 3,120 |
| **Balances with the National Bank of Hungary** | | | | |
| Opening balances under IAS 39 | 33,165 | - | - | 33,165 |
| Remeasurement: ECL allowance | - | - | (4) | (4) |
| Closing balance under IFRS 9 | - | - | - | 33,161 |
| **Due from banks** | | | | |
| Opening balances under IAS 39 | 48,796 | - | - | 48,796 |
| Remeasurement: ECL allowance | - | - | (12) | (12) |
| Closing balance under IFRS 9 | - | - | - | 48,784 |
| **Refinanced mortgage loans** | | | | |
| Opening balance under IAS 39 | 76,597 | - | - | 76,597 |
| Remeasurement: ECL allowance | - | - | (1) | (1) |
| Closing balance under IFRS 9 | - | - | - | 76,596 |
| **Loans and advances to customers** | | | | |
| Opening balance under IAS 39 | 310,632 | - | - | 310,632 |
| Subtraction: to FVPL (IFRS 9) | - | (209) | - | (209) |
| Remeasurement: ECL allowance | - | - | (1,160) | (1,160) |
| Closing balance under IFRS 9 | - | - | - | 309,263 |
| **Total financial assets measured at amortised cost** | **472,325** | **(209)** | **(1,192)** | **470,924** |

*All figures in tables are in HUF million except otherwise noted*

| Financial assets measured at FVPL | IAS 39 carrying amount 31 December 2017 | Reclassi-fications | Remeasu-rements | IFRS 9 carrying amount 1 January 2018 |
|---|---|---|---|---|
| **Securities held for trading** | | | | |
| Opening balance under IAS 39 | 46,651 | - | - | 46,651 |
| Reclassification due to business modell change | - | (34,168) | - | (34,168) |
| Closing balance under IFRS 9 | - | - | - | 12,483 |
| **Loans and advances to customers** | | | | |
| Opening balance under IAS 39 | - | - | - | - |
| Addition: from amortised cost (IAS 39) | - | 209 | - | 209 |
| Closing balance under IFRS 9 | - | - | - | 209 |
| **Derivative financial assets** | | | | |
| Opening balance under IAS 39 and closing balance under IFRS 9 | 410 | - | - | 410 |
| **Total financial assets measured at FVPL** | **47,061** | **(33,959)** | **-** | **13,102** |

*All figures in tables are in HUF million except otherwise noted*

| Financial assets measured at FVOCI | IAS 39 carrying amount 31 December 2017 | Reclassi-fications | Remeasu-rements | IFRS 9 carrying amount 1 January 2018 |
|---|---|---|---|---|
| **Investment securities - FVOCI (debt instruments)** | | | | |
| Opening balance under IAS 39 | - | - | - | - |
| Addition: from available for sale (IAS 39) | - | 79,516 | - | 79,516 |
| Reclassificication due to business modell change | - | 34,168 | - | 34,168 |
| Remeasurement: ECL allowance | - | - | (10) | (10) |
| Closing balance under IFRS 9 | - | - | - | 113,674 |
| **Investment securities - FVOCI (equity instruments)** | | | | |
| Opening balance under IAS 39 | - | - | - | - |
| Addition: from available for sale (IAS 39) | - | 682 | - | 682 |
| Remeasurement: ECL allowance | - | - | (6) | (6) |
| Closing balance under IFRS 9 | - | - | - | 676 |
| **Investment securities - Available for sale financial assets** | | | | |
| Opening balance under IAS 39 | 80,198 | - | - | 80,198 |
| Subtraction: to mandatory FVPL (IFRS 9) | - | - | - | - |
| Subtraction: to FVOCI - equity instruments | - | (682) | - | (682) |
| Subtraction: to FVOCI - debt instruments | - | (79,516) | - | (79,516) |
| Closing balance under IFRS 9 | - | - | - | - |
| **Total financial assets measured at FVOCI** | **80,198** | **34,168** | **(16)** | **114,350** |

*All figures in tables are in HUF million except otherwise noted*

## Notes to the Consolidated Financial Statements

### c) Reconciliation of impairment loss

| Measurement category | Loan loss allowance under IAS 39/Provision under IAS 37 | Reclassi-fication | Remeasu-rement | Loan loss allowance under IFRS 9 |
|---|---|---|---|---|
| **Loans and receivables (IAS 39)/Financial assets at amortised cost (IFRS 9)** | | | | |
| Cash on hand | - | - | 15 | 15 |
| Balances with the National Bank of Hungary | - | - | 4 | 4 |
| Due from banks | - | - | 12 | 12 |
| Refinanced mortgage loans | - | - | 1 | 1 |
| Loans and advances to customers | 16,591 | (1) | 1,160 | 17,751 |
| **Total** | **16,591** | **(1)** | **1,192** | **17,783** |
| | | | | |
| **Available for sale financial instruments (IAS 39)/Financial assets at FVOCI (IFRS 9)** | | | | |
| Financial assets available-for-sale | - | - | 17 | 17 |
| **Loan commitments** | | | | |
| Provisions (loan commitments) | 674 | - | 161 | 835 |
| **Total** | **674** | **-** | **178** | **852** |

*All figures in tables are in HUF million except otherwise noted*

| Assets to be measured at Amortised cost | Stage 1 12-month ECL | Stage 2 Lifetime ECL | Stage 3 Lifetime ECL | POCI Purchased or originated credit-impaired | Total |
|---|---|---|---|---|---|
| **Gross carrying value per asset type** | | | | | |
| Cash on hand | 3,135 | - | - | - | **3,135** |
| Balances with the National Bank of Hungary | 33,165 | - | - | - | **33,165** |
| Due from banks | 48,796 | - | - | - | **48,796** |
| Financial assets available-for-sale | 113,683 | - | - | - | **113,683** |
| Investment securities | 682 | - | - | - | **682** |
| Refinanced mortgage loans | 76,597 | - | - | - | **76,597** |
| Retail mortgage loans | 160,315 | 2,033 | 21,367 | 312 | **184,027** |
| Retail other loans | 12,840 | 106 | 3,153 | 24 | **16,123** |
| Corporate mortgage loans | 46,290 | - | 1,676 | - | **47,966** |
| Corporate other loans | 78,460 | 34 | 402 | - | **78,896** |
| Receivables from customers | 547 | - | - | - | **547** |
| **Total gross carrying value** | **574,510** | **2,173** | **26,598** | **336** | **603,617** |
| | | | | | |
| **Loss allowance under IFRS 9 per asset type** | | | | | |
| Cash on hand | 15 | - | - | - | **15** |
| Balances with the National Bank of Hungary | 4 | - | - | - | **4** |
| Due from banks | 12 | - | - | - | **12** |
| Financial assets available-for-sale | 10 | - | - | - | **10** |
| Investment securities | 6 | - | - | - | **6** |
| Refinanced mortgage loans | 1 | - | - | - | **1** |
| Retail mortgage loans | 492 | 318 | 11,211 | 89 | **12,110** |
| Retail other loans | 47 | 20 | 2,935 | 22 | **3,024** |
| Corporate mortgage loans | 704 | - | 1,178 | - | **1,882** |
| Corporate other loans | 600 | - | 134 | - | **734** |
| Receivables from customers | 2 | - | - | - | **2** |
| **Total loss allowance under IFRS 9** | **1,893** | **338** | **15,458** | **111** | **17,800** |

*All figures in tables are in HUF million except otherwise noted*

## 54. SIGNIFICANT EVENTS AFTER BALANCE SHEET DATE

On 13 February 2018, the Board of Directors decided on the change of name of the FHB Commercial Bank Ltd., which also changed the brand. This is foreseen for the first half of 2018. Based on the decision of the Board of Directors, the new name of FHB Commercial Bank Ltd. will be Takarék Commercial Bank Ltd.

# FHB MORTGAGE BANK PLC.

# CONSOLIDATED BUSINESS REPORT FOR 2017
# ACCORDING TO IFRS

Budapest, 5 April, 2018.

