

OTP MORTGAGE BANK LTD.

SEPARATE FINANCIAL STATEMENTS
IN ACCORDANCE WITH
INTERNATIONAL FINANCIAL REPORTING
STANDARDS AS ADOPTED BY
THE EUROPEAN UNION TOGETHER WITH
INDEPENDENT AUDITOR'S REPORT

FOR THE YEAR ENDED
31 DECEMBER 2017

INDEPENDENT AUDITOR'S REPORT

To the Shareholder of OTP Jelzálogbank Zrt.

Opinion

We have audited the separate financial statements of OTP Jelzálogbank Zrt. (the "Bank") for the year 2017, which comprise the separate statement of financial position as at December 31, 2017, which shows total assets of HUF 1,080,051 million, the related separate statement of profit or loss and the separate statement of comprehensive income, which shows a net profit for the period of HUF 22,802 million, the separate statement of changes in equity, and the separate statement of cash-flows for the year then ended, and notes to the separate financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying separate financial statements give a true and fair view of the financial position of the Bank as at December 31, 2017 and of its financial performance and its cash-flows for the year then ended, in accordance with International Financial Reporting Standards as adopted by the European Union (the "EU IFRS"), and the separate financial statements were prepared in all material respects in accordance with the provisions of the effective Hungarian Act C of 2000 on Accounting (the "Accounting Act") relevant to the entities preparing separate 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 Separate Financial Statements*" section of our report.

We are independent of the Bank 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 separate financial statements of the current period. These matters were addressed in the context of our separate audit of the separate 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	How our audit addressed the matter
Impairment of loans	
<p>(See notes 7. and 23.1. of the Notes to the Separate Financial Statements for the details)</p> <p>At the year end, the Bank reported total gross loans of HUF 990,789 million and a provision for impairment on loan losses of HUF 8,888 million. The determination of impairment of loans requires application of professional judgement and use of subjective assumptions by management in case of the application of portfolio based collective impairment models. The most significant assumptions applied in calculating the provision are the following:</p> <ul style="list-style-type: none">- valuation of collateral;- estimated time to realize collateral;- probability of default and recovery rates; and- estimation of future cash-flows expected to be realized. <p>Based on the significance of the above described circumstances, the calculation of impairment of loans was considered as a key audit matter.</p>	<p>Our response as auditors included:</p> <ul style="list-style-type: none">- involvement of our actuarial and valuation experts to assist us in performing our procedures;- evaluating internal controls relating to monitoring of loans and calculating and recording of impairment;- assessing the relevant controls, whether the impairment triggers are captured and whether the estimation of the impairment is appropriate;- assessing the appropriateness of collective provisioning models; and- evaluating inputs, assumptions, management estimates and parameters applied, including comparison with historical data, and recalculating the impairment charge.

Other Information

Other information comprises the business report of the Bank for 2017, which we obtained prior to the date of this auditor's report, and the annual report for 2017, which is expected to be made available to us after that date, but does not include the separate financial statements and our independent auditor's report thereon. Management is responsible for the other information and for the preparation of the business report in accordance with the relevant provisions of the Accounting Act and other regulations. Our opinion on the separate financial statements provided in the section of our independent auditor's report entitled "*Opinion*" does not apply to the other information.

Our responsibility in connection with our audit of the separate financial statements is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the separate 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 business report also include reviewing the business report to assess whether the business report was prepared in accordance with the relevant provisions of the Accounting Act and other regulations, if any, including the assessment whether the 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 business report.

In our opinion, the business report of the Bank for 2017 corresponds to the separate financial statements of the Bank for 2017 and the relevant provisions of the Accounting Act in all material respects. The information referred to in Section 95/B. (2) a)-d), g) and h) of the Accounting Act has been provided.

As the Bank is not subject to additional requirements under any other regulation in connection with the business report, we have not formulated an opinion on this matter.

In addition to the above, based on the information obtained about the Bank 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.

When we read the annual report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

Responsibilities of Management and Those Charged with Governance for the Separate Financial Statements

Management is responsible for the preparation and fair presentation of the separate 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 separate financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the separate financial statements, management is responsible for assessing the Bank'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 Bank or to cease operations, or has no realistic alternative but to do so.

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

The Auditor's Responsibilities for the Audit of the Separate Financial Statements

Our objectives during the audit are to obtain reasonable assurance about whether the separate 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 separate 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 separate 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 Bank'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 Bank'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 separate 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 Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the separate financial statements, including the notes to the separate financial statements, and whether the separate financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in the Bank'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 separate 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 Bank by the Shareholder's resolution on March 21, 2017 and our uninterrupted engagement has lasted for 17 years.

Consistence with the Additional Report to the Audit Committee


We confirm that our audit opinion on the separate financial statements expressed herein is consistent with the additional report to the Audit Committee of the Bank, which we issued on March 22, 2018 in accordance with Article 11 of Regulation (EU) No. 537/2014 of the European Parliament and the Council.


Provision of Non-audit Services

We declare that no prohibited non-audit services referred to in Article 5 (1) of Regulation (EU) No. 537/2014 of the European Parliament and the Council were provided by us to the Bank. In addition, there are no other non-audit services which were provided by us to the Bank and its controlled undertakings and which have not been disclosed in the business report.

The engagement partner on the audit resulting in this independent auditor's report is the statutory registered auditor signing this report.

Budapest, March 22, 2018


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


.....
dr. Hruby Attila
Statutory registered auditor
Registration number: 007118

OTP MORTGAGE BANK LTD.

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OTP MORTGAGE BANK LTD.
SEPARATE STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2017
(in HUF million)

	Note	2017	2016
Cash, amounts due from banks and balances with the National Bank of Hungary	4.	3,760	18
Placements with other banks, net of allowance for placement losses	5.	75,340	2,580
Securities available-for-sale	6.	11,291	11,728
Loans, net of allowances for loan losses	7.	985,532	962,344
Investments in subsidiaries, associates and other investments	8.	1,206	1,206
Property and equipment	9.	31	5
Intangible assets	9.	156	143
Other assets	10.	<u>2,735</u>	<u>4,836</u>
TOTAL ASSETS		<u>1,080,051</u>	<u>982,860</u>
Amounts due to banks and Hungarian Government, deposits from the National Bank of Hungary and other banks	11.	583,453	527,235
Liabilities from issued securities	12.	406,845	372,422
Deferred tax liabilities		557	832
Other liabilities	13.	13,537	3,894
Subordinated bonds and loans	14.	<u>-</u>	<u>4,876</u>
TOTAL LIABILITIES		<u>1,004,392</u>	<u>909,259</u>
Share capital	15.	27,000	27,000
Retained earnings and reserves	16.	<u>48,659</u>	<u>46,601</u>
TOTAL SHAREHOLDER'S EQUITY		<u>75,659</u>	<u>73,601</u>
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY		<u>1,080,051</u>	<u>982,860</u>

Budapest, 22 March 2018



 András Becsei
 Chief Executive Officer

OTP MORTGAGE BANK LTD.
SEPARATE STATEMENT OF PROFIT OR LOSS FOR THE YEAR ENDED
31 DECEMBER 2017 (in HUF million)

	Note	2017	2016
<i><u>Interest Income:</u></i>			
Loans		39,262	45,489
Placements with other banks, net of allowance for placement losses		599	4,545
Amounts due from banks and balances with the National Bank of Hungary		3	-
Interest subsidy on housing loans financed by mortgage bonds		16,548	19,940
Securities available-for-sale		<u>346</u>	<u>289</u>
Total Interest Income		<u>56,758</u>	<u>70,263</u>
<i><u>Interest Expense:</u></i>			
Amounts due to banks and Hungarian Government, deposits from the National Bank of Hungary and other banks		(2,571)	(10,717)
Liabilities from issued securities		(23,707)	(25,251)
Subordinated bonds and loans		<u>(11)</u>	<u>(137)</u>
Total Interest Expense		<u>(26,289)</u>	<u>(36,105)</u>
NET INTEREST INCOME		30,469	34,158
Provision for impairment on loan and placement losses	7.	(195)	992
NET INTEREST INCOME AFTER PROVISION FOR IMPAIRMENT ON LOAN AND PLACEMENT LOSSES		30,274	35,150
Income from fees and commissions	18.	3,090	2,180
Expenses from fees and commissions	18.	<u>(3,628)</u>	<u>(3,090)</u>
Net loss from fees and commissions		<u>(538)</u>	<u>(910)</u>
Foreign exchange losses/gains, net		(72)	72
Losses on securities available-for-sale, net		-	(184)
Other operating losses, net		(3,182)	(3,164)
Net operating expense		<u>(3,254)</u>	<u>(3,276)</u>
Personnel expenses		(532)	(474)
Depreciation and amortization		(101)	(107)
Other administrative expenses	19.	<u>(2,820)</u>	<u>(7,525)</u>
Other administrative expenses		<u>(3,453)</u>	<u>(8,106)</u>
PROFIT BEFORE INCOME TAX		23,029	22,858
Income tax expense	21.	<u>(227)</u>	<u>(733)</u>
NET PROFIT FOR THE PERIOD		<u>22,802</u>	<u>22,125</u>
Earnings per share (in HUF)			
Basic and diluted	22.	<u>84,452</u>	<u>81,944</u>

OTP MORTGAGE BANK LTD.
SEPARATE STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED
31 DECEMBER 2017 (in HUF million)

	Note	2017	2016
NET PROFIT FOR THE PERIOD		<u>22,802</u>	<u>22,125</u>
Items that may be reclassified subsequently from other comprehensive income to profit or loss:			
Fair value adjustment of securities available-for-sale	6.	(133)	703
Deferred tax related to securities available-for-sale		12	(134)
Effect of the tax rate-modification (19%→9%)		<u>-</u>	<u>44</u>
Other comprehensive income, net of income tax		<u>(121)</u>	<u>613</u>
NET COMPREHENSIVE INCOME		<u>22,681</u>	<u>22,738</u>

OTP MORTGAGE BANK LTD.
SEPARATE STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2017
(in HUF million)

	Note	Share Capital	Retained earnings and reserves	Total
Balance as at 1 January 2016		<u>27,000</u>	<u>54,823</u>	<u>81,823</u>
Net profit for the period		-	22,125	22,125
Other comprehensive income		-	613	613
Dividend for the year 2015		_____ -	<u>(30,960)</u>	<u>(30,960)</u>
Balance as at 31 December 2016	<u>16</u>	<u>27,000</u>	<u>46,601</u>	<u>73,601</u>
Net profit for the period		-	22,802	22,802
Other comprehensive income		-	(121)	(121)
Dividend for the year 2016		_____ -	<u>(20,623)</u>	<u>(20,623)</u>
Balance as at 31 December 2017	<u>16</u>	<u>27,000</u>	<u>48,659</u>	<u>75,659</u>

OTP MORTGAGE BANK LTD.
SEPARATE STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2017
(in HUF million)

	Note	2017	2016
OPERATING ACTIVITIES			
Profit before income tax		23,029	22,858
Depreciation and amortization	9.	101	107
Provision for impairment on loan and placement losses		195	992
Release of provision for impairment on other assets	10.	-	(5)
Unrealised gains on fair value adjustment of derivative financial instruments		-	294
(Increase)/Decrease in loans, net of allowances for loan losses	7.	(23,383)	16,557
Decrease in other assets before provisions for losses	10.	2,101	22,972
Increase/(Decrease) in other liabilities	13.	9,643	(40,300)
Income tax paid		<u>(490)</u>	<u>(1)</u>
Net cash provided by operating activities		<u>11,196</u>	<u>23,474</u>
Interest received		56,758	70,499
Interest paid		(26,289)	(54,919)
INVESTING ACTIVITIES			
Net (increase)/decrease in placements with other banks	5.	(72,760)	68,010
Proceeds from sale of securities available-for-sale	6.	304	632
Increase in investments in subsidiaries		-	(1,206)
Additions to property, equipment and intangible assets		(170)	(132)
Disposal to property, equipment and intangible assets		<u>30</u>	<u>57</u>
Net cash (used in) / provided by investing activities		<u>(72,596)</u>	<u>67,361</u>
FINANCING ACTIVITIES			
Net increase in amounts due to OTP Bank and other banks	11.	56,218	255,727
Cash received from issuance of securities		192,100	-
Cash used for repurchase and redemption of issued securities		(157,677)	(316,098)
Increase in subordinated bonds and loans	14.	-	611
Decrease in subordinated bonds and loans	14.	(4,876)	(139)
Dividend paid	16.	<u>(20,623)</u>	<u>(30,960)</u>
Net cash provided by / (used in) financing activities		<u>65,142</u>	<u>(90,859)</u>
Net increase / (decrease) in cash and cash equivalents		<u>3,742</u>	<u>(24)</u>
Cash and cash equivalents at the beginning of the year		<u>18</u>	<u>42</u>
Cash and cash equivalents at the end of the year		<u>3,760</u>	<u>18</u>

OTP MORTGAGE BANK LTD.
NOTES TO SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED
31 DECEMBER 2017

NOTE 1: ORGANIZATION AND BASIS OF FINANCIAL STATEMENTS

1.1. General information

OTP Bank Plc. ("OTP Bank") established OTP Mortgage Bank Ltd. ("OTP Mortgage Bank" or the "Bank") as a fully owned subsidiary on 15 May 2001. The State Financial Supervisory Authority issued the operating license on 10 January 2002, and the Bank commenced operations on 1 February 2002.

OTP Bank is the ultimate parent of OTP Mortgage Bank, and also the ultimate parent of OTP Group.

These separate financial statements authorised for issue on 22 March 2018.

The Bank completed its publication in accordance with Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises, 575/2013/EU directive (CRR). OTP Mortgage Bank completed its publication with Separate Financial Statements prepared in accordance with IFRS as adopted by European Union jointly with OTP Bank Plc on the homepage of OTP Bank Plc (<http://www.otpbank.hu/>), on the homepage of the Bank (<http://www.otpjzb.hu>). Separate Financial Statements in accordance with IFRS as adopted by the EU is published on the homepage of the Bank, on the homepage Budapest Stock Exchange (<http://www.bet.hu>), furthermore on the website of the National Bank of Hungary (www.kozzetetelek.hu).

The Bank's registered office address is Nádor u. 21, Budapest 1051.

Internet homepage: https://www.otpbank.hu/OTP_JZB/online/index.jsp

Signatory of the separate financial statements is the Executive Officer, András Becsei.

The Mortgage Bank's Financial Statements were prepared by OTP Bank Plc. based on the Services Agreement between The Mortgage Bank and OTP Bank Plc. Responsible person for the control and management of accounting services: Zoltán Tuboly (Budapest), Managing Director of Accounting and Financial Department, Registration Number: 177289, IFRS qualified chartered accountant.

Due to Hungarian legislation audit services are statutory for OTP Mortgage Bank. Disclosure information about the auditor: Deloitte Auditing and Consulting Ltd. (000083), 1068 Budapest Dózsa György Street 84/C. Registered under 01-09-071057 by Budapest-Capital Regional Court, as registry court. Statutory registered auditor: dr. Attila Hruby, registration number: 007118.

Audit service fee agreed by the Articles of Association for the year ended 2017 is an amount of HUF 44 million + VAT.

The Bank is a specialized financial institution with its main business being governed by Act XXX of 1997 on Mortgage Lending Institutions and Mortgage Bonds.

The main activity of the Bank is financing of purchase, renovation and development of residential properties. The purchased portfolio contain mainly subsidised housing loans, in addition housing and free purpose mortgage loans denominated in foreign currency that were converted back to foreign exchange. Over the past few years, the granted subsidized HUF housing loans and the granted HUF housing and free purpose mortgage loan are the dominant part of the entire mortgage bank portfolio. The Bank provides presently HUF denominated subsidised and not subsidised housing and free purpose mortgage loans, and HUF denominated real estate development loans too. From 2017 the Bank expanded their services with independent liens purchase and sale by instalment, provides also by refinancing loans to commercial banks.

