# Takarék Mortgage Bank Plc.

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

*December 31, 2018*

# Takarék 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 2018

**Consolidated Financial Statements in Accordance with the International Financial Reporting Standards adopted by the European Union – 31 December 2018**

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## GENERAL INFORMATION

### Chairman of the Board of Directors

József Vida

### External Members of the Board of Directors

Gábor Gergő Soltész
Éva Hegedűs

### Internal Members of the Board of Directors

Dr. Gyula László Nagy
Attila Mészáros

### Chief Executive Officers

Dr. Gyula László Nagy (Chief Executive Officer from 26/04/2017)
Attila Mészáros (Deputy Chief Executive Officer from 11/10/2018)

### Large Shareholders Liaison Officer and Secretary

Rita Bozzai

### Small Shareholders Liaison Officer

info@takarek.hu

### Auditor

Deloitte Ltd.

### Seat of the Bank, central office

Budapest.
Üllői út 48.
1082

# Deloitte.

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Közösségi adószám: HU10443785

## INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Takarék Mortgage Bank Plc.

### *Report on the Audit of the Consolidated Financial Statements*

#### *Opinion*

We have audited the consolidated financial statements of Takarék Mortgage Bank Plc. and its subsidiaries (the „Group") for the year 2018 which comprise the consolidated statement of financial position as at December 31, 2018 – which shows a total assets of HUF 754,516 million –, and the related consolidated statement of recognized income, consolidated statement of comprehensive income – which shows a net profit for the year of HUF 6,586 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, 2018 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 |
|---|---|
| **Individual assessed impairment of non-performing loans** | |
| The net value of loans and advances to customers comprise 49% of the total assets.<br><br>The determination of impairment of loans requires application of professional judgement and use of subjective assumptions by management in case of determination of individual assessed impairment of loans.<br><br>The most significant assumptions applied in provisioning calculation are the followings:<br><br>- valuation of collaterals,<br><br>- estimated time to realize collaterals,<br><br>- probability of default<br><br>- estimate that future cash-flows expected to be realized.<br><br>- IFRS9 credit risk staging methodology and application.<br><br>Based on the significance of the above described circumstances the calculation of impairment of individual assessed impairment of non-performing loans 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>- 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>-evaluate the subsequent events (sales of loan portfolio), their effects on financial statements. |

***Other Information***

Other information comprises the information included in the "Corporate Governance Report at Takarék Mortgage Bank Plc." and the business report of the Bank for 2018, 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 2018 corresponds to the consolidated financial statements of the Group for 2018 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 Takarék Mortgage Bank Plc. by the General Meeting of Shareholders on April 27, 2018 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 Takarék Mortgage Bank Plc., which we issued on April 2, 2019 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 Takarék 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 2, 2019

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 2018

| | Notes | 2018 | 2017 |
|---|---|---|---|
| Interest income | 4 | 23,730 | 22,684 |
| Interest expense | 4 | (9,039) | (9,839) |
| **Net interest income** | | **14,691** | **12,845** |
| Fee and commission income | 5 | 8,191 | 7,811 |
| Fee and commission expense | 5 | (3,149) | (2,236) |
| **Net fee and commission income** | | **5,042** | **5,575** |
| Profit from foreign exchange transactions | | 381 | 446 |
| Change in fair value of financial instruments | 35 | 3,003 | 85 |
| Gains from securities | | 1,847 | 1,390 |
| Net result from investment services | | - | 192 |
| **Net trading result** | | **5,231** | **2,113** |
| Other operating income | 6 | 5,373 | 1,090 |
| Other operating expense | 7 | (5,740) | (11,528) |
| **Operating income, net** | | **24,597** | **10,095** |
| Provision for impairment losses | 20 | 757 | (1,634) |
| General and administrative expenses | 8 | (18,605) | (17,783) |
| **Profit/(loss) before tax** | | **6,749** | **(9,322)** |
| Income tax expense | 11 | (163) | (1,889) |
| Profit from discontinued operations | 18 | - | 3,023 |
| **Profit/(loss) for the year** | | **6,586** | **(8,188)** |
| Attributable to: profit/(loss) of shareholders of the Bank | | 6,897 | (3,949) |
| Attributable to: non-controlling interests | | (311) | (4,239) |
| **Earnings per share (HUF 100 face value)** | 31 | | |
| *Basic earnings per share (HUF)* | | **61.39** | **(40.74)** |
| *Diluted earnings per share (HUF)* | | **61.39** | **(40.74)** |

*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 2018

| | Notes | 2018 | 2017 |
|---|---|---|---|
| Profit/(loss) for the year | | 6,586 | (8,188) |
| Other comprehensive income | | | |
| Items that may be reclassified to profit or loss: | | | |
| Change in Cash-flow hedge reserve | | 25 | 5 |
| Change in fair value of securities at fair value through other comprehensive income | | (368) | 721 |
| Foreign currency translation reserve | | - | 2 |
| Deferred tax effect for other comprehensive income | | 31 | (65) |
| Other comprehensive (loss)/profit for the period net of taxes | 12 | (312) | 663 |
| **Total comprehensive income for the year, net of income taxes** | | **6,274** | **(7,525)** |
| Attributable to: profit/ (loss) of shareholders of the Bank | | 6,585 | (3,286) |
| Attributable to: non-controlling interests | | (311) | (4,239) |

## Consolidated Statement of Financial Position as at 31 December 2018

| | Notes | 31 December 2018 | 31 December 2017 |
|---|---|---|---|
| **Assets** | | | |
| Cash on hand | | 3,157 | 3,135 |
| Balances with the National Bank of Hungary | 14 | 2,073 | 33,165 |
| Due from banks | 15 | 61,664 | 48,797 |
| Securities at fair value through profit or loss | 16 | - | 46,651 |
| Securities at fair value through other comprehensive income | 17 | 192,142 | 80,198 |
| Derivative financial assets | 35 | 3,962 | 410 |
| Refinanced mortgage loans | 19 | 105,296 | 76,597 |
| Loans and advances to customers at amortised cost and at fair value | 20 | 372,594 | 310,632 |
| Tangible assets | 21 | 2,171 | 2,847 |
| Goodwill and other intangible assets | 22 | 388 | 1,128 |
| Deferred tax asset | 11 | 679 | 811 |
| Other assets | 23 | 10,390 | 6,206 |
| **Total assets** | | **754,516** | **610,577** |

## Consolidated Statement of Financial Position as at 31 December 2018

| | Notes | 31 December 2018 | 31 December 2017 |
|---|---|---|---|
| **Liabilities** | | | |
| Due to banks | 24 | 156,659 | 33,983 |
| Deposits from customers | 27 | 304,333 | 329,253 |
| Derivative financial liabilities | 35 | 2,371 | 1,078 |
| Issued securities | 25 | 214,389 | 176,947 |
| Financial liabilities at fair value through profit or loss, except for derivatives | 26 | 6,693 | 7,016 |
| Current tax liability | | - | 21 |
| Provisions | 29 | 3,988 | 6,251 |
| Other liabilities | 30 | 10,847 | 5,696 |
| **Total liabilities** | | **699,280** | **560,245** |
| **Shareholders' equity** | | | |
| Share capital | 31 | 10,849 | 10,849 |
| Treasury shares | 31 | (207) | (207) |
| Retained earnings | | 2,479 | (2,796) |
| Other reserve | 31 | 29,598 | 29,658 |
| Non-controlling interest | 31 | 12,517 | 12,828 |
| **Total shareholders' equity** | | **55,236** | **50,332** |
| **Total liabilities and shareholders' equity** | | **754,516** | **610,577** |

Budapest, 2 April 2019

**Dr. Gyula László Nagy**
CEO

**Attila Mészáros**
Deputy CEO

## Consolidated Statement of Cash Flows for the year ended 31 December 2018

| | Notes | 2018 | 2017 |
|---|---|---|---|
| Cash flow from operating activities | | | |
| Profit/(Loss) for the year | | 6,586 | (8,188) |
| Non-cash adjustments to net profit/(loss) from: | | | |
| Depreciation and amortization | 21,22 | 288 | 409 |
| Impairment of tangible assets | 21,22 | 656 | 1,035 |
| Release of provision for losses | | (5,923) | (1,125) |
| Release of other provision | | (1,686) | - |
| Loss on tangible assets derecognized | | 118 | 1,609 |
| Gain/ (loss) on intangible assets derecognized | | 284 | (28) |
| Capitalized interest on loans and advanced to customers at amortised cost and fair value | | 567 | 718 |
| Fair value adjustment of derivatives | 35 | (2,236) | 27 |
| Fair value adjustment on financial liabilities at fair value through profit or loss, other than derivatives | | 186 | 59 |
| Change in foreign currency translation reserve | | - | 2 |
| Finance lease liabilities | | - | (3) |
| **Operating loss before change in operating assets** | | **(1,160)** | **(5,485)** |
| Decrease/(Increase) in operating assets: | | | |
| Securities at fair value through profit or loss | | 46,651 | (5,917) |
| Securities at fair value through other comprehensive income | | (112,281) | (14,518) |
| Refinanced mortgage loans | | (28,699) | (45,174) |
| Loans and advances to customers at amortised cost and at fair value | | (58,553) | (23,135) |
| Other assets | | (4,052) | 1,009 |
| Increase/(Decrease) in operating liabilities: | | | |
| Deposits from customers | | (24,920) | 32,181 |
| Due to banks | | (124,246) | (220,304) |
| Other liabilities | | 5,131 | 1,608 |
| **Net cash flow from operating activities** | | **(302,129)** | **(279,735)** |

## Consolidated Statement of Cash Flows for the year ended 31 December 2018 - continued

| | Notes | 2018 | 2017 |
|---|---|---|---|
| **Cash flow from investing activities** | | | |
| Proceeds from sales of tangible assets | | 272 | 119 |
| Purchase of tangible and intangible assets | | (202) | (871) |
| **Net cash outflow from investing activities** | | **70** | **(752)** |
| **Cash flow from financing activities** | | | |
| Proceed from issued securities | | 157,570 | 73,960 |
| Principal repayment on issued securities | | (120,636) | (72,330) |
| Repayment of long term loans | | 246,922 | 227,796 |
| Dividend payment to non-controlling interests | | - | 254 |
| **Net cash outflow from financing activity** | | **283,856** | **229,680** |
| Decrease in cash and cash equivalents | | (18,203) | (50,807) |
| Net effect of the sale of subsidiaries and joint venture | 18 | - | 653 |
| Opening balance of cash and cash equivalents | | 85,097 | 135,251 |
| Closing balance of cash and cash equivalents | | **66,894** | **85,097** |
| **Breakdown of cash and cash equivalents:** | | | |
| Cash on hand | | 3,157 | 3,135 |
| Balances with the National Bank of Hungary | | 2,073 | 33,165 |
| Due from banks with a maturity of less than 90 days | | 61,664 | 48,797 |
| **Closing balance of cash and cash equivalents** | | **66,894** | **85,097** |
| *Supplementary data* | | | |
| *Income tax paid* | | *(709)* | *(803)* |
| *Interest received* | | *23,557* | *23,537* |
| *Interest paid* | | *(8,462)* | *(14,304)* |

## Consolidated Statement of Changes in Equity for the year ended 31 December 2018

| | Notes | Share capital | Treasury shares | Share premium | General reserve | Cash flow hedge reserve | Change in fair value of securities at fair value through other comprehensive income | Foreign currency translation reserve | Retained earnings | Non-controlling interest | Share-holder's equity |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **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 |
| Transfer to general reserve | | | | | 460 | | | | (460) | | - |
| **1 January 2018** | | **10,849** | **(207)** | **27,926** | **460** | **5** | **1,267** | **-** | **(2,796)** | **12,828** | **50,332** |
| IFRS9 adjustment | 52 | | | | | | | | (1,370) | - | (1,370) |
| **1 January 2018 - Opening** | | **10,849** | **(207)** | **27,926** | **460** | **5** | **1,267** | **-** | **(4,166)** | **12,828** | **48,962** |
| Profit for the year | | | | | | | | | 6,897 | (311) | 6,586 |
| Other comprehensive income | 12 | | | | | 23 | (335) | - | | | (312) |
| Change in non-controlling | | | | | | | | | | | - |
| Transfer to general reserve | | | | | 252 | | | | (252) | | - |
| **31 December 2018** | | **10,849** | **(207)** | **27,926** | **712** | **28** | **932** | **-** | **2,479** | **12,517** | **55,236** |

**Notes to the Consolidated Financial Statements**

## 1. DESCRIPTION OF THE BANK

Takarék Mortgage Bank Public Limited Company (formerly FHB Mortgage Bank Plc., hereinafter “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 Takarék 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 Takarék Commercial Bank Ltd., thereby significantly expanding the range of services provided by the Group. Takarék Mortgage Bank Plc. is the parent company of the group. (The Bank and its subsidiaries are jointly referred to as the Group, Bank Group.)

The strategic partnership program with Allianz was adopted by the Board of Directors of Takarék Mortgage Bank, the plan included the acquisition of the Allianz Bank, which merged into the Takarék Commercial Bank Ltd in 2011. This strategic partnership was terminated in 2018. The Board of Directors also approved “The bank of the families” concept, meaning a customer- and service-driven sales attitude.

In 2013, Takarék 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, the Bank 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.

Based on the Act CXXXV of 2013 on integration of cooperative financial institutions and modification of certain rules on economic issues (Szhitv), Takarék Mortgage Bank Plc. and under its qualifying holding and prudential supervisory Takarék 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.

**Notes to the Consolidated Financial Statements**

Takarék 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 the Group, the Mortgage Bank exercised its rights over the Group companies until 2017, the rights were transferred to MTB Magyar Takarékszövetkezeti Bank Zrt. in 2017 according to the strategy of SZHISZ.

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

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

On 30 November 2018, the General Meeting of MTB Magyar Takarékszövetkezeti Bank Zrt. adopted the Takarék Group's new business strategy for the period 2019-2023, which opens a new chapter in the one and a half century history of Savings Cooperatives. One of the most important elements of this is the foundation of a new, universal, commercial bank in which the savings cooperatives merge and the new bank will serve the customers of all savings. This new bank will be the national commercial bank of the Takarék Group.

The consolidated financial statements for the year ended 31 December 2018 were authorized for issue in accordance with a resolution of the Board of Directors on 2 April 2019. The final approval on the consolidated financial statements is provided by the General Meeting.

**Notes to the Consolidated Financial Statements**

## 2. ACCOUNTING POLICIES

### 2. 1. *Basis of preparation*

The consolidated financial statements have been prepared on a historical cost basis, except for securities at fair value through profit or loss, securities at fair value through other comprehensive income, derivative financial instruments, loans at fair value through profit or loss, financial liabilities at fair value through profit or loss, that are recorded 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 2018***

The following amendments to the existing standards and new interpretation issued by the International Accounting Standards Board (IASB) and adopted by the EU are effective for the current reporting period:

- **IFRS 9 "Financial Instruments"** - adopted by the EU on 22 November 2016 (effective for annual periods beginning on or after 1 January 2018),

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

- **Amendments to IFRS 2 "Share-based Payment"** - Classification and Measurement of Share-based Payment Transactions – adopted by the EU on 26 February 2018 (effective for annual periods beginning on or after 1 January 2018),

- **Amendments to IFRS 4 "Insurance Contracts"** - Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts – adopted by the EU on 3 November 2017 (effective for annual periods beginning on or after 1 January 2018 or when IFRS 9 "Financial Instruments" is applied first time),

- **Amendments to IFRS 15 "Revenue from Contracts with Customers"** - Clarifications to IFRS 15 Revenue from Contracts with Customers – adopted by the EU on 31 October 2017 (effective for annual periods beginning on or after 1 January 2018).

- **Amendments to IAS 40 "Investment Property"** - Transfers of Investment Property – adopted by the EU on 14 March 2018 (effective for annual periods beginning on or after 1 January 2018),

- **Amendments to IFRS 1 and IAS 28 due to "Improvements to IFRSs (cycle 2014 -2016)"** resulting from the annual improvement project of IFRS (IFRS 1, IFRS 12 and IAS 28) primarily with a view to removing inconsistencies and clarifying wording – adopted by the EU on 7 February 2018 (amendments to IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after 1 January 2018),

- **IFRIC 22 “Foreign Currency Transactions and Advance Consideration”** – adopted by the EU on 28 March 2018 (effective for annual periods beginning on or after 1 January 2018).

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:

- **IFRS 16 “Leases”** – adopted by the EU on 31 October 2017 (effective for annual periods beginning on or after 1 January 2019),

- **Amendments to IFRS 9 “Financial Instruments”** - Prepayment Features with Negative Compensation – adopted by the EU on 22 March 2018 (effective for annual periods beginning on or after 1 January 2019),

- **IFRIC 23 “Uncertainty over Income Tax Treatments”** – adopted by the EU on 23 October 2018 (effective for annual periods beginning on or after 1 January 2019).

The Bank has elected not to adopt these new standards and amendments to existing standards in advance of their effective dates.

The effects of IFRS 16 are presented in Note 54.

***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 for the following new standards, amendments to the existing standards and new interpretation, which were not endorsed for use in EU as at [date of publication of financial statements] (the effective dates stated below is for IFRS in full):

- **IFRS 14 “Regulatory Deferral Accounts”** (effective for annual periods beginning on or after 1 January 2016) - the European Commission has decided not to launch the endorsement process of this interim standard and to wait for the final standard,

- **IFRS 17 “Insurance Contracts”** (effective for annual periods beginning on or after 1 January 2021),

- **Amendments to IFRS 3 “Business Combinations”** - Definition of a Business (effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020 and to asset acquisitions that occur on or after the beginning of that period).

- **Amendments to IFRS 10 "Consolidated Financial Statements" and IAS 28 "Investments in Associates and Joint Ventures"** - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture and further amendments (effective date deferred indefinitely until the research project on the equity method has been concluded),

- **Amendments to IAS 1 "Presentation of Financial Statements" and IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors"** - Definition of Material (effective for annual periods beginning on or after 1 January 2020),

- **Amendments to IAS 19 "Employee Benefits"** - Plan Amendment, Curtailment or Settlement (effective for annual periods beginning on or after 1 January 2019),

- **Amendments to IAS 28 "Investments in Associates and Joint Ventures"** - Long-term Interests in Associates and Joint Ventures (effective for annual periods beginning on or after 1 January 2019),

- **Amendments to various standards due to "Improvements to IFRSs (cycle 2015 -2017)"** resulting from the annual improvement project of IFRS (IFRS 3, IFRS 11, IAS 12 and IAS 23) primarily with a view to removing inconsistencies and clarifying wording (effective for annual periods beginning on or after 1 January 2019),

- **Amendments to References to the Conceptual Framework in IFRS Standards** (effective for annual periods beginning on or after 1 January 2020).

The Group anticipates that the adoption of these new standards, amendments to the existing standards and new 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 its subsidiary with registered office in Hungary. The functional currency of the German branch of Takarék Commercial Bank Ltd. is the Euro (EUR).

### *2.4 Basis of Consolidation*

The consolidated financial statements comprise the financial statements of the Bank and its subsidiary as at 31 December 2018.
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.

**Notes to the Consolidated Financial Statements**

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 list of the subsidiaries of the Bank as at 31 December 2018 is the following:

| Companies included in the consolidation | Main shareholder** | Core business | Relation-ship * |
|---|---|---|---|
| Takarék Commercial Bank Ltd. | Takarék Mortgage Bank Plc. 51% | Universal banking services | S |

** Relationship: "S"=subsidiary.*

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

### *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 held for trading**
  - Securities at fair value through profit or loss
  - Derivative financial assets
- **Non-trading financial assets mandatorily at fair value through profit or loss**
  - Loans and advances to customers at fair value
- **Financial assets at fair value through other comprehensive income**
  - Securities at fair value through other comprehensive income
- **Financial assets at amortised cost:**
  - Balances with the National Bank of Hungary
  - Due from banks
  - Refinanced mortgage loans

- Loans and advances to customers at amortised cost

The Bank groups the recognised financial liabilities as follows:

- **Financial liabilities held for trading**
  - Derivative financial liabilities

- **Financial liabilities classified at fair value through profit or loss**
  - Financial liabilities at fair value through profit or loss, other than derivatives

- **Financial liabilities measured at amortised cost (other financial liabilities):**
  - Due to banks
  - Deposits from customers
  - Issued securities

***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 at fair value through profit or loss***

Securities at fair value through profit or loss are held within a business model whose objective is not to hold securities in order to collect contractual cash flows or not to hold securities both collecting contractual cash flows and selling securities. Securities at fair value through profit or loss 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 that have been acquired principally for the purpose of selling or repurchasing in the near term depending on the market price.