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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 within the Republic of 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 24 November 2003.

***Ownership structure of the FHB Mortgage Bank Ltd. as of the 31 December 2017:***

| | 31 December 2017 | | 31 December 2016 | |
|---|---|---|---|---|
| Shareholder | Holding % | Number of shares | Holding % | Number of shares |
| ***Ordinary shares (Series "A")*** | | | | |
| Domestic institutional investors | 50.5 | 54,735,748 | 39.0 | 42,345,991 |
| Foreign institutional investors | 0.1 | 126,899 | 10.7 | 11,597,658 |
| Domestic private investors | 5.3 | 5,750,222 | 5.9 | 6,435,206 |
| Foreign private investors | 0.0 | 39,388 | 0.0 | 22,330 |
| Employees, directors and senior management | 0.0 | 11,517 | 0.1 | 87,963 |
| Government held owner | 4.5 | 4,832,225 | 4.5 | 4,832,225 |
| Treasury shares | 0.2 | 253,601 | 0.2 | 253,601 |
| Other | 0.2 | 250,410 | 0.4 | 425,036 |
| *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*** |

On 31 December 2017 FHB Mortgage Bank Plc. had series "A", "B" and "C" shares. Majority (89.7%) of FHB shares were owned by domestic institutional investors.

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 partnership program with Allianz was adopted by the Board of Directors of FHB Mortgage Bank, the plan included the acquisition of the Allianz Bank, which merged into the FHB Commercial Bank Ltd in 2011. The Board of Directors also approved “The bank of the families” concept, meaning a customer- and service-driven sales attitude.

In 2013, FHB Mortgage Bank managed several acquisitions, there through broadened the Banking Group and the range of activities. It included the acquisition of Diófa Alapkezelő Zrt. (Diófa Fund Management Ltd.), the purchase of the Díjbeszedő Operational and Service Limited Liability Company, hereinafter the “DÜSZ”), that come into being after a demerge from Díjbeszedő Holding Ltd. (DBH), the Díjbeszedő Faktorház Co. Plc. (“DBF”), DíjNET Ltd., Díjbeszedő Informatikai Ltd. (“DBIT”) and the portion of the ownership of the Magyar Posta (Hungarian Post).

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 some of their jointly controlled companies, furthermore in course of the harmonization of their business activities.

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. (hereinafter the Takarékbank).

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 under its qualifying holding and prudential supervisory FHB Commercial Bank Ltd. became a member of Integration Organisation of Cooperative Credit Institution (SZHISZ) in September 2015, and also the member of the Guarantee Group of Cooperative Credit Institutions, and a member of the country’s fourth largest banking group.

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 not listed on the Budapest Stock Exchange, they were purchased by the members of the Integration.

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, than 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.

Accommodation of the FHB Mortgage Bank and FHB Commercial Bank within the Integration of Cooperative Financial Institutions began in autumn of 2015 finished in 2017. As a part of the procedure changing the organisations in line with the Strategy of the Integration started in 2017.

As a first step, the FHB Mortgage Bank was reshaped to a simple profile mortgage bank, with remaining issuance and refinance functions, and all other human resources and capacities were transferred to the Takarékbank and the FHB Commercial Bank.

On 27 June 2017 General Assembly of the Takarékbank accepted the 5 year strategy of the Integration. The function of the central financial institution will be solely performed by Takarékbank; the FHB Mortgage Bank’s current group management functions will be passed over to the Takarékbank. According to the plans, the satellite institutions of the Integration, including the mutual fund management, factoring and leasing service suppliers will be directly subordinated to the Takarékbank.

FHB Mortgage Bank – pursuing the Strategy – acquired 25.1% of shares in the MATAK (Hungarian Savings Investment and Asset Management Ltd.) by capital increase with HUF 253 million nominal value in 12 December 2017.

On 27 December 2017 FHB Mortgage Bank sold the FHB Ingatlan Ltd. and the Takarék Invest Befektetési és Ingatlankezelő Ltd. to the Takarékbank. According to the Syndication Contract, Takarék Invest Befektetési és Ingatlankezelő Ltd. and its subsidiary and joint ventures companies (Díjbeszedő Holding Ltd. (DBH), the Díjbeszedő Faktorház Co. Plc. (“DBF”), DíjNET Ltd., Díjbeszedő Informatikai Ltd. (“DBIT”), Magyar Posta (Hungarian Post) and FHB Leasing Ltd.) were transferred to the Takarékbank.

On 29 December 2017 the shares of 88.29% of Diófa Asset Management Ltd. were sold to the Takarékbank.

***As a consequence of the transactions listed above, investments of the FHB Mortgage Bank were on the 31 December 2017:***

| Companies | FHB Mortgage Bank Plc. | FHB Commercial Bank Ltd. | Total |
|---|---|---|---|
| FHB Mortgage Bank Plc. | 51.00% | - | 51.00% |
| Hungarian Card Service Plc. | - | 99.18% | 99.18% |
| Bank of Hungarian Savings Cooperatives Co. Ltd. | 1 „C" share | 1 „C" share | 0.00% |

The participations devested were not included in the consolidated profit and loss and balance sheet report as of 31 December 2017.

The FHB Bank Group is undergoing a significant reorganization and restructuring. The aim of this process is to fully integrate the FHB Banking Group into the Takarék Group and to create a new, efficient, transparent, non-parallel organizational structure and cooperation between the leading departments of the Takarék Group. According to the business strategy accepted by the Takarék Group on 27 June 2017, the function of the central institution will be solely performed by Takarékbank, the tasks of commercial banks will be performed by the FHB Commercial Bank, while the FHB Mortgage Bank performs exclusive mortgage operating. In accordance with the above strategy, the FHB Commercial Bank becomes the flagship of the Takarék Group, while the FHB Mortgage Bank becomes the second largest mortgage bank in the Hungarian market after a significant portfolio cleaning.

The integration of the FHB Group into the Takarék Group requires significant reorganization efforts and expenditures, by staffing, branch building, brand change, IT systems, work processes. Due to cover to this tasks the Bank has set up significant provision in 2017, these one-off impacts have been accounted only in the 2017 Consolidated Financial Statements. This ensuring that the figures of 2018 presented primarily the results of the business activities and the FHB Commercial Bank can start the business growth and profitability with the help of the started reorganization processes in 2018. The Bank Group has set the necessary reserves for the credit risk in 2016, additional significant impairment was not needed in 2017.

In 2017 the record profit of non-consolidated financial statement of FHB Mortgage Bank includes the sale of investment due to the reorganization of Group management processes. With regard to mortgage refinancing portfolio, it is ranked first in diversification in the Hungarian market.

## 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 merger with Allianz Bank Ltd. into FHB Commercial Bank on 1 April 2011, the number of employees, number of branches and financial assets of Commercial Bank boosted significantly, the product portfolio expended.

The Commercial Bank provided 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 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.

FHB Mortgage Bank operates as a simple mortgage bank from the second quarter of 2018, the direct client mortgage loan finance function is to be subordinated to the Commercial bank, although loans contracted earlier will remain in the portfolio of the Mortgage Bank.

The large commercial bank of the Integration represents the Takarék Group as a prestigious institution, competing with large banks in Budapest and the sizable cities; after it closed operations in smaller settlements in 2017.