The Bank employs limited number of staff at its head office and use approximately 367 branches of OTP Bank engaged in the housing loan business. Under syndication agreement between OTP Bank and OTP Mortgage Bank, OTP Bank provides services for OTP Mortgage Bank concerning the administration of the mortgage loans, for which fees are paid by OTP Mortgage Bank. Credit scoring and lending are performed at the branches of OTP Bank in accordance with the regulations of OTP Mortgage Bank. Loans are approved by OTP Mortgage Bank and OTP Bank acts for and on behalf of OTP Mortgage Bank during the conclusion of a loan agreement. The mortgage right, along with the restraint of transfer and encumbrance on property pledged to secure loans is entered in the property register for the benefit of OTP Mortgage Bank. Pledge of the mortgage bonds is the actual loans registered as normal collateral – collateralised by property inspector – and additional collateral values – prescribed by law – registered in the Bank's collateral register.

As the sole shareholder, OTP Bank provides financial and administrative support to the Bank. Details of related party balances and transactions are summarised in Note 26 to these financial statements.

A significant proportion of mortgage loans are extended for periods for more than ten or fifteen years whereas mortgage bonds generally have a shorter maturity (1-10 years). The remaining average maturity of the loan portfolio of the Bank is 10.3 years. The Bank is lengthening the average maturity of its outstanding mortgage bonds to reduce the liquidity gaps.

As at 31 December 2016 and 2017 the number and the average number of the employees at the Bank were 29 and 34 respectively.

OTP MORTGAGE BANK LTD.
NOTES TO SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED
31 DECEMBER 2017

NOTE 1: ORGANIZATION AND BASIS OF FINANCIAL STATEMENTS [continued]

1.2. Base of Accounting

The Bank maintains its accounting records and prepares its statutory accounts in accordance with the commercial, banking and fiscal regulations prevailing in Hungary.

OTP Mortgage Bank's functional currency is the Hungarian Forint ("HUF").

The accounting policies followed by the Bank in the preparation of these financial statements conform with International Financial Reporting Standards ("IFRS") as adopted by the European Union. Some of the accounting principles prescribed for statutory purposes are different from those generally recognized in international financial markets.

The OTP Mortgage Bank applying the option, allowed by Article 55 paragraph 177 Accounting Act effective as at 1 January 2017, to prepare its Separate Financial Statements exclusively in accordance with the IFRS issued by International Accounting Standards Board ("IASB") and accepted by the European Union. For previous annual periods separate financial statements of the Bank are mandatorily prepared in accordance with Act on Accounting, besides mandatory compliance the Bank had prepared separate financial statements in accordance with IFRS as adopted by the EU.

IFRS as adopted by the EU do not currently differ from IFRS as issued by the IASB, except for portfolio hedge accounting under IAS 39 Financial Instruments: Recognition and Measurement ("IAS 39") which has not been approved by the EU. As the Bank does not apply portfolio hedge accounting under IAS 39, there would be no impact on these financial statements, had it been approved by the EU before the preparation of these financial statements.

1.2.1. The effect of adopting new and revised International Financial Reporting Standards effective from 1 January 2017

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:

- **Amendments to IAS 7 "Statement of Cash Flows"** - Disclosure Initiative – adopted by EU on 6 November 2017 (effective for annual periods beginning on or after 1 January 2017),
- **Amendments to IAS 12 "Income Taxes"** - Recognition of Deferred Tax Assets for Unrealised Losses – adopted by EU on 6 November 2017 (effective for annual periods beginning on or after 1 January 2017),
- **Amendments to IFRS 12 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 12 are to be applied for annual periods beginning on or after 1 January 2017).

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

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

- **Amendments to IFRS 2 "Share-based Payment"** - Classification and Measurement of Share-based Payment Transactions (effective for annual periods beginning on or after 1 January 2018),
- **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),
- **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 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 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).

OTP MORTGAGE BANK LTD.
NOTES TO SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED
31 DECEMBER 2017

NOTE 1: ORGANIZATION AND BASIS OF FINANCIAL STATEMENTS [continued]

1.2.2. New and revised Standards and Interpretations issued by IASB and adopted by the EU but not yet effective [continued]

The adoption of the above presented Amendments and new Standards and Interpretations would have no significant impact on the separate financial statements in the period of initial application except for IFRS 9 and IFRS 16.

Implementation of IFRS 16

The scoping and the assessment of IFRS 16 standard's financial effect has been started. The overwhelming majority of the expected financial effect can be related to the office building and branch office rentals. Based on the preliminary estimations of the financial effect, we expect significant material change in the separate financial position, while the effect in the Separate Statement of Profit or Loss is expected to be insignificant. The analysis and estimating quantitative effects are still in progress during the preparation of these Separate Financial Statements.

Under IFRS 16 a lessee recognises a right-of-use asset and a lease liability. The right-of-use asset is treated similarly to other non-financial assets and depreciated accordingly. The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease if that can be readily determined. If that rate cannot be readily determined, the lessee shall use their incremental borrowing rate. As with IFRS 16's predecessor, IAS 17, lessors classify leases as operating or finance in nature. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. Otherwise a lease is classified as an operating lease. For finance leases a lessor recognises finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the net investment. A lessor recognises operating lease payments as income on a straight-line basis or, if more representative of the pattern in which benefit from use of the underlying asset is diminished, another systematic basis.

Implementation of IFRS 9

The Bank analysed the estimated impact of the application of IFRS 9 in accordance with IAS 8, paragraph 30-31 and is presented in the Bank's separate financial statements the following way.

IFRS 9 "Financial Instruments" replaces IAS 39 "Financial Instruments: Recognition and Measurement" for annual reporting periods commencing on or after 1 January 2018. It contains changes to the requirements relating to the recognition and measurement, impairment, derecognition and hedge accounting.

The Bank started its preparation for IFRS 9 actively in 2016 led by the Bank's Risk Management and Finance Divisions, and during 2017 the most of the preparation was finalized. The preparations covered the key challenges that the Bank faces with the new standard.

The identification of gaps between its currently developed methodologies and the IFRS 9 requirements in classification and measurement, impairment and hedge accounting was completed in recent months, with various harmonizing processes required in respect of a measuring a significant increase in credit risk (SICR). Finalisation of most of these activities is planned for the first half of 2018, some of them may not be finalised by the end of 2018 for the insignificant portfolios.

Classification and measurement

IFRS 9 introduced a new approach for the classification of financial assets driven by cash flow characteristics and the business model in which an asset is held. The Bank recognizes the financial liabilities on amortized cost except in those cases when the standard requires otherwise, or according to the fair value option the entity chose to recognize the financial instrument on the fair value through profit or loss. Preliminary analyses of the business models and contractual cash flows on the Bank's significant portfolios were performed to determine by product segments those financial instruments that would be measured at amortised cost, at fair value through profit or loss or at fair value through Other Comprehensive Income.

Hedge accounting

IFRS 9 introduced a substantially revised model for hedge accounting, with enhanced disclosures about risk management activity. The new model aligns accounting treatment with risk management activities, having enabled entities to better reflect these activities in their financial statements. In addition, users of the financial statements are provided with better information about risk management and the effect of hedge accounting on the financial statements. OTP Bank has already started to implement the requirements of IFRS 9 for the hedge accounting.

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NOTE 1: ORGANIZATION AND BASIS OF FINANCIAL STATEMENTS [continued]

1.2. Base of Accounting [continued]

1.2.2. New and revised Standards and Interpretations issued by IASB and adopted by the EU but not yet effective [continued]

Impairment

IFRS 9 introduced an expected-loss impairment model instead of the previously applied incurred loss model that requires a more timely recognition of credit losses. The standard requires entities to account for expected credit losses from the moment when financial instruments are first identified.

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

The increased credit-impairment is identified by transactions on the basis of predetermined conditions and beyond this the estimation is made on portfolio level. Assets where no significant increase of credit risk (excluding purchased or originated credit-impaired financial assets) was identified remains to be provisioned based on a 12-month expected loss methodology.

For purchased or originated credit-impaired financial assets the same lifetime expected loss methodology was extended in order to be able to capture the cumulative changes in lifetime expected credit losses since the initial recognition as a credit-impaired instrument.

The Bank chose the using of the simplified impairment approach for trade receivables and contract assets.

The Bank started to further improve its risk management definitions, processes and methodological analysis in line with the expectations of IFRS 9. The Bank has started developing the methodology – using the behavioural scoring model - for the identification of significant increase of credit risk and the calculation of expected credit losses through the use IFRS 9 compliant risk parameters.

Based on the gap analyses and the changes in methodology the main principles regarding the IT solutions for IFRS 9 implementation were laid down. Preliminary specifications were prepared and IT implementation was completed mostly in 2017 although there are ongoing aspects such as rating/scoring models for significant portfolios where the developments have not yet been finished.

The estimation of quantitative impact of IFRS 9 is based on the best estimation of our management as of the date of the issue of these separate financial statements. However the management of the Bank consider uncertainties exist in respect of certain aspects of the methodology described above, together with interpretations of the standard, and evolving industry practice, and these uncertainties could result in these initial estimates varying to what is ultimately adjusted as of 1 January 2018, and the amount of the variance could be significant.

Effect of transition to IFRS 9 on CET1 capital is not significant in case of the separate financial statements.

<i>Amounts in HUF million before tax</i>	Opening balance according to IAS 39 as at 1 January 2018	Remeasurement due to reclassification	Remeasurement due to impairment and provisions	Opening balance according to IFRS 9 as at 1 January 2018
Placements with other banks	75,340	-	(92)	75,248
Loans	985,532	-	(6,824)	978,708
Securities	11,291	-	(14)	11,277
Off- balance sheet items	<u>(118)</u>	<u>-</u>	<u>(1,182)</u>	<u>(1,300)</u>
Total	<u><u>=</u></u>	<u><u>=</u></u>	<u><u>(8,112)</u></u>	<u><u>=</u></u>

OTP MORTGAGE BANK LTD.
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NOTE 1: ORGANIZATION AND BASIS OF FINANCIAL STATEMENTS [continued]

1.2. Base of Accounting [continued]

1.2.2. New and revised Standards and Interpretations issued by IASB and adopted by the EU but not yet effective [continued]

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

- **IFRS 14 “Regulatory Deferral Accounts”** (effective for annual periods beginning on or after 1 January 2016) - the European Commission has decided not to launch the endorsement process of this interim standard and to wait for the final standard,
- **IFRS 17 “Insurance Contracts”** (effective for annual periods beginning on or after 1 January 2021),
- **Amendments to IFRS 9 “Financial Instruments”** - Prepayment Features with Negative Compensation (effective for annual periods beginning on or after 1 January 2019),
- **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 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 IAS 40 “Investment Property”** - Transfers of Investment Property (effective for annual periods beginning on or after 1 January 2018),
- **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)
- **IFRIC 22 “Foreign Currency Transactions and Advance Consideration”** (effective for annual periods beginning on or after 1 January 2018),
- **IFRIC 23 “Uncertainty over Income Tax Treatments”** (effective for annual periods beginning on or after 1 January 2019).

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 Bank’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 financial statements, if applied as at the balance sheet date.

The adoption of the above presented Amendments and new Standards and Interpretations would have no significant impact on the separate financial statements in the period of initial application.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Significant accounting policies applied in the preparation of the accompanying financial statements are summarized below:

2.1. Basis of presentation

These separate financial statements have also been prepared under the historical cost convention with the exception of certain financial instruments, which are recorded at fair value. Revenues and expenses are recorded in the period in which they are earned or incurred.

The presentation of separate financial statements in conformity with IFRS as adopted by the European Union requires management of the Bank to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities (see Note 3) as at the date of the financial statements and their reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Future changes in economic conditions, business strategies, regulatory requirements, accounting rules and other factors could result in a change in estimates that could have a material impact on future financial statements.

OTP MORTGAGE BANK LTD.
NOTES TO SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED
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NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES [continued]

2.2. Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into HUF at exchange rates quoted by the National Bank of Hungary ("NBH") as at the date of the financial statements. Income and expenses arising in foreign currencies are converted at the middle rate of exchange quoted by OTP Bank Plc. on the transaction date. Resulting foreign exchange gains or losses are recorded to the Separate Statement of Profit or Loss.

2.3. Consolidated financial statements

These financial statements present the separate financial position and results of operations of the Bank. Consolidated financial statements are prepared by the Bank and consolidated net profit for the year and shareholders' equity differ significantly from that presented in these separate financial statements. See Note 2.4 for the description of the method of accounting for investments in subsidiaries and associated companies in these separate financial statements. The consolidated financial statements and the separate financial statements are published on the same date. As the ultimate parent, the Mortgage Bank is preparing consolidated financial statements of the Group of the Bank. The Ingatlanpont Ltd. is also part of a larger consolidation, which is made by OTP Bank, as a parent company managing the group.

2.4. Investments in subsidiaries

Investments in subsidiaries comprise those investments where the Bank, through direct and indirect ownership interest, controls the investee. Control is achieved when the Bank has power over the investee, is exposed or has rights, to variable returns from its involvement with the investee and has the ability to use its power to affect its returns.

Investments in subsidiaries are recorded at the cost of acquisition, less impairment for permanent diminution in value, when appropriate. After initial measurement investments in subsidiaries are measured at cost.

Impairment is determined based on the future economic benefits of the subsidiary and macroeconomic factors.

2.5. Securities and other financial assets

The Bank classifies its financial assets into the following categories: fair value through profit or loss (either held for trading or assets initially classified as fair value through profit or loss), held-to-maturity loan and receivables and available-for-sale. Securities that are acquired principally for the purpose of generating profit from short-term fluctuations in price are classified as securities held for trading. Investments in financial assets (other than those which meet the definition of loans and receivables) with fixed maturity that the management has the expressed intention and ability to hold to maturity are classified as held-to-maturity. Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale.

The Bank had no securities classified as held for trading or held-to-maturity as at 31 December 2017 and 2016.

2.5.1. Securities available-for-sale

Investments in securities are accounted for on a settlement date basis and are initially measured at fair value. Available-for-sale investments are measured at subsequent reporting dates at fair value. Unrealised gains and losses on available-for-sale financial instruments are recognized in other comprehensive income, unless such available-for-sale security is part of an effective fair value hedge. Such gains and losses will be reported when realised in profit and loss for the applicable period. The provision for impairment is calculated based on discounted cash-flow methodology for debt instruments and calculated based on fair value on equity instruments, using the expected future cash-flow and original effective interest rate if there is objective evidence of impairment based on significant or prolonged decrease on fair value.

Interest received from available for sale securities are recognised as interest income in the Separate Statement of Profit or Loss. Such securities consist of bonds issued by the NBH and the Hungarian Government as at 31 December 2017.

Available-for-sale securities are re-measured at fair value based on quoted prices or amounts derived from cash flow models. In circumstances where the quoted market prices are not readily available, the fair value of debt securities is estimated using the present value of future cash flows and any unquoted equity instruments are calculated using the EPS ratio.

Those available-for-sale financial assets that do not have a quoted market price and whose fair value cannot be reliably measured by other models mentioned above are measured at cost, less provision for impairment when appropriate. This exception is related only to equity instruments. Impairment on equity AFS securities is accounted only if there is a significant or prolonged decrease in the market value. Impairment losses recognised in profit or loss for equity AFS securities is not reversed through profit or loss.