***d) Securities at fair value through other comprehensive income***

Securities at fair value through other comprehensive income are held within a business model whose objective is achieved by both collecting of contractual cash flows and selling securities, and the contractual terms of these securities give rise on specified dates to cash flows that are solely payment of principal and interest on the principal amount outstanding. Investments in securities are accounted for on a settlement date basis and are initially measured at fair value. Securities at fair value through other comprehensive income are measured at subsequent reporting dates at fair value. Unrealized gains and losses (Fair value difference) on securities at fair value through other comprehensive income are recognized directly in other comprehensive income , interest and foreign exchange gains/losses on this items are recognized consolidated statement of profit or loss, unless such financial asset at fair value through other comprehensive income is part of an effective hedge. Such gains and losses will be reported when realized in consolidated statement of profit or loss for the applicable period.

***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.

### *f) Loans and advances to customers at amortised cost*

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 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.
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 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.

When the contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in the derecognition of that financial asset, Bank shall recalculate the gross carrying amount of the financial asset and shall recognise a modification gain or loss in profit or loss. The gross carrying amount of the financial asset shall be recalculated as the present value of the renegotiated or modified contractual cash flows that are discounted at the financial asset's original effective interest rate.

When the contractual terms of a financial asset are modified and the modification does not result in derecognition, the Bank determines if the financial asset's credit risk has increased significantly since initial recognition. If the credit risk remains significantly higher than what was expected at initial recognition the loss allowance will continue to be measured at an amount equal to lifetime ECL. The

loss allowance on restructured loans will generally only be measured based on 12-month ECL when there is evidence of the borrower's improved repayment behaviour following modification leading to a reversal of the previous significant increase in credit risk.

### *h) Impairment losses on loans*

IFRS 9:
Impairment losses on loan and placement losses with other banks represent Management assessment for potential losses in relation to these activities.
Impairment losses on loans and placements with other banks is recognised by the Bank based on the expected credit loss model in accordance with IFRS 9. Based on the three stage model allowance for impairment is recognised at an amount equal to 12-month expected credit loss from the initial recognition, unless purchased or originated credit-impaired (POCI). On financial assets with significantly increased credit risk or credit impaired financial assets (based on objective evidences) provision for impairment is recognised in amount of lifetime expected credit loss.

IAS 39, (comparative data is prepared on this basis):
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.
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 expense 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.

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 (according to IAS 39)*

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 classified 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.

In case financial liabilities classified as measured at fair value through profit or loss because it eliminates or significantly reduces a measurement or recognition inconsistency (accounting mismatch) changes in fair value related to credit risk are recognised in consolidated statement of profit or loss.

### *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 expense 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 IFRS 9. 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. (see g) point about modification in contractual cash flow)

### 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.

**Notes to the Consolidated Financial Statements**

### *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 32, 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 expense (other personnel costs) as a separate line item against share option reserve under shareholders' equity for the period the benefit is earned.

The cumulative expense 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.

### *cc) Income and expense*

Interest income and interest expense (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.

**Notes to the Consolidated Financial Statements**

### *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'.

Those loans which connect interest subsidy are measured at amoritised cost, meet the requirement of the SPPI test, and the allowance is calculated according to expected credit loss model. (see the credit risk model in notes 39)

*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 subsidiary 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.

**Notes to the Consolidated Financial Statements**

### *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 years 2018 and 2017 the tax base is the total assets according to Hungarian Accounting Standards of the second financial year preceding the tax year (2016, 2015), 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 liability defined in accordance with the amount of special tax for credit institutions paid by Takarék Mortgage Bank Ltd. and Takarék Commercial Bank Ltd. in 2018.

## *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 35)

*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 32)

**Notes to the Consolidated Financial Statements**

*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*

IFRS 9:

The Group regularly assesses its financial instruments portfolio for impairment. Management determines the adequacy of the impairments based upon reviews of individual loans and placements, recent loss experience, current economic conditions, the risk characteristics of the various categories of loans and other pertinent factors.

The use of a new, three stage model was implemented for IFRS 9 purposes. The new impairment methodology (see notes 39) is used to classify financial instruments in order to determine whether credit risk has significantly increased since initial recognition and to identify the credit-impaired assets. For instruments with credit-impairment or significant increase of credit risk lifetime expected losses will be recognized.

Comparative data is presented according to IAS 39:

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 21 and 22.

### *2.8 Reclassification and error*

After the balance sheet date of the consolidated financial statements of 2017 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*

According to the Monetary Council's decision of 21 November 2017, the Hungarian National Bank announced a mortgage bond purchase program, in the framework of which the Hungarian National Bank buys mortgage bonds that meet certain conditions, and which are based in Hungary. In 2018 the Mortgage Bank participated in this program of the Hungarian National Bank with great success.

With its 20/2015. (VI.29.) regulation, the Hungarian National Bank increased the minimum level of the Mortgage Financing Indicator from 0.15 to 0.20, and also started a mortgage bond purchase program, which lead to the raising of the refinancing portfolio of the Mortgage Bank.

## 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

| | 2018 | 2017 |
|---|---|---|
| ***Interest income*** | | |
| Loans and advances to customers at amortised cost and fair value | 18,122 | 17,542 |
| Refinanced mortgage loans | 2,338 | 2,644 |
| Due from banks | 296 | 396 |
| *Interest income on assets carried at amortised cost* | *20,756* | *20,582* |
| | | |
| Securities at fair value through profit or loss | - | 425 |
| Securities at fair value through other comprehensive income | 1,736 | 857 |
| Interest on derivative transactions | 1,238 | 820 |
| *Interest income on assets carried at fair value* | *2,974* | *2,102* |
| **Total** | **23,730** | **22,684** |

Accrued interest receivable on stage 3 impaired loans amounted to HUF 62 million in 2018 according to IFRS 9. Accrued interest receivable on impaired loans amounted to HUF 36 million in 2017 according to IAS 39.

| | 2018 | 2017 |
|---|---|---|
| ***Interest expense*** | | |
| Mortgage bonds | 6,070 | 6,811 |
| Due to banks | 61 | 46 |
| Interest paid on deposits | 521 | 1,008 |
| Interest on bonds | 361 | 769 |
| Interest expense on leases | - | - |
| *Interest expense on liabilities carried at amortised cost* | *7,013* | *8,634* |
| | | |
| Interest on derivative transactions | 1,303 | 867 |
| Mortgage bonds | 723 | 338 |
| Interest on bonds | - | - |
| *Interest expense on liabilities carried at fair value* | *2,026* | *1,205* |
| **Total** | **9,039** | **9,839** |

The interest income from loans and refinanced mortgage loans includes HUF 1,642 million interest subsidy in 2018 (2017: HUF 2,372 million).

## 5. FEE AND COMMISSION INCOME AND EXPENSE

| | 2018 | 2017 |
|---|---|---|
| ***Fee and commission income*** | | |
| Mortgage loans of the Bank | 380 | 566 |
| Refinanced mortgage loans | 501 | 70 |
| Handling commission | 153 | 168 |
| Real estate appraisal fee | 82 | 84 |
| Deposit fee income | 3,707 | 3,587 |
| Agency fee income | 608 | 348 |
| Card business | 2,063 | 1,881 |
| Investment services | 6 | 301 |
| Postal giro (PEK) commission | 382 | 374 |
| Other | 309 | 432 |
| **Total** | **8,191** | **7,811** |

| | 2018 | 2017 |
|---|---|---|
| ***Fee and commission expense*** | | |
| Investment services* | - | 593 |
| Agency fees and commissions | 740 | 601 |
| Card business | 1,710 | 779 |
| Treasury services | 235 | - |
| Fees and commissions to banks and to clearing house | 172 | 166 |
| Postal giro (PEK) commission | 14 | 0 |
| Other | 278 | 97 |
| **Total** | **3,149** | **2,236** |

* MTB Magyar Takarékszövetkezeti Bank Zrt. extended the provision of investment services also to the customers of the Group from 2017, supported by the Takarék Commercial Bank, as investment agent.

## 6. OTHER OPERATING INCOME

| | 2018 | 2017 |
|---|---|---|
| Reversal of provision* | 2,856 | - |
| Income from sold inventory | 235 | 9 |
| Rental income on property | 1,030 | 65 |
| Invoiced expenses and services | 562 | 581 |
| Tax refunds for previous years | 511 | 160 |
| Other | 179 | 275 |
| **Total** | **5,373** | **1,090** |

*The main part of reversal of provision is connected to the change of the contractual obligation related to IT software, the booked fee increased the maintenance cost in 2018.

## 7. OTHER OPERATING EXPENSE

| | 2018 | 2017 |
|---|---|---|
| Bank tax (detailed in a) below) | 2,937 | 3,503 |
| Other payable taxes and contributions* | 698 | 820 |
| Impairment of non-financial assets | 637 | 1,580 |
| Provision for expected liabilities (Note 30) | - | 3,988 |
| Donation | - | 5 |
| Tax penalty, late penalty | 24 | 72 |
| Supervisory and other fees | 1,123 | 1,246 |
| Loss on sold property | 217 | 35 |
| Loss on damages compensations paid | 38 | 13 |
| Other | 66 | 266 |
| **Total** | **5,740** | **11,528** |

*Include the local business tax and the innovation contribution in 2017 and in 2018.

### a) Bank tax

The amount of Bank tax booked for 2018 by group members is detailed in the following table:

| | 2018 | 2017 |
|---|---|---|
| Takarék Mortgage Bank Plc. | 156 | 365 |
| Takarék Commercial Bank Ltd.* | 2,781 | 3,138 |
| **Total** | **2,937** | **3,503** |

*Include the obligation of financial transaction levy, based on the Act CXVI. of 2012.

## 8. GENERAL AND ADMINISTRATIVE EXPENSES

| | Note | 2018 | 2017 |
|---|---|---|---|
| Staff costs | 9 | 6,046 | 7,270 |
| Marketing and advertising | | 235 | 438 |
| General and administrative costs | | 1,130 | 1,748 |
| Rental fee | 10 | 914 | 1,136 |
| Depreciation | 21 | 212 | 273 |
| Amortisation | 22 | 76 | 136 |
| Consultancy fees** | | 1,512 | 607 |
| Maintenance costs* | | 8,023 | 5,513 |
| Other taxes | | 37 | 40 |
| Insurance fees | | 18 | 38 |
| Database system usage | | 161 | 178 |
| Other | | 241 | 406 |
| **Total** | | **18,605** | **17,783** |

*The maintenance cost increased by HUF million 3,178 because of the reversal of provision set up in 2017 connected to the IT software.

**Consultancy fee increased due to the Takarék Group's adopted new business strategy for the period 2019-2023.

## 9. STAFF COSTS

| | 2018 | 2017 |
|---|---|---|
| Wages and salaries | 4,620 | 5,262 |
| Social security contribution | 1,036 | 1,330 |
| Other personnel related payments | 390 | 679 |
| **Total** | **6,046** | **7,270** |

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 724 (2017: 811).

**Notes to the Consolidated Financial Statements**

## 10. RENTAL FEE (OPERATING LEASE)

### Non-cancellable operating leases

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

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| | Minimum lease payments | Minimum lease payments |
| Within 12 month | 2,403 | 2,243 |
| Between 1 and 5 years | 800 | 1,414 |
| Over 5 years | 758 | 758 |
| **Total** | **3,961** | **4,415** |

| | Minimum lease payments | Contingent rents | Sublease payments | Total |
|---|---|---|---|---|
| Expense in the period 2018 | 927 | - | (12) | 914 |
| Expense in the period 2017 | 1,155 | - | (16) | 1,139 |

**Notes to the Consolidated Financial Statements**

## 11. INCOME TAX

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| **Current income tax** | **-** | **-** |
| Corporate income tax* | - | - |
| **Deferred tax expense** | **163** | **1,889** |
| **Total** | **163** | **1,889** |

*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 and in 2018.

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 2018 and in 2017.

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 2018 | 31 December 2017 |
|---|---|---|
| *Profit/ (Loss) before tax* | *6,749* | *(9,322)* |
| Calculated corporate income tax (9%) | 607 | (839) |
| Items modifying the Hungarian tax base | (786) | 635 |
| Effect of the reduction of the available taxable profit | 274 | 2,220 |
| Effect of other modifications | 68 | (127) |
| **Total income tax expense/(benefit)** | **163** | **1,889** |

## Notes to the Consolidated Financial Statements

*Deferred tax position*

| | 31 December 2018 | | | | |
|---|---|---|---|---|---|
| | Deferred tax assets | Deferred tax liabilities | Deferred tax net position | Income statement effect | Deferred tax position in reserves |
| Disbursement fee | (44) | - | (44) | (69) | - |
| Derivatives | (115) | - | (115) | (235) | - |
| Impairment | 180 | - | 180 | 300 | - |
| Suspended interest | (42) | - | (42) | 115 | - |
| Acquisition | - | - | - | 38 | - |
| Cash-flow hedge reserve | (2) | - | (2) | - | (2) |
| Tax loss carried forward | 990 | - | 990 | (274) | - |
| Effect of consolidation | (319) | - | (319) | (50) | - |
| Securities at fair value through other comprehensive income | 31 | - | 31 | 12 | 33 |
| **Net deferred tax position** | **679** | **-** | **679** | **(163)** | **31** |

## Notes to the Consolidated Financial Statements

| | 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)** |

## Notes to the Consolidated Financial Statements

## 12. OTHER COMPREHENSIVE INCOME

### Components of other comprehensive income

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| **Other comprehensive income** | | |
| Cash-flow hedge reserve | 25 | 5 |
| including: change in fair value | 25 | 5 |
| including: reclassification to profit or loss | - | - |
| Securities at fair value through other comprehensive income | (368) | 721 |
| including: change in fair value | (504) | 614 |
| including: reclassification to profit or loss | 136 | 107 |
| Foreign currency translation | - | 2 |
| Deferred tax effect | 31 | (65) |
| **Total** | **(312)** | **663** |

### Deferred tax effects relating to other comprehensive income

| | 31 December 2018 | | | 31 December 2017 | | |
|---|---|---|---|---|---|---|
| | 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 | 25 | (2) | 23 | 5 | - | 5 |
| Securities at fair value through other comprehensive income | (368) | 33 | (335) | 721 | (65) | 656 |
| Foreign currency translation | - | - | - | 2 | - | 2 |
| **Total** | **(343)** | **31** | **(312)** | **728** | **(65)** | **663** |

## 13. FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The Banking Group has introduced the new IFRS 9 standard since 1 January 2018, the classification and the reconciliation of carrying amounts of financial assets and liabilities from IAS 39 to IFRS 9 are reported below:

### 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 |

## Notes to the Consolidated Financial Statements

### b) Reconciliation of carrying amounts of financial assets 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** |

| 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 model 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** |

## Notes to the Consolidated Financial Statements

| Financial assets measured at 8FVOCI | 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 | - | - | (16) | (16) |
| Closing balance under IFRS 9 | - | - | - | 113,668 |
| **Investment securities - FVOCI (equity instruments)** | | | | |
| Opening balance under IAS 39 | - | - | - | - |
| Addition: from available for sale (IAS 39) | - | 682 | - | 682 |
| Closing balance under IFRS 9 | - | - | - | 682 |
| **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** |

**Notes to the Consolidated Financial Statements**

**c) Classification of carrying amounts of financial assets and liabilities according to IFRS 9**

| | Notes | 31. December 2018 | 1 January 2018 |
|---|---|---|---|
| **Financial assets** | | | |
| *Cash and cash equivalents* | | *3,157* | *3,120* |
| *Financial assets held for trading* | | *3,962* | *15,237* |
| - Securites at fair value through profit or loss | | - | 14,827 |
| - Derivative financial assets | 35 | 3,962 | 410 |
| *Non-trading financial assets mandatorily at fair value through profit or loss* | | *164* | *209* |
| - Loans and advances to customers at fair value | 20 | 164 | 209 |
| *Financial assets at fair value through other comprehensive income* | | *192,142* | *112,005* |
| - Securities at fair value through other comprehensive income | 17 | 192,142 | 112,005 |
| *Financial assets at amortised cost* | | *541,463* | *467,803* |
| - Balances with the National Bank of Hungary | 14 | 2,073 | 33,160 |
| - Due from banks | 15 | 61,664 | 48,784 |
| - Refinanced mortgage loans | 19 | 105,296 | 76,596 |
| - Loans and advances to customers at amortised cost | 20 | 372,430 | 309,263 |
| **Total financial assets** | | **740,888** | **598,374** |
| **Financial liabilities** | | | |
| *Financial liabilities held for trading* | | *2,371* | *1,078* |
| - Derivative financial liabilities | 35 | 2,371 | 1,078 |
| *Financial liabilities classified at fair value through profit or loss* | | *6,693* | *7,016* |
| - Financial liabilities at fair value through profit or loss, other than derivatives | 26 | 6,693 | 7,016 |
| *Financial liabilities measured at amortised cost (other financial liabilities)* | | *675,381* | *540,183* |
| - Due to banks | 24 | 156,659 | 33,983 |
| - Deposits from customers | 27 | 304,333 | 329,253 |
| - Issued securities | 25 | 214,389 | 176,947 |
| **Total financial liabilities** | | **684,445** | **548,277** |

**Notes to the Consolidated Financial Statements**

## 14. 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 2018 | 31 December 2017 |
|---|---|---|
| Short term deposits | - | 28,235 |
| Nostro account at National Bank of Hungary | 2,071 | 4,925 |
| Accrued interest for the period | 2 | 5 |
| **Total** | **2,073** | **33,165** |

## 15. DUE FROM BANKS

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Nostro accounts | 2,706 | 3,028 |
| Term deposits | 58,967 | 45,768 |
| Accrued interest for the period | 6 | 1 |
| IFRS 9 impairment | (15) | - |
| **Total** | **61,664** | **48,797** |

## 16. SECURITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Hungarian Government bonds | - | 28,631 |
| Hungarian Treasury bills | - | 3,842 |
| Hungarian Development Bank bonds | - | 12,271 |
| Mortgage bonds | - | 1,138 |
| Student Loan Centre Ltd. bond | - | 97 |
| Foreign bonds | - | 672 |
| **Total** | **-** | **46,651** |

MTB Magyar Takarékszövetkezeti Bank Zrt. extended the provision of investment services also to the customers of the Group from 2017, supported by the Takarék Commercial Bank, as investment agent. The Bank has sold this portfolio to the MTB Magyar Takarékszövetkezeti Bank Zrt.

**Notes to the Consolidated Financial Statements**

## 17. SECURITIES AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Hungarian Government bonds | 152,995 | 29,849 |
| Hungarian Discount Treasury bills | 12,409 | 16,822 |
| Domestic issued bonds | 18,712 | 16,191 |
| Mortgage bonds | 5,600 | 8,799 |
| Investment funds | 443 | 449 |
| Foreign bank bonds | 1,705 | 7,857 |
| Equity investments classified as FVOCI | 292 | 231 |
| IFRS 9 impairment | (15) | - |
| **Total** | **192,142** | **80,198** |

Equity investments include shares of SZHISZ for HUF 20 million (2017: HUF 20 million), shares of Garantiqa Creditgurantee Ltd. for HUF 30 million (2017: HUF 30 million) as well as SWIFT shares for HUF 1 million (2017: HUF 1 million) and VISA Europe shares for HUF 241 million (2017: HUF 180 million). The investments represent less than 1% stake in the companies, these securities are classified as FVOCI category in 31 December 2018.

## 18. SALE AND PURCHASE OF SUBSIDIARIES, CHANGE IN THE GROUP OWNERSHIP INTEREST IN SUBSIDIARIES

**Purchase of subsidiaries, change in the group ownership interest in subsidiaries**

There was no purchase of subsidiaries or change in the group ownership interest in subsidiaries in 2018 and in 2017.

## 19. 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, Takarék Mortgage Bank refinanced also market rate (not supported) mortgage loans. In 2018, 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 Takarék Mortgage Bank has been highly active. By the end of 2018 the number of refinanced bank partners increased to 12. As a result, the refinanced loan portfolio of the Mortgage Bank increased by 25.42% and amounted to HUF 169.29 billion (with the refinanced loan portfolio of Takarék Commercial Bank) at the end of the year. The balance as at 31 December 2018 includes loans disbursed to 30,846 customers (2017: 31,017).