# 2 THE MACROECONOMIC ENVIRONMENT IN 2017

## 2.1 THE HUNGARIAN ECONOMY IN 2017[1]

| Indicator | 2015 | 2016 | 2017 |
|---|---|---|---|
| Real GDP growth | 3.4% | 2.2% | 4.0% |
| Industrial output growth | 7.4% | 0.9% | 4.9% |
| Average annual rate of inflation | -0.1% | 0.4% | 2.3% |
| Average annual rate of unemployment | 6.8% | 5.1% | 4.2% |
| ESA-based budget balance (relative to GDP)* | -2.0% | -1.9% | -2.3% |
| Net external financing capacity (relative to GDP)* | 8.1% | 6.2% | 5.8% |
| Base rate (end-of-year) | 1.35% | 0.90% | 0.90% |
| EUR-HUF exchange rate (end-of-year) | 313.12 | 311.02 | 310.14 |

**Estimate for 2017*
*Sources: KSH, MNB, NGM*

From the aspect of external demand Hungary enjoyed fairly good impulses throughout 2017. In the European Union GDP increased by 2.4% last year, which was the strongest growth rate since 2007, while the US economy expanded by 2.5%. Most recent short-term cyclical indicators also point to the direction of ongoing boom in these economies. With only a few exceptions developing economies also experienced robust economic performance last year. Despite the economic upturn, monetary conditions remained loose in general, with only the Fed taking meaningful steps toward stricter conditions by hiking its policy rates. While most commodity and energy prices started to rise last year, inflation remained subdued, and hence financing conditions were fairly friendly, lending support to the continued strengthening of the Hungarian economy.

Hungary's economic growth accelerated to 4% in 2017 from 2.2% in the previous year, driven mostly by gross fixed capital formation, which rebounded sharply from the marked fall in 2016 and also private consumption that was supported by a more than 10% growth in real wages and continued improvements in the labour market (employment increased by 1,6% to 4,5 million by the end of 2017) From the production side market service sector reflecting to the upturn in domestic demand contributed markedly to growth, and the construction sector also had an exceptionally strong year, and industrial production has become more geared expanding by 5% last year. The strong rebound of domestic demand, of course, led to a major acceleration in import growth, but export also expanded considerably, thereby Hungary still ran convenient trade surplus. Owing partly to the wide trade surplus economic growth is still accompanied by favourable external (and internal) balance developments.

Due to the relaxed financing environment and the uptick in fiscal revenues due to increasing economic activity there was even room for a limited expansion in expenditures towards the end of 2017, with the deficit remaining comfortably below the 3% Maastricht criterion. Public debt relative to GDP decreased by 2 percentage points compared to end-2016, thus it remained on a downward path for the sixth successive year.

[1] Data used in this chapter are based on the relevant reports and releases of the KSH (Central Statistical Office), MNB (National Bank of Hungary) and the analyses prepared by Takarekbank (Bank of Hungarian Savings Cooperatives)

Developments also remained encouraging with respect to the evolution of external balances: similarly to 2016 the net external financing capacity of the Hungarian economy remained close to 6% of GDP, although the surplus of the current account was somewhat smaller, while that of the capital account (reflecting mainly the net inflow of EU related transactions) was somewhat higher than in 2016. This improvement is also observable in foreign debt figures: gross foreign debt excluding intercompany loans between foreign companies and their Hungarian subsidiaries accounted for only 85% of GDP at the end of 2017, whereas net foreign debt contracted to just above 15% of GDP. In the wake of stronger domestic demand inflation started to rise, but despite strong real wage growth there have been no demand driven price pressures that threatened with the overshooting of the inflation target.

Although the 12-month rate of headline CPI inflation reached 3% in the early months of 2017, it later came down to around 2.5% and slowly declined towards 2% by the end of the year, while core inflation also started to decelerate from its September peak of 2.9%. Hence the MNB could remain in easing mode, even if there was no more room for slashing rates further (except for a single 10bp cut in the overnight deposit rate, which constitutes the lower edge of the interest rate corridor). Yet, the central bank continued crowding out the free liquidity of commercial banks from its own deposit facilities, capping the maximum amount to be placed in the three-month deposit facility in HUF 75 billion by the end of 2017. The crowded out liquidity resulted in actually zero short-term interest rates in the interbank market. Meanwhile it was enough for the MNB to make some hints that it is going to concentrate on the long end of the yield curve, so it has led to decline of the long-term rates. While last year the central bank finally terminated its Credit for Growth programme that was launched back in 2013, it still remained active in promoting the financing of especially small and medium-size enterprises by offering interest swap facilities for commercial banks at preferential rates.

The Forint proved to be a fairly stable currency in 2017 as well: it fluctuated in a relatively narrow band (302-315) vis-a-vis the Euro, and on average was somewhat stronger against the common European currency in 2017 than in 2016. Supported by favourable external developments and robust economic growth the Forint was not even adversely affected by the fact that no further upgrades of Hungary's sovereign debt rating by major rating agencies took place last year, although two of them adjusted the outlook to 'positive' on the already investment grade rating.

The number of new building permits and simplified filings related to new buildings exhibited strong growth last year, and the number of newly built dwellings had an even higher growth dynamics. Building permits and simplified filings increased by 20.4% after rising to 37,997 last year from 31,559 in 2016. This performance was mainly driven by developments in Budapest, where the annual growth rate reached 56%. The growth in the number of newly built dwellings amounted to 44%, rising from 9,994 in 2016 to 14,389 last year. Compared to 2016 the strongest expansion was seen in rural cities, where the rate of annual growth reached 60%. Approximately half of the 14,389 new flats were built by entrepreneurs, the other half by private individuals. The average size of a newly built flat increased again after a decrease in 2016: to 100 square metres from last year's 94.

## 2.2 THE BANKING SECTOR IN 2017[2]

The total assets of the banking sector amounted to HUF 36,354 billion at the end of 2017, up 5.7% from HUF 34,395 billion a year before. According to preliminary figures the combined pre-tax profit of the banking sector reached HUF 694 billion last year, significantly above last year's HUF 503.6 billion, but the lion's share of the increase comes from de-provisioning, not a real improvement in the normal business activity. The stock of gross credit, which was extended by the banking sector increased by 6.7% in 2017 and reached HUF 18,871.5 at the end of the year. Within this household credit increased by only 2.8%, but corporate credit was up by 9.5%.

7.6% of stock household credits in amount of HUF 5,750 billion were in a 90+ days arrear at the end of last year, while the weight of non-performing loans was 10.9% (HUF 628 billion). Both figures show significant decrease compared to end-2016 figures, which were 10.8% and 14.9% respectively. In case of non-financial corporate sector 3.5% (HUF 127 billion) of their outstanding HUF 3,628 billion Forint denominated credit was in a 90+ days arrear, which is a marked decrease compared to 5.4% prevailing at the end of 2016.

[2] This section relies on data provided by the MNB with a preliminary nature

Out of the HUF 2,827 billion foreign currency denominated corporate credit 2.9% was in a 90+ days arrear, also considerably down from 5.4% at the end of 2016. The share of client deposits within total liabilities increased to 56.3% in 2017, which means a volume of HUF 20,469 billion. 37.8% of this amount is deposited by households, 36.8% by the non-financial corporate sector.

### 2.2.1 Household savings

According to data provided by the MNB at the end of 2017 the amount of household savings in deposits and securities increased to HUF 16,748 billion from HUF 15,430 billion a year before, resulting 8.5% growth. The shift from deposits to securities continued last year: whereas the stock of deposits increased by only 4.8% (from HUF 7,425 billion to HUF 7,783 billion), that of securities (government papers, shares of investment funds, shares quoted on the stock exchange and bonds issued by the private sector) went up by 12%, reaching HUF 8,965 billion by the end of 2017. Consequently, the share of deposits decreased to 46.5% from 48.1% at the end of 2016. Besides deposits and securities households also possessed HUF 4,238 billion in cash (Forint and foreign currencies combined), they had savings of more than HUF 4,000 billion in various insurance policies and had HUF 14,750 billion assets in the form of OTC shares and shares in privately owned ventures.

Within deposits the stock of sight deposits increased by 14.7%, and their share correspondingly rose to 67.1%. The stock of term deposits, on the other hand, contracted by 10.9%, and the volume was as low as HUF 2,564 billion at the end of 2017 with regard to their currency denomination 84.7% of household deposits were denominated in Forint, and only 15.3% in other currencies. This means that following years of moderate increase the weight of foreign currency deposits took a downward turn again.

