



TAKARÉK MORTGAGE BANK PLC.

**BUSINESS REPORT FOR 2019
ACCORDING TO IFRS**

Budapest, March 31, 2020

A handwritten signature in blue ink, appearing to be "G. Nagy", written over a light blue grid background.

dr. Gyula László Nagy
Chief Executive Officer

A handwritten signature in blue ink, appearing to be "A. Mészáros", written over a light blue grid background.

Attila Mészáros
Deputy General Manager



TABLE OF CONTENTS

1	Overview of Takarék Mortgage Bank PLC	3
1.1	Takarék Mortgage Bank Plc.....	3
1.2	Takarék Commercial Bank Ltd.....	5
2	The macroeconomic Environment in 2019.....	5
2.1	The Hungarian economy in 2019	5
2.2	The banking sector in 2019.....	6
3	Report on business activities.....	8
3.1	Major financial indicators (ifrs, non-consolidated figures)	8
3.2	Lending	8
3.3	Refinancing	9
3.4	Portfolio quality, impairment.....	9
3.5	Securities issues	9
3.6	Balance sheet developments (ifrs, non-consolidated figures).....	10
3.7	Profit & Loss developments (ifrs, non-consolidated figures)	13
4	Liquidity management	15
5	Risk management principles	16
5.1	Risk management policy	16
5.2	Credit risk.....	16
5.3	Liquidity and maturity risk.....	16
5.4	Exchange rate risk	17
5.5	Interest rate risk	17
5.6	Operational risk.....	17
6	Organization changes and headcount.....	17
7	Protection of environment	18
8	Other services provided by the auditor company	18
9	Post Balance Sheet date events	18

1 OVERVIEW OF TAKARÉK MORTGAGE BANK PLC.

1.1 TAKARÉK MORTGAGE BANK PLC.

Takarék Mortgage Bank Public Limited Company (formerly FHB Mortgage Bank Plc., hereafter referred to as “the Bank” or “the Company”) was established by the Hungarian State on October 21, 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 Mortgage Bonds (Jht.) on March 6, 1998. The Bank started operation as of March 16, 1998.

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

Ownership structure of Takarék Mortgage Bank Plc.:

Shareholder	31 December 2018		31 December 2019	
	Holding %	Number of shares	Holding %	Number of shares
Ordinary shares listed on BSE (Series “A”)				
Domestic institutional investors	52.56	57,069,304	52.80	57,285,447
Foreign institutional investors	0.02	20,576	0.02	22,224
Domestic private investors	3.47	3,759,643	3.31	3,594,103
Foreign private investors	0.06	60,400	0.01	12,410
Employees, directors and senior management	0.00	-	0.00	-
Treasury shares	0.23	253,601	0.23	253,601
Government held owner	4.45	4,832,225	4.45	4,832,225
Other	0.00	4,261	0.00	-
<i>Subtotal</i>	<i>60.80</i>	<i>66,000,010</i>	<i>60.82</i>	<i>66,000,010</i>
Dividend preference not listed on BSE (Series “B”)				
Domestic institutional investors	13.05	14,163,430	13.05	14,163,430
<i>Subtotal</i>	<i>13.05</i>	<i>14,163,430</i>	<i>13.05</i>	<i>14,163,430</i>
Ordinary shares not listed on BSE (Series “C”)				
Domestic institutional investors	26.11	2,832,686	26.11	2,832,686
<i>Subtotal</i>	<i>26.11</i>	<i>2,832,686</i>	<i>26.11</i>	<i>2,832,686</i>
Total	99.96	82,996,126	99.98	82,996,126

The Board of 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 TakaréK Commercial Bank Ltd. (henceforth "the Commercial Bank"), thereby significantly expanding the range of services provided as a group.

In 2013, the Bank managed several acquisitions, thereby broadening the range of activities provided by the group as well as expanding the number of affiliated companies. It included the acquisition of Diófa Alapkezelő Zrt. (Diófa Fund Management Ltd.), the purchase of the Díjbeszedő Operational and Service Limited Liability Company (DÜSZ), that came into being after a secession from Díjbeszedő Holding Ltd. (DBH), the Díjbeszedő Faktorház Co. Plc. (DBF), DíjNET Ltd., Díjbeszedő Informatikai Ltd. (DBIT), and certain share of ownership in the Magyar Posta Befektetési Zrt. (Hungarian Post). The Bank sold these ownership shares to the MTB Bank of Hungarian Savings Cooperatives Ltd. (hereafter "MTB") in December 2017.

Based on the Act CXXXV of 2013 on the integration of cooperative financial institutions and modification of certain legal rules on economic issues (Szhivt), the Bank and the Commercial Bank (under the Bank's qualifying holding and prudential supervisory) became a member of the Integration Organisation of Cooperative Credit Institutions (SZHISZ) in September 2015, and also the member of the Guarantee Group of Cooperative Credit Institutions, and thus a member of Hungary's then fourth largest banking group (the TakaréK Group).

At the end of December 2015 the Bank increased its share capital by HUF 4,249 million face value, which equaled HUF 30.5 billion issue value. The capital increase was made 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 TakaréK Group.

The shareholder structure of the Company changed significantly in the last quarter of 2016. On October 14, 2016 A64 Vagyonkezelő Ltd. sold its shares in the Company over the counter to B3 TakaréK and Fókusz TakaréK, on December 9, 2016 MTB bought the shares of VCP Finanz Holding Ltd. As a result, MTB and the cooperative credit institutions obtained more than 68% of the shares of the Company by the end of the year.

The integration process of the Bank and the Commercial Bank within the Integration of Cooperative Credit Institutions that started in the autumn of 2015 finished in 2017. The organizational restructuring of the Bank, in line with the strategy of the Integration, started immediately after this. As a first step, the Bank was reclassified as a simple profile mortgage bank, with only issuance and refinancing functions remaining, while all other human resources and capacities were transferred to MTB and the Commercial Bank.