## 20. LOANS AND ADVANCES TO CUSTOMERS

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Housing loans | 130,261 | 113,034 |
| General purpose mortgage loans | 65,438 | 66,584 |
| Customer loans and overdrafts | 13,062 | 10,330 |
| Loans to employees | 923 | 1,159 |
| Loans to companies at amortised cost | 169,641 | 132,731 |
| **Loans and advances to customers at amortised cost gross subtotal** | **379,325** | **323,838** |
| Loans to companies at fair value | 164 | - |
| **Loans gross subtotal** | **379,489** | **323,838** |
| Fair value adjustment of hedged items | 240 | 28 |
| Accrued part of disbursed loans under Funding of Growth Scheme* | - | *2,768* |
| Derecognition | (336) | (1,300) |
| Accrued interest | 5,206 | 4,773 |
| Amortized origination cost | 610 | (115) |
| **Loans gross total** | **385,209** | **327,224** |
| Loan impairment | (12,615) | (16,592) |
| **Loan portfolio reported** | **372,594** | **310,632** |

*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 IFRS 9.B5.1.2A. The Accrued part of disbursed loans under Funding of Growth Scheme is reported in other assets in 2018.

**Notes to the Consolidated Financial Statements**

Loan impairment based on individual rating: HUF 2,468 million (2017: HUF 13,118 million), based on portfolio rating: HUF 10,147 million (2017: HUF 3,473 million).

*Changes in impairment for credit losses:*

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Impairment as at 1 January | 16,592 | 23,853 |
| IFRS 9 implementation effect | 1,370 | - |
| Provision for impairment in the period | 3,956 | 5,708 |
| Exchange rate change of impairment | 50 | (36) |
| Reverse of impairment for the period | (5,433) | (10,234) |
| Derecognition due to foreign currency loans conversion to HUF at a fixed rate | - | - |
| Derecognition due to sale of assets | (3,920) | (2,389) |
| Derecognition due to disposal | - | (310) |
| **Impairment as at end of period** | **12,615** | **16,592** |

*Breakdown of the credit loss expense for the period*

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Change of impairment in the period* | (1,476) | (4,525) |
| Unwinding interest effect on impairment | (2,147) | - |
| Losses from the repayment of the loans at a fixed rate | 8 | 34 |
| Written-off loans | 437 | 1,149 |
| Loss on loans sold | 1,704 | 4,017 |
| Loss on terminated loans | 94 | 75 |
| Impairment on financial assets other than loans | 30 | - |
| Charge for commitments | 593 | 884 |
| **Credit losses on loans and advances and other financial assets** | **(757)** | **1,634** |

* 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 stage 3 loans was HUF 10,326 million as of 31 December 2018 (31 December 2017: HUF 22,878 million the non-performing loans).
Within the total balance of mortgage loans 99.46% have maturity over five years (2017: 99.78%), exceeding the minimum level of 80% that is required by the Section 5(1) of Act XXX of 1997 on Mortgage Loan companies.

The total outstanding mortgage loan principal 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 2018, loan to value is 29.38% (31 December 2017: 31.02%).

## 21. TANGIBLE ASSETS 31 December 2018

| | Property and Leasehold improvement | Office equipment | Total |
|---|---|---|---|
| ***Gross value*** | | | |
| Opening balance | 3,515 | 1,390 | 4,905 |
| Increase | 58 | 142 | 200 |
| Decrease | (164) | (400) | (564) |
| Closing balance | **3,409** | **1,132** | **4,541** |
| ***Depreciation*** | | | |
| Opening balance | 918 | 806 | 1,724 |
| Annual depreciation | 139 | 73 | 212 |
| Decrease | (19) | (155) | (174) |
| Closing balance | **1,038** | **724** | **1,762** |
| ***Impairment*** | | | |
| Opening balance | 210 | 124 | 334 |
| Increase* | 274 | - | 274 |
| Decrease** | - | - | - |
| Closing balance | **484** | **124** | **608** |
| **Net value** | **1,887** | **284** | **2,171** |

*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.

**Notes to the Consolidated Financial Statements**

**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 2017 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.

**Notes to the Consolidated Financial Statements**

## 22. INTANGIBLE ASSETS 31 December 2018

| | Software | Other intangible assets | Agency cooperation | Total |
|---|---|---|---|---|
| ***Gross value*** | | | | |
| Opening balance | 2,738 | 429 | 645 | 3,812 |
| Increase | - | 2 | - | 2 |
| Decrease | (557) | (268) | - | (825) |
| Derecognize of intangible assets due to disposal | - | - | - | - |
| Closing balance | **2,181** | **163** | **645** | **2,989** |
| ***Amortisation*** | | | | |
| Opening balance | 1,602 | 150 | 231 | 1,983 |
| Annual amortisation | 42 | 2 | 32 | 76 |
| Decrease | (363) | (178) | - | (541) |
| Closing balance | **1,281** | **(26)** | **263** | **1,518** |
| ***Impairment*** | | | | |
| Opening balance | 579 | 122 | - | 701 |
| Increase | - | - | 382 | 382 |
| Reversal | - | - | - | - |
| Closing balance | **579** | **122** | **382** | **1,083** |
| **Net value** | **321** | **67** | **-** | **388** |

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 2018.

The Bank estimates the recoverable amount of the intangible asset. The impairment of this year connected to the agency cooperation 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 2018.

**Notes to the Consolidated Financial Statements**

**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 2017 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.

## 23. OTHER ASSETS

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Prepaid expenses | 1,362 | 205 |
| Reclaimable taxes | 845 | 313 |
| Settlements with the Hungarian State | 124 | 149 |
| Repossessed collateral | 103 | 177 |
| Debtors | 499 | 547 |
| Deposits | 3,354 | 3,060 |
| Receivables from investment services | - | 10 |
| Accrued part of disbursed loans under Funding of Growth Scheme* | 2,944 | - |
| Other | 1,158 | 1,745 |
| **Total** | **10,389** | **6,206** |

*The Accrued part of disbursed loans under Funding of Growth Scheme is reported in other assets in 2018.

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

## 24. DUE TO BANKS

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Long term loans received | 17,193 | 22,001 |
| Short term loans received | 139,465 | 9,120 |
| Accrued part of disbursed liabilities under Funding for Growth Scheme* | - | 2,861 |
| Accrued interest | 1 | 1 |
| **Total** | **156,659** | **33,983** |

* See Notes 20. The Accrued part of disbursed loans under Funding of Growth Scheme is reported in other liabilities (Notes 30) in 2018.

**Notes to the Consolidated Financial Statements**

## 25. 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 2018 | | 31 December 2017 | |
|---|---|---|---|---|
| | Gross book value | Face value | Gross book value | Face value |
| ***Non-listed mortgage bonds*** | | | | |
| Fixed interest | 16,480 | 16,449 | 16,573 | 16,449 |
| Floating interest | - | - | - | - |
| ***Listed mortgage bonds*** | | | | |
| Fixed interest | 177,406 | 176,200 | 61,417 | 56,915 |
| Floating interest | 10,067 | 10,072 | 86,339 | 86,513 |
| **Total mortgage bonds** | **203,953** | **202,721** | **164,329** | **159,877** |
| ***Non-listed bonds*** | | | | |
| Fixed interest | - | - | 1,084 | 1,078 |
| Floating interest | - | - | - | - |
| ***Subordinated bonds*** | - | - | - | - |
| ***Listed bonds*** | | | | |
| Fixed interest | 5,836 | 5,786 | 7,371 | 7,261 |
| Floating interest | - | - | 275 | 275 |
| ***Total bonds*** | **5,836** | **5,786** | **8,730** | **8,614** |
| Accrued interest (*mortgage bonds*) | 4,431 | - | 3,588 | - |
| Accrued interest (*bonds*) | 169 | - | 300 | - |
| **Total issued securities** | **214,389** | **208,507** | **176,947** | **168,491** |

**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.

**Notes to the Consolidated Financial Statements**

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.

**Notes to the Consolidated Financial Statements**

## 26. 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 2018 | | 31 December 2017 | |
|---|---|---|---|---|
| | Fair value | Face value | Fair value | Face value |
| ***Listed mortgage bonds*** | | | | |
| Fixed interest | 6,693 | 5,787 | 7,016 | 5,893 |
| Floating interest | - | - | - | - |
| **Total mortgage bonds** | **6,693** | **5,787** | **7,016** | **5,893** |
| **Total Financial liabilities at fair value through profit or loss, except derivatives** | **6,693** | **5,787** | **7,016** | **5,893** |

The total credit risk which is due to financial liabilities through profit or loss was HUF 80.9 million as of 31 December 2018 (31 December 2017: HUF 68.8 million).

## 27. DEPOSITS FROM CUSTOMERS

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

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Current accounts | 198,416 | 166,453 |
| Term deposits | 105,839 | 162,594 |
| Accrued interest | 78 | 206 |
| **Total** | **304,333** | **329,253** |

*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*

**Notes to the Consolidated Financial Statements**

## 28. SHARES IN ASSOCIATES AND JOINT VENTURES

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Opening balance | - | 4,816 |
| Decrease from joint ventures and associates* | - | (4,816) |
| **Closing balance** | **-** | **-** |

*In 2017 the decrease from joint ventures and associates include the disposal of Takarék Invest Befektetési és Ingatlankezelő Ltd. and its subsidiary and joint ventures to the MTB Magyar Takarékszövetkezeti Bank Zrt.

## 29. 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 20) or in other operating expense (Note 7).

| 2018 | Credit risk provision | Contractual obligation | Other provision | Expected costs of legal cases | Total |
|---|---|---|---|---|---|
| Opening balance | 674 | 4,905 | 630 | 42 | 6,251 |
| Increase in the period | 1,472 | 2,123 | 572 | 10 | 4,177 |
| Utilization in the period | (879) | (4,906) | (619) | (36) | (6,440) |
| **Closing balance** | **1,267** | **2,122** | **583** | **16** | **3,988** |

The credit risk provision in 2018 is attributable to the off-balance sheet items.

On 30 November 2018, the General Meeting of MTB Magyar Takarékszövetkezeti Bank Zrt. adopted the Takarék Group's new business strategy for the period 2019-2023. Due to this the Bank present HUF 459 million provision for the organization changes.

In 2018, the Bank expressed its willingness to change of some information systems and update the used information system, due to the new business strategy. For the contractual obligation, which is part of the existing contract, the Bank has set up provision of HUF 1,989 million.

| 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** |

## 30. OTHER LIABILITIES

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Taxes payable | 512 | 1,424 |
| Creditors | 107 | 1,253 |
| Accrued expenses | 1,736 | 914 |
| Liability from investments services | 4 | 44 |
| Customer loan prepayments | 840 | 625 |
| Repo liability | 3,767 | - |
| Accrued part of disbursed liabilities under Funding for Growth Scheme* | 2,061 | - |
| Other | 1,820 | 1,436 |
| **Total** | **10,847** | **5,696** |

* The Accrued part of disbursed loans under Funding of Growth Scheme is reported in other liabilities in 2018, it has been reclassified from Due to banks (Notes 24).

**Notes to the Consolidated Financial Statements**

## 31. 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 MTB Magyar Takarékszövetkezeti Bank Ltd. made a public bid to the owners of the Bank. As a result of this transaction the MTB Magyar Takarékszövetkezeti Bank Ltd. bought number of 20,092,211 shares and its ownership is 37% as at 31 December 2018.

As of 31 December 2018 the Bank's share capital consists of series "A", "B" and "C" shares. Domestic institutional investors have the majority of shares (91.76%).

The ownership structure of the Bank as at 31 December 2018 and 31 December 2017 was as follows:

| | 31 December 2018 | | 31 December 2017 | |
|---|---|---|---|---|
| **Shareholder** | **Holding %** | **Number of shares** | **Holding %** | **Number of shares** |
| ***Ordinary shares (Series "A")*** | | | | |
| Domestic institutional investors | 52.6 | 57,069,304 | 50.5 | 54,735,748 |
| Foreign institutional investors | 0.0 | 20,576 | 0.1 | 126,899 |
| Domestic private investors | 3.5 | 3,759,643 | 5.3 | 5,750,222 |
| Foreign private investors | 0.0 | 60,400 | 0.0 | 39,388 |
| Employees, directors and senior management | 0.0 | 0 | 0.0 | 11,517 |
| Government held owner | 4.5 | 4,832,225 | 4.5 | 4,832,225 |
| Treasury shares | 0.2 | 253,601 | 0.2 | 253,601 |
| Other | 0.0 | 4,261 | 0.2 | 250,410 |
| *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*** |

## Notes to the Consolidated Financial Statements

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

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Profit/(Loss) of shareholders of the Bank | 6,897 | (3,949) |
| Change of general reserve | (252) | (460) |
| **Attributable profit** | **6,645** | **(4,409)** |
| 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 2018 | 31 December 2017 |
|---|---|---|
| Opening balance | 207 | 207 |
| Purchase | - | - |
| **Closing balance** | **207** | **207** |

### c) Other reserves

| | Note | 31 December 2018 | 31 December 2017 |
|---|---|---|---|
| Share premium | | 27,926 | 27,926 |
| General reserve | 33 | 712 | 460 |
| Cash-flow hedge reserve | | 28 | 5 |
| Change in fair value of financial assets at fair value through other comprehensive | 31 | 932 | 1,267 |
| Foreign currency translation reserve | | - | - |
| **Total other reserves** | | **29,598** | **29,658** |

### d) Securities at fair value through other comprehensive income reserve

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Opening balance | 1,267 | 611 |
| Net unrealised gains on securities at fair value through other comprehensive income | (502) | 721 |
| Net realised losses on securities at fair value through other comprehensive income | 136 | - |
| Deferred tax | 31 | (65) |
| **Closing balance** | **932** | **1,267** |

### e) Non-controlling interest

| | 31 December 2018 |
|---|---|
| Opening balance | 12,828 |
| Dividend payment to NCI | - |
| Share of profit/(loss) of the year | (311) |
| **Closing balance** | **12,517** |

*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 |
|---|---|---|---|
| Takarék Commercial Bank Ltd. | 49% | (315) | 12,517 |
| Magyar Kártya Szolgáltató Ltd. | 1% | 4 | - |
| **Total** | **-** | **(311)** | **12,517** |

**Notes to the Consolidated Financial Statements**

## 32. SHARE-BASED PAYMENTS

Share options are granted to employees and also others providing similar services, it is difficult to estimate the fair value of those benefits that are coming from these services, therefore the Group measures the fair value by reference to the fair value of the equity instruments granted.
The Group hasn't got approved share based incentive scheme in 2018 and in 2017.

## 33. 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 712 million as at 31 December 2018 (General reserve was HUF 460 million as at 31 December 2017). The other reserves are presented in Note 31.

## 34. 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 2018 | 31 December 2017 |
|---|---|---|
| Guarantees | 5,414 | 5,405 |
| Loan commitments | 99,445 | 71,046 |
| **Total** | **104,859** | **76,451** |

## 35. 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: shares of Garantiqa Creditguarantee Ltd., shares of SWIFT and shares of Integration of Savings Cooperatives the total value of these is HUF 51 million (2017: HUF 51 million). Visa shares are reported for HUF 241 million in 2018 (2017: HUF 180 million).

Securities at fair value through other comprehensive income: Securities at fair value through other comprehensive income 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 at amortised cost 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
- In case of loan repricing events the model recalculates the interest cash flow
- In case of loans where amortized cost is calculated with simplified approach no FV correction is applied

The cash flow series calculated in this way are discounted with the yield curve applied in the Bank's evaluation, which contains the following components:

- Relevant market yield curve
- Spread implied by the annual risk cost
- Spread implied by the capital allocated to the loans (regulatory minimum requirement and all addons)
- Allocated operational costs

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.

**Notes to the Consolidated Financial Statements**

| | 31 December 2018 | | 31 December 2017 | |
|---|---|---|---|---|
| | Carrying amount | Fair value | Carrying amount | Fair value |
| Refinanced mortgage loans | 105,296 | 105,296 | 76,597 | 76,597 |
| Loans and advances to customers at amortised cost | 372,737 | 373,918 | 310,632 | 311,629 |

**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.

| | 31 December 2018 | | 31 December 2017 | |
|---|---|---|---|---|
| | Bookvalue | Fair value | Book value | Fair value |
| ***Non-listed mortgage bonds*** | | | | |
| Fixed interest | 17,528 | 17,955 | 17,621 | 19,281 |
| Floating interest | - | - | - | - |
| ***Listed mortgage bonds*** | | | | |
| Fixed interest | 180,772 | 182,491 | 63,836 | 68,560 |
| Floating interest | 10,086 | 10,107 | 86,460 | 87,125 |
| **Total mortgage bonds** | **208,385** | **210,553** | **167,917** | **174,966** |
| ***Non-listed bonds*** | | | | |
| Fixed interest | - | - | 1,153 | 1,165 |
| Floating interest | - | - | - | - |
| ***Listed bonds*** | | | | |
| Fixed interest | 6,004 | 6,153 | 7,601 | 7,930 |
| Floating interest | - | - | 276 | 276 |
| **Total bonds** | **6,004** | **6,153** | **9,030** | **9,371** |
| **Total issued security** | **214,389** | **216,706** | **176,947** | **184,337** |

Book 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.

| | Fair value | | Notional amount | |
|---|---|---|---|---|
| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
| **Derivatives designated as cash-flow hedges** | | | | |
| Positive fair value of cash flow hedges | 1 | 14 | 33 | 909 |
| Including: CCIRS | 1 | 14 | 33 | 909 |
| **Swap deals classified as HFT** | | | | |
| Positive fair value of trading swaps | 3,961 | 339 | 103,796 | 33,249 |
| Including: CCIRS | - | - | - | - |
| Including: IRS | 3,941 | 261 | 103,153 | 21,829 |
| Including: FXS | 20 | 78 | 643 | 11,420 |
| **Fair value hedge** | | | | |
| Positive fair value of IRS fair value hedge | - | 2 | - | 620 |
| Including: CCIRS | - | - | - | - |
| Including: IRS | - | 2 | - | 620 |
| **Forward deals** | | | | |
| Positive fair value of forward deals | - | 55 | - | 1,828 |
| **Total derivative financial assets** | **3,962** | **410** | **103,828** | **36,606** |

| | 31 December 2018 | 31 December 2017 | 31 December 2018 | 31 December 2017 |
|---|---|---|---|---|
| **Derivatives designated as cash-flow hedges** | | | | |
| Negative fair value of cash flow hedges | (11) | (2) | 1,475 | 545 |
| Including: CCIRS | (11) | (2) | 1,475 | 545 |
| **Swap deals classified as HFT** | | | | |
| Negative fair value of trading swaps | (1,896) | (653) | 127,286 | 56,069 |
| Including: CCIRS | - | - | - | - |
| Including: IRS | (1,896) | (464) | 127,286 | 42,400 |
| Including: FXS | - | (189) | - | 13,669 |
| **Fair value hedge** | | | | |
| Negative fair value of fair value hedges | (464) | (375) | 29,577 | 17,561 |
| Including: CCIRS | - | - | - | - |
| Including: IRS | (464) | (375) | 29,577 | 17,561 |
| **Forward deals** | | | | |
| Negative fair value of forward deals | - | (47) | 26 | 6,559 |
| **Total derivative financial liabilities** | **(2,371)** | **(1,078)** | **158,363** | **80,735** |

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.

Cash flow hedge transactions as defined by IFRS 9 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 2018**

| Description of the hedging instrument | Types of hedged items | Fair value of the hedging instrument | Fair value of the hedged items | Losses on the hedging instrument | Gains on the hedged items |
|---|---|---|---|---|---|
| IRS | loans and advances to customers at amortised cost | (262) | 15,575 | (240) | 240 |
| IRS | Securities at fair value through other comprehensive income | (202) | 11,029 | (99) | 99 |

In 2018 two new IRS was designated as hedging instrument in fair value hedge connection.

**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) |

**Notes to the Consolidated Financial Statements**

**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 2018 | | |
|---|---|---|---|
| | Level 1 | Level 2 | Level 3 |
| **Assets** | | | |
| Securities at fair value through other comprehensive income | 191,699 | 443 | - |
| Derivative financial assets | - | 3,961 | 1 |
| **Total assets carried at fair value** | **191,699** | **4,404** | **1** |
| **Liabilities** | | | |
| Derivative financial liabilities | - | 2,360 | 11 |
| Financial liabilities at fair value through profit or loss, except derivatives | - | 6,693 | - |
| **Total liabilities carried at fair value** | **-** | **9,053** | **11** |

| | 31 December 2017 | | |
|---|---|---|---|
| | Level 1 | Level 2 | Level 3 |
| **Assets** | | | |
| Securities at fair value through profit or loss | 46,651 | - | - |
| Securities at fair value through other comprehensive income | 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** |

## 36. RISK MANAGEMENT

### a) Overview

Takarék Mortgage Bank Plc. and its subsidiary – Takarék 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 banks.