### 2.2.2 Households' mortgage loans

The disbursement of new mortgage loans stabilized in the HUF 60-70 billion range on a monthly basis from May 2017, rising from HUF 45-50 billion, which characterized the first four months and most of 2016. This resulted in a full-year HUF 708 billion new disbursement in 2017, up 35% from 2016's HUF 523 billion. In fact, a meaningful growth rate characterized only the home equity loan segment, where new disbursements were 40% higher in 2017 than a year before. Growth in the new disbursement of mortgage-backed general purpose loans amounted to only 6%.

#### 2.2.2.1 The stock of households' mortgage debts

The stock of households' mortgage debt was HUF 4,226 billion at the end of 2017, which implies HUF 122 billion contraction (-2.8%) from HUF 4,348 billion in December 2016. Within this, however, there was growth in home equity loans: compared to end of 2016's HUF 2,924 billion the stock increased to HUF 3,037 billion (+4%) by the end of 2017. Meanwhile, the stock of mortgage-backed general purpose loans contracted by HUF 236 billion (-16.5%), and its volume was HUF 1,189 billion at the end of last year. The share of foreign currency denominated loans was under 0.5% of the total stock and continues shrinking further.

#### 2.2.2.2 Policy tools for home protection and the promotion of housing

In the course of 2017 the National Asset Management Plc continued to purchase real estates from debtors who ran into default. The company purchased more than 6,000 flats, with which its portfolio contains more than 30,000 flats altogether. There were changes in the regulation of private bankruptcy proceedings, due to the low participation so far in the scheme, despite that the number of clients applying for private bankruptcy remained well below 2,000 last year. There was, however, clear increase in the number of those who applied for state subsidy and preferential credit under the Family Housing Allowance scheme; the combined volume of subsidies and credit exceeded HUF 100 billion last year. It was also last year, when the so called Qualified Consumer Friendly Housing Loans were introduced (the criteria are determined by the MNB). By the end of 2017 already 9 banks and all savings cooperatives had products that qualified, and in the last four months of 2017 HUF 40 billion new loans was extended under the conditions of QCFHL.

### 2.2.3 Households' other loans

There was a mixed picture in the development of consumer loans last year, but personal loans were without doubt the hottest products in 2017, as new disbursements were 47% higher than in 2016. By the end of 2017 their stock increased to HUF 488 billion, which has never been as high as that since February 2012 (i.e. 70 months). Despite an 80% rise in new car loan disbursements, the outstanding stock decreased to HUF 168 billion by the end of 2017, while the insignificant growth in the stock of commercial loans was only due to methodological changes.

The stock of overdraft and credit card loans remained on a declining path in 2017 as well: at the end of 2017 the outstanding stock was only HUF 305 billion, decreased by 4.9% from at the end of 2016.This is explained by the fact that this relatively expensive form of credit is no more popular as household incomes significantly increased and the availability and conditions of personal loans improved a lot.

### 2.2.4 Corporate loans and deposits

Banks opened a total HUF 3,776 billion credit line for the non-financial corporate sector in 2017, 28% more than in the previous year. The stock of debt held by the sector increased to HUF 6,493 billion by the end of 2017 from HUF 5,931 billion at the end of 2016 (which implies 9.5% growth). The stock of Forint denominated loans increased by 7.1%, and these made up 56.2% of the total stock. Although there were ample cheap Forint sources, the non-financial corporate sector also increased the stock of their foreign currency denominated loans by 12.6% last year.

Non-financial corporates had HUF 7,557 billion in deposits at the end of 2017, which is 14.2% growth compared to the end of 2016. The share of sight deposits was 87.2% on the 31 of December 2017, while foreign currency denominated deposits had a share of 28%.

# 3 REPORT ON THE BUSINESS ACTIVITIES

## 3.1 MAJOR FINANCIAL INDICATORS

| in HUF billion | 31/12/2016 | 31/12/2017 | Change |
|---|---|---|---|
| Balance sheet total | 593.4 | 610.6 | 2.9% |
| Book value of loans | 349.7 | 403.8 | 15.5% |
| Mortgage bonds issued | 143.1 | 174.9 | 22.2% |
| Bonds issued | 39.1 | 9.0 | -76.9% |
| Deposits | 297.1 | 329.3 | 10.8% |
| Shareholders' equity | 57.6 | 50.3 | -12.6% |
| Own funds | 45.6 | 43.6 | -4.4% |
| Loss before tax | -9.6 | -9.3 | 3.1% |
| Income tax expense | -5.8 | -1.9 | 67.2% |
| Profit/(loss) from discontinued operations | -0.1 | 3.0 | - |
| Loss for the year | -15.5 | -8.2 | -47.1% |
| Average net interest margin (NIM, %) | 1.8% | 2.1% | 0.3%-pt |
| Cost/income ratio w/o other results (CIR, %) | 79.6% | 86.6% | 7.0%-pt |
| EPS (HUF) | -102.1 | -40.7 | -60.1% |
| ROAA (return on average assets, %) | -2.3% | -1.4% | 0.5%-pt |
| ROAA excluding special banking tax (%) | -2.1% | -1.7% | 0.4%-pt |
| ROAE (return on average equity, %) | -18.7% | -15.2% | -3.5%-pt |
| ROAE excluding special banking tax (%) | -16.7% | -19.5% | -2.8%-pt |

FHB Group's consolidated balance sheet total calculated according to International Financial Reporting Standards (IFRS) was HUF 610.6 billion as of 31 December 2017, which was 2.9% and HUF 17.2 billion higher than a year before. Concerning 2017, growth in total assets was contributed primarily to the volume growth of the refinanced mortgage loans, and to the deposits on the liability side Net amount of loans grew by HUF 16.2 billion or 5.5% in one year, of which growth in refinanced loans was 143.8%.

On the liability side HUF 13.2 billion decrease in interbank deposits was offset by HUF 32.2 billion increase in customer deposits.

The Bank's consolidated loss in 2017 was HUF 8.2 billion loss; net interest income amounted to HUF 12.8 billion. Net interest margin on average assets was 2.1%, by 3 basis points higher year-on-year.

The Group's cost to income ratio without other results was 86.6% in 2017 compared to 79.6% in 2016.

## 3.2 LENDING

The volume of gross loans of FHB Group amounted to HUF 327.2 billion as of 31 December 2017. Year-on-year increase was 2.8%, due to the intensively growing disbursements, which can compensate contractual instalments.

The share of foreign currency loans to total outstanding loan portfolio was 10.1% as of 31 December 2017, compared to the 10.4% in previous year. The share of foreign currency loans in household loans was 1.0%, the same as it was in the previous year (1.0%).

Household loans continued to dominate within the loan portfolio, however its share fell to 59.4% from 65.0% of the 31st of December 2016. Changes in the composition of the loan portfolio were a result of the retail loan portfolio showed decrease of HUF 12.5 billion (-6.0%) year on year, while the volume of corporate loans grew by 19.2% or by HUF 21.4 billion.

The composition of the loan portfolio of 31 December 2017:

| in HUF million | 31/12/2016 | 31/12/2017 | Change |
|---|---|---|---|
| **Retail loans** | **207,009** | **194,493** | **-6.0%** |
| Housing loans | 112,930 | 115,983 | 2.7% |
| Other mortgage loans | 78,852 | 67,021 | -15.0% |
| Consumer loans | 11,190 | 10,330 | -7.7% |
| Loans for employees | 1,299 | 1,159 | -10.8% |
| Retail real estate leasing | 2,738 | 0 | -100.0% |
| **Corporate loans** | **111,317** | **132,731** | **19.2%** |
| Corporate loans | 104,076 | 132,731 | 27.5% |
| Corporate real estate leasing | 2,120 | 0 | -100.0% |
| Equipment leasing and loan | 5,121 | 0 | -100.0% |
| **Total own lending, gross** | **318,326** | **327,224** | **2.8%** |
| Impairment | -23,853 | -16,592 | -30.4% |
| **Loans, net** | **294,473** | **310,632** | **5.5%** |
| Refinanced loans | 31,423 | 76,597 | 143.8% |

During 2017 HUF 30.2 billion retail and HUF 43.1 billion corporate loan disbursements occurred, latter is 18.2% smaller than in 2016. In 2017 the Bank placed HUF 2.1 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 28.5 billion during twelve months), which shows 24.3% decrease in 2017 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 25.0 billion in case of first product, while in case of latter HUF 3.1 billion. During 2017 the volume of disbursed housing loans was 47.4% higher than in the same period of 2016, while the disbursement of personal loans remarkably decreased.