OTP MORTGAGE BANK LTD.
NOTES TO SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED
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NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES [continued]

2.5. Securities and other financial assets [continued]

2.5.2. Derivative financial instruments

In the normal course of business, the Bank is a party to contracts for derivative financial instruments, which represent a very low initial investment compared to the notional value of the contract and their value depends on value of underlying asset and are settled in the future. The derivative financial instruments used include interest rate forward or swap agreements and currency forward or swap agreements and options. These financial instruments are used by the Bank to hedge interest rate risk and currency exposures associated with its transactions in the financial markets.

Derivative financial instruments are accounted for on a trade date basis and are initially measured at fair value and at subsequent reporting dates also at fair value. Fair values are obtained from quoted market prices, discounted cash flow models and option pricing models as appropriate. The Mortgage Bank adopts multi curve valuation approach for calculating the net present value of future cash flows – based on different curves used for determining forward rates and used for discounting purposes. It shows the best estimation of such derivative deals that are collateralised as OTP Bank has almost all of its open derivative transactions collateralised.

Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognized in profit or loss and included in the Separate Statement of Profit or Loss for the period. Each derivative deal is determined as asset when fair value is positive and as liability when fair value is negative.

The Bank has certain swap and forward transactions, which are qualified as hedging instrument based on the Bank's risk management policy. However these financial instruments are not qualified as hedging instrument based on IAS 39 *Financial Instruments Recognition and Measurement*, therefore the Bank qualified these derivative financial instruments as held for trading, and fair value adjustment is recognised directly in the Separate Statement of Profit or Loss.

The Bank maintains strict control limits on net open derivative positions, i.e. the difference between purchase and sale contracts, by both amount and term. At any time the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Bank (i.e. assets), which in relation to derivatives is only a small fraction of the contract or notional values used to express the volume of instruments outstanding. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market movements.

Foreign currency contracts

Foreign currency contracts are agreements to exchange specific amounts of currencies at a specified rate of exchange, at a spot date (settlement occurs two days after the trade date) or at a forward date (settlement occurs more than two days after the trade date). The notional amount of these contracts does not represent the actual market or credit risk associated with these contracts.

Foreign currency contracts can be used by the Bank for risk management purposes. The Bank's risk management foreign currency contracts were used to hedge against exchange rate fluctuations on loans and advances to credit institutions denominated in foreign currency.

Foreign exchange swaps and interest rate swaps

The Bank enters into foreign-exchange swap and interest rate swap transactions. The swap transaction is a complex agreement concerning the swap of certain financial instruments, which usually consist of a prompt and one or more futures contracts.

Interest rate swaps obligate two parties to exchange one or more payments calculated with reference to fixed or periodically reset rates of interest applied to a specific notional principal amount (the base of the interest calculation). Notional principal is the amount upon which interest rates are applied to determine the payment streams under interest rate swaps. Such notional principal amounts are often used to express the volume of these transactions but are not actually exchanged between the counterparties. The Bank's interest rate swaps were used for management of interest rate exposures and have been accounted for at mark-to-market fair value.

OTP MORTGAGE BANK LTD.
NOTES TO SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED
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NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES [continued]

2.5. Securities and other financial assets [continued]

2.5.2. Derivative financial instruments [continued]

Cross-currency interest rate swap (CCIRS)

The Bank enters into cross-currency interest rate swap (CCIRS) transactions which have special attributes, i.e. the parties exchange the notional amount at the beginning and also at the maturity of the transaction. Special types of these deals are the mark-to-market CCIRS agreements. At this kind of deals the parties – in accordance with the foreign exchange prices – revalue the notional amount during lifetime of the transaction.

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 Separate Statement of Profit or Loss along with the corresponding change in fair value of the hedged asset or liability that is attributable to the specific hedged risk. The ineffective portion of the hedge is charged directly to the Separate Statement of Profit or Loss.

The conditions of hedge accounting applied by the Bank are the following: formally designed as hedge, proper hedge documentation is prepared, effectiveness test is performed and based on it the hedge is qualified as effective.

Changes in fair value of derivatives that are designated and qualify as the effective portion of the cash flow hedges and that prove to be highly effective in relation to hedged risk are recognized as reserve in other comprehensive income. Amounts deferred in equity are transferred to the Separate Statement of Profit or Loss and classified as revenue or expense in the periods during which the hedged assets and liabilities affect the Separate Statement of Profit or Loss for the period. The ineffective element of the hedge is charged directly to the Separate Statement of Profit or Loss.

2.5.3. Derivative financial instruments designated as a fair-value or cash-flow hedge

The Bank terminates the hedge accounting if the hedging instrument expires or is sold, terminated or exercised, or the hedge no longer meets the criteria for hedge accounting or the Bank revokes the designation.

Certain derivative transactions, while providing effective economic hedges under the Bank's risk management policy, do not qualify for hedge accounting under the specific rules of IAS 39 (Recognition and Measurement) and are therefore treated as derivatives held for trading with fair value gains and losses charged directly to the Separate Statement of Profit or Loss.

2.6. Offsetting

Financial assets and liabilities may be offset and the net amount is reported in the statement of financial position when the Bank has a legally enforceable right to set off the recognised amounts and the transactions are intended to be reported in the statement of financial position on a net basis.

The Bank does not offset any financial assets and financial liabilities.

2.7. Embedded derivatives

Sometimes, a derivative may be a component of a combined financial instrument that includes a host contract and a derivative (the embedded derivative) effecting cash-flows or otherwise modifying the characteristics of the host instrument. An embedded derivative must be separated from the host instrument and accounted for as a separate derivative if, and only if:

- The economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract;
- A separate financial instrument with the same terms as the embedded derivative would meet the definition of a derivative as a stand-alone instrument; and
- The host instrument is not measured at fair or is measured at fair value but changes in fair value are recognised in other comprehensive income.

The Bank has not had embedded derivatives in 2017 and in 2016.

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NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES [continued]

2.8. Loans, placements with other banks and allowance for loan and placement losses

Loans and placements with other banks are accounted at amortised cost. Amortised cost contains the following items: the principal amounts outstanding including accrued interest, transaction costs, net of allowance for loan or placement losses. Transaction fees and charges should adjust the carrying amount at initial recognition and be included in effective interest calculation. Loans and placements with other banks are derecognised when the contractual rights to the cash-flows expire or they are transferred. Interest and amortised cost are accounted using effective interest rate method. When a borrower is unable to meet payments as they fall due or, in the opinion of the Management, there is an indication that a borrower may be unable to meet payments as they fall due, all unpaid interest becomes impaired.

According to IAS 39, initially financial assets shall be recognized at fair value which is usually equal to transaction value of loans and receivables. Initial fair value of loans and receivables lent at interest below market conditions is lower than their transaction price. As a consequence the Bank is deferring the difference between the fair value at initial recognition and the transaction price relating to loans and receivables because input data for measuring the fair values is not available on observable markets.

The amount of allowance is the difference between the carrying amount and the recoverable amount, being the present value of the expected cash-flows, including amounts recoverable from guarantees and collaterals, discounted at the original effective interest rate.

Allowance for losses on loans and placements with other banks represent management assessment for potential losses in relation to these activities.

The allowances for loan and placement losses are maintained to cover losses that have been specifically identified. Collective impairment losses of portfolios of loans, for which no objective evidence of impairment has been identified on an individual basis, are maintained to reduce the carrying amount of the portfolios of financial assets with similar credit risk characteristics to their estimated recoverable amounts at the balance sheet date. The expected cash-flows for portfolios of similar assets are estimated based on historical loss experience. Historical loss experience is the basis for calculating the expected loss, which is adjusted by the loss confirmation period, which represents the average time lag between occurrence of a loss event and confirmation of the loss. This concept enables recognition of those losses that have occurred in the portfolio at the balance sheet date.

If the reason for provisioning is no longer deemed appropriate, the redundant provisioning charge is released into income. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss shall be reversed by adjusting an allowance account. The reversal shall not result in a carrying amount of the financial asset that exceeds what the amortised cost would have been had the impairment not been recognised at the date the impairment is reversed.

Write-offs are generally recorded after all reasonable restructuring or collection activities have taken place and the possibility of further recovery is considered to be remote. The loan is written off against the related account "Provisions for impairment on loan and placement losses" in the Separate Statement of Profit or Loss. If the reason for provisioning is no longer deemed appropriate, the redundant provisioning charge is released into income.

2.9. Liabilities from issued securities

Issued mortgage bonds are measured at amortized cost. The costs related to their issuance is included in the amortized cost of the issued securities and amortized over the term of the securities using effective interest method. Collateral of mortgage bonds are secured by the actual amount of loan receivables – involved by collateral inspector - and as required additional collateral – determined by law – registered in the Bank's collateral register.

2.10. Property, equipment and intangible assets

Property, equipment and intangible assets are stated at cost, less accumulated depreciation and amortization and impairment, if any. The depreciable amount (book value less residual value) of the non-current assets must be allocated over their useful lives. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets based on the following annual percentages:

Intangible assets	
Software	33.3%
Property rights	33.3%
Property	6.0%
Office equipment and vehicles	14.5-33.3%

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NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES [continued]

2.10. Property, equipment and intangible assets [continued]

Depreciation and amortization on properties, equipment and intangible assets starts on the day when such assets are placed into service. At each balance sheet date, the Bank reviews the carrying value of its tangible and intangible assets to determine if there is any indication that those assets have suffered an impairment loss. If such indication exists, the recoverable amount of the asset is estimated to determine the extent (if any) of the impairment loss. Where it is not possible to estimate the recoverable amount of an individual asset, the Bank estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where the carrying value of property, equipment, other tangible fixed assets and intangible assets is greater than the estimated recoverable amount, it is written down immediately to the estimated recoverable amount.

2.11. Interest income and interest expense

Interest income and expenses are recognised in profit or loss in the period to which they relate, using the effective interest rate method. Interest from loans and deposits are accrued on a daily basis. Interest income and expenses include relevant transaction costs and the amortisation of any discount or premium between the initial carrying amount of an interest-bearing instrument and its amount at maturity calculated on an effective interest rate basis. The Bank recognises interest income when it assumes that the interest associated with the transaction will flow to the Bank and the amount of the revenue can be reasonably measured. All interest income and expense arising from loans, placements with other banks, securities available-for-sale and amounts due to OTP Bank and other banks, liabilities from issued securities, subordinated bonds and loans are presented under these lines of the financial statements. Any fees received or paid related to the origination of the loan are an integral part of the effective interest rate and revenue is recognized with the effective interest rate that exactly discounts the estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset.

2.12. Fees and Commissions

Fees and commissions are recognised using effective interest method referring to provisions of IAS 39, when they relate and have to be included in the amortised cost model. Certain fees and commissions that are not involved in the amortised cost model are recognised in the separate statement of comprehensive income on an accrual basis based on IAS 18 *Revenue*.

2.13. Income tax

The annual taxation charge is based on the tax payable under Hungarian fiscal law, adjusted for deferred taxation. Deferred taxation is accounted for using the balance sheet liability method in respect of temporary differences between the tax bases of assets and liabilities and their carrying value for financial reporting purposes, measured at the tax rates that are expected to apply when the asset is realised or the liability is settled, based on tax rates that have been enacted at the date of the balance sheet. Deferred tax assets are recognized by the Bank for the amounts of income taxes that are recoverable in future periods in respect of deductible temporary differences as well as the carry forward of unused tax losses and the carry forward of unused tax credits.

2.14. Government subsidies

The Bank receives subsidies from the Hungarian government designed to compensate for the difference between the amount of interest charged to the customer, such interest being capped by legislation, and the interest charge on the issued mortgage bonds. Such subsidies are calculated on a monthly basis, are applicable over the life of the loan and are recognized among interest income in the Separate Statement of Profit or Loss in the period to which they relate.

2.15. Statement of Cash Flows

For the purposes of reporting cash flows, cash and cash equivalents include cash, amounts due from banks and balances with the NBH. Cash flows from hedging activities are classified in the same category as the item being hedged.

2.16. Segment reporting

The Bank's main operation is mortgage lending to retail customers in Hungary, and the related value-appraisal services. Since the Bank has only one main product (mortgage loan), revenues from external customers are reported aggregately. The management believes that the Bank operates in a single business and geographical segment. The segment reporting is disclosed at a consolidated level in OTP Bank's consolidated financial statements. From 2011 the loan financing activity is widened with loan portfolio from OTP Bank Romania. The significant part of the total loan portfolio is from Hungary.

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NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES [continued]

2.17 Comparative figures

There were no changes in prior period data due to either prior period error or change in accounting policies. In some notes certain amounts in the Separate Financial Statements for the year ended 31 December 2016 have been restructured within the particular note to conform with the current year presentation and these amounts are not significant.

NOTE 3: SIGNIFICANT ACCOUNTING ESTIMATES AND DECISIONS IN THE APPLICATION OF ACCOUNTING POLICIES

The presentation of financial statements in conformity with IFRS as adopted by the European Union requires the management of the Bank to make judgements about estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as at the date of the financial statements and their reported amounts of revenues and expenses during the reporting period. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. The estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognized in the period. Actual results could differ from those estimates. Significant areas of subjective judgements include:

3.1. Impairment on loans and placements

The Bank regularly assesses its loan portfolio for impairment. Management determines the adequacy of the allowances 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. Provisioning involves many uncertainties about the outcome of those risks and requires the Management of the Bank to make many subjective judgements in estimating the loss amounts. An impairment loss is incurred when there is objective evidence of impairment due to one or more events that occurred after the initial recognition of the asset (a loss event¹), when the loss has a reliably measurable impact on the expected future cash flows from the financial asset or group of financial assets. Future cash flows are assessed by the Bank on the basis of estimates based on historical parameters. The adopted methodology used for estimating impairment allowances is in line with the further possibilities of accumulation of historic impairment data from the existing information systems and applications. As a consequence, acquiring new data by the Bank could affect the level of impairment allowances in the future.

3.2. Valuation of instruments without direct quotations

Financial instruments without direct quotations in an active market are valued using the valuation model technique. The models are regularly reviewed and each model is calibrated for the most recent available market data. While the models are built only on available data, their use is subject to certain assumptions and estimates (e.g. for correlations, volatilities, etc). Changes in the model assumptions may affect the reported fair value of the relevant financial instruments.

IFRS 13 *Fair Value Measurement* seeks to increase consistency and comparability in fair value measurements and related disclosures through a 'fair value hierarchy'. The hierarchy categorises the inputs used in valuation techniques into three levels. The hierarchy gives the highest priority to (unadjusted) quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions.

3.3. Provisions

Provision is recognized and measured based on IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The Bank is involved in a number of ongoing legal disputes. Based upon historical experience and expert reports, the Bank assesses the developments in these cases, and the likelihood and the amount of potential financial losses which are appropriately provided for. (See Note 13)

A provision is recognized by the Bank when it has a present obligation as a result of a past event, 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.

Provision for off-balance sheet items includes provision for litigation and for commitments to extend credit.

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NOTE 4: CASH, AMOUNTS DUE FROM BANKS AND BALANCES WITH THE NATIONAL BANK OF HUNGARY (in HUF million)

Amounts due from banks and balances with the NBH:

	2017	2016
Within one year		
in HUF	3,753	8
in foreign currency	<u>3</u>	<u>10</u>
Subtotal	<u>3,756</u>	<u>18</u>
Accrued interest	<u>4</u>	<u>-</u>
Total	<u>3,760</u>	<u>18</u>
From this: amounts due from OTP Bank	769	18
Compulsory reserve	10	10
Rate of the compulsory reserve	2%	2%

The main amount of cash due from banks shows the balance of the nostro accounts placed at OTP Bank of HUF 3,760 million and HUF 18 million as at 31 December 2017 and 2016, respectively. The remaining amounts represent the balances of the Bank's clearing account placed at the NBH.