Risk Strategy – approved by the Board of Directors of MTB Magyar Takarékszövetkezeti Bank Zrt. is mandatory for credit institutions and companies under consolidated supervision led by MTB Magyar Takarékszövetkezeti Bank Zrt. – 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 Takarék Mortgage Bank Plc. and Takarék Commercial Bank Ltd. 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 Takarék Mortgage Bank Plc. and Takarék 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 operational risks.

In 2018 regarding to credit risk in accordance with the aims set the refinanced loan portfolio increased and the customer loan portfolio increased with the dynamic reduction of non-performing loans in via sales.

To maintain a diversified liability structure in 2018 Takarék Mortgage Bank Plc. obtained sources from the capital markets several times through security issue, which replaced the maturing liabilities with long term liabilities. The deposit portfolio of Takarék Commercial Bank Ltd. decreased due to the persistently low interest rate enviroment. The bank disposed significant amount of liquid assets during the year, mainly in form of government securities.

## 37. RISK MANAGEMENT STRUCTURE

### Board of Directors

The Boards of Directors of the banks are responsible for the Takarék Mortgage Bank's and Takarék Commercial Bank's risk management policy and strategy. The Boards of Directors approve the basic framework rules for risk management and guidelines of applicable methodologies. Due to the Integration Membership the 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 MTB Magyar Takarékszövetkezeti Bank Zrt., 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.

### Risk Control Board

The competence of the Risk Control Committees of the Banks includes risk strategy, capital management and operational risk issues.

### Assets and Liabilities Committee

The Assets and Liabilities Committee of the banks make decisions with respect to assets and liability management, market-, liquidity-, and counterparty risk management furthermore product development 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 credit, liquidity, market and operational risk.

### Assets and Liabilities Management and Liquidity Management Departments

Assets and Liabilities Management and Liquidity Management 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, prudent management of the balance sheet structure.

### 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 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 risk reports on a monthly basis and the Risk Control Board at least on quarterly basis and decide on topics within their competence. The Boards of Directors discuss 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.

## 38. 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 structurewith natural hedge 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.

For refinancing the partner banks should ensure the continued compliance of the exposures with the refinancing conditions besides their own credit quality.

Risk taking to retail clients is based on the use of standardized loan schemes and lending processes, resulting in a portfolio characterized by high number of customers, small amounts of individual loans and diversification.

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

The 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 Takarék Mortgage Bank Plc. also for the refinanced loans portfolio.

**Notes to the Consolidated Financial Statements**

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 2018 | 31 December 2017 |
|---|---|---|
| Balances with the National Bank of Hungary | 2,073 | 33,165 |
| Dues from banks | 61,664 | 48,797 |
| Financial assets at fair value through profit or loss | - | 46,651 |
| Securities at fair value through other comprehensive income | 192,142 | 80,198 |
| Derivative financial assets | 3,962 | 410 |
| Refinanced mortgage loans | 105,296 | 76,597 |
| Loans and advances to customers at amortised cost and fair value | 379,489 | 323,838 |
| Other assets | 10,390 | 6,206 |
| **Total** | **755,016** | **615,862** |
| Off-balance sheet commitments | 104,859 | 70,751 |
| **Total** | **104,859** | **70,751** |
| **Total credit risk exposure** | **859,875** | **683,613** |

## 39. CREDIT RISK

IFRS 9 replaces the rules under IAS 39 for impairment. IFRS 9 is effective for annual periods beginning on or after January 1, 2018. The standard has been endorsed by the European Union (EU).

### Impairment

The impairment requirements of IFRS 9 apply to all debt instruments that are measured at amortized cost or FVOCI, and to off balance sheet lending commitments such as loan commitments and financial guarantees (hereafter collectively referred to as “Financial Assets”). This contrasts to the IAS 39 impairment model which was not applicable to loan commitments and financial guarantee contracts, as these were instead covered by International Accounting Standard 37: “Provisions, Contingent Liabilities and Contingent Assets” (IAS 37).

Under IFRS 9, the Bank first evaluates individually the Financial Assets whether objective evidence of impairment exists for loans that are individually significant. It then collectively assesses loans that are not individually significant and loans which are significant but for which there is no objective evidence of impairment available under the individual assessment.

**Notes to the Consolidated Financial Statements**

**Staged Approach to the Determination of Expected Credit Losses**

IFRS 9 introduces a three stage approach to impairment for Financial Assets that are performing at the date of origination or purchase. This approach is summarised as follows:

- ***Stage 1***: The Bank recognizes a credit loss allowance at an amount equal to 12-month expected credit losses. This represents the portion of lifetime expected credit losses from default events that are expected within 12 months of the reporting date, assuming that credit risk has not increased significantly after initial recognition.
- ***Stage 2:*** The Bank recognizes a credit loss allowance at an amount equal to lifetime expected credit losses (LTECL) for those Financial Assets which are considered to have experienced a significant increase in credit risk since initial recognition. This requires the computation of ECL based on lifetime probability of default (LTPD) that represents the probability of default occurring over the remaining lifetime of the Financial Asset. Allowance for credit losses are higher in this stage because of an increase in credit risk and the impact of a longer time horizon being considered compared to 12 months in Stage 1.
- ***Stage 3:*** The Bank recognizes a loss allowance at an amount equal to lifetime expected credit losses, reflecting a Probability of Default (PD) of 100 %, via the recoverable cash flows for the asset, for those Financial Assets that are credit-impaired. The Bank definition of default is aligned with the regulatory definition. The treatment of loans in Stage 3 remains substantially the same as the treatment of impaired loans under IAS 39 except for homogeneous portfolios as described below.

Financial Assets that are credit impaired upon initial recognition are categorised purchased or originated credit-impaired (POCI) with a carrying value already reflecting the lifetime expected credit losses. The accounting treatment for these (POCI) assets is discussed further below.

**Significant Increase in Credit Risk**

Under IFRS 9, when determining whether the credit risk (i.e., risk of default) of a Financial Asset has increased significantly since initial recognition, the Group considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes quantitative and qualitative information based on the Bank historical experience, credit risk assessment and forward-looking information (including macro-economic factors). The assessment of significant credit deterioration is key in determining when to move from measuring an allowance based on 12-month ECLs to one that is based on lifetime ECLs (i.e., Stage 1 to Stage 2). The Bank’s framework aligns with the internal Credit Risk Management process and covers rating related and process related indicators which are discussed further in the section below on Model Descriptions.

**Credit Impaired Financial Assets in Stage 3**

The Bank has aligned its definition of credit impaired under IFRS 9 to when a Financial Asset has defaulted for regulatory purposes, according to the Capital Requirements Regulation (CRR) under Art. 178.

**Notes to the Consolidated Financial Statements**

The determination of whether a Financial Asset is credit impaired focusses exclusively on default risk, without taking into consideration the effects of credit risk mitigants such as collateral or guarantees. Specifically, a Financial Asset is credit impaired and in Stage 3 when:

- The Bank considers the obligor is unlikely to pay its credit obligations. Determination may include forbearance actions, where a concession has been granted to the borrower or economic or legal reasons that are qualitative indicators of credit impairment; or
- Contractual payments of either principal or interest by the obligor are past due by more than 90 days.

For Financial Assets considered to be credit impaired, the ECL allowance covers the amount of loss the Bank is expected to suffer. The estimation of ECLs is done on a case-by-case basis for non-homogeneous portfolios, or by applying portfolio based parameters to individual Financial Assets in these portfolios via the Bank's ECL model for homogeneous portfolios.

Forecasts of future economic conditions when calculating ECLs are considered. The lifetime expected losses are estimated based on the probability-weighted present value of the difference between 1) the contractual cash flows that are due to the Bank under the contract; and 2) the cash flows that the Group expects to receive.

A Financial Asset can be classified as in default but without an allowance for credit losses (i.e., no impairment loss is expected). This may be due to the value of collateral. The Bank's ECL calculation is conducted on a quarterly basis.

**Default**
The bank uses the CRR definition of default as a primary indicator of loss events. Default,  as a loss event occure when:

- the obiligiation is more then 90 days past due on any material credit obligation;
- as a result of specific information or an event,  the obligor is unlikely to fulfil its credit obligation in full, without recourse to actions such as realising security;
- the obligor is subject  to distressed restructuring, i.e. a change in cotract terms, for the clients in financial difficulties, resulting in a material loss;
- the obligor is subject to bankruptcy or similar protection proceedings

**Purchased or Originated Credit Impaired Financial Assets**

A Financial Asset is considered purchased or originated credit-impaired if there is objective evidence of impairment at the time of initial recognition (i.e., rated in default by Credit Risk Management). Such defaulted Financial Assets are termed POCI Financial Assets. Typically the purchase price or fair value at origination embeds expectations of lifetime expected credit losses and therefore no separate credit loss allowance is recognised on initial recognition. Subsequently, POCI Financial Assets are measured to reflect lifetime expected credit losses, and all subsequent changes in lifetime expected credit losses, whether positive or negative, are recognised in the income statement as a component of the provision for credit losses.

**Notes to the Consolidated Financial Statements**

**Writte off**
Loans and debt securities are written off when the Bank has no reasonable expectations of recovering the financial asset (either in its entirety or a portion of it). This is the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. A write-off constitutes a derecognition event. The Bank may apply enforcement activities to financial assets written off. Recoveries resulting from the Group's enforcement activities will result in impairment gains, which will be presented in Provision for impairment losses in the consolidated statement of Profit or Loss.

## Model Descriptions - Expected Credit Loss

### Stage Determination

At initial recognition, Financial Assets which are not POCI are reflected in Stage 1. If there is a significant increase in credit risk, the Financial Asset is transferred to Stage 2. Significant increase in credit risk is determined by using rating-related and process- related indicators as discussed below. In contrast, the assignment of a financial instrument to Stage 3 is based on the status of the obligor being in default.

Rating-Related Indicators: Based on a dynamic change in counterparty PDs that is linked to all transactions with the counter- party, the Bank compares lifetime PD at the reporting date, with expectations at the date of initial recognition. Based on historically observed migration behaviour and available forward-looking information, an expected forward rating distribution is obtained. A quantile of this distribution, which is defined for each counterparty class, is chosen as the threshold. If for the remaining lifetime the PD of a transaction given current expectations exceeds the PD of the relevant threshold rating, the Financial Asset is considered as significantly deteriorated. The thresholds used to determine Stage 2 indicators are determined using expert judgment and validated annually.

Process-Related Indicators: Process-related indicators are derived via usage of existing risk management indicators, which allow the Bank to identify whether the credit risk of Financial Assets has significantly increased. These include obligors being added mandatorily to a credit watchlist, being mandatorily transferred to workout status, payments being 30 days or more overdue or in forbearance.

On an ongoing basis, as long as the condition for one or more of the indicators is fulfilled and the Financial Asset is not recognized as defaulted, the asset will remain in Stage 2. If none of the indicator conditions is any longer fulfilled and the Financial Asset is not defaulted, the asset transfers back to Stage 1. In case of a default, the Financial Asset is allocated to Stage 3.

### Expected Lifetime model

The expected lifetime of a Financial Asset is a key factor in determining the lifetime expected credit losses. Lifetime expected credit losses represent default events over the expected life of a Financial Asset. The Bank measures expected credit losses considering the risk of default over the maximum contractual period (including any borrower's extension options) over which it is exposed to credit risk.

Retail overdrafts, credit card facilities and certain corporate revolving facilities typically include both a loan and an undrawn commitment component. The expected lifetime of such on-demand facilities exceeds their contractual life as they are typically cancelled only when the Bank becomes aware of an increase in credit risk. The expected lifetime is estimated by taking into consideration historical information and the Bank's Credit Risk Management actions such as credit limit reductions and facility cancellation. Where such facilities are subject to an individual review by Credit Risk Management, the lifetime for calculating expected credit losses.

**Notes to the Consolidated Financial Statements**

**Forward-Looking Information**

Under IFRS 9, the allowance for credit losses is based on reasonable and supportable forward looking information obtainable, which takes into consideration past events, current conditions and forecasts of future economic conditions.

To incorporate forward-looking information into allowance for credit losses, the Group uses two key elements: As its base scenario, the Bank uses the macroeconomic forecasts provided by Hunarian National Bank. These forecasts cover a number of macroeconomic variables (e.g., GDP, unemployment rates) and reflect Regulator search's view as to the most likely development of those variables, typically over a two year period and updated quarterly.

This base scenario is then translated into a multiple scenario analysis by leveraging the stress test environment. This environment generates the impact of a multitude of economic scenarios and is used as basis for deriving multi-year PD curves for different rating and counterparty classes, which are applied in the calculation of expected credit losses and in the identification of significant deterioration in credit quality of Financial Assets.

The general use of forward-looking information, including macro-economic factors, as well as adjustments taking into account extraordinary factors, are monitored by the Bank's Risk Management.

**Assumptions and the Estimation Techniques**

IFRS 9 does not distinguish between individually significant or not individually significant Financial Assets and as such the Bank calculates expected credit losses for each Financial Asset individually. Similarly, the determination of the need to transfer between stages is made on an individual asset basis.

The Bank uses three main components to measure ECL. These are PD, Loss Given Default (LGD) and Exposure at Default (EAD). Incorporating forecasts of future economic conditions into the measurement of expected credit losses influences the allowance for credit losses for each stage. In order to calculate lifetime expected credit losses, the Bank's calculation includes deriving the corresponding lifetime PDs from migration matrices that reflect economic forecasts.

The expected credit loss calculation for stage 3 distinguishes between transactions in homogeneous and non-homogenous port- folios, and purchased or originated credit-impaired transactions. For transactions that are in Stage 3 and in a homogeneous portfolio, a similar approach as for Stage 1 and 2 transactions is taken. Since a Stage 3 transaction is defaulted, the probability of default is equal to 100 %.

Below the estimation techniques for the input factors are described in more detail.

The one-year PD for counterparties is derived from our internal PD model. The Bank assigns a PD to each relevant counterparty credit exposure for our exposure.

The counterparty ratings assigned are derived based on internally developed rating models which specify consistent and distinct customer-relevant criteria and assign a rating grade based on a specific set of criteria as given for a certain customer. The set of criteria is generated from information sets relevant for the respective customer segments including general customer behaviour, financial and external data. The methods in use range from statistical scoring models to expert-based models taking into account the relevant available quantitative and qualitative information. Expert-based models are usually applied for counterparties in the exposure classes "Central governments and central banks ", "Institutions " and "Corporates " with the exception of those "Corporates " segments . For the latter as well as for the retail segment statistical scoring or hybrid models combining both approaches are commonly used. Quantitative

rating methodologies are developed based on applicable statistical modelling techniques, such as logistic regression.

One-year PDs are extended to multi-year PD curves using conditional transition matrices. The first step in the estimation process is the calculation of through-the-cycle (TTC) matrices, which are derived from a multi-year rating history. For the next two years, economic forecasts are available. These forecasts are used to transform the TTC matrices into point-in-time (PIT) rating migration matrices.

LGD is defined as the likely loss intensity in case of a counterparty default. It provides an estimation of the exposure that cannot be recovered in a default event and therefore captures the severity of a loss. Conceptually, LGD estimates are independent of a customer's probability of default. The LGD models ensure that the main drivers for losses (i.e., different levels and quality of collateralization and customer or product types or seniority of facility) are reflected in specific LGD factors. In our LGD models we assign collateral type specific LGD parameters to the collateralized exposure.

The EAD over the lifetime of a Financial Asset is modelled taking into account expected repayment profiles. We apply specific Credit Conversion Factors (CCFs) in order to calculate an EAD value. Conceptually, the EAD is defined as the expected amount of the credit exposure to a counterparty at the time of its default. In instances where a transaction involves an unused limit, a percentage share of this unused limit is added to the outstanding amount in order to appropriately reflect the expected outstanding amount in case of a counterparty default.

**Notes to the Consolidated Financial Statements**

IFRS 9 credit risk tables are presented below.

*Gross carrying amount movement table- Balance Sheet - 31 December 2018*

| Asset type | Stage 1 | Stage 2 | Stage 3 | POCI | Total |
|---|---|---|---|---|---|
| | 12-month ECL | Lifetime ECL | Lifetime ECL | Purchased or originated credit-impaired | |
| **Gross carrying amount as at 1 January 2018** | 561,349 | 11,627 | 30,311 | 330 | 603,617 |
| Transfers: | | | | | |
| Transfer from Stage 1 to Stage 2 | - | (606) | - | - | (606) |
| Transfer from Stage 1 to Stage 3 | - | - | (722) | - | (722) |
| Transfer from Stage 2 to Stage 3 | - | - | (67) | - | (67) |
| Transfer from Stage 3 to Stage 2 | - | (26) | - | - | (26) |
| Transfer from Stage 2 to Stage 1 | (78) | - | - | - | (78) |
| Transfer from Stage 3 to Stage 1 | 19 | - | - | - | 19 |
| Changes in EAD | (9,831) | (37) | 3,065 | 234 | (6,569) |
| Financial assets derecognised during the period other than write-offs | (184,679) | (231) | (11,311) | (250) | (196,471) |
| New financial assets originated or purchased | 349,636 | 320 | 1,399 | 39 | 351,394 |
| FX and other movements | (919) | - | (180) | - | (1,099) |
| **Gross carrying amount as at 31 December 2018** | **715,497** | **11,047** | **22,495** | **353** | **749,392** |

## Notes to the Consolidated Financial Statements

*Impairment- Credit risk exposure- Gross carrying amount per asset type, and loss allowance – 31 December 2018*

| | Stage 1 | Stage 2 | Stage 3 | POCI | Total |
|---|---|---|---|---|---|
| | 12-month ECL | Lifetime ECL | Lifetime ECL | Purchased or originated credit-impaired | |
| **Gross carrying amount per asset type** | | | | | |
| Cash on hand | 3,157 | - | - | - | 3,157 |
| *Investment grade* | *3,157* | - | - | - | *3,157* |
| Balances with the National Bank of Hungary | 2,073 | - | - | - | 2,073 |
| *Investment grade* | *2,073* | - | - | - | *2,073* |
| Due from banks | 61,679 | - | - | - | 61,679 |
| *Investment grade* | *61,679* | - | - | - | *61,679* |
| Securities at fair value through other comprehensive income | 192,142 | - | - | - | 192,142 |
| *Investment grade* | *192,142* | - | - | - | *192,142* |
| Refinanced mortgage loans | 105,296 | - | - | - | 105,296 |
| *Investment grade* | *105,296* | - | - | - | *105,296* |
| Retail mortgage loans | 169,738 | 10,646 | 11,756 | 292 | 192,432 |
| *Investment grade* | *680* | *5,518* | - | - | *6,198* |
| *Default grade* | - | - | *11,756* | *292* | *12,048* |
| *Non-investment grade* | *169,058* | *5,128* | - | - | *174,186* |
| Retail other loans | 34,836 | 295 | 3,465 | 61 | 38,657 |
| *Investment grade* | *26,107* | *239* | - | - | *26,346* |
| *Default grade* | - | - | *3,465* | *61* | *3,526* |
| *Non-investment grade* | *8,729* | *56* | - | - | *8,785* |
| Corporate mortgage loans | 36,030 | 106 | 4,701 | - | 40,837 |
| *Investment grade* | *36,030* | *106* | - | - | *36,136* |
| *Default grade* | - | - | *4,701* | - | *4,701* |
| Corporate other loans | 110,546 | - | 2,573 | - | 113,119 |
| *Investment grade* | *25,208* | - | - | - | *25,208* |
| *Default grade* | - | - | *2,573* | - | *2,573* |
| *Non-investment grade* | *85,338* | - | - | - | *85,338* |
| **Total gross carrying amount** | **715,497** | **11,047** | **22,495** | **353** | **749,392** |
| Loss allowance | 1,411 | 679 | 10,326 | 229 | 12,645 |
| **Carrying amount** | **714,086** | **10,368** | **12,169** | **124** | **736,747** |