On June 27, 2017 the General Assembly of MTB accepted the 5-year strategy of the Integration. According to that, the function of the central financial body of TakaréK Group will be solely performed by MTB; hence the Bank's group management functions were passed over to MTB. Consequently, the satellite institutions of the Integration including mutual fund management, factoring and leasing services as well as central suppliers became directly subordinated to the MTB.

From April 2018 the Bank made no more new loan disbursements, it disbursed only allotments and non-refundable state subsidies on previously agreed credit contracts. New credit contracts for households from this time are only available in the Commercial Bank. Previously made credit contracts were kept in the Bank's portfolio until their expiry, but the active functions of the Bank remained solely those that relate to classic mortgage bank functions (issuance of mortgage bonds and refinancing).

The general assembly of the Company on April 27, 2018 made a decision over the changing of the name of the Bank. It is from June 25, 2018 that the Company's valid name is TakaréK Mortgage Bank Plc.. In the revised 5-year strategy of the TakaréK Group (accepted on November 30, 2018 by MTB's general meeting) the Bank's principal role remained unchanged: it solely performs classic mortgage bank activities.

Following the end-2017 sale of most of its ownership shares, the only direct ownership of the Bank was the one in the Commercial Bank. This was kept up until October 29, 2019, when this 51% ownership share was fully sold to MTB.

1.2 TAKARÉK COMMERCIAL BANK LTD.

In line with the mid-term strategic plan for the years 2006-2010, the Board of Directors of the Bank decided to establish the Commercial Bank in February 2006. After receiving licence, banking operation started on December 5, 2006. In 2007, the Commercial Bank broadened its branch network and gradually took over the distribution of retail and corporate loans from the Bank and started funding activity by continuously developing account management and card services. In 2008 the Commercial Bank launched its SME business line, later in 2010 it started its investment services business line.

As a result of the merger with Allianz Bank Ltd. on April 1, 2011, the number of employees, number of branches and the size of financial assets of the Commercial Bank increased significantly, the product portfolio considerably widened.

In September 2014, the Bank and Magyar Posta Zrt. entered into contract on the purchase (by the latter) of ordinary shares representing 49% of the share capital of the Commercial Bank. Before the transaction, the general meeting of the Commercial Bank Ltd. decided on a capital increase of approximately HUF 20 billion. This was registered on October 1, 2014.

In November 2013 the Commercial Bank established the Hungarian Card Service Ltd. the activity of which is linked to card related electronic payment platform services. On September 28, 2018 the Commercial Bank sold its 99.39% share in the company.

As the large commercial bank of the Integration, the Commercial Bank represents the TakaréK Group as a prestigious financial institution, competing with large banks in Budapest and cities with higher population; it closed its operations in smaller settlements in 2017. The Commercial Bank ceased to provide investment services on its own account from December 18, 2017. It continues to serve its previous clients through its network as an agent of MTB. The management of client accounts and portfolios were taken over by MTB.

The Commercial Bank changed its name on April 16, 2018. In line with the TakaréK Group's strategy for the 2019-2023 period (which was approved by the general meeting of MTB on November 30, 2018), at the end of October 2019 the Commercial Bank merged into the new large commercial bank of the Integration, which unifies TakaréK Group's all banking related activities, except that of mortgage banking.

2 THE MACROECONOMIC ENVIRONMENT IN 2019

2.1 THE HUNGARIAN ECONOMY IN 2019¹

Indicator	2017	2018	2019
Real GDP growth	4.3%	5.1%	4.9%
Industrial output growth	4.6%	3.5%	5.4%
Average annual rate of inflation	2.3%	2.8%	3.3%
Average annual rate of unemployment	4.2%	3.7%	3.4%
ESA-based budget balance (relative to GDP)*	-2.4%	-2.3%	-1.7%
Net external financing capacity (relative to GDP)*	3.1%	2.1%	1.7%
Base rate (end-of-year)	0.90%	0.90%	0.90%
EUR-HUF exchange rate (end-of-year)	310.14	321.51	330.52

*Estimate for 2019

Sources: KSH, MNB, NGM

The external environment – at least in terms of the real economy – was less supportive for Hungary's economy in 2019 than a year before. GDP growth slowed worldwide, but it was particularly the case in the European Union, within this

¹ Data used in this chapter are based on the relevant reports and data releases of KSH (Central Statistical Office), MNB (National Bank of Hungary) and analyses prepared by MTB

Germany, Hungary's most important trading partner. However, as a reaction to the economic slowdown and strengthening geopolitical risks, the policy bias of major central banks, which back in 2018 was obviously tightening, changed to the opposite in 2019. On the other side of the Atlantic, the Fed, which in 2018 raised the fed funds rate by altogether 100bps in four steps, in fact cut this rate by 75bps last year in three steps to arrest the slowdown in the economy. ECB was already unable to tighten back in 2018, so it had much lesser space to ease conditions through policy rates last year, the only such step was the 10bp cut (to -0.5%) of the deposit rate.

Despite the slowdown in the external environment the Hungarian economy could retain its strong growth dynamics: from 5.1% in 2018 GDP-growth hardly slowed to 4.9% in 2019. The robust growth rate was driven mostly by gross fixed capital formation expanding at double-digit rates for the third consecutive year, and also private consumption that was supported by 8% growth in real wages and continued improvements in the labour market (employment increased by another 1% and the number of employees exceeded 4.5 million at the end of 2019). From the production side market services sector - reflecting the upturn in domestic demand – contributed markedly to growth, and the construction sector had a strong year again, while industrial production also picked up from 2018. The strong increase in domestic demand, maintained faster import than export growth, nevertheless the trade surplus was still healthy enough, yet somewhat narrower than a year before.