The amount of compulsory reserve is the multiplication of liabilities considered in compulsory reserve calculation and compulsory reserve rate, which determined by the NBH in a specific decree. The Bank shall complete compulsory reserve requirements in average in the second month after the reserve calculation period, requirements with completed once a month on the last calendar day. The Bank complies with the compulsory reserve requirements by the deposit of the adequate amount of cash as the calculated compulsory reserve on the bank account at NBH in monthly average.

NOTE 5: PLACEMENTS WITH OTHER BANKS (in HUF million)

	2017	2016
Within one year		
in HUF	25,912	2,580
Over one year		
in HUF	<u>49,415</u>	<u>-</u>
Subtotal	<u>75,327</u>	<u>2,580</u>
Accrued interest	<u>13</u>	<u>-</u>
Total	<u>75,340</u>	<u>2,580</u>
From this: amounts due from OTP Bank	75,340	2,580
Interest conditions on placements with other banks	2017	2016
in HUF	0.00%-0.90%	0.03%
in foreign currency	-	0.34%-3.15%
Average interest of placements with other banks	2017	2016
in HUF	0.25%	1.07%

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NOTE 6: SECURITIES AVAILABLE-FOR-SALE (in HUF million)

	2017	2016
Hungarian government bonds	<u>10,947</u>	<u>11,390</u>
	<u>10,947</u>	<u>11,390</u>
Accrued interest	344	338
Total	<u>11,291</u>	<u>11,728</u>

The whole portfolio was denominated in HUF as at 31 December 2017.

Interest conditions and the remaining maturity of securities available-for-sale can be analysed as follows:

	2017	2016
Over one year, fixed interest	10,947	11,390
Interest conditions of securities available for sale	6.5%	6.5%

The valuation of the securities available-for-sale was as follows as at 31 December 2017:

	2017	
	Cost	Fair value
Hungarian government bonds	<u>10,644</u>	<u>10,947</u>
Total	<u>10,644</u>	<u>10,947</u>

The valuation of the securities available-for-sale was as follows as at 31 December 2016:

	2016	
	Cost	Fair value
Hungarian government bonds	<u>10,954</u>	<u>11,390</u>
Total	<u>10,954</u>	<u>11,390</u>

NOTE 7: LOANS, NET OF ALLOWANCES FOR LOAN LOSSES (in HUF million)

	2017	2016
Short-term loans (within one year)		
in HUF	81,988	52,702
in CHF	15	6
in EUR	124	4
in JPY	425	2
in foreign currency total	<u>564</u>	<u>12</u>
	<u>82,552</u>	<u>52,714</u>
Long-term loans (over one year)		
in HUF	908,237	917,542
in CHF	-	38
in EUR	-	296
in JPY	-	<u>553</u>
in foreign currency total	<u>-</u>	<u>887</u>
	<u>908,237</u>	<u>918,429</u>
Loans Gross Total	<u>990,789</u>	<u>971,143</u>
Provision for impairment	(8,888)	(14,235)
Accrued interest	<u>3,631</u>	<u>5,436</u>
Total	<u>985,532</u>	<u>962,344</u>

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NOTE 7: LOANS, NET OF ALLOWANCES FOR LOAN LOSSES (in HUF million) [continued]

A significant part of the loans above are mortgage loans for purchasing real estate or for any purpose. The loans have collateral notified in the public property register in favour of OTP Mortgage Bank. Such loans and their collateral are included in the Bank's register and mortgage bonds can be issued up to this registered amount. The remaining parts of the loans are real estate development loans given to individual farmers that work in the agro-industry. Real estate and arable land can be accepted as collateral of these loans.

Interest conditions on loans, net of allowance for loan losses:

	2017	2016
Loans denominated in HUF with the maturity over one year	0.86%-16.84%	0.54%-18.15%
Average interest rate of mortgage loans denominated in foreign currency for purchasing real estate		
CHF	6.74%	7.02%
EUR	7.54%	7.54%
JPY	4.69%	4.76%
Average interest rate of mortgage loans denominated in foreign currency for any purposes		
CHF	6.99%	6.99%
EUR	7.98%	7.16%
JPY	4.83%	4.87%
Average interest rate of real estate development loans		
HUF	6.63%	8.02%
EUR	6.17%	6.18%

OTP Mortgage Bank Ltd. only provides loans with the original maturity over one year.

An analysis of the loan portfolio by type, before allowances for loan losses, is as follows:

	2017	2016
Mortgage loans	986,210 99.54%	967,027 99.58%
SME loans	2,495 0.25%	2,383 0.25%
Loans to medium and large corporates	2,084 0.21%	1,733 0.18%
Total	<u>990,789</u> <u>100.00%</u>	<u>971,143</u> <u>100.00%</u>

An analysis of the change in the provision for impairment on loan losses is as follows:

	2017	2016
Balance as at 1 January	14,235	25,894
Provision for the year	195	21,402
Release of provision	(5,552)	(33,061)
Reclassification	10	-
Balance as at 31 December	<u>8,888</u>	<u>14,235</u>

The Bank sells non-performing non subsidised loans without recourse at estimated fair value to an OTP Group member, OTP Faktoring Ltd, in addition the Bank sells non-performing subsidised loans without resource at estimated fair value to OTP Bank Plc.

NOTE 8: INVESTMENTS IN SUBSIDIARIES (in HUF million)

	2017	2016
Investments in subsidiaries	<u>1,206</u>	<u>1,206</u>
Total	<u>1,206</u>	<u>1,206</u>

In December 2016 the Bank acquired 100% share in OTP Ingatlanpont Ltd., and then executed capital increase. The Bank's ownership was registered in January 2017 at the Registry Court.

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NOTE 9: **PROPERTY, EQUIPMENT AND INTANGIBLE ASSETS**
(in HUF million)

For the year ended 31 December 2017

<u>Cost</u>	Intangible assets	Office equipment and vehicles	Construction in progress	Total
Balance as at 1 January 2017	1,524	86	-	1,610
Additions	105	30	35	170
Disposals	-	(19)	(30)	(49)
Balance as at 31 December 2017	<u>1,629</u>	<u>97</u>	<u>5</u>	<u>1,732</u>

**Accumulated Depreciation and
Amortization**

Balance as at 1 January 2017	1,381	81	-	1,462
Charge for the year	92	9	-	101
Disposals	-	(19)	-	(19)
Balance as at 31 December 2017	<u>1,473</u>	<u>71</u>	<u>-</u>	<u>1,544</u>

Net book value

Balance as at 1 January 2017	<u>143</u>	<u>5</u>	<u>-</u>	<u>148</u>
Balance as at 31 December 2017	<u>156</u>	<u>26</u>	<u>5</u>	<u>187</u>

For the year ended 31 December 2016

<u>Cost</u>	Intangible assets	Office equipment and vehicles	Construction in progress	Total
Balance as at 1 January 2016	<u>1,450</u>	<u>85</u>	<u>-</u>	<u>1,535</u>
Additions	129	3	-	132
Disposals	(55)	(2)	-	(57)
Balance as at 31 December 2016	<u>1,524</u>	<u>86</u>	<u>-</u>	<u>1,610</u>

**Accumulated Depreciation and
Amortization**

Balance as at 1 January 2016	<u>1,284</u>	<u>71</u>	<u>-</u>	<u>1,355</u>
Charge for the year	97	10	-	107
Disposals	-	-	-	-
Balance as at 31 December 2016	<u>1,381</u>	<u>81</u>	<u>-</u>	<u>1,462</u>

Net book value

Balance as at 1 January 2016	<u>166</u>	<u>14</u>	<u>-</u>	<u>180</u>
Balance as at 31 December 2016	<u>143</u>	<u>5</u>	<u>-</u>	<u>148</u>

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NOTE 10: OTHER ASSETS (in HUF million)

	2017	2016
Current income tax receivable	1,932	2,789
Trade receivables, other advances	706	1,105
Prepayments	53	44
Receivables from the Hungarian Government	7	20
Derivative financial instruments designated as held-for-trading ¹	-	801
Other assets	<u>43</u>	<u>83</u>
	<u>2,741</u>	<u>4,842</u>
 Provision for other assets	 (6)	 (6)
 Total	 <u>2,735</u>	 <u>4,836</u>

Receivables from the Hungarian Government represent receivables from government subsidies on housing mortgage loans.

NOTE 11: AMOUNTS DUE TO BANKS AND HUNGARIAN GOVERNMENT, DEPOSITS FROM THE NATIONAL BANK OF HUNGARY AND OTHER BANKS (in HUF million)

	2017	2016
Within one year		
In HUF	571,012	513,877
In EUR	93	309
In JPY	425	530
In CHF	<u>16</u>	<u>40</u>
Total in foreign currency	<u>534</u>	<u>879</u>
	<u>571,546</u>	<u>514,756</u>
 Over one year		
in HUF	<u>11,759</u>	<u>11,760</u>
	<u>583,305</u>	<u>526,516</u>
 Accrued interest	 148	 719
 Total	 <u>583,453</u>	 <u>527,235</u>
 From this: amounts due to OTP Bank	 583,453	 527,235
 Interest conditions on amounts due to OTP Bank and other banks		
	2017	2016
In HUF	0.03%-2.04%	0.90%-4.39%
In foreign currency	(0.75%)-0.01%	(0.05%)-3.15%

¹ For more details (including types of derivatives) see Note 29.

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NOTE 12: LIABILITIES FROM ISSUED SECURITIES (in HUF million)

	2017	2016
Within one year:		
In EUR	—	<u>155,797</u>
	—	<u>155,797</u>
Over one year		
In HUF	<u>396,427</u>	<u>206,453</u>
	<u>396,427</u>	<u>206,453</u>
Subtotal	396,427	362,250
Accrued interest	<u>10,418</u>	<u>10,172</u>
Total	<u>406,845</u>	<u>372,422</u>

Issued mortgage bonds during the period (nominal value)	192,100	-
Mortgage bonds became due or repurchased during the period (nominal value)	155,500	156,011

Interest conditions on issued securities

	2017	2016
In HUF	0.63%-11.00%	9.00% - 11.00%
In foreign currency	-	0.34%

A reconciliation of the face value and the amortized cost is as follows:

	2017	2016
Nominal value of the issued securities	391,350	354,760
Unamortized premiums	5,077	7,200
Fair value hedge adjustment	—	<u>290</u>
Amortized cost	<u>396,427</u>	<u>362,250</u>

Face value and interest of mortgage bonds issued by OTP Mortgage Bank shall not exceed registered normal and additional collaterals (face value and interest). The Mortgage Bank keeps record of loans, normal and additional collateral values which are shown separately. Independent property inspector monitors the availability of mortgage bond's collateral values in accordance with regulations, the registration of loans, and its pledges as collaterals as the normal collateral of the mortgage bonds, those property register data and the normal and additional collateral in the coverage register.

There was a maturing mortgage bond in amount of 155,5 HUF billion; mortgage bonds were issued in amount of 192,1 HUF billion in 2017.

The Bank issued the following mortgage bonds to the Budapest Stock Exchange in 2017: with a nominal value of HUF 122,1 billion maturing in 4 years with fixed interest rate, with a nominal value of HUF 40 billion maturing in 3 years with variable interest rate and with a nominal value of HUF 30 billion maturing in 5 years with variable interest rate.

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NOTE 12: LIABILITIES FROM ISSUED SECURITIES (in HUF million) [continued]

Issued securities denominated in HUF as at 31 December 2017 (in HUF million)

Name	Date of issue	Maturity	Nominal value in HUF million	Interest condition in % p.a.	Hedged
1 OJB 2019 I	17/03/2004	18/03/2019	31,517	9.48% fixed	not hedged
2 OJB 2019 II	31/05/2011	18/03/2019	7,733	9.48% fixed	not hedged
3 OJB 2020 I	19/11/2004	12/11/2020	5,503	9.00% fixed	not hedged
4 OJB 2020 II	31/05/2011	12/11/2020	4,497	9.00% fixed	not hedged
5 OJB 2020 III	23/02/2017	20/05/2020	40,000	0.63% floating	not hedged
6 OJB 2021 I	15/02/2017	27/10/2021	122,100	2.00% fixed	not hedged
7 OJB 2022 I	24/02/2017	24/05/2022	30,000	0.78% floating	not hedged
8 OJB 2025 I	31/07/2009	31/07/2025	150,000	11.00% fixed	not hedged
Total issued securities in HUF			<u>391,350</u>		
Unamortized premium			5,077		
Fair value hedge adjustment			-		
Total issued securities in HUF			<u>396,427</u>		
Accrued interest			10,418		
Total in HUF			<u>406,845</u>		

NOTE 13: OTHER LIABILITIES (in HUF million)

	2017	2016
Accounts payables	9,323	664
Other tax payables	1,238	605
Accrued fees	720	975
Provision on off-balance sheet commitments and contingent liabilities	1,243	619
Salaries and social security payable	82	29
Other	931	1,002
Subtotal	<u>13,537</u>	<u>3,894</u>
Deferred tax liabilities	557	832
Total	<u>14,094</u>	<u>4,726</u>

NOTE 14: SUBORDINATED BONDS AND LOANS (in HUF million)

	2017	2016
With the maturity over one year denominated in CHF	-	4,876

On 30 January 2009, OTP Bank provided CHF 15 million subordinated loan to the Bank with the maturity of 8 years. The loan is due at 30 January 2017. The interest of the loan is 3 month CHF LIBOR + 3.88%.

The CHF denominated subordinated loan is being hedged in fair value relationship. See Note 29 for further details of hedge accounting.

The Bank repaid the subordinated loan at maturity date. Cross-currency foreign exchange swap as hedging instrument related to the subordinated loan was terminated at the same time.

NOTE 15: SHARE CAPITAL (in HUF million)

All 27,000 shares are ordinary shares with a nominal value of HUF 100 thousand and are authorised and fully paid.

	2017	2016
Share capital (in HUF million)	<u>27,000</u>	<u>27,000</u>

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NOTE 16: RETAINED EARNINGS AND RESERVES (in HUF million)

Equity correlation table shall contain the opening and closing balances of the shareholder's equity in accordance with IFRS, furthermore deducted from this the opening and closing balances of the specified equity elements. Equity correlation table shall contain also untied retained earnings available for the payment of dividends, covering retained earnings from the last financial year for which accounts have been adopted comprising net profit for the period of that financial year minus cumulative unrealized gains claimed in connection with any increase in the fair value of investment properties, as provided in IAS 40 - Investment Property, reduced by the cumulative income tax accounted for under IAS 12 - Income Taxes.

The equity correlation table of the Bank based on paragraph 114/B of Act on Accounting as at 31 December 2017:

31 December 2017 Closing	Share capital	Tied up reserve	Retained earnings and reserves	Evaluation reserve	Net income after income taxes	Share capital total
Capital items according to IFRS	27,000	-	48,659	-	-	75,659
Other comprehensive income	-	-	(276)	276	-	-
Net profit for the year	-	-	(22,802)	-	22,802	-
General reserve	-	<u>10,364</u>	<u>(10,364)</u>	-	-	-
Capital items according to 114/B.§ of Accounting Act	<u>27,000</u>	<u>10,364</u>	<u>15,217</u>	<u>276</u>	<u>22,802</u>	<u>75,659</u>

The equity correlation table of the Bank based on paragraph 114/B of Act on Accounting as at 1 January 2017:

1 January 2017 Opening	Share capital	Tied up reserve	Retained earnings and reserves	Evaluation reserve	Net income after income taxes	Share capital total
Capital items according to IFRS	27,000	-	46,601	-	-	73,601
Other comprehensive income	-	-	(397)	397	-	-
Net profit for the year	-	-	(22,125)	-	22,125	-
General reserve	-	<u>10,364</u>	<u>(10,364)</u>	-	-	-
Capital items according to 114/B.§ of Accounting Act	<u>27,000</u>	<u>10,364</u>	<u>13,715</u>	<u>397</u>	<u>22,125</u>	<u>73,601</u>

Dividends are recognised in the period in which they are approved by the owners. In 2017 the Bank paid HUF 20,623 million dividend from the profit for the year 2016. Regarding to the net profit for the year 2017 dividend is expected to be proposed by the management in amount of HUF 18,265 million.