## Notes to the Consolidated Financial Statements

| | Stage 1 | Stage 2 | Stage 3 | POCI | Total |
|---|---|---|---|---|---|
| | 12-month ECL | Lifetime ECL | Lifetime ECL | Purchased or originated credit-impaired | |
| **Exposure to credit risk on loan commitments and financial guarantees** | | | | | |
| Loan commitment | 98,967 | 146 | 333 | - | 99,446 |
| Bank guarantees | 5,378 | - | 35 | - | 5,413 |
| **Total exposure** | **104,345** | **146** | **368** | **-** | **104,859** |

*Impairment*

| Asset type | Stage 1 | Stage 2 | Stage 3 | POCI | Total |
|---|---|---|---|---|---|
| | 12-month ECL | Lifetime ECL | Lifetime ECL | Purchased or originated credit-impaired | |
| **Impairment loss as at 1 January 2018** | **2,680** | **318** | **14,693** | **109** | **17,800** |
| **Movements with P&L impact** | | | | | |
| Transfers: | | | | | |
| Transfers from Stage 1 to Stage 2 | - | 503 | - | - | 503 |
| Transfers from Stage 1 to Stage 3 | - | - | 1,561 | - | 1,561 |
| Transfers from Stage 2 to Stage 1 | (122) | - | - | - | (122) |
| Transfers from Stage 3 to Stage 1 | (795) | - | - | - | (795) |
| Transfers from Stage 3 to Stage 2 | - | (99) | - | - | (99) |
| Transfers from Stage 2 to Stage 3 | - | - | 34 | - | 34 |
| New financial assets originated or purchased | 365 | 13 | 640 | 28 | 1,046 |
| Changes in PDs/LGDs/EADs | (420) | (23) | (710) | 177 | (976) |
| FX and other movements | (13) | - | 748 | - | 735 |
| **Other movements with no P&L impact** | | | | | |
| Financial assets derecognised during the period other than write-offs | (284) | (33) | (6,640) | (85) | (7,042) |
| **Impairment loss as at 31 December 2018** | **1,411** | **679** | **10,326** | **229** | **12,645** |

## Notes to the Consolidated Financial Statements

*Provision*

| Asset type | Stage 1 12-month ECL | Stage 2 Lifetime ECL | Stage 3 Lifetime ECL | Total |
|---|---|---|---|---|
| **Provision as at 1 January 2018** | **750** | **11** | **91** | **852** |
| **Movements with P&L impact** | | | | |
| Transfers: | | | | |
| Transfers from Stage 1 to Stage 2 | | 6 | - | 6 |
| Transfers from Stage 1 to Stage 3 | (2) | - | 39 | 37 |
| Transfers from Stage 2 to Stage 1 | (2) | - | - | (2) |
| Transfers from Stage 3 to Stage 1 | (21) | - | - | (21) |
| Transfers from Stage 3 to Stage 2 | - | (6) | - | (6) |
| New financial assets originated or purchased | 790 | 1 | 41 | 832 |
| Changes in PDs/LGDs/EADs | 97 | (1) | (40) | 56 |
| **Other movements with no P&L impact** | | | | |
| Financial assets derecognised during the period other than write-offs | (458) | (2) | (27) | (487) |
| **Impairment loss as at 31 December 2018** | **1,154** | **9** | **104** | **1,267** |

*Impairment*

| | Gross exposure | Impairment allowance | Carrying amount | Fair value of collateral held |
|---|---|---|---|---|
| **Credit-impaired assets (stage 3)** | | | | |
| Retail mortgage loans | 11,756 | 4,157 | 7,599 | 12,701 |
| Retail other loans | 3,465 | 2,864 | 601 | 46 |
| Corporate mortgage loans | 4,701 | 2,104 | 2,597 | 8,176 |
| Corporate other loans | 2,573 | 1,201 | 1,372 | 565 |
| **Total credit-impaired assets** | **22,495** | **10,326** | **12,169** | **21,488** |

**Notes to the Consolidated Financial Statements**

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

| Class | Historic default rate 31.12.2018 (%) | Uncovered 31.12.2018 HUF million | Total 31.12.2018 HUF million |
|---|---|---|---|
| Class 1 | 0.00 | 182,678 | 182,678 |
| Class 2 | 0.00 | 1,094 | 1,094 |
| Class 3 | 0.00 | 8,527 | 10,335 |
| Class 4 | 0.27 | 20,344 | 109,819 |
| Class 5-7 | 3.38 | 105,075 | 224,394 |
| **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 |

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 internal 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 classification of credit assets into risk grades is based on Takarék 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).

**Notes to the Consolidated Financial Statements**

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.

The following table present the Group's receivables and commitments according to IAS 39 in 2017.

| | 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 20) 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.

**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 be unable to service the debt or refinance the contract according to the original terms and conditions because of the debtor's financial difficulties and significant deterioration of ability to pay.
Furthermore buffer account loans granted within the framework of the FX rate protection scheme are qualified as forborne as loans, as well as ones concerning to the buffer account loan has been opened.

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

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

Rating of forborne loans:

1. If the loans are classified as forborne loans the classification category can not be better than it was before.
2. The forborne loans are classified as "to-be- monitored" if the original loan was classified as "problem-free" or "to-be- monitored" and following the forbearance, the number of days past due

did not exceed 15 days in case of corporate loans or 30 days in case of retail loan, respectively, during 180 days without break.

3. The forborne loans are possible to be classified as "problem free" after one year of the forbearance if the number of days past due did not exceed 15 days in case of corporate loans or 30 days in case of retail loan, respectively, during 365 days without break.

*An analysis of forborne gross loan portfolio by loan types as 31 December 2018 and 2017*

| Loan type | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Individual loans | 13,562 | 19,039 |
| *Fx rate protection scheme (original loan)* | 3,430 | 4,913 |
| *Fx rate protection scheme (buffer account)* | 305 | 263 |
| Corporate loans | 611 | 650 |
| **Total** | **14,173** | **19,689** |

*An analysis of impaired forborne loan portfolio by loan types as 31 December 2018 and 2017*

| Loan type | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Individual loans | 13,562 | 17,986 |
| *Fx rate protection scheme (original loan)* | 3,430 | 3,902 |
| *Fx rate protection scheme (buffer account)* | 305 | 263 |
| Corporate loans | 611 | 650 |
| **Total** | **14,173** | **18,636** |

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

*An analysis of forborne loan portfolio by loan types and risk classes as 31 December 2018*

| Loan type | Not past due | 1-30 DPD | 31-60 DPD | 61-90 DPD | 91-360 DPD | 360+DPD | Total |
|---|---|---|---|---|---|---|---|
| Individual loans | 7,280 | 1,139 | 384 | 293 | 544 | 3,922 | 13,562 |
| *allowance* | *145* | *104* | *43* | *49* | *158* | *1,970* | *2,469* |
| Corporate loans | 478 | - | - | - | - | 133 | 611 |
| *allowance* | *56* | - | - | - | - | *115* | *171* |
| **Total capital of loans** | **7,758** | **1,139** | **384** | **293** | **544** | **4,055** | **14,173** |
| ***Total allowance*** | ***201*** | ***104*** | ***43*** | ***49*** | ***158*** | ***2,085*** | ***2,640*** |

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

**Notes to the Consolidated Financial Statements**

*An analysis of forborne loan portfolio impaired and not impaired by loan types and risk classes as 31 December 2018*

| Loan type | Not past due | | | Past due | | | Total |
|---|---|---|---|---|---|---|---|
| | Impaired | Not impaired | Total | Impaired | Not impaired | Total | |
| Individual loans | 7,280 | - | 7,280 | 6,282 | - | 6,282 | 13,562 |
| *allowance* | *145* | *-* | *145* | *2,324* | *-* | *2,324* | *2,469* |
| *collateral* | *13,352* | *5* | *13,357* | *7,342* | *-* | *7,342* | *20,699* |
| Corporate loans | 478 | - | 478 | 133 | - | 133 | 611 |
| *allowance* | *56* | *-* | *56* | *115* | *-* | *115* | *171* |
| *collateral* | *981* | *-* | *981* | *21* | *-* | *21* | *1,002* |
| **Total capital of loans** | **7,758** | **-** | **7,758** | **6,415** | **-** | **6,415** | **14,173** |
| ***Total allowance*** | ***201*** | ***-*** | ***201*** | ***2,439*** | ***-*** | ***2,439*** | ***2,640*** |
| ***Total collateral*** | ***14,333*** | ***5*** | ***14,338*** | ***7,363*** | ***-*** | ***7,363*** | ***21,701*** |

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

*An analysis of forborne loan portfolio by type of forbearance as 31 December 2018 and 31 December 2017*

| | 31 December 2018 | | 31 December 2017 | |
|---|---|---|---|---|
| | capital | allowance | capital | allowance |
| Retail loans | 13,562 | 2,469 | 19,039 | 6,994 |
| *bridge loan* | 7,995 | 1,669 | 11,337 | 4,548 |
| *Fx rate protection scheme (original loan)* | 3,430 | 467 | 4,913 | 1,549 |
| *Fx rate protection scheme (buffer account)* | 305 | 34 | 263 | 125 |
| *Fx housing loan converted to HUF* | 307 | 99 | 436 | 200 |
| other | 1,525 | 199 | 2,090 | 572 |
| Corporate loans | 611 | 171 | 650 | 158 |
| **Total** | **14,173** | **2,640** | **19,689** | **7,152** |

*Changes in impairment of forborne loan portfolio*

| | 31 December 2018 |
|---|---|
| Impairment as at 1 January | 7,152 |
| Provision for impairment in the period | 214 |
| Reverse of impairment for the period | (416) |
| Derecognition due to sale of assets | (4,310) |
| Derecognition due to disposal | - |
| **Impairment as at end of period** | **2,640** |

**Notes to the Consolidated Financial Statements**

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

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

**Real estate collateral**
The Takarék Mortgage Bank Plc. and Takarék Commercial Bank Ltd. accept 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),assigned claims, lien on claims..

The table below shows the structure of the collaterals in 2018 and 2017:

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Mortgage | 837,126 | 883,648 |
| Bail | 16,392 | 16,467 |
| Guarantee | 7,447 | 7,083 |
| Other collaterals | 1,938 | 1,938 |
| **Total** | **862,903** | **909,136** |

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.

## 41. MARKET RISK

Due to the nature of its business as a mortgage bank and to the special legal regulation relating to it, Takarék 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.

## 42. 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 Takarék Mortgage Bank Plc. and Takarék Commercial Bank Ltd. 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 2018 | | 31 December 2017 | |
|---|---|---|---|---|
| | 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 | 43,239 | 1.17 | 109,772 | 1.09 |
| Securities at fair value through profit or loss and at fair value through other comprehensive income | 32,513 | 1.53 | 38,688 | 3.42 |
| Refinanced mortgage loans | 91,842 | 2.60 | 58,933 | 4.64 |
| Loans and advances to customers at amortised cost and fair value | 315,331 | 5.24 | 275,118 | 6.36 |
| **Total interest earning assets** | **482,925** | **4.12** | **482,512** | **4.71** |
| | | | | |
| **Interest bearing liabilities** | | | | |
| Due to banks | 34,505 | 0.14 | 25,940 | 0.09 |
| Deposits | 278,384 | 0.16 | 298,607 | 0.33 |
| Issued securities and Financial liabilities at fair value through profit or loss, except derivatives | 189,307 | 3.57 | 175,472 | 4.47 |
| Other loan | - | - | 4 | - |
| **Total interest bearing liabilities** | **502,196** | **1.44** | **500,022** | **1.77** |

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

| | Sensitivity of interest income 2018 | Sensitivity of equity (2018) | | | | |
|---|---|---|---|---|---|---|
| | | 0-6 months | 6-12 months | 1-5 years | Over 5 years | Total |
| HUF | 4 | 0.87 | 0.87 | (7.65) | 5.88 | (0.03) |
| EUR | (0.7) | - | (0.02) | (0.04) | - | (0.06) |
| CHF | 0.02 | 0.01 | - | - | - | 0.01 |

| | 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 2018 +10 bp | Sensitivity of interest income 2018 +25 bp | Sensitivity of equity (2018) +10 bp | Sensitivity of equity (2018) +25bp |
|---|---|---|---|---|
| HUF | 40 | 100 | (0.25) | (0.63) |
| EUR | (7) | (17.5) | (0.67) | (1.67) |
| CHF | 0.2 | 0.5 | 0.17 | 0.42 |

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 2018 net interest income would increase by HUF 4 million in case of HUF, it would increase by HUF 0.7 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 0.03 million in HUF, the decrease by HUF 0.07 million in EUR, the increase by HUF 0.02 million in CHF.

## 43. 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 2018) | Effect on capital (31 December 2018) | Effect on earning before income tax (31 December 2017) | Effect on capital (31 December 2017) |
|---|---|---|---|---|
| EUR | 3.47 | 3.16 | 276.5 | 282.8 |
| CHF | 0.03 | 0.03 | 4.5 | 5.0 |

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 3.47 million HUF, in case of CHF items it could increase with 0.03 million HUF. The similar effect for the capital could mean an increase of 3.16 million in case of EUR items and 0.03 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.)

## Notes to the Consolidated Financial Statements

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

| 31 December 2018 | CHF | EUR | HUF | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash on hand | 47 | 405 | 2,705 | 3,157 |
| Balances with the National Bank of Hungary | - | - | 2,073 | 2,073 |
| Due from Banks | 163 | 15,049 | 46,452 | 61,664 |
| Securities at fair value through other comprehensive income | - | 11,693 | 180,449 | 192,142 |
| Derivative financial assets | - | - | 3,962 | 3,962 |
| Refinanced mortgage loans | - | - | 105,296 | 105,296 |
| Loans and advances to customers at amortised cost and fair value | 1,381 | 43,192 | 328,021 | 372,594 |
| Investment property | - | - | - | - |
| Tangible assets | - | - | 2,171 | 2,171 |
| Goodwill and other intangibles | - | - | 388 | 388 |
| Deferred tax asset | - | - | 679 | 679 |
| Other assets | - | 575 | 9,815 | 10,390 |
| **Total assets** | **1,591** | **70,914** | **682,011** | **754,516** |
| Nominal values of derivative assets | - | 949 | 239 | 1,188 |
| **Total assets incl. derivatives** | **1,591** | **71,863** | **682,250** | **755,704** |

| 31 December 2018 | CHF | EUR | HUF | Total |
|---|---|---|---|---|
| **Liabilities** | | | | |
| Due to banks | 1,283 | 5,069 | 150,307 | 156,659 |
| Deposits | 328 | 53,834 | 250,171 | 304,333 |
| Derivative financial liabilities | - | - | 2,371 | 2,371 |
| Issued securities | - | 2,491 | 211,898 | 214,389 |
| Financial liabilities at fair value through profit or loss, except | - | 6,693 | - | 6,693 |
| Leasing liability | - | - | - | - |
| Current tax liability | - | - | - | - |
| Deferred tax liability | - | - | - | - |
| Provisions | - | - | 3,988 | 3,988 |
| Other liabilities | - | 1,208 | 9,639 | 10,847 |
| **Total liabilities** | **1,611** | **69,295** | **628,374** | **699,280** |

| 31 December 2018 | CHF | EUR | HUF | Total |
|---|---|---|---|---|
| **Shareholders' equity** | **-** | **-** | **55,236** | **55,236** |
| **Total liabilities and shareholders' equity** | **1,611** | **69,295** | **683,610** | **754,516** |
| Nominal values of derivative liabilities | - | 125 | 1,044 | 1,169 |
| **Total liabilities incl. derivatives** | **1,611** | **69,420** | **684,654** | **755,685** |
| Position | 20 | (2,443) | 2,404 | (19) |

*Consolidated FX financial position of the group in terms of main currencies (31 December 2017):*

| 31 December 2017 | CHF | EUR | HUF | Total |
|---|---|---|---|---|
| **Total assets incl. derivatives** | **1,852** | **80,095** | **566,032** | **647,979** |
| **Total liabilities incl. derivatives** | **1,808** | **80,366** | **565,738** | **647,912** |
| **Shareholders' equity** | **-** | **-** | **50,332** | **50,332** |
| **Position** | (44) | 271 | (294) | (67) |

## 44. 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.

*Prepayment risk of the Bank:*

| | Effect on net interest income | Effect on equity | Effect on net interest income | Effect on equity |
|---|---|---|---|---|
| | 31.12.2018 | 31.12.2018 | 31.12.2017 | 31.12.2017 |
| | HUF million | HUF million | HUF million | HUF million |
| **Loans** | **(384)** | **(279)** | **(388)** | **(274)** |
| HUF | (386) | (282) | (390) | (278) |
| EUR | 2 | 3 | 2 | 4 |
| CHF | - | - | - | - |
| **Refinanced mortgage loans** | **(1)** | **9** | **(3)** | **120** |
| HUF | (1) | 9 | (3) | 113 |
| EUR | - | - | - | 7 |
| CHF | - | - | - | - |
| **Total** | **(385)** | **(270)** | **(391)** | **(154)** |

## 45. 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 Banks apply maturity transformation regulated by limits in order to improve profitability while maintaining solvency at all times.
The Banks regularly review prepayments by clients prior to term and takes into consideration their impact in managing market and liquidity risks.

The 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.

## Notes to the Consolidated Financial Statements

*Contractual maturities of undiscounted cash flows of financial liabilities as of 31 December 2018*

| | On demand | Within 3 months | 3 - 12 months | 1 –5 years | 5 – 10 years | 10 – 15 years | Total |
|---|---|---|---|---|---|---|---|
| **Banking liabilities** | | | | | | | |
| Due to banks | 4,029 | 135,106 | 331 | 11,452 | 5,741 | - | 156,659 |
| Deposits | 198,505 | 84,230 | 20,615 | 983 | - | - | 304,333 |
| Derivative financial liabilities | - | 115 | 28 | 664 | 1,564 | - | 2,371 |
| Issued securities | - | 637 | 26,707 | 149,087 | 60,156 | - | 236,587 |
| Financial liabilities at fair value through profit or loss, except derivatives | - | 259 | - | 6,434 | - | - | 6,693 |
| Off balance sheet commitments | 3,169 | 3,667 | 38,306 | 59,393 | 271 | 53 | 104,859 |
| **Total banking liabilities** | **205,703** | **224,014** | **85,987** | **228,013** | **67,732** | **53** | **811,502** |

| | On demand | Within 3 months | 3 - 12 months | 1 –5 years | 5 – 10 years | 10 – 15 years | Total |
|---|---|---|---|---|---|---|---|
| Receivables from derivatives | - | 418 | 1,399 | 6,101 | 3,120 | - | 11,038 |
| Liabilities from derivatives | - | 2,457 | 1,349 | 4,490 | 1,262 | - | 9,558 |
| **Net value of derivatives** | **-** | **(2,039)** | **50** | **1,611** | **1,858** | **-** | **1,480** |

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

**Notes to the Consolidated Financial Statements**

*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.

**Notes to the Consolidated Financial Statements**

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 2018*

| | Less than 12 months | Over 12 months |
|---|---|---|
| **Assets** | | |
| Cash on hand | 3,157 | - |
| Balances with the National Bank of Hungary | 2,073 | - |
| Due from banks | 6,546 | 55,118 |
| Securities at fair value through profit or loss | - | - |
| Securities at fair value through other comprehensive income | 38,546 | 153,596 |
| Derivative financial assets | 121 | 3,841 |
| Refinanced mortgage loans | 9,191 | 96,105 |
| Loans and advances to customers at amortised cost and fair value | 39,555 | 333,039 |
| Tangible assets | - | 2,171 |
| Goodwill and other intangible assets | - | 388 |
| Deferred tax assets | - | 679 |
| Other assets | 10,390 | - |
| **Total assets** | **109,579** | **644,937** |

| | Less than 12 months | Over 12 months |
|---|---|---|
| **Liabilities** | | |
| Due to banks | 139,466 | 17,193 |
| Deposits from customers | 303,350 | 983 |
| Derivative financial liabilities | 143 | 2,228 |
| Issued securities | 27,344 | 187,045 |
| Financial liabilities at fair value through profit or loss, except derivatives | 259 | 6,434 |
| Provisions | 3,988 | - |
| Other liabilities | 10,847 | - |
| **Total liabilities** | **485,397** | **213,883** |

*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 at fair value through profit or loss | 8,994 | 37,657 |
| Securities at fair value through other comprehensive income | 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** |

| | 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** |

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 Takarék Mortgage Bank Ltd and the Takarék Commercial Bank Ltd are members of the SZHISZ, as a result above exemption also applies to them.