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 2016, FHB Commercial Bank Ltd. opened the 21 MFB Points undertaken on the contract with the Hungarian Development Bank Ltd. (MFB). During 2017 there was a huge interest toward the interest-free credit facilities for developments.

## 3.3 REFINANCING

By 31 December 2017 consolidated volume of refinanced loans increased by 143.8% in one year to HUF 76.6 billion.

In 2017, the refinanced portfolio changed significantly due to the MFAR (Mortgage funding adequacy ratio) indicator coming into force on 1 April 2017 (20/2015 and 6/2016 NBH decrees), as a result the refinancing activity of FHB Mortgage Bank has been highly active, and resulting some new refinancing agreements with new partners.

## 3.4 CUSTOMER DEPOSITS, BANK ACCOUNT SERVICES

The total volume of deposits increased by 10.8% in 2017, mostly on the basis of the corporate deposit growth. Corporate time deposit grew by HUF 43.1 billion, and the sight deposit increased by HUF 33.3 billion. The amount of household deposits increased by HUF 0.5 billion, reaching HUF 128.8 billion to the end of 2017. Sight household deposit was HUF 58.1 billion formulating 45.1% of the total household volume.

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 26.5 billion at the end of 2017.

At the end of 2017 FHB Commercial Bank managed 210.1 thousand household and 12.3 thousand corporate current accounts, to which 185.9 thousand household and 6.8 corporate bank cards were ordered. Both, the number of current accounts and bank cards were increased. Accounts opened by the Post almost reached 73 thousand by number at the end of the year. Bank card transaction volume grew significantly during 2017, purchases by POS terminals grew over 11 million and 2.6 million ATM cash withdrawals were managed through the year.

## 3.5 INVESTMENT SERVICES

The independent investment services business line of the FHB Commercial Bank sold to Takarékbank in 2017, contributing to a more concentrated and unified service for the clients of the Takarék Group. After the 17th December 2017, similarly to the other credit cooperative institutions of the Integration, offers investment service products to clients as an agent of the Takarékbank, including mostly mutual funds, government bonds and stock exchange quoted securities.

## 3.6 SECURITIES ISSUES

### 3.6.1 Mortgage and senior bond issued

The Bank managed 15 issue transactions in 2017, with HUF 58.7 billion mortgage bond issue value.

There were no senior bond or foreign exchange denominated mortgage bond issues in 2017. Contrary 5 mortgage bonds denominated in HUF repurchased in the value of HUF 15.3 billion and one mortgage bond in foreign currency in the value of EUR 1.97 million.

### 3.6.2 Mortgage bond coverage

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 coverage 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 FHB Mortgage Bank was HUF 244.1 billion as of 31 December 2017, 7.3% more than the figure as of 31 December 2016 (HUF 227.6 billion).

***Value of mortgage bonds and assets involved as collateral as of 31 December 2017***

| in HUF million | 31 December 2016 | 31 December 2017 | Change |
|---|---|---|---|
| Outstanding mortgage bonds in circulation | | | |
| Face value | 153,385 | 176,693 | +15.2% |
| Interest | 28,328 | 20,974 | -26.0% |
| **Total** | **181,713** | **197,667** | **+8.8%** |
| Value of the regular collateral | | | |
| Principal | 170,890 | 198,021 | +15.9% |
| Interest | 56,718 | 46,103 | -18.7% |
| **Total** | **227,608** | **244,124** | **+7.3%** |
| Value of assets involved as supplementary collateral | | | |
| Government and Hungarian Development Bank bonds | 8,001 | 22,865 | +185.8% |
| **Total** | **8,001** | **22,865** | **+185.8%** |

As of 31 December 2017, the present value of ordinary collateral was HUF 240.1 billion and the present value of mortgage bonds was HUF 195.8 billion, thus the present value of collateral exceeded significantly 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 122.6% in the same period.

As of 31 December 2017 net value of ordinary and supplementary collateral principal to the unpaid face value of mortgage bonds in circulation was 125.0%, and the net ordinary and supplementary collateral principal to the unpaid interest on mortgage bonds in circulation was 219.8%.

# 4 LIQUIDITY MANAGEMENT

In accordance with the special legal status of FHB Mortgage Bank the Bank is not allowed to collect client deposit, thus the structure of liabilities consists of mortgage-bonds, other, not covered bonds and due to banks. The Mortgage Bank covers its liquidity positions mostly against the entities within the Takarék Group. The Mortgage Bank is entitled to cover its (refinanced and own) loan amount by mortgage bonds only by the extent of its capital which can be considered in the coverage-pool. As a consequence of this, liquid assets financed from uncovered liabilities to meet the pledges derived from the 13% coverage excess and the (12 months) liquidity puffer.

In the observed period the amount of refinanced loans, the composition of maturity- and interest rates of new refinanced loans and the favorable development of the domestic interest rate environment significantly affected the funding structure of the Mortgage Bank. The gross in refinance loan (HUF 34.2 billion in amount, which equals to nearly 34% gross in a year) was influenced by the compliance to ensure the necessary bond coverage to meet the demands of the Mortgage Credit Compliance Demand Indicator (JMM) of the domestic bank system, which on one hand increased the refinancing demand on mortgage bonds from partner banks. On the other hand it also enhanced the additional need for mortgage bond coverage for the Takarék Group to ensure JMM compliance.

The volume of unsecured bonds significantly decreased through the year (by 76%). This was due to the facts that some bonds matured in the fourth quarter and the Bank didn't issue any unsecured bonds in 2017.
The amount of mortgage bonds grew by 15% in the last year. The shares of mortgage bonds increased by 10% and the interbank liabilities by 4% within the total fund structure of the bank in 2017. This tendency is expected to continue in the short term due to the increased issuance of mortgage bonds and refinanced loans.

In this year the liquidity management of the FHB Group has been carried out on a groupwise level, which means that the entities aggregated their positions and the unnecessary liabilities of the group has been released to the outer market, while the necessary liabilities not covered by the group has been accessed from the market.

The significant part of funds from the parent bank (FHB Mortgage Bank Plc.) comes from refinancing segment, most of the annual changes are attributable to this segment.

# 5 RISK MANAGEMENT PRINCIPLES

## 5.1 RISK MANAGEMENT POLICY

FHB Mortgage Bank and its subsidiary – FHB Commercial Bank – are members of Integration Organisation of Cooperative Credit Institution (SZHISZ). Due to the membership of Integration the scope of the risk management policies of the Integration, as well as risk strategy have been extended to both FHB banks.

Risk Strategy – approved by the Board of Directors of Takarékbank Ltd. is mandatory for credit institutions and companies under consolidated supervision led by Takarékbank Ltd.– 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. The primary tools for creating a risk culture are internal policies, strategies, regulations and guidelines, communication and training of employees.

The Hungarian National Bank terminated the obligation of the FHB Mortgage Bank to comply with the prudential requirements in the second-fourth and sixth-eight parts of the CRR on a subconsolidation level since the 1st of January 2017. At the same time it exempted the Bank from the individual fulfillment of the second-eight part of the CRR.

The FHB Mortgage Bank must comply with the requirements of the Integration Organisation of Cooperative Credit Institution and its central bank.

The primary goals of risk management of FHB Mortgage Bank are to protect its financial strength, its reputation and the contribution to the use of capital for competitive business activities, which results in the increase of shareholder value. The protection of financial strength and reputation means that the risk management limits the impact of infavourable events on the capital and on the profit of the Bank.

The Bank's willingness to take risks must be in line with the financial resources available to cover possible losses. In accordance the Bank calculate the current and future economical capital requirements for the quantifiable risk types, just like the the capital requirements of the first Pillar.