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NOTE 17: INTEREST SUBSIDIES RELATED TO HOUSING LOANS

During 2017 5 types of interest subsidised loans were among OTP Mortgage Bank's portfolio:

- (i) loans granted before 16 June 2003
- (ii) loans granted between 16 June 2003 and 22 December 2003
- (iii) loans granted between 22 December 2003 and 30 June 2009
- (iv) loans granted after 1 October 2009
- (v) loans granted after 2012

Interest subsidised loans fulfil the following conditions

- granted for purchase, building of new property, or purchase, renovation, enlargement of existing property
- maximised interest rate
- interest subsidy fixed to the reference rate of the government bonds or to the reference rate of the issued mortgage bonds
- subsidy till the maturity of the loan, but maximum for 20 years, and loans granted after 2012 maximum for 5 years (except the subsidized mortgage loans of families with 3 children granted maximum 25 years).

Relevant elements of the currently available interest subsidised loans:

- the applicants can be dedicated people in the Government Regulation
- purpose of the loan:
 - o purchasing or building of new property
 - o purchasing or modernisation or enlargement of used property
- in case of building or purchasing of property the building costs or the purchase price without the building plot price shall not exceed the amount of HUF 30 million, in case of purchase of used properties the amount of HUF 20 million, in case of modernisation or enlargement shall not exceed the costs the amount of HUF 15 million
- loan amount shall not exceed in case of new properties the amount of HUF 15 million, and in case of used properties the amount of HUF 10 million.

The interest subsidy is determined in the per cent of government bonds' yields depending on the purpose of the loan, and it can be granted as a maximum for 5 years.

- Families with two or three children can apply maximum HUF 10 million loan for building or purchasing of property, next to the family housing allowance without building cost and purchase price limit, and interest payment subsidized by the State for the first 25 years of the term

Due to the strict conditions the loan demand remains moderate. Loans granted during of 2017 about HUF 7,714 million based on the conditions of 2009 and HUF 176,373 million based on conditions of 2012. Net closing amount of the loan with the conditions of 2009 was HUF 4,031 million and for the conditions of 2012 was HUF 150,778 million.

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NOTE 18: NET LOSS FROM FEES AND COMMISSIONS (in HUF million)

Income from fees and commissions

	2017	2016
Fees and commissions relating to lending	2,743	1,876
Other	<u>347</u>	<u>304</u>
Total	<u>3,090</u>	<u>2,180</u>

Expense from fees and commissions

	2017	2016
Fees and commissions relating to issued securities	184	95
Fees and commissions relating to lending	1,852	2,995
Valuator fees	1,107	-
Others	<u>485</u>	<u>-</u>
Total	<u>3,628</u>	<u>3,090</u>

Net loss from fees and commissions	<u>(538)</u>	<u>(910)</u>
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The other fees mainly consist of the cost of services in connection with lending activity and mortgage bond issues, which are not directly attributable to separate issuance.

NOTE 19: OTHER ADMINISTRATIVE EXPENSES (in HUF million)

	2017	2016
Taxes, other than income tax:		
Bank tax	1,048	4,007
Credit institution's contribution	-	1,806
Other taxes	<u>901</u>	<u>909</u>
Total taxes, other than income tax	1,949	6,722
Services	458	408
Professional fees	327	312
Rental fees	49	48
Material type expenses	22	21
Administration expenses	14	14
Advertising	<u>1</u>	<u>-</u>
Total	<u>2,820</u>	<u>7,525</u>

Taxes, other than income taxes are Credit institution's contribution that is payable by the Bank on HUF denominated loans having interest subsidy from the Hungarian government, bank tax and other local taxes in 2016.

The total amount of the bank tax is HUF 1,048 million recognised as an expense thus decreased the corporate tax base.

Taxes, other than income taxes contain bank tax and other local taxes in 2017, Credit institution's contribution that is payable by the Bank on HUF denominated loans having interest subsidy from the Hungarian government has expired since 1 January 2017.

NOTE 20: COMPENSATION OF KEY MANAGEMENT PERSONNEL (in HUF million)

	2017	2016
Key executives (Managing Director and Deputies)	63	44
Total	<u>63</u>	<u>44</u>

The remunerations of key management personnel include only short-term benefits.

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NOTE 21: INCOME TAX (in HUF million)

The Bank is presently liable for income tax at a rate of 9% of taxable income.

A reconciliation of the total income tax charge for the years ended 31 December 2017 and 2016 is as follows:

	2017	2016
Current tax expense	490	1
Deferred tax (benefit)/expense	<u>(263)</u>	<u>732</u>
Total income tax expense	<u>227</u>	<u>733</u>

A reconciliation of the deferred tax liability as at 31 December 2017 and 2016 is as follows:

	2017	2016
Balance as at 1 January	(832)	(10)
Recognized in other comprehensive income as tax benefit/(expense)	12	(90)
Deferred tax benefit/(expense)	<u>263</u>	<u>(732)</u>
Balance as at 31 December	<u>(557)</u>	<u>(832)</u>

A reconciliation of deferred tax assets and liabilities as at 31 December 2017 and 2016 is as follows:

	2017	2016
Premium amortization for available-for-sale financial assets	38	56
Below market fair value adjustment in accordance with regulations related to customer loans	379	568
IBNR provision	<u>93</u>	<u>139</u>
Deferred tax assets	<u>510</u>	<u>763</u>
Fair value adjustment for available-for-sale financial assets	(27)	(39)
Fair value adjustment of other derivative financial instrument	(4)	(6)
Effect of using effective interest rate method	(1,033)	(1,547)
Premium amortization for available for issued securities	(1)	(2)
One-off effect arising on transition to IFRS	-	-
Difference in depreciation and amortization	<u>(2)</u>	<u>(1)</u>
Deferred tax liabilities	<u>(1,067)</u>	<u>(1,595)</u>
Net deferred tax liabilities	<u>(557)</u>	<u>(832)</u>

A reconciliation of the effective tax rate as at 31 December 2017 and 2016 is as follows:

	2017	2016
Profit before income tax	23,029	22,858
Income tax at statutory tax rate (In 2017 9%, in 2016 19%)	2,073	4,343
<i><u>Income tax adjustments due to permanent differences are as follows:</u></i>		
Permanent differences due to local tax	97	(2,521)
Tax allowance for the year	(1,678)	(2,725)
Tax refund in accordance with Acts on customer Loans	(265)	755
Capital contribution	<u>-</u>	<u>881</u>
Income tax	<u>227</u>	<u>733</u>
<i>Effective tax-rate</i>	<i>0.98%</i>	<i>3.21%</i>

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NOTE 22: EARNINGS PER SHARE

Earnings per share attributable to ordinary shares are determined by dividing Net profit for the year by the weighted average number of ordinary shares outstanding during the period. The Bank has no preference shares and no options or other rights related to shares.

	2017	2016
Net profit for the year (in HUF million)	22,802	22,125
Weighted average number of ordinary shares outstanding during the year for calculating basic EPS (number of share)	<u>270,000</u>	<u>270,000</u>
EPS (in HUF) basic and diluted	<u>84.452</u>	<u>81.944</u>

NOTE 23: FINANCIAL RISK MANAGEMENT (in HUF million)

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial instruments may result in certain risks to the Bank. The most significant risks the Bank faces include¹:

23.1. Credit risk

The Bank takes on exposure to credit risk, which is the risk that the counter-party will be unable to pay amounts in full when due. The risk of the mortgage lending activity is controlled and the safety is enhanced by the legal environment, which provides that loans can only be extended against a specific collateral of real property and with certain legal assurances.

In the treasury activity the Bank structures the levels of credit risk it undertakes by placing limits to each counter-party. Actual exposures against limits are monitored daily.

Analysis by loan types

An analysis of the gross loan portfolio by loan types and DPD classes is as follows. The table consists of only on-balance sheet items.

As at 31 December 2017

Loan type	DPD 0-90	DPD 90-360	DPD 360+	Total carrying amount /allowance
Placements with other banks	75,340	-	-	75,340
Loans to medium and large corporates	2,078	17	-	2,095
Retail loans	980,919	7,910	989	989,818
SME loans ²	2,507	-	-	2,507
Gross loan portfolio total	<u>1,060,844</u>	<u>7,927</u>	<u>989</u>	<u>1,069,760</u>
Allowance Total	<u>(5,938)</u>	<u>(2,518)</u>	<u>(432)</u>	<u>(8,888)</u>
Net loan portfolio total	<u>1,054,906</u>	<u>5,409</u>	<u>557</u>	<u>1,060,872</u>
Total placements with other banks				75,340
Total loans				994,420
Total allowance				<u>(8,888)</u>
Total				<u>1,060,872</u>

¹ The management of liquidity risk related to financial instruments are shown in Note 28.

² Small and medium enterprises

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NOTES TO SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED
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NOTE 23: FINANCIAL RISK MANAGEMENT (in HUF million) [continued]

23.1. Credit risk [continued]

As at 31 December 2016

Loan type	DPD 0-90	DPD 90-360	DPD 360+	Total carrying amount /allowance
Placements with other banks	2,580	-	-	2,580
Loans to medium and large corporates	1,732	11	-	1,743
Retail loans	953,744	14,470	4,226	972,440
SME loans	2,391	5	-	2,396
Gross loan portfolio total	<u>960,447</u>	<u>14,486</u>	<u>4,226</u>	<u>979,159</u>
<i>Allowance Total</i>	<i><u>(7,757)</u></i>	<i><u>(4,753)</u></i>	<i><u>(1,725)</u></i>	<i><u>(14,235)</u></i>
Net loan portfolio total	<u>952,690</u>	<u>9,733</u>	<u>2,501</u>	<u>964,924</u>
Total placements with other banks				2,580
Total loans				976,579
<i>Total allowance</i>				<i><u>(14,235)</u></i>
Total				<u>964,924</u>

Classification into risk classes

Exposures with small amounts are subject to **collective valuation** method, which is a simplified assessment. The exposures subject to collective valuation method are classified into five valuation groups which have been formed based on past due days from which three classes were presented (A: 0-90 days past due - DPD, B: 91-360 DPD, C: over 360 days past due).

The Bank intends – where a great number of items and sufficient long-term historical data is available – to apply models on statistical basis. The impairment is calculated according to the possibility of listing the loan into default categories examined on the base of objective valuation criteria (delay of payment, change of exchange) and the expected recovery from the collecting. If the loss of the exposure can't be modelled reliably, the impairment is determined by expert keys.

Not impaired loan portfolio

As at 31 December 2017

Loan type	Not past due	DPD 0-90	DPD 90-360	DPD 360+	Total
Loans to medium and large corporates	1,625	432	8	-	2,065
Placements with other banks	78,299	-	-	-	78,299
Retail loans	847,442	120,453	-	-	967,895
SME loans	<u>1,754</u>	<u>740</u>	<u>-</u>	<u>-</u>	<u>2,494</u>
Total	<u>929,120</u>	<u>121,625</u>	<u>8</u>	<u>-</u>	<u>1,050,753</u>

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NOTE 23: FINANCIAL RISK MANAGEMENT (in HUF million) [continued]

23.1. Credit risk [continued]

As at 31 December 2016

Loan type	Not past due	DPD 0-90	DPD 90-360	DPD 360+	Total
Loans to medium and large corporates	1,495	211	-	-	1,706
Placements with other banks	2,580	-	-	-	2,580
Retail loans	825,734	109,857	-	-	935,591
SME loans	<u>1,627</u>	<u>751</u>	<u>-</u>	<u>-</u>	<u>2,378</u>
Total	<u>831,436</u>	<u>110,819</u>	<u>-</u>	<u>-</u>	<u>942,255</u>

Not impaired loan portfolio increased related to the prior period, mainly balance of placements. Not past due and past due composition changed insignificantly, the Bank had DPD 90+ not impaired loan as at 31 December 2017.

Collateral

The collateral value held by the Bank by types is as follows (**total collateral value**). The collateral coverloans as well as off-balance sheet exposures.

Types of collateral	2017	2016
Government guarantees	57,909	69,992
Mortgage	<u>2,575,385</u>	<u>2,229,161</u>
Total	<u>2,633,294</u>	<u>2,299,153</u>

The collateral value held by the Bank by types is as follows (**to the extent of the exposures**). The collateral coverloans as well as off-balance sheet exposures.

Types of collateral	2017	2016
Government guarantees	57,650	69,680
Mortgage	<u>945,774</u>	<u>861,757</u>
Total	<u>1,003,424</u>	<u>931,437</u>

Non-qualified gross loan portfolio by countries

	2017	2016
Hungary	990,690	971,023
Romania	<u>99</u>	<u>110</u>
Total	<u>990,789</u>	<u>971,143</u>

Restructured loans

	2017		2016	
	Gross portfolio	Allowance	Gross portfolio	Allowance
Retail loans	<u>7,057</u>	<u>467</u>	<u>10,842</u>	<u>2,084</u>
Total	<u>7,057</u>	<u>467</u>	<u>10,842</u>	<u>2,084</u>

Restructured portfolio: it contains every loan which is relevant restructured and less than 91 days delinquent.

A loan is considered relevant restructured, if

- it was restructured in the last 12 months, or
- it was restructured more than 12 months ago, but the connected preferential period is not expired or expired in the last 12 months.

Hungarian FX mortgage loans in the fixed exchange rate scheme are not included.

In case of loans that have been restructured more than once the last restructuring is considered.

OTP MORTGAGE BANK LTD.
NOTES TO SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED
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NOTE 23: FINANCIAL RISK MANAGEMENT (in HUF million) [continued]

23.1. Credit risk [continued]

Available-for-sale securities as at 31 December 2017

		Baa3		Not rated	Total
Hungarian government bonds	10,947	100.00%	-	0.00%	10,947
Total	10,947	100.00%	-	0.00%	10,947

Accrued interest 344

Total **11,291**

23.2. Market risk

Market risks arise from positions taken in securities and other instruments. The Bank takes no significant exposure to market risks. Market risks are generally monitored and controlled by the Asset and Liability Management function.

23.2.1. Interest rate sensitivity analysis¹

The sensitivity analysis below has been determined based on the exposure to interest rates for both derivatives and non-derivative instruments at the balance sheet date. The analysis is prepared assuming the amount of assets and liabilities outstanding at the balance sheet date were outstanding for the whole year. The analysis was prepared by assuming only the adverse interest rate changes. The main assumptions were as follows:

- Floating-rate assets and liabilities were repriced to the modelled benchmark yields at the repricing dates assuming the unchanged margin compared to the last repricing.
- Fixed-rate assets and liabilities were repriced at the contractual maturity date.
- As for liabilities with discretionary repricing feature by the Bank were assumed to be repriced with two-weeks delay, assuming no change in the margin compared to the last repricing date.
- The assets and liabilities with interest rate lower than 0.3% assumed to be unchanged during the whole period.
- The sensitivity of interest income to changes in BUBOR is analysed.

The simulation was prepared by assuming two scenarios:

1. gradually decreasing BUBOR to 0.0%, HUF basic interest rate remains unchanged (probable scenario)
2. BUBOR decreasing with 0.5% and at the same time the HUF basic interest rate reduces to 3 months BUBOR level in the next year (alternative scenario)

The net interest income in a one year period after January 1, 2018 would be decreased by HUF 5 million (probable scenario) and HUF 70 million (alternative scenario) as a result of these simulation.