According to this in the next table includes the liquidity ratio of the whole members of Integration Organisation of Cooperative Credit Institution.:

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| LCR (liquidity coverage ratio) | 192.52% | 299.08% |
| NSFR (net stable funding ratio) | 117.39% | 129.81% |

## 46. MANAGEMENT OF OPERATIONAL RISK

Operational risk 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.

## 47. TREATMENT OF RISK CONCENTRATION

The 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.

## 48. 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 Group applied (a) the IRB (Internal Rating Based ) method for credit risk from 1 July 2008 and (b) the AMA (Advanced Measurement Method) for operational risk from 31 December 2011 regarding the calculation of capital requirements. The National Bank of Hungary at the application of MTB Magyar Takarékszövetkezeti Bank Zrt. permitted to Takarék Mortgage Bank and Takarék Commercial Bank to use the same approaches applied by the members of Integration, namely the standard method for credit risk and BIA (Basic Indicator Approach) for operational risk from 30 June 2018.

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, MTB Magyar Takarékszövetkezeti Bank Zrt., and Takarék Mortgage Bank - authorized Takarék 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 Takarék Mortgage Bank Ltd and the Takarék 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 regulatory capital of the members of Integration Organisation of Cooperative Credit Institution includes the following elements: share capital – repurchased treasury shares + share premium + general reserve + share option reserve + retained earnings – intangible assets.

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Own Funds | 233,499 | 230,782 |
| TIER 1 Capital | 233,499 | 230,782 |
| Common Equity TIER 1 Capital | 233,499 | 230,782 |

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| ROAE (return on average equity %) | 6.3 | (15.2) |

## 49. 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. MTB Magyar Takarékszövetkezeti Bank Zrt. 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 Takarék Group, including the fund management, the leasing and factoring services and the centralized debt collection were taken over in December 2017 by the MTB Magyar Takarékszövetkezeti Bank Zrt., 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 2018 is the following:

| Companies included in the consolidation* | Main shareholder*** | Core business |
|---|---|---|
| Takarék Commercial Bank Ltd. | Takarék Mortgage Bank Plc 51% | Credit institution |
| Takarék Real Estate Ltd. | MTB Magyar Takarékszövetkezeti Bank Zrt. 100% | Real estate valuation services, real estate agency and sales |
| Takarék INVEST Befektetési és Ingatlankezelő Ltd. | MTB Magyar Takarékszövetkezeti Bank Zrt. 100% | Own property management, leasing, and operating , facility management |
| Diófa Alapkezelő Ltd. | MTB Magyar Takarékszövetkezeti Bank Zrt. 88.29% | Fund and property management |
| Takarék Lízing Ltd. | Takarék INVEST Befektetési és Ingatlankezelő Ltd. 100% | Lending and leasing |
| Central European Credit d.d. (Croatia) | Takarék Lízing Ltd. 100% | Lending |
| Diófa Ingatlankezelő Ltd. | Diófa Alapkezelő Ltd. Ltd. 100% | Real estate management |
| Kary-villa Real Estate Investment Ltd. | Takarék 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 |

**Notes to the Consolidated Financial Statements**

| Companies included in the consolidation* | Main shareholder*** | Core business |
|---|---|---|
| DÍJNET Ltd. | Takarék INVEST Befektetési és Ingatlankezelő Ltd. 51% | Providing electronic bill payment services |
| Mohácsi Takarékbank Zrt. | MTB Magyar Takarékszövetkezeti Bank Zrt.100% | Credit institution |
| Pannon Takarék Bank Zrt. | MTB Magyar Takarékszövetkezeti Bank Zrt. 83.09% | Credit institution |
| Magyar Posta Befektetési Szolgáltató Ltd. | Takarék INVEST Befektetési és Ingatlankezelő Ltd. 50%, Magyar Posta Ltd. 50% | Selling investment products |
| MTB Magyar Takarékszövetkezeti Bank Zrt. | Magyar Takarék Befektetési és Vagyongazdálkodási Ltd. 56.57% | Credit institution, the central bank of the integration of Savings Cooperatives |
| Takarék Faktorház Ltd. | MTB Magyar Takarékszövetkezeti Bank Zrt. 100% | Providing full factoring services |
| Takarékszövetkezeti Informatikai Ltd. | MTB Magyar Takarékszövetkezeti Bank Zrt. 52.38% SZHISZ** 47.62% | The leading IT service provider of the integration of Savings Cooperatives – as outsourced activity – primarily provides IT system operation and system integration services in the field of banking IT |
| Tak-Invest Zrt. | MTB Magyar Takarékszövetkezeti Bank Zrt. 87.90% | IT service provider |
| Takarék Központi Követeléskezelő Ltd. | MTB Magyar Takarékszövetkezeti Bank Zrt. 97.49% | Debt collection, debt recovery, intermediation of financial services |
| TKK Ingatlan Ltd. | Takarék Központi Követeléskezelő Ltd. 100% | Sale of properties |
| MA-TAK-EL Magyar Takarék Ellátó Ltd. | MTB Magyar Takarékszövetkezeti Bank Zrt. 59.09% and Magyar Takarék Befektetési és Vagyongazdálkodási Ltd. 40.91% | Providing bank security, facility management and other operating services excluding IT services |
| DBH Investment Zrt. | MTB Magyar Takarékszövetkezeti Bank Zrt. 99.5% | Fund and property management |
| Takarékinfo Központi Adatfeldolgozó Zrt. | MTB Magyar Takarékszövetkezeti Bank Zrt. 13,91 %-ban, Takarék INVEST Befektetési és Ingatlankezelő Kft. 13,91 %-ban, SZHISZ 20,00%-ban | data processing, web-hosting service |

**Notes to the Consolidated Financial Statements**

| Companies included in the consolidation* | Main shareholder*** | Core business |
|---|---|---|
| MPT Security Zrt. | MTB Magyar Takarékszövetkezeti Bank Zrt. 40,00 %-ban, Takarék INVEST Befektetési és Ingatlankezelő Kft. 10,00 %-ban | securitiy service |
| MPTO Magyar Posta Takarék Oktatási Szolgáltató Zrt. | MTB Magyar Takarékszövetkezeti Bank Zrt. 40,00 %-ban, Takarékinfo Központi Adatfeldolgozó Zrt. 10,00 %-ban | teaching |

**** From the point of view of MTB Magyar Takarékszövetkezeti Bank Zrt., as parent company of Takarék Group (including Takarék Mortgage Bank and Takarék Commercial Bank).***

***** "SZHISZ" = Integration of Savings Cooperatives***

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

Controlled companies of MTB and Integration of Savings Cooperatives (SZHISZ), without the ownership of Takarék Mortgage Bank, 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 TAKARÉK Szövetkezet | owners outside the scope of consolidation | Savings Cooperative |
| Nyugat Takarék Szövetkezet | 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 MTB Magyar Takarékszövetkezeti Bank Zrt., as parent company of Takarék Group.***

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| Loans to executives, members of the Board of Directors and Supervisory Board | - | - |
| Gross remuneration | | |
| Salary | 39 | 19 |
| Bonus | 7 | - |
| Honorarium | 28 | 29 |
| **Total remuneration** | **74** | **48** |

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 2018 and 2017 between the Group and other related parties are disclosed on the next page.

## Notes to the Consolidated Financial Statements

*Details of transactions as of 31 December 2018*

| | Parent | Associates and joint ventures | Key management |
|---|---|---|---|
| Due from banks | 60,066 | - | - |
| Loans and advances to customers at amortised cost | - | 17,789 | 2 |
| Other assets | 77 | 14 | - |
| **Total assets** | **60,143** | **17,803** | **2** |
| Due to banks | 134,068 | 4,000 | - |
| Deposits from customers | - | 11,496 | - |
| Other liabilities | - | 56 | - |
| **Total liabilities** | **134,068** | **15,552** | **-** |
| Interest income | 922 | 275 | - |
| Interest expense | (1,148) | (12) | - |
| **Net interest income** | **(226)** | **263** | **-** |
| Fee and commission income | 4 | 78 | - |
| Fee and commission expense | (218) | (582) | - |
| **Net fee and commission income** | **(214)** | **(504)** | **-** |
| Other operating income | 1,124 | 54 | - |
| Other operating expense | - | - | - |
| **Operating income** | **684** | **(186)** | **-** |
| Operating expense | (1,105) | (5,892) | (74) |
| **Profit/loss on transactions with related parties** | **(421)** | **(6,078)** | **(74)** |

*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)** |

## 50. NET GAINS

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

| 2018 | Securities at fair value through profit or loss | Securities at fair value through other comprehensive income | Loans and advances to customers at amortised cost and at fair value | Financial liabilities at fair value through profit or loss | Financial liabilities at amortised cost | Not linked to financial instruments | Total |
|---|---|---|---|---|---|---|---|
| Interest income | 1,238 | 1,736 | 20,756 | - | - | - | 23,730 |
| Interest expense | - | - | - | (2,026) | (7,013) | - | (9,039) |
| **Net interest income** | **1,238** | **1,736** | **20,756** | **(2,026)** | **(7,013)** | **-** | **14,691** |
| Fee and commission income | - | - | 3,786 | - | 3,713 | 692 | 8,191 |
| Fee and commission expense | - | - | (2,450) | - | (235) | (464) | (3,149) |
| **Net fee and commission income** | **-** | **-** | **1,336** | **-** | **3,478** | **228** | **5,042** |
| Change in fair value of derivatives | 2,418 | - | - | 585 | - | - | 3,003 |
| Gains from securities | - | (1,238) | - | 48 | 1,544 | 1,493 | 1,847 |
| Other operating income | - | - | - | - | - | 5,373 | 5,373 |
| Other operating expense | - | - | - | - | - | (5,740) | (5,740) |
| **Operating income** | **3,656** | **498** | **22,092** | **(1,393)** | **(1,991)** | **(1,354)** | **24,216** |

**Notes to the Consolidated Financial Statements**

| 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** |

**Notes to the Consolidated Financial Statements**

## 51. 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 Takarék 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, Takarék Group has provided investment services as an agent of the MTB Magyar Takarékszövetkezeti Bank Zrt.
- **Treasury:** the segment's responsiblities include liquidity management, asset and liability management, and security issue on behalf of the Takarék Mortgage Bank.
- **Refinancing:** refinancing mortgage loans to Takarék Commercial Bank and other partner institutions
- **Other:** the Bank's core business is supported by subsidiary, which profitability's is reported in this category.

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

| Segment report, 31 December 2018 | Retail | Corporate | Treasury | Refinancing | Other | Total |
|---|---|---|---|---|---|---|
| Net interest income | 10,487 | 2,768 | 519 | 917 | 0 | 14,691 |
| Other net income | 3,060 | 1,971 | 4,944 | (70) | 1 | 9,906 |
| Provision for impairment on loan losses | 709 | 205 | 1 | - | 0 | 915 |
| Direct expense | (15,715) | (1,902) | (361) | (627) | 0 | (18,605) |
| Operating result | (1,459) | 3,042 | 5,103 | 220 | 1 | 6,907 |
| Profit before tax | (1,459) | 3,042 | 5,103 | 220 | 1 | 6,907 |
| | | | | | | |
| Segment assets | 201,263 | 171,459 | 259,857 | 105,296 | 16,769 | 754,644 |
| Segment liabilities and equity | 128,917 | 175,416 | 161,091 | 214,389 | 74,831 | 754,644 |

| 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 |

## 52. IMPACTS OF IMPLEMENTATION OF IFRS 9 AS 1 JANUARY 2018

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

Classification of financial assets and business models

The Bank Group will apply the exemption provided by IFRS 9 Chapter 7 which allows to accomplishing SPPI and business model test with the consideration of facts and circumstances that exist at the date of transition, therefore on 01. January 2018. With the involvement of consultants the Bank Group 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).
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.

**a) Classification of financial assets and liabilities from IAS 39 to IFRS 9 (**see in Notes 13)

**b) Reconciliation of carrying amounts of financial assets and liabilities from IAS 39 to IFRS 9** (see in Notes 13)

**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 | 17,750 |
| **Total** | **16,591** | **(1)** | **1,192** | **17,782** |
| **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** |

**Notes to the Consolidated Financial Statements**

| Assets to be measured at Amortised cost – 01 January 2018 | Stage 1 | Stage 2 | Stage 3 | POCI | Total |
|---|---|---|---|---|---|
| | 12-month ECL | Lifetime ECL | Lifetime ECL | Purchased or originated credit-impaired | |
| **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** |
| Securities at fair value through other comprehensive income | 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** |
| **Impairment loss 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** |
| Securities at fair value through other comprehensive income | 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** |

## 53. IMPACTS OF IMPLEMENTATION OF IFRS 16

### General impact of application of IFRS 16 Leases

IFRS 16 provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements for both lessors and lessees. IFRS 16 becomes effective for accounting periods beginning on or after 1 January 2019 and will supersede the current lease guidance including IAS 17 'Leases' and related interpretations: IFRIC 4 'Determining Whether an Arrangement Contains a Lease', SIC 15 'Operating Leases – Incentives' and SIC 27 'Evaluating the Substance of Transactions in the Legal Form of a Lease'.
The purpose of the new standard is to ease the comparability of the financial statements, presenting both financial and operating leases in the statement of financial position of the lessees, and providing corresponding information to the users of the financial statements about the risks associated with the agreements. In contrast to a lessee accounting, IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17.
The date of initial application of IFRS 16 for the Bank will be 1 January 2019.
The Bank has chosen the modified retrospective application (cumulative catch-up approach) of IFRS 16 in accordance with IFRS 16:C5(b). Consequently, the Bank will not restate its comparative figures but will recognize the cumulative effect of adopting IFRS 16 as an adjustment to equity (retained earnings) at the date of the initial application.

### Impact of the new definition of a lease

IFRS 16 provides a new definition of a lease. The essential element differentiating the definition of a lease under IAS 17 and under IFRS 16 is the concept of control. Pursuant to IFRS 16, an agreement is a lease or contains a lease if it transfers the rights to control the use of an identified asset for a given period in exchange for compensation. Control is considered to exist if the customer has:

- The right to obtain substantially all of the economic benefits from the use of an identified asset; and
- The right to direct the use of that asset.

The Bank will apply the new definition of a lease and related guidance set out in IFRS 16 to all lease contracts entered into or modified before and on or after 1 January 2019.

In preparation for the first-time application of IFRS 16, the Bank has carried out an implementation project. The project has shown that the new definition in IFRS 16 will not change significantly the scope of contracts that meet the definition of a lease for the Bank.

### Impact on lessee accounting

The new standard discontinues the differentiation between operating and finance leases in the lessee's books, and requires to recognise a right-of-use asset and lease liability regarding all of the lesses's lease agreements except for short-term leases and low asset value leases which are subject to exemptions.
On initial application of IFRS 16, for leases previously classified as operating leases (except as noted below), the Bank will recognise right-of-use assets and lease liabilities in the consolidated statement of financial position. The paragraphs below explain the measurement methods that will be applied to those leases.

**Notes to the Consolidated Financial Statements**

On initial application of IFRS 16, for each lease separately, the lease liability will be initially measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application. Additionally, the Bank decided to use following practical expedients in respect of the measurement of these lease liabilities:

- apply a single discount rate to a portfolio of leases with reasonably similar characteristics;
- use hindsight, such as in determining the lease term if the contract contains options to extend or terminate the lease.

On initial application of IFRS 16, the right-of-use asset, will be initially measured at an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of initial application.

Additionally, when initially measuring the right-of-use assets, the Bank

- Will rely on its assessment of whether leases are onerous applying IAS 37 Provisions, Contingent Liabilities and Contingent Assets immediately before the date of initial application as an alternative to performing an impairment review of the right-of-use asset on a date of initial application. As a consequence, the right-of-use asset recognised at the date of initial application will be adjusted by the amount of any provision for onerous leases recognised in the statement of financial position immediately before the date of initial application.
- Will exclude initial direct costs from the measurement of the right-of-use asset at the date of initial application.

Subsequently, the Bank will:
(a) Recognise depreciation of right-of-use assets and interest on lease liabilities in the consolidated statement of profit or loss;
(b) Not to separate the total amount of cash paid into a principal portion and interest in the cash flow statement/consolidated cash flow statement.

No changes in accounting will be made in case of operating leases which as at 1 January 2019 will have the remaining lease period of 12 months or less, and leases of low-value assets (such as personal computers and office furniture. In those cases, the Bank opted to recognise a lease expense on a straight-line basis as permitted by IFRS 16.

As at 31 December 2018, the Bank 21 has non-cancellable operating lease commitments that are related to leases other than short-term leases and leases of low-value assets. Summary of the related contracts:

| Leased asset category | Number of contracts |
|---|---|
| Properties | 20 |
| - with indefinite term | 11 |
| - with definite term | 1 |
| Company car | 1 |
| - with indefinite term | 0 |
| - with definite term | 1 |
| **Total** | **21** |

The Bank will recognise a right-of-use asset of HUF 1,263 million and a corresponding lease liability of HUF 1,278 million in respect of all these leases. The estimate impact on profit or loss in 2019 is to decrease rental fees by HUF 736 million, to increase depreciation by HUF 723 million, and to increase interest expense by HUF 12 million.
The Bank has no provision for onerous lease contracts or lease liability incentives as at 31 December 2018 that should be derecognised and considered in measurement of the right-of-use assets and lease liabilities.

Under IAS 17, all lease payments on operating leases are presented as part of cash flows from operating activities. The impact of the changes under IFRS 16 would be to increase the cash generated by operating activities by HUF 735 million and to decrease net cash used in financing activities by the same amount.

The summary of the financial impact on adopting IFRS 16 is presented in the table below (related only to leases entered or modified before 1 January 2019):

| in million HUF | 01 January 2019 | 31 December 2019 |
|---|---|---|
| Right-of-use asset | 1 263 | 541 |
| Lease liability | 1 278 | 554 |
| Provision for onerous contracts | - | - |
| Other items | - | - |
| Cumulative impact recognized as an adjustment to the equity at the date of initial application | (15) | |
| Expected impact on statement of comprehensive income: | - | 1 |
| - Increase of depreciation | - | (723) |
| - Increase of interest expense | - | (12) |
| - Decrease of rental fee | - | 736 |
| Expected impact on statement of cash flows: | - | 0 |
| - Increase of net cash-flow from operating activities | - | 735 |
| - Decrease of net cash-flow from financing activities | - | (735) |

The summary data presented in this section is based on the Bank's best estimate. Due to the 2019 interim methodological clarifications, we do not exclude the possibility of changing the estimate in the 2019 Consolidated Financial Statements. In this case, this fact will be presented in the 2019 Consolidated Financial Statements.

**Estimated impact on financial ratios, bank covenants and other arrangements**

Adopting IFRS 16 will not have material impact on financial ratios, bank covenants and other arrangements.

## 54. SIGNIFICANT EVENTS AFTER BALANCE SHEET DATE

The National Bank of Hungary terminated its covered bond purchasing program from January 2019.
The National Bank of Hungary announced in September 2018, that it would cease to buy covered bonds on the secondary market from October 2018, and that it would not continue to purchase covered bonds on the primary market auctions any more. (The MNB Monetary Council decided to launch a mortgage bond purchase program on 21 November 2017, within the framework of which it purchased fixed interest rate covered bonds with three years or more maturity on the primary issue auctions and also on the secondary market).

On 14 February 2019, the General Assembly decided to change of name of the Magyar Takarékszövetkezeti Bank Ltd.. This is foreseen from 1. April 2019. Based on the decision of the Board of Directors, the new name will be MTB Bank of Hungarian Savings Cooperatives Co. Ltd.