Alongside strong growth performance both internal and external balances remained on a favourable path. The budget deficit in ESA-terms likely remained below 2% of GDP, while public debt relative to GDP may have decreased by another 2 percentage points, thus remained on a downward path for the eighth successive year and sank comfortably below 70%. Developments also remained encouraging with respect to the evolution of external balances: similarly to 2017 the net external financing capacity of the Hungarian economy remained positive for the eleventh year running. Although the surplus of the current account is no a decreasing trend, and declined to below 2% of GDP last year, it was still enough to slash net foreign debt further, which thus stood at just 7% of GDP at the end of 2019.

The 12-month rate of headline CPI inflation was more volatile in 2019 than in the previous years (fluctuating between 2.7% and 4%), with average annual inflation reaching 3.3%. By the end of the year even core inflation stabilized at the upper edge of the central bank's tolerance band (4%), however, filtering out the impact of indirect taxes and looking ahead the central bank is unlikely to see reasons to meaningfully tighten monetary conditions. Yet, the soft conditions upheld throughout 2019 made the Forint an underperformer among regional currencies with the Hungarian local currency hitting new all-time lows against the Euro. True, in early 2019 two rating agencies improved its grade on Hungary's long-term debt, which lent some support to the Forint, but since Forint denominated assets bear the lowest real interest rates (at the same time funding in Forint is the cheapest) in the region, the currency remained on a downward slide even despite the strong performance of the real economy.

The number of newly built dwellings in 2019 increased by 19.5% compared to 2018, but following a 3% fall in 2018, the number of new building permits fell another 4.3% last year. The decline mostly affected towns in the countryside, whereas Budapest even faced a growing number of building permits. The 19.5% growth in the number of newly built dwellings means that 21,127 flats were reported as new last year compared to 17,681 flats in 2018. Budapest clearly was the driving force behind these developments, since the annual growth rate exceeded 50%, while cities in the countryside that were the leading force of residential real estate markets in the previous years, saw their growth rates slow down considerably. Of the newly built 21,127 flats 58% was constructed by entrepreneurs whereas 42% by private persons, which is an increase in the case of the former, but a heavy decrease in the case of the latter.

2.2 THE BANKING SECTOR IN 2019²

The total assets of the banking sector amounted to HUF 43,497 billion at the end of 2019, up 10.2% from HUF 39,459 billion a year before. According to non-audited preliminary figures the combined pre-tax profit of the banking sector

² This section relies on data provided by the MNB with a preliminary nature. We use data relating to the Hungarian operation of banks (branches) only, hence excluding the affiliates of Hungarian banks operating abroad.

reached HUF 550 billion last year, almost exactly HUF 30 billion below last year's figure, but it was expected in the wake of much smaller net income from de-provisioning, as well as a continued increase in operating expenditures. The stock of net credit of the banking sector increased by 15.4% in 2019 and reached HUF 23,331 billion at the end of the year. Within this household credit increased by 18.1%, while the non-financial corporate sector was up by 12.2%.

5.2% of the stock of Forint denominated household credits were in a 90+ day arrear at the end of last year, while the share of non-performing loans was 6.8%. Both figures show significant decrease compared to end-2018 figures, which were 7.4% and 9.9% respectively. In the case of the non-financial corporate sector only 2% of their credit was in a 90+ day arrear, which is a marked decrease compared to 2.8% prevailing at the end of 2018.

The share of client deposits within total liabilities increased to 56% in 2019, its volume reached HUF 24,360 billion. 38.7% of this stock was owned by households, whereas 38.5% by the non-financial corporate sector.

2.2.1 Disbursement of household mortgage loans

The disbursement of new mortgage loans went up from a monthly HUF 60 to HUF 90 billion in the first half of 2019, before moderating in the wake of the introduction of the Waiting for Baby loan facility. Following the first wave of applicants for the latter, the monthly volume of new mortgage credit disbursements rose again to the HUF 80 to 90 billion range. The total annual disbursement finally reached HUF 979 billion, up 7% from 2018's HUF 915 billion. Both in the home equity loan segment, and the mortgage-backed general purpose loan segment the annual growth of disbursements was 7% compared to 2018.

2.2.2 Stock of household mortgage loans

The stock of household mortgage loans stood at HUF 4,526 billion at the end of 2019 according to the central bank's data release. This represents HUF 164 billion increment (+3.8%) over end-2018's HUF 4,363 billion stock. Within this it was home equity loans that drove the increase: from HUF 3,341 billion at the end of 2018 the stock increased to HUF 3,641 billion (up 9%) by the end of 2019. Meanwhile, the stock of mortgage-backed general purpose loans decreased by HUF 136 billion during 2019, and hence the outstanding stock was HUF 885 billion at the end of last year. The share of foreign currency denominated loans within total mortgage loans was less than 0.2%.

2.2.3 The market of mortgage bonds

In the course of 2019 the face value of the stock of mortgage bonds issued by the five mortgage banks residing in Hungary increased by HUF 61 billion, which implies 5% growth, and thus the end-year stock was close to HUF 1,280 billion at face value. The much higher growth in 2018 was due to the active presence of the central bank in the market segment; indeed, the central bank purchased HUF 300 billion mortgage bonds in net terms during 2018. However, in 2019 the program was no more in effect, and while the Mortgage Adequacy Financig Ratio was raised from 20% to 25% last year, banks made pre-arrangements for meeting the new limit already in 2018, and thus there was no need on their side to issue new series in 2019 (the market leader OTP Mortgage Bank for example had no mortgage bond issuance at all last year).

3 REPORT ON BUSINESS ACTIVITIES

In the course of 2018-2019 the Bank underwent radical structural, major operational and thorough ownership changes, which obviously markedly impacted the Bank's business and financial activities, the development of its balance sheet and profitability.