The effects of the parallel shifts of the yield-curves to the net interest income on a one-year period can be summarized as follows (in HUF million):

Description		Effects to the net interest income in one year period	
		2017	2016
HUF	(0.1%) parallel shift	26	56
HUF	0.1% parallel shift	(26)	(56)
Total		(26)	(56)

¹ Quantitative data on interest rate risk are shown in Note 27

OTP MORTGAGE BANK LTD.
NOTES TO SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED
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NOTE 23: FINANCIAL RISK MANAGEMENT (in HUF million) [continued]

23.2. Market risk [continued]

23.2.2. Foreign exchange rate sensitivity analysis¹

The foreign exchange sensitivity analysis has been determined based on the net open position, taking into account both balance sheet exposure and off balance sheet exposure. The simulation was made on the assumption, that the price changes happens as a one off event, and neither does it take into consideration possible balance sheet dynamics, nor the potential increase or decrease of risk costs related to foreign exchange denominated assets.

The total net open position of OTP Mortgage Bank Ltd. was an amount of HUF 1 million short on 31 December 2016, which consisted of EUR exposure only. Since OTP Mortgage Bank has completed the conversion of foreign currency consumer mortgage loans into HUF, from its operation does not arise material FX exposures.

Potential losses from the foreign exchange denominated exposure are considerably low compared to surplus capital.

23.3. Capital management

The primary objective of the capital management of the Bank is to ensure the prudent operation, the entire compliance with the prescriptions of the regulator for a persistent business operation and maximising the shareholder value, accompanied by an optimal financing structure.

The capital management of the Bank includes the management and evaluation of the shareholder's equity available for hedging risks, other types of funds to be recorded in the equity and all material risks to be covered by the capital.

The basis of the capital management of the Bank in the short turn is the continuous monitoring of its capital position, in the long turn the strategic and the business planning, which includes the monitoring and forecast of the capital position of the Bank.

The Bank maintains the capital adequacy required by the regulatory bodies and the planned risk taking mainly by means of ensuring and developing its profitability. In case the planned risk level of the Bank exceeded its Core and Supplementary capital, the Bank ensures the prudent operation by occasional measures including the owner of the Bank.

Capital adequacy

The capital adequacy of the Bank is supervised based on the financial statements data prepared in accordance with the International Financial Reporting Standards (IFRS) issued by International Accounting Standards Board (IASB) and accepted by the European Union, rulings and indicators defined by the Basel Committee.

The Bank has entirely complied with the regulatory capital requirements for the year similar to prior years.

The capital adequacy calculations of the Bank for the year 2017 are prepared based on the data of the audited financial statements prepared in accordance with IFRS. The Bank uses the standard method for determining the regulatory capital requirements of the credit risk and market risk, and the alternative standard method in case of the operational risk. In 2017 the Mortgage Bank's solvency ratio is 13.5%. Regulatory capital is 57,242; the total required regulatory capital is 33,965.

In HUF million	2017 IFRS	2016 IFRS	2016
Core capital	57,242	52,835	44,430
Supplementary capital	-	71	71
Regulatory capital	57,242	52,906	44,501
Credit risk capital requirement	32,019	30,464	29,835
Market risk capital requirement	137	230	230
Operational risk capital requirement	1,809	2,382	2,382
Total required regulatory capital	33,965	33,076	32,447
Surplus capital	<u>23,277</u>	<u>19,830</u>	<u>12,054</u>
 Solvency ratio	 <u>13.5%</u>	 <u>12.80%</u>	 <u>10.97%</u>

¹ Quantitative data on foreign exchange rate risk are shown in Note 25

OTP MORTGAGE BANK LTD.
NOTES TO SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED
31 DECEMBER 2017

NOTE 23: FINANCIAL RISK MANAGEMENT (in HUF million) [continued]

23.3. Capital management [continued]

Capital adequacy [continued]

The positive components of the Core capital are the following:

Issued capital, Retained earnings of the previous year, Retained earnings, Cumulative Comprehensive Income, Other Reserves

The negative components of the Core capital are the following:

Prudential filter, Intangible assets

NOTE 24: OFF-BALANCE SHEET ITEMS AND DERIVATIVE FINANCIAL INSTRUMENTS
(in HUF million)

Off balance sheet items

	2017	2016
Current litigations	1,574	1,668
Loan facilities	<u>28,339</u>	<u>14,465</u>
Contingent and future liabilities total	<u>29,913</u>	<u>16,133</u>

NOTE 25: NET FOREIGN CURRENCY POSITION AND FOREIGN CURRENCY RISK
(in HUF million)

As at 31 December 2017

	CHF	EUR	JPY	Total
Assets	124	16	428	568
Liabilities	(106)	(16)	(425)	(547)
Off-balance sheet assets and liabilities, net	-	-	-	-
Net position	<u>18</u>	<u>-</u>	<u>3</u>	<u>21</u>

As at 31 December 2016

	CHF	EUR	JPY	Total
Assets	64	403	534	1,001
Liabilities	(4,404)	(155,926)	(530)	(160,860)
Off-balance sheet assets and liabilities, net	<u>4,341</u>	<u>155,510</u>	-	<u>159,851</u>
Net position	<u>1</u>	<u>(13)</u>	<u>4</u>	<u>(8)</u>

Whilst the Bank monitors its foreign exchange position for compliance with the regulatory requirements of the NBH and own limit system established in respect of limits on open positions. The measurement of the Bank's open foreign currency position involves monitoring the VaR limit on the foreign exchange exposure of the Bank.

OTP MORTGAGE BANK LTD.
NOTES TO SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED
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NOTE 26: RELATED PARTY TRANSACTIONS (in HUF million)

26.1. Outstanding balances/Transactions due from or due to OTP Bank Plc.

26.1.1. Outstanding balances in the Separate Statement of Financial Position related to OTP Bank Plc.

The Bank had the following assets and liabilities due from, or due to the OTP Bank Plc.:

Assets	2017	2016
Cash, amounts due from OTP Bank	769	18
Placements with OTP Bank	75,340	2,580
Accrued receivables	53	43
Fair value hedge derivatives – positive fair value	-	801
Liabilities	2017	2016
Amounts due to OTP Bank and other banks	(583,453)	(527,235)
Face value of issued mortgage bonds held by OTP Bank	(391,350)	(225,948)
Accrued interest expense due to OTP Bank	(10,418)	(9,516)
Other liabilities due to OTP Bank	(5449)	(950)

26.1.2. Transactions in the Separate Statement of Profit or Loss related to OTP Bank Plc.

	2017	2016
Interest income	10,653	2,679
Interest expense	(2,582)	(34,391)
Account handling fees paid to OTP Bank	10,741	12,629
Other fees and commissions relating to lending received from OTP Bank	483	312
Other fees and commissions relating to lending paid to OTP Bank	(175)	(97)
Revenue from the value appraisal activity from OTP Bank	474	309

26.1.3. Transactions of the OTP Mortgage Bank's loan portfolio related to OTP Bank Plc.

	2017	2016
Performing loans purchased from OTP Bank	399	562
Book value of performing loans purchased from OTP Bank	447	565

26.2. Outstanding balances related to key management personnel

The management, the members of the Board of Directors and the Supervisory Board and their close relatives have loans of HUF 892,1 million as at 31 December 2017. These loans were covered by HUF 1,612.1 million mortgages.

26.3. Outstanding balances/Transactions related to other related party¹

26.3.1. Transactions related to OTP Building Society Ltd.

	2017	2016
Face value of issued mortgage bonds held by OTP Building Society Ltd.	44,282	44,282
Accrued interest expense	(1,995)	(1,995)

26.3.2. Transactions of the OTP Mortgage Bank's loan portfolio related to OTP Faktoring Ltd.

	2017	2016
Book value of non-performing loans sold to OTP Faktoring Ltd.	7,271	13,756
Selling price of the non-performing loans related to OTP Faktoring Ltd.	6,302	12,850

¹The Bank has significant transactions with OTP Building Society Ltd., OTP Faktoring Ltd. and Merkantil Bank Ltd. in OTP Group, these transactions are highlighted.

OTP MORTGAGE BANK LTD.
NOTES TO SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED
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NOTE 26: RELATED PARTY TRANSACTIONS (in HUF million) [continued]

26.3.3. Transactions related to Merkantil Bank Ltd.

	2017	2016
Face value of issued mortgage bonds held by Merkantil Bank Ltd.	45,000	45,000
Accrued interest expense	(2,075)	(2,075)

26.3.4. Further Outstanding balances/Transactions related to other related party

	2017	2016
Other liabilities due to other related party	-	(65)
Other operating income from other related party	5	-
Revenue from the value appraisal activity from OTP Faktoring Ltd. and from other related party	964	168

Compensation of key management personnel is shown in Note 20.

In the normal course of the business the Bank enters into other transactions with the entities within the OTP Group, the amounts and volumes of which are not significant to these financial statements taken as a whole. Only significant transactions were highlighted.

NOTE 27: INTEREST RATE RISK MANAGEMENT

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The length of time for which the rate of interest is fixed on a financial instrument, therefore, indicates to what extent it is exposed to interest rate risk.

The majority of the Bank's interest bearing assets and liabilities are structured to match either short-term assets and short-term liabilities, or long-term assets and liabilities with repricing opportunities within one year, or long-term assets and corresponding liabilities where repricing is performed simultaneously.

In addition, the significant spread existing between the different types of interest bearing assets and liabilities enables the Bank to benefit from a high level of flexibility in adjusting for its interest rate matching and interest rate risk exposure.

The following table presents the interest repricing dates of the Bank. Variable yield assets and liabilities have been reported in accordance with their next repricing date. Fixed income assets and liabilities have been reported in accordance with their maturity.

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NOTE 27: INTEREST RATE RISK MANAGEMENT [continued]

31 December 2017	Within 1 month		within 3 months over 1 month		within 1 year over 3 months		within 2 years over 1 year		over 2 years		Non-interest - bearing		Total		Total
ASSETS	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	
Cash, amounts due from banks and balances with the National Bank of Hungary	785	-	2,972	-	-	-	-	-	-	-	3	-	3,760	-	3,760
<i>fixed interest</i>	785	-	2,972	-	-	-	-	-	-	-	-	-	3,757	-	3,757
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	3	-	3	-	3
Placements with other banks	75,327	-	-	-	-	-	-	-	-	-	13	-	75,340	-	75,340
<i>variable interest</i>	22,000	-	-	-	-	-	-	-	-	-	-	-	22,000	-	22,000
<i>fixed interest</i>	53,327	-	-	-	-	-	-	-	-	-	-	-	53,327	-	53,327
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	13	-	13	-	13
Securities available-for-sale	-	-	-	-	-	-	10,947	-	-	-	344	-	11,291	-	11,291
<i>fixed interest</i>	-	-	-	-	-	-	10,947	-	-	-	-	-	10,947	-	10,947
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	344	-	344	-	344
Loans, net of allowances for loan losses	178,699	289	341,762	275	115,384	-	62,605	-	282,887	-	3,629	2	984,966	566	985,532
<i>fix interest</i>	-	-	-	-	-	-	-	-	948	-	-	-	948	-	948
<i>variable interest</i>	178,699	289	341,762	275	115,384	-	62,605	-	281,939	-	-	-	980,389	564	980,953
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	3,629	2	3,629	2	3,631

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NOTE 27: **INTEREST RATE RISK MANAGEMENT (in HUF million) [continued]**

31 December 2017	Within 1 month		within 3 months over 1 month		within 1 year over 3 months		within 2 years over 1 year		over 2 years		Non-interest -bearing		Total		Total
LIABILITIES	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	
Amounts due to OTP Bank and other banks	170,012	-	401,000	534	-	-	11,759	-	-	-	148	-	582,919	534	583,453
<i>fixed interest</i>	-	-	-	534	-	-	11,759	-	-	-	-	-	11,759	534	12,293
<i>variable interest</i>	170,012	-	401,000	-	-	-	-	-	-	-	-	-	571,012	-	571,012
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	148	-	148	-	148
Liabilities from issued securities	69,922	-	-	-	-	-	39,336	-	287,168	-	10,419	-	406,845	-	406,845
<i>fixed interest</i>	-	-	-	-	-	-	39,336	-	287,168	-	-	-	326,504	-	326,504
<i>variable interest</i>	69,922	-	-	-	-	-	-	-	-	-	-	-	69,922	-	69,922
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	10,419	-	10,419	-	10,419
NET POSITION	14,877	289	(56,266)	(259)	115,384	-	22,457	-	(4,281)	-	(6,578)	2	85,593	32	85,625

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NOTES TO SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED
31 DECEMBER 2017

NOTE 27: INTEREST RATE RISK MANAGEMENT (in HUF million) [continued]

31 December 2016	Within 1 month		within 3 months over 1 month		within 1 year over 3 months		within 2 years over 1 year		over 2 years		Non-interest - bearing		Total		Total
ASSETS	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	
Cash, amounts due from banks and balances with the National Bank of Hungary	8	10	-	-	-	-	-	-	-	-	-	-	8	10	18
<i>fixed interest</i>	8	10	-	-	-	-	-	-	-	-	-	-	8	10	18
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Placements with other banks	2,580	-	-	-	-	-	-	-	-	-	-	-	2,580	-	2,580
<i>fixed interest</i>	2,580	-	-	-	-	-	-	-	-	-	-	-	2,580	-	2,580
<i>variable interest</i>	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Securities available-for-sale	-	-	-	-	-	-	-	-	11,390	-	338	-	11,728	-	11,728
<i>fixed interest</i>	-	-	-	-	-	-	-	-	11,390	-	-	-	11,390	-	11,390
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	338	-	338	-	338
Loans, net of allowances for loan losses	194,989	140	342,552	228	66,024	497	93,580	-	258,898	-	5,433	3	961,476	868	962,344
<i>variable interest</i>	194,989	140	342,552	228	66,024	497	93,580	-	258,898	-	-	-	956,043	865	956,908
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	5,433	3	5,433	3	5,436
Derivative financial instruments	-	160,477	-	-	-	-	-	-	-	-	-	-	-	160,477	160,477
<i>fixed interest</i>	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
<i>variable interest</i>	-	160,477	-	-	-	-	-	-	-	-	-	-	-	160,477	160,477

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NOTE 27: INTEREST RATE RISK MANAGEMENT (in HUF million) [continued]

31 December 2016	Within 1 month		within 3 months over 1 month		within 1 year over 3 months		within 2 years over 1 year		over 2 years		Non-interest-bearing		Total		Total
LIABILITIES	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	
Amounts due to OTP Bank and other banks	79,878	-	324,000	879	110,000	-	-	-	11,759	-	719	-	526,356	879	527,235
<i>fixed interest</i>	9,878	-	4,000	879	110,000	-	-	-	11,759	-	-	-	135,637	879	136,516
<i>variable interest</i>	70,000	-	320,000	-	-	-	-	-	-	-	-	-	390,000	-	390,000
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	719	-	719	-	719
Liabilities from issued securities	-	155,798	-	-	-	-	-	-	206,453	-	9,973	198	216,426	155,996	372,422
<i>fixed interest</i>	-	-	-	-	-	-	-	-	206,453	-	-	-	206,453	-	206,453
<i>variable interest</i>	-	155,798	-	-	-	-	-	-	-	-	-	-	-	155,798	155,798
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	9,973	198	9,973	198	10,171
Derivative financial instruments	159,676	-	-	-	-	-	-	-	-	-	-	-	159,676	-	159,676
<i>fixed interest</i>	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
<i>variable interest</i>	159,676	-	-	-	-	-	-	-	-	-	-	-	159,676	-	159,676
Subordinated bonds and loans	-	4,852	-	-	-	-	-	-	-	-	-	24	-	4,876	4,876
<i>fixed interest</i>	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
<i>variable interest</i>	-	4,852	-	-	-	-	-	-	-	-	-	-	-	4,852	4,852
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	-	24	-	24	24
NET POSITION	(41,977)	(23)	18,552	(651)	(43,976)	497	93,580	-	52,076	-	(4,921)	(219)	73,334	(396)	72,938

OTP MORTGAGE BANK LTD.
NOTES TO SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED
31 DECEMBER 2017

NOTE 28: MATURITY ANALYSIS OF ASSETS AND LIABILITIES AND LIQUIDITY RISK (in HUF million)

Liquidity risk is a measure of the extent to which the Bank may be required to raise funds to meet its commitments associated with financial instruments. The Bank maintains its liquidity profiles in accordance with regulations laid down by the NBH.