# TAKERÉK MORTGAGE BANK PLC.

# CONSOLIDATED BUSINESS REPORT FOR 2018 ACCORDING TO IFRS

Budapest, April 2, 2019

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# 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 on 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. as of December 31, 2018:***

| Shareholder | December 31, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| | Ownership ratio % | Nr of shares | Ownership ratio % | Nr of shares |
| **Ordinary „A" shares listed on BSE** | | | | |
| Domestic institutional investors | 52.6 | 57,069,304 | 50.5 | 54,735,748 |
| Foreign institutional investors | 0 | 20,576 | 0.1 | 126,899 |
| Domestic private investors | 3.5 | 3,759,643 | 5.3 | 5,750,222 |
| Foreign private investors | 0 | 60,400 | 0 | 39,388 |
| Employees, management | 0 | 0 | 0 | 11,517 |
| State ownership | 4.5 | 4,832,225 | 4.5 | 4,832,225 |
| Repurchased shares | 0.2 | 253,601 | 0.2 | 253,601 |
| Other investors | 0 | 4,261 | 0.2 | 250,410 |
| Series „A" total | 60.8 | 66,000,010 | 60.8 | 66,000,010 |
| **Dividend preference „B" shares not listed on BSE** | | | | |
| Domestic institutional investors | 13.1 | 14,163,430 | 13.1 | 14,163,430 |
| Series „B" total | 13.1 | 14,163,430 | 13.1 | 14,163,430 |
| **Ordinary „C" shares not listed on BSE** | | | | |
| Domestic institutional investors | 26.1 | 2,832,686 | 26.1 | 2,832,686 |
| Series „C" total | 26.1 | 2,832,686 | 26.1 | 2,832,686 |
| **Total** | **100** | **82,996,126** | **100** | **82,996,126** |

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 affiliates. 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 Bank of Hungarian Savings Cooperatives Ltd. (hereafter “MTB”) in December 2017.

Based on the Act CXXXV of 2013 on integration of cooperative financial institutions and modification of certain rules on economic issues (Szhitv), 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 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 remaining issuance and refinancing functions, and 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 2017-2021 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. According to the plans, the satellite institutions of the Integration, including mutual fund management, factoring and leasing service suppliers became directly subordinated to the MTB.

***As a consequence of the transactions listed above, investments of the Takarék Mortgage Bank as of December 31, 2018:***

| Companies | Takarék Mortgage Bank Plc. | Takarék Commercial Bank Ltd. | Total |
|---|---|---|---|
| Takarék Commercial Bank Ltd. | 51.00% | - | 51.00% |
| Bank of Hungarian Savings Cooperatives Ltd. | 1 „C” share | 1 „C” share | 0.00% |

From April 2018 the Bank made no more new loan disbursements, it disbursed allotments and non-refundable state subsidies only on previously agreed credit contracts. New credit contracts for households from this time were made 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 Takarék Mortgage Bank Plc. as the Company’s name. In the revised for the 2019-2023 period 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.

### 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 due to continuously developing account and bank 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. contracted on the purchase (by the latter) of ordinary shares representing 49% of the share capital of the Commercial Bank. The closing of the transaction – after the central bank of Hungary gave the necessary permission to the Hungarian Post to acquire the shares – took place on September 30, 2014. Before the transaction, the general meeting of the Commercial Bank Ltd. decided on approximately HUF 20 billion capital increase. 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. According to 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 2019 the Commercial Bank will merge into the new large commercial bank, which unifies Takarék Group's all banking related activities, except that of mortgage banking.

## 2 THE MACROECONOMIC ENVIRONMENT IN 2018

### 2.1 THE HUNGARIAN ECONOMY IN 2018[1]

| Indicator | 2016 | 2017 | 2018 |
|---|---|---|---|
| Real GDP growth | 2.3% | 4.1% | 4.9% |
| Industrial output growth | 0.9% | 4.9% | 3.6% |
| Average annual rate of inflation | 0.4% | 2.3% | 2.8% |
| Average annual rate of unemployment | 5.1% | 4.2% | 3.7% |
| ESA-based budget balance (relative to GDP)* | -1.9% | -2.2% | -2.0% |
| Net external financing capacity (relative to GDP)* | 6.2% | 5.8% | 4.1% |
| Base rate (end-of-year) | 0.90% | 0.90% | 0.90% |
| EUR-HUF exchange rate (end-of-year) | 311.02 | 310.14 | 321.51 |

**Estimate for 2018*
*Sources: KSH, MNB, NGM*

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

External demand was markedly less supportive for Hungary's economy in 2018 than a year before. GDP growth in the European Union substantially slowed: following 2017's 2.4%, the EU's economy expanded by only 1.9% last year, and the year-on-year growth rate was no more than 1.4% in the fourth quarter. Whereas in the US GDP growth accelerated from 2.5% in 2017 to 3% last year, the fourth quarter also brought slowdown in the other side of the Atlantic, which may set a new trend in the light of recent protectionist measures in foreign trade. Yet, overall the external financing environment remained friendly: although the FED raised its policy rate four times by 100bps combined, this was already priced in by markets, and towards the end of the year the FED's communication has lost its bias for tightening. The ECB, on the other hand, could not even start taking meaningful steps toward stricter conditions. It only called its quantitavie easing program an end, but will renew expiring papers in its portfolio, and the hiking of policy rates is not on the horizon.

With this background Hungary's economic growth could even accelerate from an already strong 4.1% back in 2017 to 4.9% last year. The 15-year high growth rate was driven mostly by gross fixed capital formation expanding at double-digit rates, and also private consumption that was supported by 8% growth in real wages and continued improvements in the labour market (employment increased by 1% and surpassed 4.5 million by the end of 2018). From the production side market service sector - reflecting to the upturn in domestic demand - contributed markedly to growth, and the construction sector had an exceptionally strong year again, counterbalancing the minor slowdown in industrial production growth. The strong increase in domestic demand, of course, led to faster import than export growth, nevertheless the trade surplus in 2018 was still healthy enough, although somewhat narrower than a year before.

The good growth performance was still accompanied by encouraging developments in both internal and external balances. Due to the relaxed financing environment and the uptick in fiscal revenues in the wake of increasing economic activity the budget deficit has barely reached 2% of GDP. Helped by strong nominal GDP growth public debt relative to GDP decreased by 2 percentage points compared to end-2017, thus it remained on a downward path for the seventh successive year. 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 slightly above 4% of GDP. Although the surplus of the current account was somewhat smaller than in 2017, that of the capital account (reflecting mainly the net inflow of EU related transactions) was higher than in a year before. This improvement is also reflected in foreign debt figures: gross foreign debt (also including intercompany loans between foreign companies and their Hungarian subsidiaries) accounted for only 75% of GDP at the end of 2018 (10 percentage points down from the previous year), whereas net foreign debt contracted to well below 10% of GDP.

The 12-month rate of headline CPI inflation fluctuated in a wider than usual range in 2018 (between 1.9% and 3.8%), with average annual inflation reaching 2.8%. The acceleration of inflation towards the end of 2018 was mostly driven by products (for example fuel), which are outside the reach of monetary policy. Core inflation, which is intact from such impacts, was less volatile and remained below 3% throughout 2018. Yet, as in 2019 the meeting of the MNB's mid-term inflation target is fairly likely, it points to the direction of monetary policy normalization in the near future. As a precursor to this, the MNB gave up on fairly-priced monetary interest rate swap deals with commercial banks and the purchase of mortgage bonds, hence these programs lasted for hardly a year among the central bank's policy tools. On the other hand, the central bank totally discontinued accepting funds to be placed in its three-month deposit facility, and announced the resumption of its Credit for Growth program from 2019 with HUF 1,000bn maximum allotment. Altogether, the domestic short-term rate and yield environment remained fairly low, but longer term rates raised markedly: the 10-year reference rate at slightly above 3% was 100bps higher than its previous year's level (although it was as high as 3.6% intra-year).

In 2018 the Forint left the narrow range (305 to 315) it used to fluctuate within during the previous years vis-à-vis the Euro. On average it depreciated by close to 3.5% against the common European currency compared to 2017. This is partly explained by the MNB remaining asynchronous with major central banks, which stepped on a tightening path (at least verbally), but externl balance indicators that stopped improving further may have been another reason for the Forint to depreciate. What's more, back in 2018 major rating agencies failed to upgrade Hungary's credit rating, although this was expected by most market players.

The number of newly built dwellings in 2018 increased by 23% compared to 2017, but new building permits fell 3% short that of 2017, as momentum looks to evaporate in the case of residential real estate projects in Budapest due to the expected tightening in regulation beyond 2019. The 23% growth in the number of newly built dwellings means that 17,681 flats were reported as new last year compared to 14,389 flats in 2017. This driving force was developments in Budapest, where the annual growth rate exceeded 40%, but cities in the countryside that were the leading force of

residential real estate markets in the previous years, saw the growth rate to slow down considerably. Of the newly built 17,681 flats 53% was constructed by entrepreneurs whereas 46% by private persons, which is an increase in the case of the former.

## 2.2 THE BANKING SECTOR IN 2018[2]

The total assets of the banking sector amounted to HUF 39,380 billion at the end of 2018, up 8.3% from HUF 36,354 billion a year before. According to not-audited preliminary figures the combined pre-tax profit of the banking sector reached HUF 584 billion last year, more than HUF 100 billion below last year's figure, but it was expected in the wake of much smaller net income from de-provisioning, as well as markedly growing operational costs. The stock of gross credit of banking sector increased by 10% in 2018 and reached HUF 20,770 billion at the end of the year. Within this household credit increased by only 6.4%, but the non-financial corporate sector was up by close to 15%.

4.5% of the stock of household credits were in a 90+ day arrear at the end of last year, while the weight of non-performing loans was 7%. Both figures show significant decrease compared to end-2017 figures, which were 7.6% and 10.9% respectively. In the case of the non-financial corporate sector only 2.3% of their credit was in a 90+ day arrear, which is a marked decrease compared to 3.5% prevailing at the end of 2017.

The share of client deposits within total liabilities rose to 57% in 2018, its volume reached HUF 22,400 billion. 38% of this stock was owned by households, whereas 38.6% by the non-financial corporate sector.

### 2.2.1 Household mortgage loans

The disbursement of new mortgage loans stabilized in the HUF 80-90 billion range on a monthly basis from May 2018, rising from HUF 60-70 billion, which characterized the first four months of the year and most of 2017. This resulted in a full-year HUF 916 billion new disbursement in 2017, up 29.4% from 2017's HUF 708 billion. In fact, a meaningful growth rate characterized only the home equity loan segment, where new disbursements were 31% higher in 2018 than a year before. Growth in the new disbursement of mortgage-backed general purpose loans amounted to only 13%.

### 2.2.2 The market of mortgage bonds

In the course of 2018 the face value of the stock mortgage bonds issued by the five mortgage banks residing in Hungary increased by almost HUF 400 billion, which implies approximately 50% growth, and consequently, the end-year stock was close to HUF 1,220 billion at face value. Contributed to this growth was the MNB's intensive mortgage bond purchase program: on net terms the central bank purchased HUF 300bn mortgage bonds throughout 2018. But the fact that the Mortgage Financing Adequacy Ratio (MFAR: the minimum statutory rate of household mortgage debt to be covered by funds arising from the issuance of mortgage bonds) was raised to 20% from the previous 15% on October 1, 2018, also contributed to higher mortgage bond issuance than in previous years.

[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.

# 3 REPORT ON THE BUSINESS ACTIVITIES

## 3.1 MAJOR FINANCIAL INDICATORS

| HUF billion | 31/12/2017 | 31/12/2018 | Change |
|---|---|---|---|
| Balance sheet total | 610.6 | 754.5 | 23.6% |
| Gross value of loans and refinancing mortgage loans | 403.8 | 490.5 | 21.5% |
| Mortgage bonds issued | 174.9 | 215.1 | 22.9% |
| Bonds issued | 9.0 | 6.0 | -33.5% |
| Deposits | 329.3 | 304.3 | -7.6% |
| Shareholders' equity | 50.3 | 55.2 | 9.7% |
| Solvency capital | 230.8 | 233.5 | 1.2% |
| Profit/Loss before tax | -9.3 | 6.7 | - |
| Profit/Loss after tax w/o the effect of discontinued operation | -11.2 | 6.6 | - |
| Average net interest margin (NIM, %) | 2.13% | 2.15% | 0.02%-pt |
| Cost/income ratio w/o other results (CIR, %) | 86.6% | 74.5% | -12.1%-pt |
| EPS (HUF) | -40.7 | 61.4 | - |
| ROAA (return on average assets, %) | -1.4% | 1.0% | 2.4%-pt |
| ROAA excluding special banking tax (%) | -1.7% | 1.0% | 2.7%-pt |
| ROAE (return on average equity, %) | -15.2% | 12.2% | 27.4%-pt |
| ROAE excluding special banking tax (%) | -19.5% | 12.8% | 32.3%-pt |

The Bank's consolidated balance sheet total calculated according to International Financial Reporting Standards (IFRS) was HUF 754.5 billion as of 31 December 2018, which was 23.6% (HUF 143.9 billion) higher than a year before. In the course of the past year growth in total assets was primarily driven by the growth in the volume of refinanced mortgage loans, while on the liability side the strongest contribution came from interbank deposits.

The net stock of loans was up by HUF 90.7 billion or 23.4% under one year (the growth rate of refinanced loans was 37.5%). On the liability side the marked HUF 122.7 billion increase in interbank deposits was augmented by HUF 40.2 billion increase in the stock of issued mortgage bonds.

The Bank's consolidated profit in 2018 was HUF 6.6 billion; net interest income amounted to HUF 14.7 billion. Net interest margin on average assets was 2.15%, 2 basis points higher than in 2017. The Bank's cost to income ratio excluding net other income was 74.5% in 2018, significantly down from 86.6% back in 2017.

## 3.2 LENDING

The volume of gross loans extended by the Bank amounted to HUF 385.2 billion as of 31 December 2018. Year-on-year growth was 17.7 %, mostly due to dynamically expanding new disbursements, which more than counterbalanced contractual instalments on earlier extended loans.

Household loans continued to dominate the loan portfolio, even though its share fell to 55.3% by the end of 2018 from 59.4% at end-2017. Changes in the composition of the loan portfolio resulted from a HUF 37.1 billion (27.9%) increase in corporate loans, whereas the stock of retail loans increased by only HUF 15.2 billion (7.8%).

**The composition of the loan portfolio as of December 31, 2018:**

| HUF million | December 31, 2017 | December 31, 2018 | Change |
|---|---|---|---|
| **Retail loans** | **191,707** | **209,684** | **9.38%** |
| Housing loans | 113,034 | 130,261 | 15.24% |
| Other mortgage loans | 66,584 | 65,438 | -1.72% |
| Consumer and other loans | 10,330 | 13,062 | 26.45% |
| Loans to employees | 1,159 | 923 | -20.36% |
| **Corporate loans** | **132,731** | **169,805** | **27.93%** |
| **Total own loans (gross)** | **323,838** | **379,489** | **17.18%** |
| Derecognition | -1,300 | -336 | -74.15% |
| Accrued interest | 4,773 | 5,206 | 9.07% |
| Revaluation to fair value | 28 | 240 | 757.14% |
| Value adjustment after depreciation | -115 | 610 | - |
| **Total gross loans** | **327,224** | **385,209** | **17.72%** |
| Impairment | -16,592 | -12,615 | -23.97% |
| **Loans, net** | **310,632** | **372,594** | **19.95%** |
| Refinanced loans | 76,597 | 105,296 | 37.47% |

In the course of 2018 new loan disbursements amounted to HUF 47.8 billion in the retail and HUF 52.4 billion in the corporate segment, the latter is 27% higher than in 2017. Among corporate loans the disbursement of fixed purpose loans was outstanding: during the year it amounted to HUF 51.4 billion, which exceeds that of the last year by 33.9%. The most significant retail loan products were home equity loans and personal loans; disbursements during the year reached HUF 32.9 billion and HUF 4.9 billion respectively. During 2018 the volume of newly disbursed home equity loans was 47.7% higher than in the preceding year, while in the case of personal loans growth was 62.7%.

On April 20, 2016 the Commercial Bank, as a member of the Consortium for Development of MFB Points with the MTB, the B3 Savings Cooperative and Budapest Bank Ltd. entered into an intermediation contract with the Hungarian Development Bank Ltd. (hereafter referred to as 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 major cities based on its branch network. Entering into this intermediation contract was a unique opportunity to increase activity 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.

## 3.3 REFINANCING

By 31 December 2018 the consolidated volume of refinanced loans increased by HUF 28.7 billion (i.e. by 37.5%) from a year ago and reached HUF 105.3 billion.

Last year the increase in the refinanced portfolio is explained significantly by the change to the MFAR (Mortgage Financing Adequacy Ratio, which was raised from 15% to 20% as of October 1, 2018. This resulted in higher refinancing activity by the Bank, and also in an increase of refinancing agreements with new partners.

### 3.4 CUSTOMER DEPOSITS, BANK ACCOUNT SERVICES

The total volume of deposits decreased by 7.6% in 2018, mostly due to a fall in the volume of corporate deposits. Corporate term deposits decreased by HUF 29.5 billion, which the HUF 8.7 billion growth in sight deposits was unable to offset. The amount of household deposits decreased by HUF 5 billion, shrinking to HUF 124 billion by the end of 2018. Within this the stock of sight deposits was HUF 83.5 billion, which represents 67% of total household deposits.

### 3.5 INVESTMENT SERVICES

The independent investment services business line of the Commercial Bank was sold to MTB in 2017, resulting in a more concentrated and unified service for the clients of the Takarék Group. Following December 17, 2017, similarly to other cooperative credit institutions within the Integration, the Bank offers investment service products to clients as an agent of MTB. These products include mutual funds, government bonds and stock exchange quoted securities.

### 3.6 SECURITIES ISSUES

As a result of capital market transactions in 2018 the Bank raised HUF 132.6 billion in new funds, of which HUF 127.8 billion in the form of mortgage bonds, HUF 4.8 billion in the form of uncovered bonds. As a result of capital market transactions of the Takarek Mortgage Bank Plc. on non consolidated level in 2018 the Bank raised HUF 163.4bn in new funds, of which HUF 143.3 billion in the form of mortgage bonds, HUF 20 bn in the form of uncovered bonds.This volume was raised through 16 issuances, of which two took place through quotation and fourteen through auction. In each issuances the entire spectrum of the Bank's dealers were involved. On the course of the transactions five different series of mortgage bonds and one series of uncovered bonds were put into circulation. Only fixed rate mortgage bonds denominated in HUF, with maturities between 5 and 10 years were issued in 2018, while the uncovered bond series had two years of remaining maturity.

Compared to the preceding years not only issuance, but also repurchase activity was stronger in 2018. Altogether HUF 80.5 billion (consolidated data HUF 65.3 billion) of mortgage bonds were repurchased, affecting eight different series. Mostly variable rate papers were repurchased by the Bank, with only one repurchase transaction involving a fixed rate paper in the value of HUF 12 billion.

Three series of mortgage bonds expired in 2018 in HUF 15.2 billion and EUR 6.94 million total value, and also three series of uncovered bonds expired in HUF 2.7 billion and EUR 3.5 million total value.

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 impairment losses) plus supplementary collateral principal each day exceeded 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 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 collateral value of real estate covering mortgage bonds issued by the Bank was HUF 269.2 billion as of December 31, 2018, 10.3% above the figure prevailing at December 31, 2017 (HUF 244.1 billion).

***Value of mortgage bonds and assets involved as collateral as of 31 December 2018 (non consolidated data)***

| HUF million | December 31, 2017 | December 31, 2018 | Change |
|---|---|---|---|
| Outstanding mortgage bonds in circulation | | | |
| Face value | 176,693 | 222,451 | 25.9% |
| Interest | 20,974 | 32,607 | 55.5% |
| **Total** | **197,667** | **255,058** | **29.0%** |
| Value of ordinary collateral | | | |
| Principal | 198,021 | 222,731 | 12.5% |
| Interest | 46,103 | 46,533 | 0.9% |
| **Total** | **244,124** | **269,264** | **10.3%** |
| Value of assets involved as supplementary collateral | | | |
| Government and Hungarian Development Bank bonds | 22,865 | 32,676 | 42.3% |
| Mortgage bonds | 0.0 | 3,500 | - |
| **Total** | **22,865** | **36,176** | **58.2%** |

As of 31 December 2018, the present value of ordinary and supplementary collateral was HUF 275.6 billion and the present value of mortgage bonds was HUF 239.4 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 115.12%.

The net value of ordinary and supplementary collateral principal to the unpaid face value of mortgage bonds in circulation was 116.32%, and the net ordinary and supplementary collateral interest to the unpaid interest on mortgage bonds in circulation was 143.38% as of December 31, 2018.

# 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. The Bank covers its liquidity positions mostly against other entities within the 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. As a consequence of this, liquid assets needed to meet the 13% coverage excess and 12-month liquidity buffers are financed from uncovered liabilities.

In the observed period the funding structure of the Bank was markedly affected by the continued increase of the amount of refinanced loans, as well as the MNB's mortgage bond purchase plan, under which the Bank issued only fixed rate mortgage bonds.