The Bank considers the prudent risk management as fundamental value.

The FHB Mortgage Bank is primarily exposed to credit, liquidity, market and operational risks.

## 5.2 CREDIT RISK

The main activity of the Mortgage Bank is refinancing of the mortgage portfolio of the partnerbanks. The Mortgage Funding Adequacy Ratio (JMM) introduced by MNB created a business opportunity for mortgage credit institutions by making them issue refinance loans with the same term as the long-term residential mortgages of partner banks, helping them in fulfillment of HUF maturities adequacy. This provided an exceptional opportunity for the FHB Mortgage Bank to acquire new business partners and to re-boost the refinancing activities.

The activity had to be reconsidered by risk management, the risk parameters had to be defined to partner banks and establish limits on the size of the risk taking.

In the first quarter the limit system of the corporate loans has been updated, which defined the directions of risk taking in 2017.

Risk management took part in the review of the lending procedures in the retail department. They reviewed the FHB Group’s income acceptance regulations, updated the manual and developed the version used by the intermediary partners. As an Integration task risk management also prepared the income acceptance policies to be used in regards with the MNB’s Consumer Friendly Product.

## 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 asset and liability management (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.

The Bank prepares its liquidity plans and financing positions regarding the expectations based on different scenarios and the effects of stress situations. Level of liquid assets is always 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.

## 5.6 OPERATING RISK

Operational risks are handled through the improvement of internal regulations and procedures, the adequate training of employees and the enhancement of controlling mechanisms. The Bank collects and analyzes losses due to operational risk and the Key Risk Indicators (KRI). The KRIs are reviewed each year. In 2017 more KRIs has been modified and new KRIs has been defined.

The Bank compiles and updates the map of operational risk through its annual operational risk self-assessment. The Bank also identifies rare accurancies, which could cause heavy losses, and measures them by scenario analysis.

The Bank compiled an inventory for the used modell risks in accordance with the surveillance requirements.

## 5.7 OTHER

In the second quarter the FHB Mortgage Bank fulfilled the disclosure requirements of CRR for the fiscal year 2016 and published the required information on risk management, capital management and remuneration policy.

# 6 ORGANIZATION CHANGES AND HEADCOUNT

The general assembly on the 26th of April 2017 recalled Márton Oláh and dr. Erik Landgraf from their position as directors and elected Edit Erika Tóth and dr. Gyula László Nagy as a member of the Board of Directors. The same assembly elected dr. Gyula László Nagy as chief executive director and Edit Tóth as Deputy General Manager.

On the 27th of June 2017 the assembly of Takarék Bank accepted the five-year-long strategy, which is supported by the Head Count Projekt. The new structure of the organization has also been approved, which creates a unified control and operation on integration level.

The FHB Mortgage Bank will function as a pure mortgage bank from 2018, so it passed the business and mortgage based loaning function to the FHB Commercial Bank and the groupcontrolling and support function with its infrastructure to the Takarék Bank.

Because of the new structure the physical location has also been reconstructed, while the two main office building stayed at Üllői Street and Pethényi Alley. The new office layout was created in a way that the central bank function would move to Pethényi Alley, while the commercial bank's and mortgage bank's support function would base at Üllői Street.

To achieve long term profitability and sustainability costreduction was necessary that was accomplished by headcount optimalization and reorganization in the financial institutions. As a first step, on the 16th of August 2017 the intention of collective redundancies has been announced in accordance with current legislations. The redundancies have been schedually carried out as a second step in the second half of 2017 in regards to legal regulations.

## 6.1 EMPLOYEE AND MANAGEMENT DIVERSIFICATION

As a driving element of the FHB Group the integration strategy requires to acknowledge and use the unique personal differences in the bank's employees and customers.

The FHB is against discrimination regarding gender, demography, family status, sexual, ethnical, political and religious interests. We believe that diversification makes a person unique. The Group doesn't tolerate direct or indirect discrimination or harassment in any form.

We work together with a mutual respect for all individual without biased. We purposefully try to involve different individuals in work and decision processes. Employees are encouraged to live in an innovative way with their individual skills.

In selection processes we primary consider knowledge, experience and competence in order to carry out the professional tasks in the highest quality.

Among our employees and managers there are many with experience obtained at other bank.

Taking the above mentioned into consideration, we also strive to increase the proportion of female employees and managers. At present the rate of genders within the company are cc 27% male and cc 73% female.

Currently there are two female senior managers at FHB Commercial Bank, one occupying the position of Chief Executive Officer. At the Mortgage Bank one of the top executive is female and in both bank many female managers are in department head and group manager positions.

Because we take primary interest in skills and experience acquired in the bank sector throughout our hiring process, there is no need for a "Diversification Policy", while the aspects and values are actively applied because of the above mentioned reasons.

## 6.2 REGULATIONS FOR THE APPOINTMENT AND DISMISSAL OF MANAGING OFFICERS AND FOR THE MODIFICATION OF THE BASIC CONSTITUTION

The General Meeting of FHB Mortgage Bank has the exclusive competence to elect and recall members of the Board of Directors and Supervisory Board. Members of both boards may be recalled at any time and may be re-elected after their term. The General Assembly of the company rules by a simple majority of the votes. The rights of employer are held by the Board of Directors in regards of the management.

The General Assembly also has the exclusive competence to define and modify the articles of association. For the modification of the constitution the General Meeting must have at least three-quarter of the votes. During voting a non-casted vote counts as „against" in the final count.

## 6.3 THE AUTHORITY OF CHIEF MANAGEMENT, ESPECIALLY FOR THE RIGHTS OF SHAREHOLDING

The Board of Directors of five members carries out the executive duties for the company. The duties and authority of the Board of Directors are defined by the articles of association and the Board of Directors. The authorities of the Board of Directors include the strategy, business and financial activities of the company, the tasks and authorities of operation, organization, increasment of capital of company. They also include the authorities related to own shares, company foundation, investments, representation of the company and the rights regarding their own functions.

The rights of the Board of Directors to issue and repurchase shares:

- is entitled to increase the share capital of the Company in the manner set out in the Articles of Association with the limits of the general authorization;
- is entitled to decide on its own equity transactions in case of authorization given by the general assembly within the set limits;
- is entitled to decide on the acquisition of the company's shares without the authorisation of the general assembly in case it is necessary to avoid serious harm to the company. In these cases the Board of Directors are obligated to provide information on the reasons for obtaining the shares of the company, the number of shares, their total nominal value, their counter value and the rate of shares compared to the capital of the company.

There isn't a Compensatory Supervisors Board in the company.

# 7 FINANCIAL ANALYSIS

## 7.1 BALANCE SHEET STRUCTURE

The Balance sheet has been constructed in accordance with controlling intention, which resulted in a different structure from categories used by accounting.