The following tables provide an analysis of liabilities into relevant maturity groupings based on the remaining period from the balance sheet date to the contractual maturity date. It is presented under the most prudent consideration of maturity dates where options or repayment schedules allow for early repayment possibilities.

The contractual amounts disclosed in the maturity analyses are the contractual undiscounted cash flows like gross finance lease obligations (before deducting finance charges); prices specified in forward agreements to purchase financial assets for cash; net amounts for pay-floating/receive-fixed interest rate swaps for which net cash flows are exchanged; contractual amounts to be exchanged in a derivative financial instrument for which gross cash flows are exchanged; gross loan commitments.

Such undiscounted cash flows differ from the amount included in the statement of financial position because the amount in that statement is based on discounted cash flows. When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the end of the reporting period. For example, when the amount payable varies with changes in an index, the amount disclosed may be based on the level of the index at the end of the period.

As at 31 December 2017	Within 3 months	Within one year and over 3 months	Within 5 years and over one year	Over 5 years	Without maturity	Total
Cash, due from banks and balances with the National Bank of Hungary	3,760	-	-	-	-	3,760
Placements with other banks, net of allowance for placement losses	22,966	2,959	49,415	-	-	75,340
Securities available for sale	344	-	10,000	-	-	10,344
Loans, net of allowance for possible loan losses	25,215	59,695	313,615	586,899	-	985,424
Property and equipment	-	-	-	-	31	31
Intangible assets	-	-	-	-	156	156
Other assets	<u>2,735</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,735</u>
TOTAL ASSETS	<u>55,020</u>	<u>62,654</u>	<u>373,030</u>	<u>586,899</u>	<u>187</u>	<u>1,077,790</u>
Amounts due to banks and Hungarian Government, deposits from the National Bank of Hungary and other banks	682	571,000	11,759	-	-	583,441
Liabilities from issued securities	10,419	-	241,350	150,000	-	401,769
Other liabilities	<u>14,094</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>14,094</u>
TOTAL LIABILITIES	<u>25,195</u>	<u>571,000</u>	<u>253,109</u>	<u>150,000</u>	<u>-</u>	<u>999,304</u>
Commitments to extend credit	<u>296</u>	<u>963</u>	<u>27,080</u>	<u>-</u>	<u>-</u>	<u>28,339</u>
Off-balance sheet commitments	<u>296</u>	<u>963</u>	<u>27,080</u>	<u>-</u>	<u>-</u>	<u>28,339</u>

OTP MORTGAGE BANK LTD.
NOTES TO SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED
31 DECEMBER 2017

NOTE 28: MATURITY ANALYSIS OF ASSETS AND LIABILITIES AND LIQUIDITY RISK (in HUF million) [continued]

As at 31 December 2016	Within 3 months	Within one year and over 3 months	Within 5 years and over one year	Over 5 years	Without maturity	Total
Cash, due from banks and balances with the National Bank of Hungary	18	-	-	-	-	18
Placements with other banks, net of allowance for placement losses	2,580	-	-	-	-	2,580
Securities available for sale	338	-	10,000	-	-	10,338
Loans, net of allowance for possible loan losses	5,882	3,555	57,073	885,992	-	952,502
Property and equipment	-	-	-	-	4	4
Intangible assets	-	-	-	-	143	143
Other assets	4,040	-	-	-	-	4,040
TOTAL ASSETS	<u>12,858</u>	<u>3,555</u>	<u>67,073</u>	<u>885,992</u>	<u>147</u>	<u>969,625</u>
Amounts due to banks and Hungarian Government, deposits from the National Bank of Hungary and other banks	14,596	500,879	11,759	-	-	527,234
Liabilities from issued securities	10,172	155,510	49,250	150,000	-	364,932
Other liabilities	3,894	-	-	-	-	3,894
Subordinated bonds and loans	4,876	-	-	-	-	4,876
TOTAL LIABILITIES	<u>33,538</u>	<u>656,389</u>	<u>61,009</u>	<u>150,000</u>	<u>-</u>	<u>900,936</u>
Receivables from derivative financial instruments designated as fair value hedge	137,259	23,059	-	-	-	160,318
Liabilities from derivative financial instruments designated as fair value hedge	(137,259)	(22,564)	-	-	-	(159,823)
Net position of financial instruments designated as fair value hedge	<u>-</u>	<u>495</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>495</u>
Net position of derivative financial instruments total	<u>-</u>	<u>495</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>495</u>
Commitments to extend credit	275	376	13,814	-	-	14,465
Off-balance sheet commitments	<u>275</u>	<u>376</u>	<u>13,814</u>	<u>-</u>	<u>-</u>	<u>14,465</u>

OTP MORTGAGE BANK LTD.
NOTES TO SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED
31 DECEMBER 2017

NOTE 29: FAIR VALUE OF FINANCIAL INSTRUMENTS (in HUF million)

In determining the fair value of a financial asset or liability the Bank in the case of instruments that are quoted on an active market uses the market price. In most cases market price is not publicly available so the Bank has to make assumptions or use valuation techniques to determine the fair value of a financial instrument. See for more information about fair value classes applied for financial assets and liabilities measured at fair value in these financial statements.

To provide a reliable estimate of the fair value of those financial instrument that are originally measured at amortised cost, the Bank used the discounted cash-flow analysis (loans, placements with other banks, amounts due to banks, deposits from customers). The fair value of issued securities and subordinated bonds is based on quoted prices (e.g. Reuters, Bloomberg). Cash and amounts due from banks and balances with the NBH represent amounts available immediately thus the fair value equals to the carrying amount.

The assumptions used when calculating the fair value of financial assets and liabilities when using valuation technique are the following:

- the discount rates are the risk free rates related to the denomination currency adjusted by the appropriate risk premium as of the end of the reporting period,
- the contractual cash-flows are considered for the performing loans and for the non-performing loans, the amortised cost less impairment is considered as fair value,
- the future cash-flows for floating interest rate instruments are estimated from the yield curves as of the end of the reporting period,
- the fair value of the deposit which can be due in demand cannot be lower than the amount payable on demand.

Fair value measurements – in relation to instruments measured not at fair value – are categorized in level 2 of the fair value hierarchy.

Fair value of financial assets and liabilities

	2017		2016	
	Carrying amount	Fair value	Carrying amount	Fair value
Cash, due from banks and balances with the National Bank of Hungary	3,760	3,760	18	18
Placements with other banks	75,340	75,340	2,580	2,580
Securities available-for-sale	11,291	11,291	11,728	11,728
Loans, net of allowance for loan losses ¹	985,532	1,203,623	962,344	1,273,098
Trade receivables, other advances	706	706	1,105	1,105
FINANCIAL ASSETS TOTAL	<u>1,076,629</u>	<u>1,294,720</u>	<u>977,775</u>	<u>1,288,529</u>
Amounts due to OTP Bank and other banks	583,453	583,766	527,235	529,289
Liabilities from issued securities	406,845	507,741	372,422	463,173
Subordinated bonds and loans	-	-	4,876	4,876
Accounts payables	9,323	9,323	664	664
FINANCIAL LIABILITIES TOTAL	<u>999,621</u>	<u>1,100,830</u>	<u>905,197</u>	<u>998,002</u>

¹ The difference between the carrying amount and the fair value derived from the interest subsidies related to housing loans.

OTP MORTGAGE BANK LTD.
NOTES TO SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED
31 DECEMBER 2017

NOTE 29: **FAIR VALUE OF FINANCIAL INSTRUMENTS (in HUF million) [continued]**

Fair value of derivative instruments

	Fair value		Notional value, net	
	2017	2016	2017	2016
CCIRS designated as fair value hedge				
Positive fair value of CCIRS classified as fair value hedge	-	801	-	395
Negative fair value of CCIRS classified as fair value hedge	-	-	-	-
Derivative financial assets total	<u>-</u>	<u>801</u>	<u>-</u>	<u>395</u>
Derivative financial liabilities total	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Derivative financial instruments total	<u>=</u>	<u>801</u>	<u>=</u>	<u>395</u>

Hedge accounting

The Bank regularly enters into hedging transactions in order to decrease its financial risks.¹

The summary of the hedging transactions of the Bank are as follows:

As at 31 December 2016

Type of hedge	Description of the hedging instrument	Fair value of the hedging instrument	Type of the risk being hedged
1) Cash flow hedges	-	-	-
2) Fair value hedges	CCIRS	HUF 801 million	Interest rate, foreign exchange
3) Net investment hedge in foreign operations	-	-	-

¹ In 2016 the Bank had no derivatives held for trading

OTP MORTGAGE BANK LTD.
NOTES TO SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED
31 DECEMBER 2017

NOTE 29: FAIR VALUE OF FINANCIAL INSTRUMENTS (in HUF million) [continued]

Fair value hedges - Issued securities

The cash-flows of the floating rate securities issued by the Bank are exposed to the change in the EUR/HUF foreign exchange rate and the risk of change in the risk-free interest rates of EUR, HUF. The interest rate risk and foreign exchange risk related to these securities are hedged with HUF-EUR CCIRS transactions, where the floating EUR cash-flows were swapped to payments linked to 3 CHF or BUBOR, resulting a decrease in the interest rate and foreign exchange exposure of issued securities.

The fair value of the hedging instruments is 290 HUF million at 31 December 2016, the hedging instruments were closed in 2017.

As at 31 December 2016

Types of hedged item	Types of hedging items	Fair value of the hedged item	Fair value of the hedging instrument	Gain/ loss attributable to the hedged risk	
				hedging instrument	hedged item
Liabilities from issued securities	CCIRS	-	-	(514)	514
Liabilities from issued securities	CCIRS	155,976	290	(1,871)	1,871

Fair value hedges – Subordinated loans

The cash-flows of the variable interest rate of subordinated loan granted to the Bank are exposed to the change in the CHF/HUF foreign exchange rate and the risk of change in the risk-free interest rates of CHF, HUF. The interest rate risk and foreign exchange risk related to these securities are hedged with HUF-CHF CCIRS transaction, where the payments linked to 3 month BUBOR are swapped to payments linked to 3 month CHF LIBOR, resulting a decrease in the interest rate and foreign exchange exposure of subordinated loan.

The fair value of the hedging instruments is 511 HUF million as at 31 December 2016 and in 2017 the Bank do not have hedging instruments.

As at 31 December 2016

Types of hedged item	Types of hedging items	Fair value of the hedged item	Fair value of the hedging instrument	Gain/ loss attributable to the hedged risk	
				hedging instrument	hedged item
Subordinated loan	CCIRS	4,342	511	471	(471)

OTP MORTGAGE BANK LTD.
NOTES TO SEPARATE FINANCIAL STATEMENTS FOR THE YEAR ENDED
31 DECEMBER 2017

NOTE 29: FAIR VALUE OF FINANCIAL INSTRUMENTS (in HUF million) [continued]

Fair value hierarchy

Methods and significant assumptions used to determine fair value of the different classes of financial instruments:

- 1st Level: quoted prices (unadjusted) in active markets for identical assets or liabilities;
- 2nd Level: inputs other than quoted prices included within Level 1, that are observable for the asset or liability either directly or indirectly;
- 3rd Level: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

As at 31 December 2017

	Total	Level 1	Level 2
Securities available for sale	10,947	10,947	-
Positive fair value of derivative financial instruments designated as fair value hedge	<u> </u>	<u> </u>	<u> </u>
Financial assets measured at fair value total	<u>10,947</u>	<u>10,947</u>	<u> </u>
Negative fair value of derivative financial instruments designated as fair value hedge	<u> </u>	<u> </u>	<u> </u>
Financial liabilities measured at fair value total	<u> </u>	<u> </u>	<u> </u>

As at 31 December 2016

	Total	Level 1	Level 2
Securities available for sale	11,390	11,390	-
Positive fair value of derivative financial instruments designated as fair value hedge	<u>801</u>	<u> </u>	<u>801</u>
Financial assets measured at fair value total	<u>12,191</u>	<u>11,390</u>	<u>801</u>
Negative fair value of derivative financial instruments designated as fair value hedge	<u> </u>	<u> </u>	<u> </u>
Financial liabilities measured at fair value total	<u> </u>	<u> </u>	<u> </u>

There were no financial assets and liabilities at fair value in Level 3 respectively in 2017 and 2016.

NOTE 30: SIGNIFICANT EVENTS DURING THE YEAR ENDED 31 DECEMBER 2017

Relevant transactions related to issued securities

See Note 12.

NOTE 31: POST BALANCE SHEET EVENTS

Transition to application of IFRS 9

See details in Note 1.2.2.

OTP MORTGAGE BANK LTD.

CONSOLIDATED FINANCIAL
STATEMENTS IN ACCORDANCE WITH
INTERNATIONAL FINANCIAL REPORTING
STANDARDS AS ADOPTED BY
THE EUROPEAN UNION TOGETHER WITH
INDEPENDENT AUDITOR’S REPORT

FOR THE YEAR ENDED
31 DECEMBER 2017

INDEPENDENT AUDITOR'S REPORT

To the Shareholder of OTP Jelzálogbank Zrt.

Opinion

We have audited the consolidated financial statements of OTP Jelzálogbank Zrt. and its subsidiary (the "Group") for the year 2017 which comprise the consolidated statement of financial position as at December 31, 2017, which shows total assets of HUF 1,079,514 million, the related consolidated statement of profit or loss and the consolidated statement of comprehensive income, which shows a net profit for the year of HUF 22,672 million, the consolidated statement of changes in equity, and the consolidated statement of cash-flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at December 31, 2017 and of its consolidated financial performance and its consolidated cash-flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union (the "EU IFRS"), and the consolidated financial statements were prepared in all material respects in accordance with the provisions of the effective Hungarian Act C of 2000 on Accounting (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	How our audit addressed the matter
Impairment of loans	
<p>(See notes 7. and 23.1. of the notes to the consolidated financial statements for the details)</p> <p>At the year end, the Group reported total gross loans of HUF 990,789 million and a provision for impairment on loan losses of HUF 8,888 million. The determination of impairment of loans requires application of professional judgement and use of subjective assumptions by management in case of the application of portfolio based collective impairment models. The most significant assumptions applied in calculating the provision are the following:</p> <ul style="list-style-type: none">- valuation of collateral;- estimated time to realize collateral;- probability of default and recovery rates; and- estimation of future cash-flows expected to be realized. <p>Based on the significance of the above described circumstances, the calculation of impairment of loans was considered as a key audit matter.</p>	<p>Our response as auditors included:</p> <ul style="list-style-type: none">- involvement of our actuarial and valuation experts to assist us in performing our procedures;- evaluating internal controls relating to monitoring of loans and calculating and recording of impairment;- assessing the relevant controls, whether the impairment triggers are captured and whether the estimation of the impairment is appropriate;- assessing the appropriateness of collective provisioning models; and- evaluating inputs, assumptions, management estimates and parameters applied, including comparison with historical data, and recalculating the impairment charge.

Other Information

Other information comprises the consolidated business report of the Group for 2017, which we obtained prior to the date of this auditor's report, and the annual report for 2017, which is expected to be made available to us after that date, but does not include the consolidated financial statements and our independent auditor's report thereon. Management is responsible for the other information and for the preparation of the consolidated business report in accordance with the relevant provisions of the Accounting Act and other regulations. Our opinion on the consolidated financial statements provided in the section of our independent auditor's report entitled "*Opinion*" does not apply to the other information.