The Bank's balance sheet was cleared from the assets and liabilities of the Commercial Bank, which was previously 51% owned by the Bank. Due to this, the consolidated balance sheet of the Bank markedly contracted. Profit/Loss figures also reflect the major changes in activity profile and operational structure, which resulted in significantly weaker profits in 2019 than a year before. Hence, it is only from next year that major balance sheet and P&L items can be directly compared across consecutive calendar years.

3.1 MAJOR FINANCIAL INDICATORS (IFRS, NON-CONSOLIDATED FIGURES)

The total assets of the Bank increased by HUF 9.1 billion (up 2.7%) in 2019, and by the end of the year its volume reached HUF 342.9 billion. Pre-tax profit, down significantly from 2018, amounted to HUF 2,446 million, while profit for the year reached HUF 2,140 million. The total comprehensive income for the year was HUF 2,858 million, markedly down from the preceding year's HUF 4,574 million.

HUF million	December 31, 2019	December 31, 2018	Change
Balance sheet total	342,897	333,787	2.7%
Financial assets valued at amortized costs	294,526	256,012	15.0%
o/w gross loans	275,801	246,407	11.9%
Financial liabilities valued at amortized costs	269,895	262,393	2.9%
o/w debt-type securities issued	265,929	247,797	7.3%
Equity	65,043	62,185	4.6%
Profit/Loss before tax	2,446	4,921	-50.3%
Full-year profit/loss	2,140	4,680	-54.3%
Total comprehensive income	2,858	4,574	-37.5%
ROAA (return on average assets, %)	0.6%	1.5%	-0.8%-pt
ROAE (return on average equity, %)	3.4%	7.8%	-4.4%-pt

3.2 LENDING

The Bank discontinued extending new loans as of April, 2018. Yet, the existing portfolio remains in the Bank's books until full expiry. Lending activity from the second quarter of 2018 is provided by the Commercial Bank, which merged into the new Takarékbank at the end of October. From Q2 2018 the Bank is only active in the refinancing segment, and thus its still existing client loans are gradually reduced due to natural amortization and successful workout process.

The stock of the Bank's earlier disbursed loans was HUF 58.6 billion at the end of 2019, down 23% from end-2018's HUF 77.1 billion. This is almost 100% household loan, as corporate loans decreased to just HUF 9 million by end-2019 from HUF 7.1 billion back at the end of 2018. Bulk of the household loan portfolio is mortgage loan, which secures 1.1% market share for the Bank in this segment (down from 1.4% prevailing in 2018).

3.3 REFINANCING

From the second quarter of 2018 the Bank performs solely classic mortgage bank functions, i.e. it issues mortgage bonds, and using the funds thus required it refinances the mortgage debt portfolios of partners within the TakaréK group and also that of external partners. Within the TakaréK Group the Bank is a special entity: it is able to raise funds in the form of mortgage bonds issuances either at domestic or external financial markets. With regard to the latter, it is able to secure foreign currency financing for corporate lending.

In its strategy the Bank puts special emphasis on cooperating with external partners. It strives to become an attractive alternative for banks and banking groups that are involved in extending mortgage loans but do not have own mortgage bank licence and thus need refinancing. The stock of refinancing loans extended by the Bank went up by HUF 47.7 billion (or 28.2%) in 2019 and their volume at the end of the year was HUF 217 billion.

3.4 PORTFOLIO QUALITY, IMPAIRMENT

The Bank had HUF 312.5 billion classified assets, HUF 0.54 billion contingent liabilities (altogether HUF 313.07 billion) in its books as of December 31, 2019.

Claims on clients amounted to HUF 58.8 billion, moreover, based on already signed contracts there was a commitment for disbursing loans to the tune of HUF 0.54 billion (0.17%) at the end of 2019. Of these 779 loan contracts were classified as Stage 3 category with an underlying volume of HUF 2.784 billion in claims and HUF 4 million as commitments with HUF 0.57 billion in impairments and provisions. HUF 55.8 billion claim and HUF 0.54 billion commitment was classified as Stage 1 and Stage 2 categories, with HUF 0.42 billion in impairments and provisions.

The share of problem free (Stage 1 and Stage 2) loans was 95.28% as of December 31, 2018, consequently the share of Stage 3 loans was 4.72%.

Average impairment considerably decreased both in the entire (excl. swaps) portfolio (0.32%) and the loan portfolio (1.66%) compared to end-2018.

3.5 SECURITIES ISSUES

As a result of capital market transactions in 2019 the Bank raised HUF 59.7 billion in new funds, exclusively in the form of mortgage bonds. This volume was raised through 15 issuances, all of which two took place through auctions at the stock exchange. In each issuance the entire spectrum of the Bank's dealers were involved. On the course of the transactions three different series of mortgage bonds were put into circulation with both fixed and variable coupons, maturities of 5 to 10-years, denominated in HUF only. The TJ24NV01 variable coupon series was the most frequently issued; it was put up for auction eight times in 2019. The third quarter was the most active with respect to issue volumes: HUF 33.5 billion was sold to investors in that period.

Alongside strong issuance activity the Bank also performed repurchases throughout 2019. In October the Bank repurchased HUF 20 billion of the variable rate bond it issued in March 2018 from the then still independently existing Commercial Bank. Besides this transaction, the Bank made repurchases of mortgage bonds affecting three earlier issued series. The volume of these repurchase transactions was HUF 500 million and EUR 4.3 million.

Three series of mortgage bonds expiring in 2019 totalled HUF 13.6 billion, and HUF 5.1 billion of uncovered bonds also expired last year. With the latter, there remained no more uncovered bonds among the Bank's still outstanding issuances.

In accordance with the relevant statutory provisions the Bank continues to keep a stricter mortgage bond coverage ratio. Accordingly, the aggregate amount of ordinary collateral (net of impairment losses) plus supplementary collateral each

day exceeded the aggregate nominal value of outstanding mortgage bonds in circulation. The same adequacy rule also 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 coverage 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 value of real estate collateral covering mortgage bonds issued by the Bank was HUF 309.3 billion as of December 31, 2019, 12.9% above the figure prevailing at December 31, 2018 (HUF 269.3 billion).