| in HUF million | 31/12/2016 | 31/12/2017 | Change |
|---|---|---|---|
| Cash on hand | 4,327 | 3,135 | -27.6% |
| Due from banks & NBH | 130,924 | 81,962 | -37.4% |
| Securities held for trading | 40,734 | 46,651 | 14.5% |
| Financial assets available for sale | 66,295 | 80,198 | 21.0% |
| Investment in associates (jointly controlled companies) | 4,816 | - | -100.0% |
| Derivate financial assets | 933 | 410 | -56.0% |
| Refinanced mortgage loans | 31,423 | 76,597 | 143.8% |
| Loans and advances to consumers | 318,326 | 327,224 | 2.8% |
| Impairment and provision | -23,853 | -16,591 | -30.4% |
| Investment property | 780 | - | -100.0% |
| Tangible assets | 4,942 | 2,847 | -42.4% |
| Goodwill and other intangible assets | 2,042 | 1,128 | -44.8% |
| Deferred tax asset | 3,030 | 811 | -73.2% |
| Other assets | 8,685 | 6,206 | -28.5% |
| **Total assets** | **593,404** | **610,577** | **2.9%** |
| Due to banks | 47,229 | 33,983 | -28.0% |
| Issued securities | 170,283 | 183,964 | 8.0% |
| Mortgage bonds | 131,140 | 167,917 | 28.0% |
| Bonds | 39,143 | 9,030 | -76.9% |
| Financial liabilities at fair value through profit or loss | 11,991 | 7,016 | -41.5% |
| Deposits from customers | 297,072 | 329,253 | 10.8% |
| Derivative financial liabilities | 1,579 | 1,078 | -31.7% |
| Finance lease liabilities | 3 | - | -100.0% |
| Current tax liability | - | 21 | - |
| Provisions | 1,546 | 6,251 | 304.3% |
| Other liabilities | 6,099 | 5,695 | -6.6% |
| **Total liabilities** | **535,802** | **560,245** | **4.6%** |
| Share capital | 10,849 | 10,849 | - |
| Share premium | 27,926 | 27,926 | - |
| Treasury shares | -207 | -207 | - |
| Cash-flow hedge reserve | - | 5 | - |
| Other reserves | 609 | 1,727 | 183.8% |
| Retained earnings | 12,661 | 1,613 | -87.3% |
| Minority interest | 16,812 | 12,828 | -23.7% |
| Balance sheet profit | -11,048 | -4,419 | -60.1% |
| **Total shareholders' equity** | **57,602** | **50,332** | **-12.6%** |
| **Total liabilities and shareholders' equity** | **593,404** | **610,577** | **2.9%** |

As of 31 December 2017, the Bank's consolidated balance sheet total by IFRS amounted to HUF 610.6 billion; and increased by HUF 17.2 billion or 2.9% compared to the value as of 31 December 2016. On the assets side volume of loans increased by 2.8%, refinanced loans increased by 143.8%, volume of securities held for trading increased by 14.5%, while interbank lending decreased by 37.4%.

Liabilities increased by 4.6% altogether compared to the reference figures of 2016. Issued securities and deposits from customers showed increase (8.0% and 10.8%, respectively), while due to banks decreased by 28.0%.

Shareholders' equity decreased by HUF 7.3 billion or 12.6% year-on-year, the main reason of which was the consolidated loss of 2017 (HUF 4.4 billion)

### 7.1.1 Interest earning assets

The Group's interest earning assets increased from HUF 568.2 billion as of 31 December 2016 to HUF 599.1 billion as of 31 December 2017. Interest earning assets contributed 98.1% to the balance sheet total.

***Interbank lending***

NBH and other interbank lending increased from HUF 131.0 billion HUF as of 31 December 2016 to HUF 82.0 billion as of 31 December 2017. The item contributed 13.4% to interest earning assets as of 31 December 2017.

***Securities***

The value of Bank's securities available-for-sale increased from HUF 66.3 billion as of 31 December 2016 to HUF 80.2 billion as of 31 December 2017. Contribution of securities available-for-sale to interest earning assets was 13.1%. From the stock of securities available for sale discount treasury bills amounting to HUF 16.8 billion and government bonds amounting to HUF 29.8 billion and other bank and corporate bonds for sale amounting to HUF 33.6 billion. As of 31 December 2017, the Bank held a portfolio of securities for trading (HUF 46.7 billion), which contributed 7.8% to interest earning assets.

***Loans***

As of 31 December 2017, the volume of loans showing an increase by HUF 8.9 billion compared to the previous year. Impairment to cover loan losses decreased from HUF 23.9 billion as of 31 December 2016 to HUF 16.6 billion as of 31 December 2017.

Volume of refinanced loans increased by 143.8% to HUF 76.6 billion during 12 months. As of 31 December 2017, the contribution of refinanced loans and gross own lending was 64.6% in total assets; the same ratio was 57.4% a year before.

Volume of corporate loans increased by 27.5%, and housing loans increased by 3% during the year.

**Portfolio quality**

In 2017, 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 non-performing loans (NPL) through individual customer agreements.

Offering real estates for entitled clients to NET program continued in 2017. Current information indicates that the program hasn't been extended, nor modified, but the NET Plc. will still accept applications in 2018.

Due to the measures of portfolio cleaning the ratio of non-performing loans significantly decreased by the end of 2017 compared to the previous year. Volume of non-performing loans was 26.8% lower compared to the end of 2016. NPL ratio has been shrinking from 10.8% as of 31 December 2016 to 7.2% as of 31 December 2017, 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 2017, that average loss coverage of outstanding loans with overdue over 90 days must reach 65%.

### 7.1.2 Non-interest earning assets

Tangible assets amounted to HUF 5.0 billion as of 31 December 2016 and decreased by HUF 2.1 billion year-on-year to HUF 2.9 billion. As of 31 December 2016 intangibles amounted to HUF 2.0 billion and decreased by 44.8% lower year-on-year to HUF 1.1 billion as of 31 December 2017

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 and dropped to zero to the end of 2017 due to the sale of Takarékinvest Ltd.

Other assets amounted to HUF 6.2 billion as of 31 December 2017, decreasing by 28.5% (HUF 2.5 billion) year-on-year. Deferred tax assets reached HUF 0.8 billion. A significant item in other assets is the value of deposits amounted to HUF 3.1 billion as of 31 December 2017, it was HUF 3.5 billion as of 31 December 2016.

### 7.1.3 Interest bearing liabilities

Interest bearing liabilities HUF 547.2 billion as of 31 December 2017, (HUF 526.6 billion at the end of 2016) represents 89.6% of the balance sheet total. Issued securities and customer deposits gave major part of interest bearing liabilities.

***Interbank funds***

As of 31 December 2017 interbank funds amounted to HUF 34.0 billion and decreased by 28.0% on yearly basis. Contribution of interbank borrowings to interest bearing liabilities was 6.2% as of 31 December 2017.

***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 32.0% as of 31 December 2017, which ratio was 27.2% in 2016. HUF 167.9 billion value of covered mortgage bonds as of 31 December 2017 was 28% higher than the figures of 31 December 2016 (HUF 131.1 billion). Increase in the value of the CMB portfolio was HUF 36.8 billion year-on-year.

The book value of bonds (both measured at amortised cost and at fair value) was HUF 9.0 billion as of 31 December 2017. The year-on-year decrease was 76.9%; the volume of bonds dropped by HUF 30.1 billion.

***Deposits***

As of 31 December 2017 deposits amounted to HUF 329.3 billion increasing by 10.8% year-on-year. The proportion of deposits in interest-bearing liabilities increased from 56.4% in 2016 to 60.2%.

Within deposits, retail deposits increased by 0.4% and corporate deposits by 36.1% compared to the previous year's balances. Over HUF 162 billion of corporate deposits are the 49.2% of the total deposits. The volume of sight deposits increased both between retail and corporate deposits. In the case of retail deposits, the sight portfolio increased by more than HUF 7.6 billion to 39.0% of the retail deposits, while the corporate deposits increased by nearly 33.3 billion forints and amounted to 49.2% of the portfolio account deposits. The total sight portfolio represented 50.6% of deposits.

### 7.1.4 Other liabilities

The Bank reported among other liabilities the volume of accounts payable of HUF 1.3 billion as well as accruals with the volume of HUF 0.9 billion. Other liabilities were HUF 5.7 billion as of 31 December 2017. At the end of 2017 the volume of the provisions amounted to HUF 6.3 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").