The amount of refinanced loans on a consolidated level increased by HUF 28.7 billion in 2018, which equals to 37.5% growth on annual terms. This was also motivated by the increase in the Mortgage Financing Adequacy Ratio (MFAR) from the previous 15 to the current 20%, which raised the need from partner institutions for refinancing, but the meeting of Takarék Group's own MFAR compliance obligation also enhanced the additional need for mortgage bond coverage. A sizable portion of mortgage bond coverage through refinancing was nevertheless made at variable rates, hence the Bank entered into various interest rate swap deals during the year with a view to cover open interest rate positions.

Developments in the structure of the Bank’s liabilities

The consolidated stock of unsecured bonds decreased in 2018, from HUF 8.7 to HUF 5.8 billion, i.e. by 33.3%.

The amount of mortgage bonds increased by 25.7% (HUF 42.7 billion) in the last year. From a face value of 165.8 billion at the end of 2017 the stock reached HUF 208.5 billion by the end of 2018. The dynamic growth of the stock of mortgage bonds is expected to continue in 2019 due to the already announced further rise of the MFAR from 20 to 25%, which increases refinancing needs and mortgage bond issuances to draw the necessary funds.

The volume of net interbank liabilities on a consolidated level increased markedly during the year: from HUF 34 billion at the end of 2017 it rocketed to HUF 156.7 billion by the end of 2018.

# 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 are also extended to the Bank.

The risk strategy, which was approved by the Board of Directors of MTB and is mandatory for all credit institutions and other companies within the Takarék Group under the consolidated supervision performed by MTB 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 MNB terminated the obligation of the Bank to comply with the prudential requirements in the second to fourth and sixth to eighth parts of the CRR on a subconsolidated basis from January 1, 2017. At the same time it exempted the Bank from the individual fulfillment of the second to eighth part of the CRR. The Bank must comply with the requirements of the Integration Organisation of Cooperative Credit Institution and its central bank.

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 infavourable 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 issue refinance 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 Takarék Mortgage 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.

In the first quarter the limit system for corporate loans was updated, which defined the directions of risk taking in 2018.

Risk management also took part in the review of lending procedures in the retail segment. They reviewed the Takarék Group's income verification regulations, updated the relevant manual and developed the version to be used by intermediaries and other partners. Risk management also prepared the income verification policies to be used with regard to the Consumer Friendly Loan Product(s) initiated by the MNB.

## 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 regulated by pre-defined limits in order to improve profitability, while maintaining solvency at all times. The Bank regularly reviews prepayments and early payments 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 activites, 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 support this. Therefore, open FX positions may occur primarily due to liquidity management, settlements related to lending and refinancing, or active and passive provisions 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 involved 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 Bank collects and analyses loss data due to operational risk and the Key Risk Indicators (KRI). The KRIs are reviewed each year, thus in 2018 various KRIs were modified and new KRIs were defined as well.

The Bank compiles and updates the map of operational risks through its annual self-assessment. The Bank also identifies those infrequent occurancies, which could result in heavy losses, and measures their impact by scenario analysis.

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.

### 5.7 OTHER

In 2018 the MNB exempted the Bank from the publication requirements of its compliance with CRR on an individual basis.

## 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 organizational changes at the Bank in 2018 were driven by the "Head Office" project, which targeted the restructuring of the central, administrative bodies of Takarék Group. In the wake of the project organizational changes served partly the functional integration of the Bank into the final setup of the Takarék Group and pointed towards the establishment of unified control functions within it.

The average number of employees of the Bank in 2018 was 36 (9 full-time, 25 part-time employees and one pensioner). The rate of fluctuation (calculated as the ratio of the number of employees leaving to the average number of employees within the calendar year) was 69.4%.

# 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 | December 31, 2017 | December 31, 2018 | Change | Change |
|---|---|---|---|---|
| Cash on hand | 3,135 | 3,157 | 0.7% | 22 |
| Due from banks & NBH | 81,961 | 63,737 | -22.2% | -18,224 |
| Securities at fair value through profit or loss | 46,651 | 0 | -100.0% | -46,651 |
| Securities at fair value through other comprehensive income | 80,198 | 192,142 | 139.6% | 111,944 |
| Derivate financial assets | 410 | 3,962 | 866.3% | 3,552 |
| Refinanced mortgage loans | 76,597 | 105,296 | 37.5% | 28,699 |
| Loans and advances to consumers at amortised cost and at fair value | 327,224 | 385,209 | 17.7% | 57,985 |
| Impairment and provision | -16,591 | -12,615 | -24.0% | 3,976 |
| Tangible assets | 2,847 | 2,171 | -23.7% | -676 |
| Goodwill and other intangible assets | 1,128 | 388 | -65.6% | -740 |
| Deferred tax asset | 811 | 679 | -16.2% | -132 |
| Other assets | 6,206 | 10,390 | 67.4% | 4,184 |
| **Total assets** | **610,577** | **754,516** | **23.6%** | **143,939** |
| Due to banks | 33,983 | 156,659 | 361.0% | 122,676 |
| Issued securities | 183,963 | 221,082 | 20.2% | 37,119 |
| Mortgage bonds | 167,917 | 208,385 | 24.1% | 40,468 |
| Bonds | 9,030 | 6,004 | -33.5% | -3,026 |
| Financial liabilities at fair value through profit or loss, except for derivative | 7,016 | 6,693 | -4.6% | -323 |
| Deposits from customers | 329,253 | 304,333 | -7.6% | -24,920 |
| Derivative financial liabilities | 1,078 | 2,371 | 120.0% | 1,293 |
| Current tax liability | 21 | 0 | -100.0% | -21 |
| Provisions | 6,251 | 3,988 | -36.2% | 2,263 |
| Other liabilities | 5,696 | 10,847 | 90.4% | 5,151 |
| **Total liabilities** | **560,245** | **699,280** | **24.8%** | **139,035** |

| in HUF million | December 31, 2017 | December 31, 2018 | Change | Change |
|---|---|---|---|---|
| Share capital | 10,849 | 10,849 | 0.0% | 0 |
| Share premium | 27,926 | 27,926 | 0.0% | 0 |
| Treasury shares | -207 | -207 | 0.0% | 0 |
| Cash-flow hedge reserve | 5 | 28 | 460.0% | 23 |
| Other reserves | 1,727 | 932 | -46.0% | -795 |
| Retained earnings | 1,613 | -3,454 | - | -5,067 |
| Non-controlling interest | 12,828 | 12,517 | -2,4% | -311 |
| Profit (loss) of the year | -4,409 | 6,645 | - | 11,054 |
| **Total shareholders' equity** | **50,332** | **55,236** | **9.7%** | **4,904** |
| **Total liabilities and shareholders' equity** | **610,577** | **754,516** | **23.6%** | **143,939** |

As of 31 December 2018, the Bank's consolidated balance sheet total by IFRS amounted to HUF 754.5 billion; and increased by HUF 143.9 billion or 23.6% compared to the value as of 31 December 2017. On the assets side volume of loans increased by 17.7%, refinanced loans increased by 37.5%, while volume of securities at fair value through profit and loss decreased by 100%, interbank lending decreased by 22.2%.

Liabilities increased by 24.8% altogether compared to the reference figures of 2017. Issued securities and due to banks showed increase (20.2% and 361%, respectively), while deposits from customers decreased by 7.6%.

Shareholders' equity increased by HUF 4.9 billion or 9.7% year-on-year, the main reason of which was the consolidated profit of 2018.

#### 7.1.1 Interest earning assets

The Group's interest earning assets increased from HUF 599.1 billion as of 31 December 2017 to HUF 740.9 billion as of 31 December 2018. Interest earning assets contributed 98.2% to the balance sheet total.

***Interbank lending***

NBH and other interbank lending decreased from HUF 82 billion HUF as of 31 December 2017 to HUF 63.7 billion as of 31 December 2018. The item contributed 8.6% to interest earning assets as of 31 December 2018.

***Securities***

The value of Bank's securities at fair value through other comprehensive income increased from HUF 80.2 billion as of 31 December 2017 to HUF 192.1 billion as of 31 December 2018. Contribution of securities at fair value through other comprehensive income of interest earning assets was 25.9%. From the stock of securities at fair value through other comprehensive income discount treasury bills amounting to HUF 12.4 billion and government bonds amounting to HUF 153 billion and other bank and corporate bonds for sale amounting to HUF 26.7 billion, and investments amounting to HUF 0.2 billion.

***Loans***

As of 31 December 2018, the volume of loans showing an increase by HUF 58 billion compared to the previous year. Impairment to cover loan losses decreased from HUF 16.6 billion as of 31 December 2017 to HUF 12.6 billion as of 31 December 2018.

Volume of refinanced loans increased by 37.5% to HUF 105.3 billion during 12 months. As of 31 December 2018, the contribution of refinanced loans and gross own lending was 66.2% in total assets; the same ratio was 64.6% a year before.

Volume of corporate loans are increased by 27.9%, and housing loans are increased by 12.3% during the year.

**Portfolio quality**

The Bank had HUF 749.39 billion classified assets, HUF 104.86 billion contingent liabilities (altogether HUF 854.25 billion) as of December 31, 2018.

Claims on clients amounted to HUF 385.05 billion, moreover, based on already signed contracts there was a commitment for disbursing loans to the tune of HUF 104.86 billion at the end of 2018. Of these 2962 loan contracts were classified as non-performing with an underlying volume of HUF 22.5 billion in claims and HUF 0.4 million as commitments with HUF 10.4 billion in impairments and provisions.

The stock of refinancing loans was HUF 105.3 billion, which is entirely classified as performing.

The total stock of due form banks was HUF 61.68 billion, which is entirely classified as performing.

The share of performing loans increased both in the entire and the loan portfolio compared to Januar 1, 2018.

As of December 31, 2018 97 % of the the classified portfolio was considered as performinghence the non-performing share amounted to 3 %.

In the loan portfolio the share of performing stock amounted to 94.16 %, the non-performing stock 5,84%.

Average impairment considerably increased both in the entire portfolio (1.69 %) and the loan portfolio (2.68 %) compared to end-2017.

### 7.1.2 Non-interest earning assets

Tangible assets amounted to HUF 2.8 billion as of 31 December 2017 and decreased by HUF 676 million year-on-year to HUF 2.2 billion. As of 31 December 2017 intangibles amounted to HUF 1.1 billion and decreased to HUF 388 million as of 31 December 2018.

Other assets amounted to HUF 10.4 billion as of 31 December 2018, decreasing by 67.4% (HUF 4.2 billion) year-on-year. Deferred tax assets reached HUF 0.7 billion. A significant item in other assets is the value of deposits amounted to HUF 3.4 billion as of 31 December 2018, it was HUF 3.1 billion as of 31 December 2017.

### 7.1.3 Interest bearing liabilities

Interest bearing liabilities in amount of HUF 682.1 billion as of 31 December 2018, (HUF 547.2 billion at the end of 2017) represents 90.4% of the balance sheet total. Issued securities and customer deposits gave major part of interest bearing liabilities.

***Interbank funds***

As of 31 December 2018 interbank funds amounted to HUF 156.7 billion and decreased by 361.0% on yearly basis. Contribution of interbank borrowings to interest bearing liabilities was 23.0% as of 31 December 2018.

***CMBs and Bonds issue***

The contribution of covered mortgage bonds – measured at amortised cost and at fair value – to the Bank's interest bearing liabilities was 32.4% as of 31 December 2018, which ratio was 33.6% in 2017. HUF 208.4 billion value of covered mortgage bonds as of 31 December 2018 was 24.1% higher than the figures of 31 December 2017 (HUF 167.9 billion). Increase in the value of the CMB portfolio was HUF 40.5 billion year-on-year.

The book value of bonds (both measured at amortised cost and at fair value) was HUF 6.0 billion as of 31 December 2018. The year-on-year decrease was 33.5%; the volume of bonds dropped by HUF 3.0 billion.

***Deposits***

Under a strategic cooperation agreement between the Bank and Hungarian Post, the Company signed a contract with Hungarian Post for certain financial mediation services. Under the agreement, beginning from December 2013 the network of Hungarian Post sells an expanding range of products in the retail term deposits and retail accounts segments. The volume of retail deposits sold through the Hungarian Post's network was HUF 19.3 billion at the end of 2018.

At the end of 2018 the Bank managed 197 thousand household and 12 thousand corporate current accounts, to which 172.4 thousand household and 6.6 thousand corporate cards were linked. Both in the number of accounts and the number of bank cards there was a slight decrease compared to the end of 2017. The number of Post-accounts wasroughly 72 thousand at the end of the year. Transactions with the underlying cards substantiall increased during 2018: purchases through POS terminals exceeded 31 million, the number of cash withdrawals through ATMs reached 5.6 million.

### 7.1.4 Other liabilities

The Bank reported among other liabilities the volume of accounts payable of HUF 107 million as well as accruals with the volume of HUF 1.7 billion. Other liabilities were HUF 10.8 billion as of 31 December 2018. At the end of 2018 the volume of the provisions amounted to HUF 3.99 billion.

A significant item among the provisions is that on 30 November 2018, the General Meeting of MTB Magyar Takarékszövetkezeti Bank Zrt. adopted the Takarék Group's new business strategy for the period 2019-2023. Due to this the Bank present HUF 459 million provision for the organization changes. Beside this, in 2018 the Bank expressed its willingness to change of some information systems and update the used information system, due to the new business strategy. For the contractual obligation, which is part of the existing contract, the Bank has set up provision of HUF 1,989 million.

### 7.1.5 Shareholders' equity

Takarek Mortgage Bank Co. Plc. at the end of December 2015 increased its share capital with HUF 4,249 million 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 2018

| 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

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

| HUF million | 2017 FY | 2018 FY | Change (%) |
|---|---|---|---|
| Interest income | 22,684 | 23,730 | 4.6% |
| Interest expense | -9,839 | -9,039 | -8.1% |
| **Net interest income** | **12,845** | **14,691** | **14.4%** |
| Fee and commission income | 7,811 | 8,191 | 4.9% |
| Fee and commission expense | -2,236 | -3,149 | 40.9% |
| **Net fee and commission income** | **5,575** | **5,042** | **-9.6%** |
| Profit/Loss from FX transactions | 446 | 381 | -14.6% |
| Change in fair value of financial instruments | 85 | 3,003 | 3432.9% |
| Net results from investment services | 1,390 | 1,847 | 32.9% |
| **Net trading result** | **1,921** | **5,231** | **172.3%** |
| Other operating revenue | 2,229 | 5,617 | 152.0% |
| Other operating expense | -11,528 | -5,740 | -50.2% |
| Net income from investment services | 192 | 0 | -100.0% |
| Profit/Loss of affiliated companies | -1,139 | -244 | -78.6% |
| **Operating income** | **10,095** | **24,597** | **143.7%** |
| Provision for impairment on loan losses | -1,634 | 757 | - |
| General and administrative expense | -17,783 | -18,605 | 4.6% |
| **Profit/Loss before tax** | **-9,322** | **6,749** | **-** |
| Income tax | -1,889 | -163 | -91.4% |
| **Profit/Loss after tax w/o the effect of discontinued operation** | **-11,211** | **6,586** | **-** |
| Profit/Loss from discontinued operation | 3,023 | 0 | -100.0% |
| **Profit/Loss for the period** | **-8,188** | **6,586** | **-** |

The Bank's consolidated profit for the year by IFRS amounted to HUF 6,586 million in 2018. The significant improvement compared to 2017 is mostly explained by the change in the fair value of financial instruments.

### 7.2.1 Net interest income

Net interest income was HUF 14.7 billion in 2018, 14.4% higher than a year before. The main factor behind this growth was decreasing interest expenses on issued securities, supported by the entry of the MNB as a power buyer of mortgage bonds from the second half of 2018.

The net figure resulted from HUF 23.7 billion interest income (up 4.6% year-on-year) and HUF 9 billion interest expense (down 8.1% year-on-year). The net interest margin (net interest income relative to average total assets, aka NIM) was 2 bps higher than in 2017.

***Composition of interest income and expenses:***

| | 2017 | 2018 | Change |
|---|---|---|---|
| **Interest income** | | | |
| Loans | 72.6% | 68.1% | *-4.5%-pt* |
| Refinancing | 6.9% | 9.9% | *3.0%-pt* |
| Mortgage bond interest subsidy | 8.1% | 6.9% | *-1.2%-pt* |
| Supplementary interest subsidy | 1.4% | 1.3% | *-0.1%-pt* |
| Securities and interbank activities | 7.4% | 8.6% | *1.2%-pt* |
| Swap transactions | 3.6% | 5.2% | *1.6%-pt* |
| **Interest expenses** | | | |
| Bonds issued | 80.5% | 79.1% | *-1.4%-pt* |
| Interbank activities | 0.5% | 0.7% | *0.2%-pt* |
| Customer deposits | 10.1% | 5.4% | *-4.7%-pt* |
| Derivatives | 8.8% | 14.4% | *5.6%-pt* |
| Other interest expense | 0.1% | 0.4% | *0.3%-pt* |

### 7.2.2 Net fees and commissions

In 2018, the Bank achieved a positive balance of HUF 5 billion from revenues and expenses on commissions and fees; 9.6% lower than a year before. From the revenue side more marked increases were observed in fees connected to mortgage loans, whereas from the expenses side especially fees connected to guarantees showed above average growth.

### 7.2.3 Net trading result

In 2018, the balance of financial transactions showed HUF 5.2 billion profit, which is HUF 3.3 billion higher than a year before. The net result of F/X transactions was HUF 381 million in 2018, which is somewhat lower (by HUF 65 million) than in the previous year.

In 2018 the change in the fair value of financial instruments showed HUF 3 billion profit, markedly up from the preceding year's HUF 85 million profit. Securities transactions resulted in HUF 1.8 billion profit against only HUF 1.4 billion in 2017.

### 7.2.4 Other operating income and expenditure

As a result of HUF 5.6 billion in other revenues and HUF 5.7 billion in other expenses the balance on other operations showed a minor loss of HUF 123 million in 2018. There was no profit on investment services, which had a HUF 192 million positive balance in the previous year.

#### 7.2.5 Operating expenses

Operating costs amounted to HUF 18.6 billion in the course of 2018, which is 4.6% higher than in 2017. The cost-to-income ratio (CIR)[3] was 74.5% in 2018, while it was 86.6% the year before.

The contribution of personnel related expenses to total operating costs was 32.5% in 2018, 8.4 percentage points lower than in 2017, when it was 40.9%.

Administrative expenses in 2018 amounted to HUF 12 billion, rising by close to 10% year-on-year. Expenses of business activity significantly decreased overall, the HUF 243 million expenses last year were 31.4% short of HUF 354 million in 2017. Commercial and advertising expenses decreased by HUF 204 million, but consultants' fees increased sharply by HUF 4.1 billion.

Other taxes paid that are reported among operating costs amounted to HUF 36.7 million in 2018, down from HUF 39.7 million in 2017.

#### 7.2.6 Impairment and loan losses

Combined risk costs amounted to HUF 757 million in 2018. Impairment losses changed by HUF 2.4 billion compared to the end of last year.

### 7.3 Capital position

Members of the SZHISZ - in view of the institutional system of joint liability - should comply with prudential requirements on a consolidated basis, individual compliance is ensured by exemption from the relevant legislation according to the decision of the MNB. Since the Bank and the Commercial Bank are members of the SZHISZ, the above exemption applies to them.

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 solvency capital on Integratin level amounted to HUF 233,499 million as of December 31, 2018, compared to HUF 230,782 million a year before.

## 8 PROTECTION OF ENVIROMENT

Although the Bank does not pursue business and 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 taking energy-saving solutions during its operation. In its internal trainings it emphasizes the importance of energy and environmentally conscious corporate and employee behavior.

## 9 OTHER SERVICES PROVIDED BY THE AUDITOR COMPANY

Under the label of other services in 2018 the auditing company invoiced the Bank HUF 1.8 million for examining whether the Bank meets the conditions to convert to reporting according to IFRS.

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

## 10 POST BALANCE SHEET DATE EVENTS

According to the Integration's strategic guidelines (approved on the general meeting of MTB on november 30, 2018), the Bank's subsidiary, the Commercial Bank will be merged into the newly created Takarékbank in the first half of 2019. This also involves the migration of legal and IT systems; the Commercial Bank continues to perform its activities in the context of the new universal commercial bank to be created by the merger of the cooperative credit institutions of the Integration.

Decisions taken so far in view of the planned merger have no legally binding consequence on the ownership structure of entities within Takarék Group, hence neither on the Bank itself.

Budapest, April 2, 2019

dr. Gyula László Nagy
Chief Executive Officer

Attila Mészáros
Board Member