Value of mortgage bonds and assets involved as collateral

HUF million	December 31, 2019	December 31, 2018	Change
Outstanding mortgage bonds in circulation			
Face value	226,746	222,451	19.9%
Interest	30,956	32,607	-5.0%
Total	297,702	255,058	16.7%
Value of ordinary collateral			
Principal	252,187	222,731	13.2%
Interest	57,136	46,533	22.8%
Total	309,323	269,264	14.9%
Value of assets involved as supplementary collateral			
Government and Hungarian Development Bank bonds	45,552	32,676*	39.4%
Mortgage bonds	-	3,575*	-
Total	45,552	36,251*	25.6%

* The volume of interest was not indicated in the value of the substitute collaterals in 2018, but the calculation has been adjusted in the 2019 Business Report. The reason behind it was twofold, first the register and the accounting system of the substitute collaterals changed, (Inforex instead of Bankmaster) and consequently there was an adjustment in the interest calculation: the volume of the interest increased, secondly in the quarterly mandatory disclosure the Bank is always indicating the interest of the substitute collateral.

As of 31 December 2019, the present value of ordinary and supplementary collateral was HUF 313.8 billion and the present value of mortgage bonds was HUF 287.9 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 108.99%.

The net value of ordinary and supplementary collateral principal to the unpaid face value of mortgage bonds in circulation was 110.35%, and the net ordinary and supplementary collateral interest to the unpaid interest on mortgage bonds in circulation was 195.52% as of December 31, 2019.

3.6 BALANCE SHEET DEVELOPMENTS (IFRS, NON-CONSOLIDATED FIGURES)

As of 31 December 2019, the Bank's balance sheet total according to non-consolidated IFRS figures amounted to HUF 342.9 billion, an increase of 2.7% compared to a year before. On the assets side it was mainly an increase in financial assets valued at amortized costs (within this the stock of loans) that explain the growth in total assets. The volume of loans increased by HUF 31.5 billion in 2019 and reached HUF 275.8 billion at the end of the period. On the liabilities side the HUF 18.1 billion growth in the stock of issued securities was instrumental, but the HUF 2.9 billion increase in shareholders' equity also played role.

in HUF million	December 31, 2019	December 31, 2018	Change
Cash, claims on central bank and other sight deposits	1,070	1,314	-18.6%
Financial assets held with trading purposes	175	2,876	-93.9%
Financial assets at fair value through other comprehensive income	43,734	39,305	11.3%
Financial assets at amortized costs	294,526	256,012	15.0%
Financial derivatives - assets	2,676	0	-
Investments into affiliated and incorporated companies	0	31,978	-
Tangible assets	157	249	-36.9%
Goodwill and other intangible assets	241	383	-37.1%
Deferred tax assets	0	218	-
Other assets	318	1,452	-78.1%
Total assets	342,897	333,787	2.7%
Financial liabilities held with trading purposes	136	831	-83.6%
Financial liabilities at fair value through profit and loss	6,552	7,437	-11.9%
Financial assets at amortized costs	269,895	262,393	2.9%
Financial derivatives - liabilities	288	0	-
Provisions	509	572	-11.0%
Deferred tax liability	93	14	-84.9%
Other liabilities	381	355	7.3%
Total liabilities	277,854	271,602	2.3%
Share capital	10,849	10,849	0.0%
Paid-in capital on top of face value	27,926	27,926	0.0%
Accumulated other comprehensive income	992	274	262.0%
Accumulated profit reserve	22,416	17,951	24.9%
Other reserves	927	712	30.2%
Treasury shares	-207	-207	0.0%
Full-year profit/loss	2,140	4,680	-54.3%
Total shareholders' equity	65,043	62,185	4.6%
Total liabilities and shareholders' equity	342,897	333,787	2.7%

3.6.1 Financial assets at fair value through other comprehensive income

The value of financial assets at fair value through other comprehensive income was HUF 43.7 billion at the end of 2019, 11.3% higher than a year earlier. Debt-type securities are the most significant within this item, whereas the share of ownership-type instruments is below 1%.

The change in the stock of debt-type securities is mostly explained by changes to the stock of government securities and bonds issued by credit institutions. The former was up HUF 11.4 billion, the latter by HUF 10 billion compared to end-2018.

3.6.2 Financial assets valued at amortized costs

The volume of financial assets valued at amortized costs increased by 15% in 2019, thus the volume amounted to HUF 294.5 billion by the end of the period.

Within this the stock of gross loans increased by 12.9%, rising to HUF 275.8 billion by the end of the year. The stock of interbank deposits and claims on central bank increased from HUF 12.5 to HUF 17.4 billion, which is 39.3% growth in one year.

3.6.3 Investments into affiliated companies, joint ventures and incorporated companies

At the start of 2019 the Bank had only one affiliated company remaining: the Commercial Bank. The 51% ownership of the Bank in this entity meant a net worth of HUF 31.9 billion at the end of 2018. In November 2019 the Commercial Bank merged into Takarékbank, the large universal credit institution that unifies all commercial banking activities within the Takaré Group apart from the mortgage bank function. As a result of this transaction, the value of the Bank's investments into affiliated companies, joint ventures and incorporated companies reduced to zero by the end of 2019.

3.6.4 Financial liabilities valued at amortized costs

Financial liabilities valued at amortized costs take up 78.7% of the Bank's total liabilities. Their volume at the end of 2019 was 2.9% higher than a year before, thus reaching HUF 269.9 billion. Within this debt-type securities, i.e. the mortgage bonds issued by the Bank to secure the long-term refinancing the mortgage debt portfolio, represent the highest share. The nominal value of mortgage bonds in circulation was HUF 265.9 billion at the end of 2019, up 7.3% from 2018.