The composition and amount of the registered capital of the company on the 31st of December 2017:

| Share Series | Nominal value (HUF/piece) | Issued amount (piece) | Total amount (HUF) |
|---|---|---|---|
| Series "A" (Ordinary Shares) | 100 | 66,000,010 | 6,600,001,000 |
| Series "B" (Dividend Preference Shares) | 100 | 14,163,430 | 1,416,343,000 |
| Series "C" (Ordinary Shares) | 1,000 | 2,832,686 | 2,832,686,000 |
| **Total amount of registered capital** | | **82,996,126** | **10,849,030,000** |

## 7.2 PROFIT & LOSS STRUCTURE

| in HUF million | 2016 FY | 2017 FY | Change (%) |
|---|---|---|---|
| Interest income | 28,225 | 22,684 | -19.6% |
| Interest expense | -16,469 | -9,839 | -40.3% |
| **Net interest income** | 11,756 | 12,845 | 9.3% |
| Fee and commission income | 8,254 | 7,811 | -5.4% |
| Fee and commission expense | -2,187 | -2,236 | 2.2% |
| **Net fee and commission income** | 6,067 | 5,575 | -8.1% |
| Profit/(Loss) from FX transactions | 279 | 446 | 59.9% |
| Change in fair value of financial instruments | 965 | 85 | -91.2% |
| Gains from securities | 3,033 | 1,390 | -54.2% |
| Net results from investment services | 262 | 192 | -26.7% |
| **Net trading result** | 4,539 | 2,113 | -53.4% |
| Other operating income | 1,619 | 1,090 | -32.7% |
| Other operating expense | -7,707 | -11,528 | 49.6% |
| **Operating income** | 16,274 | 10,095 | -38.0% |
| Provision for impairment on loan losses | -8,047 | -1,634 | -79.7% |
| General and administrative expense | -17,799 | -17,783 | -0.1% |
| **Profit/(Loss) before tax** | -9,572 | -9,322 | -2.6% |
| Income tax benefit/(expense) | -5,799 | -1,889 | -67.4% |
| Profit/(Loss) from discontinued operation | -131 | 3,023 | - |
| **Profit/(Loss) for the period** | -15,502 | -8,188 | -47.2% |

The Bank's consolidated loss for the year by IFRS amounted to HUF 8,188 million in 2017, the total consolidated comprehensive income of the Bank amounted to HUF 7,525 million loss. The lower loss is mainly due to the significant drop of net interest expense, and the decrease of the earlier loan losses, predominantly related to retail FX based loans.

### 7.2.1 Net interest income

Net interest income was HUF 12.8 billion in 2017, 9.3% higher than a year before. The reason of growth was the decreasing interest expense of securities, thanks to low interest rate environment it was possible to involve cheaper financing funds instead of maturing bonds.

The net figure emerged as a balance of HUF 22.7 billion interest income (19.6% lower year-on-year) and HUF 9.9 billion interest expense (y/y: -40.3%). The net interest margin to average total assets (NIM) was 3 bps higher compared to 2016.

***Distribution of interest income and expenses shows the following table:***

| | 2016 FY | 2017 FY | Change |
|---|---|---|---|
| **Interest income** | | | |
| Loans | 59.6% | 72.6% | *13.0%-pt* |
| Refinancing | 8.2% | 6.9% | *-1.3%-pt* |
| Mortgage bond interest subsidy | 15.2% | 8.1% | *-7.1%-pt* |
| Supplementary interest subsidy | 1.6% | 1.4% | *-0.2%-pt* |
| Securities and interbank activities | 14.2% | 7.4% | *-6.8%-pt* |
| Swap transactions | 1.3% | 3.6% | *2.3%-pt* |
| **Interest expenses** | | | |
| Bonds issued | 79.3% | 80.5% | *1.2%-pt* |
| Interbank activities | 0.6% | 0.5% | *-0.1%-pt* |
| Customer deposits | 14.4% | 10.1% | *-4.3%-pt* |
| Derivatives | 5.8% | 8.8% | *3.0%-pt* |
| Other interest expense | 0.0% | 0.1% | *0.1%-pt* |

### 7.2.2 Net fees and commissions

In 2017, the Bank achieved a positive balance of HUF 5.6 billion from income and expenditures on commissions and fees; 8.1% lower than a year before. The main reason for this is the one-off fees related to repayment of refinanced loans of AXA Bank in 2016. Compared to the previous year, fee incomes related to mortgage loans, and guarantee fees decreased. Besides bank account and bankcard related fees and fund management fees increased.

The increase of 2.2% of fee and commission expense is mainly due to an increase of agency fees of HUF 131 million. Card related fee expenses (HUF 779 million) increased by 16.4% year-on-year, while payment fees reached HUF 166 million in 2017.

### 7.2.3 Net trading result

In 2017, the balance of financial transactions was HUF 1,921 million profit, which is lower by HUF 2,355 million than a year before. The net result of F/X transactions was HUF 446 million in 2017, which is significantly better (by HUF 167 million) than the previous year.

In 2017 the change in the fair value of FVTPL was HUF 85 million profit, which is lower than a year before (HUF 965 million profit). The securities transactions resulted in HUF 1,390 million profit, while it was HUF 3,033 million profit in the previous year. Net results from investment services was HUF 192 million, which is 26.7% higher than the previous year data.

### 7.2.4 Other operating income and expenditure

In the year of 2017, the balance of other operating income and expenditure was HUF 10.4 billion net expenditure; arising from HUF 1 billion income and HUF 11.5 billion expenditure.
In the amount of other operating income of the previous year there was a 0.4 billion income from damages compensations received, which also explains the decline of net operating income in the current year.
The increase of other operating expense by HUF 3.8 billion is explained by the provision set up in the current year most of which can be related to the integration of the Bank Group into integrated IT system.

In 2017 the real estate related income (real estate rent, property management) contributed HUF 107 million to other operating income. The Bank group also had HUF 505 million income from card service fees of Hungarian Card Service Plc.

### 7.2.5 Operating expenses

Operating costs amounted to HUF 17.8 billion in 2017 which is 0.1% lower than in 2016.

Cost-to-income ratio (CIR)[3] was 86.6% in 2017, while 78.8% in 2016.

The contribution of personnel expenses to total operating costs was 40.9% in 2017, 1.38%-points higher than 2016 (39.5%).

Administrative expenses in 2017 (HUF 9,710 million) increased year-on-year (1.2%). Expenses of business activity altogether significantly decreased year-on-year, HUF 354 million expenses in 2017 is lower by 55.4% lower than a year before (HUF 793.4 million). Commercial and advertising decreased by HUF 428.1 million forints (49.4%), and consultants' fees decreased by 140.5 million forints.

Other taxes paid reported among operating costs amounted to HUF 39.7 million in 2017, compared to HUF 38.7 million in 2016.

### 7.2.6 Impairment and loan losses

The credit risk costs amounted to HUF 1,634 million in the year of 2017. Beyond the provisioning/releasing impairment for loan losses, the risk cost line is charged by the results of portfolio cleaning. The impairment reduced by 79.7%, HUF 6 billion compared to the end of last year.

## 7.3 Capital position

Members of the SZHISZ - in view of the institutional system of joint and several liability - should examine compliance with prudential requirements on a consolidated basis, individual compliance is ensured exemption by the relevant legislation and the relevant decision of the MNB. Since FHB Mortgage Bank Plc. and FHB Commercial Bank Ltd. are members of the SZHISZ, so the above exemption applies.

Accordingly the regulatory capital of the group contains the following elements: registered capital - repurchased own shares + capital reserve + general reserve + share option reserve + accumulated wealth - intangible assets - IRB loss. The regulatory capital amounted to HUF 43,603 million as of 31 December 2017, compared to HUF 45,612 million in 2016.

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

## 8 PROTECTION OF ENVIROMENT

Although FHB Mortgage Bank Plc. does not pursue business and non-profit activities related to environmental protection, it strives to ensure environmentally-friendly work places, maintains and cares the natural and ornamental plants of its environment. It strives to take energy-saving solutions during its operation. In its internal training it emphasizes the importance of energy and environmentally conscious corporate and employee behavior.

## 9 OTHER SERVICES PROVIDED BY THE AUDITOR COMPANY

In 2017, the auditing company invoiced to FHB Mortgage Bank Plc in other services HUF 1.3 million related to the issued bonds.

## 10 POST BALANCE SHEET DATE EVENTS

The Board of Directors decided to change the name and image of the company. This will most likely happen in the first half of 2018.

The Hungarian National Bank has announced its mortgage purchase program, which will probably decrease the cost of mortgage-based refinancing in 2018.

Budapest, 5 April, 2018

**dr. Gyula László Nagy**
Chief Executive Officer

**Edit Erika Tóth**
Deputy Chief Executive Officer