3.6.5 Equity, capital adequacy

The shareholders' equity was HUF 65 billion at the end of 2019, up HUF 2.9bn from 2018. The prudential requirement on capital adequacy should be interpreted in the Takaré Group's context. The Group level capital adequacy requirement was met at the end of 2019.

3.6.6 Off balance sheet items

The value of off balance sheet contingent liabilities was HUF 18.2 billion at the end of 2019, 11.7% higher than a year before. Within this the decisive item is the volume of unused (or not yet drawn upon) credit lines by clients and refinancing partners, which stood at HUF 18.1 billion at the end of 2019 (HUF 15.7 billion at end-2018).

3.7 PROFIT & LOSS DEVELOPMENTS (IFRS, NON-CONSOLIDATED FIGURES)

HUF million	2019	2018	Change (%)
Interest income	10,261	11,087	-7.5%
Interest expense	-7,698	-8,385	-8.2%
Net interest income	2,563	2,702	-5.1%
Fee and commission income	591	610	-3.1%
Fee and commission expense	-436	-1,449	-69.9%
Net fee and commission income	155	-839	-
Dividend income	0	234	-
Forex transactions	-10	4	-
Profit/Loss on derecognition of financial assets and liabilities not valued at fair value through profit and loss	423	3,002	-85.9%
Profit on financial assets and liabilities held for trading purposes	2,319	1,526	52.0%
Losses arising from hedging operations	-913	0	-
Profit/Loss on financial assets and liabilities at fair value through profit and loss	147	156	-5.8%
Net trading result	1,966	4,922	-60.1%
Profit/Loss on derecognition of non-financial assets	41	22	86.4%
Net other operating revenue	787	1,078	-27.0%
Net other operating expense	-8	-12	-33.3%
Operating income	5,504	7,873	-30.1%
Provisioning and deprovisioning	14	633	-97.8%
Net depreciation of financial assets and liabilities not valued at fair value through profit and loss	380	412	-7.8%
Net depreciation of non-financial assets	-121	-3	-
Operating costs	-3,337	-3,994	-16.4%
Profit/Loss on reclassification	6	0	-
Profit/Loss before tax	2,246	4,921	-50.3%
Income tax	-306	-241	27.0%
Profit/Loss for the period	2,140	4,680	-54.3%
Other comprehensive income	718	-106	-
Items not reclassifiable as income	9	0	-
Items reclassifiable as income	709	-106	-
Hedging instruments	-186	0	-
Debt-type instruments at fair value through other comprehensive income	895	-116	-
Corporate tax on items reclassifiable as income	0	10	-
Total comprehensive income	2,858	4,574	-37.5%

The Bank's pre-tax profit was HUF 2.4 billion in 2019, significantly short of 2018's HUF 4.9 billion (-50.3%). The developments in the Bank's P&L structure were markedly impacted by the major change in the Bank's business strategy, whereby the Bank's activity was reduced to exclusively refinance partner banks. On top of this, the clearing of the balance sheet from financial assets and liabilities at fair value through profit and loss also contributed to the smaller profit, although it was the consequence of retaining pure mortgage banking profile only. Full-year profit was HUF 2.1 billion in 2019 (down from 2018's 4.7 billion). Total comprehensive income also remained below that of 2018: it amounted to HUF 2.9 billion as opposed to HUF 4.6 billion a year earlier.

3.7.1 Net interest income

Net interest income was HUF 2.6 billion in 2019 as a result of HUF 10.3 billion in income (down 7.5% from 2018) and HUF 7.7 billion in expenses (down 8.2% from 2018). In sum, net interest income was HUF 139 million (5.1%) lower in 2019 than in the preceding year.

With respect to interest income the HUF 1.2 billion decrease in the volume of financial assets valued at amortized costs and the HUF 1.1 billion increase in the case of derivative deals were the most decisive factors.

Interest expenses were 8.2% lower in 2019 than in 2018. Within this financial liabilities valued at amortized costs has the decisive role: its volume was HUF 6.7 billion in 2019, HUF 728 million short of the preceding year's one.

3.7.2 Net fees and commissions

In 2019 the Bank achieved a positive balance of HUF 155 million on commissions and fees as opposed to HUF 839 million loss back in 2018. Income from fees and commissions reached HUF 591 million (down 3.1% from 2018), while expenses amounted to HUF 436 million (down by a significant 705 from 2018's HUF 1,449 million).

3.7.3 Net trading result

In 2019 the balance of financial transactions showed HUF 2 billion profit, which is HUF 3 billion lower than a year before. This is mostly explained by a marked decline in the volume of both financial assets and liabilities valued at amortized costs.

3.7.4 Net operating income

The net operating income of the Bank amounted to HUF 5.5 billion in 2019, markedly below the preceding year's HUF 7.9 billion.

3.7.5 Operating expenses

Due to reduced activity in the wake of performing classic mortgage bank functions only, operating expenses decreased further in 2019. The HUF 3.3 billion cost level was down 16.4% from 2018. The largest reductions took place in general and administrative costs (-23.8%), personnel costs (-24.6%), sector-specific taxes (-51.3%) and consultancy fees (-62.7%).

HUF million	2019	2018	Change (%)
Personnel costs	315	418	-24.6%
Advertisements	127	2	-
General and administrative costs	773	1,015	-23.8%
Leasing fees	21	15	40.0%
Depreciation of tangible assets	120	121	-0.8%
Depreciation of intangible assets	36	42	-14.3%
Consultancy fees	285	764	-62.7%
Maintenance costs	836	851	-1.8%
Sector-specific tax on credit institutions	76	156	-51.3%
Other taxes and fees	192	182	5.5%
Insurance costs	8	10	-20.0%
IT costs	29	31	-6.5%
Fees for supervisory and other prudential activities	394	286	37.8%
Other non-specified costs	125	101	23.8%
Total costs	3,337	3,994	-16.4%

3.7.6 Impairment and loan losses

The net balance of impairment and loan losses was HUF 273 million in 2019.

3.7.7 Pre-tax profit

The Bank's pre-tax profit in 2019 was HUF 2.4 billion.

4 LIQUIDITY MANAGEMENT

In accordance with the special legal status of the Bank, the institution is not allowed to collect client deposits, thus among its liabilities the main components are mortgage bonds, other uncovered bonds and interbank liabilities. As a member of TakaréK Group the Bank covers its liquidity positions mostly against other entities within TakaréK Group. The Bank is entitled to cover its amount of refinanced and self-issued loans by mortgage bonds only to the extent of its capital, which can be taken into account in the coverage pool. Ensuring the necessary capital backing up mortgage debt, managing the actual excess coverage position and liquid assets needed to meet the liquidity buffers to ensure orderly future principal and interest payments on mortgage bonds are financed from uncovered liabilities.

Effective from March 28, 2019 the mortgage bonds issued by the Bank are rated by S&P Global (currently at BBB with stable outlook). On March 31, 2019 the Bank terminated its rating contract with Moody's Investor Services, which thus withdrew its rating on the Bank's mortgage bonds, as there was no more possibility for updating information necessary to evaluate/adjust the rating. Hence, the Bank's obligation of maintaining excess coverage and liquidity, which was necessary in order to confirm and maintain a valid rating from Moody's, was also abolished. From the second quarter of 2019 a new internal regulation was introduced, whereby the Bank maintains 2% excess coverage and 6-month liquidity buffer.

In this new regime, the liquidity need is primarily determined by the actual size of the above-mentioned 6-month liquidity buffer, which develops according to cash-flows on the Bank's own issued mortgage bonds expected on a six-month horizon.

Developments in the structure of the Bank's liabilities

The structure of the Bank's liabilities were mostly influenced by the dynamic increase in the stock of refinanced loans, the active presence in the market of primary mortgage bond issuances (in order to secure the MFAR compliance of TakaréK Group), and also the liquidity that emerged in the wake of selling the Bank's ownership in the Commercial Bank.

The stock of refinancing loans increased by HUF 47.7 billion (+28.2%) in 2019 and reached HUF 217 billion by the end of the year. This growth led to an increase in the need for accumulating funds through the issuance of mortgage bonds.

The amount of mortgage bonds increased by close to 20% (HUF 44.3 billion) in the last year. From a face value of 222.5 billion at the end of 2018 the stock reached HUF 266.8 billion by the end of 2019. Throughout 2019, the Bank raised a total of HUF 59.7 billion in new funds exclusively in the form of mortgage bond issues, through stock market auctions and with the involvement of the entire distribution circle. The Mortgage Bank repurchased mortgage bonds with a total value of HUF 500 million and EUR 4.3 million three times in the entire 2019 year, while in 2019 a total nominal value of HUF 13.6 billion matured.

At the end of 2019, the outstanding amount of unsecured bonds issued by the Mortgage Bank was lower than the maturity date of the year. In the first quarter, the Bank repurchased the entire outstanding 20 billion HUF nominal amount of outstanding bonds.

The stock of interbank liabilities continued to decrease further and by the end of 2019, this means that almost the entire liability side of the Bank consists of mortgage bonds.

5 RISK MANAGEMENT PRINCIPLES

5.1 RISK MANAGEMENT POLICY

The Bank is a member of the Integration Organisation of Cooperative Credit Institutions (SZHISZ). Due to this membership the rules and principles of risk management policies in the Integration, as well as the risk strategy also apply to the Bank.

The risk strategy, which was approved by the Board of Directors of MTB (as the business management body of the Integration) and is mandatory for all credit institutions and other companies within the TakaréK Group under the consolidated supervision cover: risk culture, risk taking principles, objectives, risk types, significant risks, risk appetite and willingness for risk taking, risk structure, risk management, the structure and organization of risk management.

The Integration and its member institutions pursue to create an integrated risk culture, which covers the entire Integration, and which is in line with their risk appetite and risk tolerance to ensure the identification, measurement and management of emerged risks. The primary tools for creating this risk culture are internal policies, strategies, regulations and guidelines, internal communication and the continuous training of employees.

The Bank must comply with the requirements of the Integration Organisation of Cooperative Credit Institution and of MTB (as the business management body of the Integration).

The primary goals of risk management in the Bank are to protect its financial strength and reputation, and 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 risk management should limit the impact of unfavourable events both on the capital and 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. To achieve this the Bank calculates current and future capital requirements for quantifiable risk types, just like the capital requirements under the first Pillar.

The Bank considers prudent risk management as a vital value.

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

5.2 CREDIT RISK

The main activity of the Bank is the refinancing of the mortgage portfolio of its partner banks. The Mortgage Financing Adequacy Ratio (MFAR) introduced by MNB created a business opportunity for mortgage credit institutions by supporting them to extend refinancing loans with similar maturity profile as that of the long-term residential mortgage loans of partner banks, helping them in eliminating their Forint maturity mismatches. This provided an exceptional opportunity for the Bank to acquire new business partners and to boost its refinancing activities.

The activity had to be reconsidered by risk management: risk parameters had to be defined, limits on the size of risk taking vis-à-vis partner banks had to be established.

With respect to the corporate clientele the sector-specific limit system applied to corporate lending was instrumental in establishing risk taking directions to year 2019.

With respect to household lending risk taking directions were determined by lending procedures, rules for income recognition and related auxiliary documents and guides.

5.3 LIQUIDITY AND MATURITY RISK

Maintaining liquidity is an essential element of banking activity. The Bank maintains its liquidity by adjusting the maturity profile of its assets and liabilities. In the framework of asset and liability management (ALM) the Bank mitigates maturity risk through both the repurchase of the securities issued earlier and new issuances. At the same time, it applies maturity

transformation control by pre-defined limits in order to improve profitability, while maintaining solvency at all times. The Bank regularly reviews prepayments and early payment requests initiated by clients and takes into consideration their impact on managing market and liquidity risks.

The Bank prepares its liquidity plans and financing positions based on expectations derived from different scenarios, and also pays attention to the possible effects of stress situations. The level of liquid assets is kept continuously high.

5.4 EXCHANGE RATE RISK

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

The Bank intends to immediately hedge exchange rate risks emanating from its core business, provided market conditions are supportive to do so. Therefore, open FX positions may occur primarily due to liquidity management, settlements related to lending and refinancing, or accrued expenses and deferred charges in those currencies, in which the Bank keeps nostro accounts.

5.5 INTEREST RATE RISK

Interest rate risk stems from interest rate changes, which impact 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 being revaluated in a particular period are not in accordance with each other.

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

5.6 OPERATIONAL RISK

Operational risks are handled through the continuous improvement of internal regulations and procedures, the adequate training of employees and the enhancement of built-in control mechanisms. The senior management of the Bank regards feedbacks as an indispensable tool in managing operational risks. It is considered a very important aspect to monitor the effectiveness of measures taken in order to eliminate operational risks. About operational risk events and the results of operational risk monitoring there is a regular monthly report. In order to identify operational risks in time the Bank supports its employees by providing internal training.

The Bank collects and analyses loss data due to operational risk based on a system of Key Risk Indicators (KRI). The KRIs are reviewed each year, thus also in 2019 various KRIs were modified and new KRIs were defined as well. In order to improve the quality of these indicators, the operational risk division of the Bank holds expert meetings with those units that are responsible for the collection and processing of data, and they jointly decide on indicators and their critical levels/limits.

The Bank compiled an inventory for the used risk models in accordance with the surveillance requirements and a list of products to identify product-specific risks.

6 ORGANIZATION CHANGES AND HEADCOUNT

The Bank functions as a classic mortgage bank from 2018, so it handed over its business and mortgage loan extending and managing functions to the Commercial Bank, while its former group control, supervision and support functions with the underlying infrastructure was passed on to MTB.

The Bank's full-time equivalent number of employees in 2019 was 14 (back in 2018 the number of employees was 36).

7 PROTECTION OF ENVIRONMENT

Although the Bank does not pursue either business or non-profit activities related to environmental protection, it strives to ensure an environment-friendly workplace, maintains and cares the natural and ornamental plants in its environment. It pursues to apply energy-saving solutions during its operation. In its internal trainings it emphasizes the importance of energy and environmentally conscious corporate and employee behavior.

8 OTHER SERVICES PROVIDED BY THE AUDITOR COMPANY

Under the label of other services and the preparation of a special report to the MNB the auditing company invoiced the Bank HUF 5.5 million in 2019.

9 POST BALANCE SHEET DATE EVENTS

The Bank (TMB) has won the Budapest Stock Exchange's BÉT Legek (BSE Bests) Award of Best Mortgage Bonds Issuer of the Year 2019 based on TMB's active capital market activity. The reason behind the decision is that the Bank issued nearly HUF 60 billion mortgage bonds in nominal value and listed them on the stock exchange. The Bank organized 15 public auctions on the BSE auction platform with the participation of the entire consortium of the Mortgage Bank (MTB Magyar Takarékszövetkezeti Bank Zrt., MKB Nyrt., Concorde Securities Zrt. and Erste Securities Zrt.) during 2019. The Bank, acting as a pure mortgage bank (ie. providing refinancing and issuing covered bonds) strives to issue mortgage bonds through regular auctions and to offer competitive assets to investors, and to provide adequate long-term funding for refinancing partners.

On February 28, 2020 S&P Global Ratings (Madrid) made a statement that it confirms the BBB rating on the Bank's mortgage bond issuance program and the already issued Forint and foreign currency denominated mortgage bond series, and subsequently improved the outlook from stable to positive. This is explained by the fact that S&P lifted the outlook (from stable to positive) on Hungary's sovereign debt rating as of February 14, 2020.

The Budapest Stock Exchange (BSE) published the new composition of the BUX and BUMIX baskets - valid from March 23, 2020 - on March 12, 2020. The CEO of the Budapest Stock Exchange Ltd. adopted the resolution 117/2020 and decided - based on Point 3.3.6.1 a) of the Index Manual - the exclusion of the shares of the Company from the BUX basket and from the BUMIX basket.

On March 11, 2020, the Management Board of the Takarek Group approved the Pandemic Plan and the Amendment of the Business Continuity Policy, and the Pandemic Operational Staff (POT) was established. From this time the POT coordinates in close cooperation with the Management Board and other relevant departments the tasks of the TakaréK Group in relation to the coronavirus crisis. The POT continually formulates instructions and recommendations to all employees and about this send information to the meetings at appropriate intervals.

The management regularly monitors the impact of the crisis on equity and profit or loss and decides on appropriate actions which it also informs the National Bank of Hungary.

This situation is expected to have an impact on macroeconomic circumstances in the future (e.g. GDP growth, unemployment, inflation), which indicators were taken into account for the purpose of the IFRS9 models; the impairment and provisioning levels are expected to increase in 2020 and 2021.

If current economic processes are sustained, payment facilities may be introduced to help clients who are defaulting on payment moratorium on repayments based on the Bank's own decisions, and these influence the classification of loans and guarantees, potentially causing an increase in impairment and provisions.

Liquidity shortage is expected in the financial markets; therefore the renewal of existing derivative contracts, government securities and mortgage bonds will potentially be subject to less favourable terms than in 2019 depending on the crisis and the responses of the central bank.