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

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

In our opinion, the consolidated business report of the Group for 2017 corresponds to the consolidated financial statements of the Group for 2017 and the relevant provisions of the Accounting Act in all material respects. The information referred to in Section 95/B. (2) a)-d), g) and h) of the Accounting Act has been provided.

As the Group is not subject to additional requirements under any other regulation in connection with the consolidated business report, we have not formulated an opinion on this matter.

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

When we read the annual report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

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 OTP Jelzálogbank Zrt. by the Shareholder's resolution on March 21, 2017 and our uninterrupted engagement has lasted for 17 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 OTP Jelzálogbank Zrt., which we issued on March 13, 2018 in accordance with Article 11 of Regulation (EU) No. 537/2014 of the European Parliament and the Council.


Provision of Non-audit Services

We declare that no prohibited non-audit services referred to in Article 5 (1) of Regulation (EU) No. 537/2014 of the European Parliament and the Council were provided by us to the Group. In addition, there are no other non-audit services which were provided by us to the OTP Jelzálogbank Zrt. and its controlled undertaking which have not been disclosed in the consolidated business report.

The engagement partner on the audit resulting in this independent auditor's report is the statutory registered auditor signing this report.

Budapest, March 22, 2018


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


.....
dr. Hruby Attila
Statutory registered auditor
Registration number: 007118

**OTP MORTGAGE BANK LTD.
CONSOLIDATED FINANCIAL STATEMENTS**

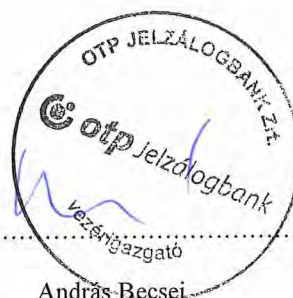
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OTP MORTGAGE BANK LTD.
CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2017
(in HUF million)

	Note	2017	2016
Cash, amounts due from banks and balances with the National Bank of Hungary	4.	4,086	460
Placements with other banks, net of allowance for placement losses	5.	75,340	2,580
Securities available-for-sale	6.	11,291	11,728
Loans, net of allowances for loan losses	7.	985,532	962,344
Investments in subsidiaries, associates and other investments	8.	45	45
Property and equipment	9.	87	35
Intangible assets	9.	158	212
Other assets	10.	<u>2,975</u>	<u>5,000</u>
TOTAL ASSETS		<u>1,079,514</u>	<u>982,404</u>
Amounts due to banks and Hungarian Government, deposits from the National Bank of Hungary and other banks	11.	583,453	527,235
Liabilities from issued securities	12.	406,845	372,422
Deferred tax liabilities		557	832
Other liabilities	13.	13,972	4,279
Subordinated bonds and loans	14.	<u>-</u>	<u>4,876</u>
TOTAL LIABILITIES		<u>1,004,827</u>	<u>909,644</u>
Share capital	15.	27,000	27,000
Retained earnings and reserves	16.	<u>47,687</u>	<u>45,760</u>
TOTAL SHAREHOLDER'S EQUITY		<u>74,687</u>	<u>72,760</u>
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY		<u>1,079,514</u>	<u>982,404</u>

Budapest, 22 March 2018



András Becsei
Chief Executive Officer

OTP MORTGAGE BANK LTD.
CONSOLIDATED STATEMENT OF PROFIT OR LOSS FOR THE YEAR ENDED
31 DECEMBER 2017 (in HUF million)

	Note	2017	2016
<i><u>Interest Income:</u></i>			
Loans		39,262	45,489
Placements with other banks, net of allowance for placement losses		599	4,545
Amounts due from banks and balances with the National Bank of Hungary		4	-
Interest subsidy on housing loans financed by mortgage bonds		16,548	19,940
Securities available-for-sale		<u>346</u>	<u>289</u>
Total Interest Income		<u>56,759</u>	<u>70,263</u>
<i><u>Interest Expense:</u></i>			
Amounts due to banks and Hungarian Government, deposits from the National Bank of Hungary and other banks		(2,571)	(10,717)
Liabilities from issued securities		(23,707)	(25,251)
Subordinated bonds and loans		<u>(11)</u>	<u>(137)</u>
Total Interest Expense		<u>(26,289)</u>	<u>(36,105)</u>
NET INTEREST INCOME		30,470	34,158
Provision for impairment on loan and placement losses	7.	(195)	992
NET INTEREST INCOME AFTER PROVISION FOR IMPAIRMENT ON LOAN AND PLACEMENT LOSSES		30,275	35,150
Income from fees and commissions	18.	3,090	2,180
Expenses from fees and commissions	18.	<u>(3,628)</u>	<u>(3,090)</u>
Net loss from fees and commissions		<u>(538)</u>	<u>(910)</u>
Foreign exchange losses/(gains), net		(72)	72
Losses on securities available-for-sale, net		-	(184)
Other operating income		730	28
Other operating expenses		<u>(3,262)</u>	<u>(3,192)</u>
Net operating expense		<u>(2,604)</u>	<u>(3,276)</u>
Personnel expenses		(879)	(474)
Depreciation and amortization		(121)	(107)
Other administrative expenses	19.	<u>(3,234)</u>	<u>(7,525)</u>
Other administrative expenses		<u>(4,234)</u>	<u>(8,106)</u>
PROFIT BEFORE INCOME TAX		22,899	22,858
Income tax expense	21.	<u>(227)</u>	<u>(733)</u>
NET PROFIT FOR THE PERIOD		<u>22,672</u>	<u>22,125</u>
Earnings per share (in HUF)			
Basic and diluted	22.	<u>83,970</u>	<u>81,944</u>

OTP MORTGAGE BANK LTD.
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31
DECEMBER 2017 (in HUF million)

	Note	2017	2016
NET PROFIT FOR THE PERIOD		<u>22,672</u>	<u>22,125</u>
Items that may be reclassified subsequently from other comprehensive income to profit or loss:			
Fair value adjustment of securities available-for-sale		(133)	703
Deferred tax related to securities available-for-sale		12	(134)
Effect of the tax rate-modification (19%→9%)		<u>-</u>	<u>44</u>
Other comprehensive income, net of income tax		<u>(121)</u>	<u>613</u>
NET COMPREHENSIVE INCOME		<u>22,551</u>	<u>22,738</u>

OTP MORTGAGE BANK LTD.
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31
DECEMBER 2017 (in HUF million)

	Note	Share Capital	Retained earnings and reserves	Total
Balance as at 1 January 2016		<u>27,000</u>	<u>54,823</u>	<u>81,823</u>
Net profit for the period		-	22,125	22,125
Other comprehensive income		-	613	613
Dividend for the year 2015		-	(30,960)	(30,960)
Consolidation difference on acquisition of OTP Ingatlanpont Ltd.		<u>-</u>	<u>(842)</u>	<u>(842)</u>
Balance as at 31 December 2016	<u>16</u>	<u>27,000</u>	<u>45,759</u>	<u>72,759</u>
Net profit for the year		-	22,672	22,672
Other comprehensive income		-	(121)	(121)
Dividend for the year 2016		<u>-</u>	<u>(20,623)</u>	<u>(20,623)</u>
Balance as at 31 December 2017	<u>16</u>	<u>27,000</u>	<u>47,687</u>	<u>74,687</u>

OTP MORTGAGE BANK LTD.
CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2017
(in HUF million)

	Note	2017	2016
OPERATING ACTIVITIES			
Profit before income tax		22,899	22,858
Depreciation and amortization	9.	121	107
Provision for impairment on loan and placement losses		195	992
(Release of provision) for impairment on other assets	10.	16	93
Unrealised gains on fair value adjustment of derivative financial instruments		-	294
(Increase)/Decrease in loans, net of allowances for loan losses	7.	(23,383)	16,557
Decrease in other assets before provisions for losses		2,009	22,710
Increase/(Decrease) in other liabilities	13.	9,693	39,915
Income tax paid		<u>(491)</u>	<u>(1)</u>
Net cash provided by operating activities		<u>11,059</u>	<u>23,695</u>
Interest received		54,976	70,499
Interest paid		(26,637)	(54,919)
INVESTING ACTIVITIES			
Net (increase)/decrease in placements with other banks		(72,760)	68,010
Purchase securities available-for-sale		-	-
Proceeds from sale of securities available-for-sale		304	632
Net increase in investments in subsidiaries		-	(45)
Additions to property, equipment and intangible assets		(170)	(132)
Disposal to property, equipment and intangible assets		<u>(51)</u>	<u>(42)</u>
Net cash (used in) / provided by in investing activities		<u>(72,575)</u>	<u>68,423</u>
FINANCING ACTIVITIES			
Net increase in amounts due to OTP Bank and other banks		56,218	255,727
Cash used for repurchase and redemption of issued securities		(157,677)	(316,098)
Cash received from issuance of securities		192,100	-
(Increase)/decrease in subordinated bonds and loans		(4,876)	472
Consolidation difference on acquisition of OTP Ingatlanpont Ltd.		-	(841)
Dividend paid		<u>(20,623)</u>	<u>(30,960)</u>
Net cash provided by / (used in) financing activities		<u>65,142</u>	<u>(90,700)</u>
Net increase in cash and cash equivalents		3,626	418
Cash and cash equivalents at the beginning of the year		<u>460</u>	<u>42</u>
Cash and cash equivalents at the end of the year		<u>4,086</u>	<u>460</u>

OTP MORTGAGE BANK LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED
31 DECEMBER 2017

NOTE 1: ORGANIZATION AND BASIS OF FINANCIAL STATEMENTS

1.1. General information

OTP Bank Plc. ("OTP Bank") established OTP Mortgage Bank Ltd. ("OTP Mortgage Bank" or the "Group") as a fully owned subsidiary on 15 May 2001. The State Financial Supervisory Authority issued the operating license on 10 January 2002, and the Bank commenced operations on 1 February 2002.

OTP Bank is the ultimate parent of OTP Mortgage Bank, and also the ultimate parent of OTP Group.

These consolidated financial statements authorised for issue on 22 March 2018.

The Group completed its publication in accordance with Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises, 575/2013/EU directive (CRR). OTP Mortgage Bank completed its publication with Consolidated Financial Statements prepared in accordance with IFRS as adopted by European Union jointly with OTP Bank Plc on the homepage of OTP Bank Plc (<http://www.otpbank.hu/>), on the homepage of the Bank (<http://www.otpjzb.hu>). Consolidated Financial Statements in accordance with IFRS as adopted by the EU is published on the homepage of the Bank, on the homepage Budapest Stock Exchange (<http://www.bet.hu>), furthermore on the website of the National Bank of Hungary (www.kozzetetelek.hu).

The Bank's registered office address is Nádor u. 21, Budapest 1051.

Internet homepage: https://www.otpbank.hu/OTP_JZB/online/index.jsp

Signatory of the consolidated financial statements is the Executive Officer, András Becsei.

The Mortgage Bank's Financial Statements were prepared by OTP Bank Plc. based on the Services Agreement between The Mortgage Bank and OTP Bank Plc. Responsible person for the control and management of accounting services: Zoltán Tuboly (Budapest), Managing Director of Accounting and Financial Department, Registration Number: 177289, IFRS qualified chartered accountant.

Due to Hungarian legislation audit services are statutory for OTP Mortgage Bank. Disclosure information about the auditor: Deloitte Auditing and Consulting Ltd. (000083), 1068 Budapest Dózsa György Street 84/C. Registered under 01-09-071057 by Budapest-Capital Regional Court, as registry court. Statutory registered auditor: dr. Attila Hruby, registration number: 007118.

Audit service fee agreed by the Articles of Association for the year ended 2017 is an amount of HUF 44 million + VAT.

The Group is a specialized financial institution with its main business being governed by Act XXX of 1997 on Mortgage Lending Institutions and Mortgage Bonds.

The main activity of the Group is financing of purchase, renovation and development of residential properties. The purchased portfolio contain mainly subsidised housing loans, in addition housing and free purpose mortgage loans denominated in foreign currency that were converted back to foreign exchange. Over the past few years, the granted subsidized HUF housing loans and the granted HUF housing and free purpose mortgage loan are the dominant part of the entire mortgage bank portfolio. The Group provides presently HUF denominated subsidised and not subsidised housing and free purpose mortgage loans, and HUF denominated real estate development loans too. From 2017 the Group expanded their services with independent liens purchase and sale by instalment, provides also by refinancing loans to commercial banks.

The Group employs limited number of staff at its head office and use approximately 367 branches of OTP Bank engaged in the housing loan business. Under syndication agreement between OTP Bank and OTP Mortgage Bank, OTP Bank provides services for OTP Mortgage Bank concerning the administration of the mortgage loans, for which fees are paid by OTP Mortgage Bank. Credit scoring and lending are performed at the branches of OTP Bank in accordance with the regulations of OTP Mortgage Bank. Loans are approved by OTP Mortgage Bank and OTP Bank acts for and on behalf of OTP Mortgage Bank during the conclusion of a loan agreement. The mortgage right, along with the restraint of transfer and encumbrance on property pledged to secure loans is entered in the property register for the benefit of OTP Mortgage Bank. Pledge of the mortgage bonds is the actual loans registered as normal collateral – collateralised by property inspector – and additional collateral values – prescribed by law – registered in the Group's collateral register.

As the sole shareholder, OTP Bank provides financial and administrative support to the Group. Details of related party balances and transactions are summarised in Note 26 to these financial statements.

A significant proportion of mortgage loans are extended for periods for more than ten or fifteen years whereas mortgage bonds generally have a shorter maturity (1-10 years). The remaining average maturity of the loan portfolio of the Group is 10.3 years. The Group is lengthening the average maturity of its outstanding mortgage bonds to reduce the liquidity gaps.

As at 31 December 2016 and 2017 the number and the average number of the employees at the Group were 34 and 29 respectively.

OTP MORTGAGE BANK LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED
31 DECEMBER 2017

NOTE 1: ORGANIZATION AND BASIS OF FINANCIAL STATEMENTS [continued]

1.2. Base of Accounting

The Group maintains its accounting records and prepares its statutory accounts in accordance with the commercial, banking and fiscal regulations prevailing in Hungary.

OTP Mortgage Bank's functional currency is the Hungarian Forint ("HUF").

The accounting policies followed by the Group in the preparation of these financial statements conform with International Financial Reporting Standards ("IFRS") as adopted by the European Union. Some of the accounting principles prescribed for statutory purposes are different from those generally recognized in international financial markets.

OTP Mortgage Bank applying the option, allowed by Article 55 §177. Hungarian Accounting Standards effective as at 01 January 2017, to prepare its Consolidated Financial Statements exclusively in accordance with the ("IFRS") issued by ("IASB") and accepted by the European Union.

As the Group does not apply portfolio hedge accounting under IAS 39, there would be no impact on these financial statements, had it been approved by the EU before the preparation of these financial statements.

1.2.1. The effect of adopting new and revised International Financial Reporting Standards effective from 1 January 2017

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:

- **Amendments to IAS 7 "Statement of Cash Flows"** - Disclosure Initiative – adopted by EU on 6 November 2017 (effective for annual periods beginning on or after 1 January 2017),
- **Amendments to IAS 12 "Income Taxes"** - Recognition of Deferred Tax Assets for Unrealised Losses – adopted by EU on 6 November 2017 (effective for annual periods beginning on or after 1 January 2017),
- **Amendments to IFRS 12 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 12 are to be applied for annual periods beginning on or after 1 January 2017).

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

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

- **Amendments to IFRS 2 "Share-based Payment"** - Classification and Measurement of Share-based Payment Transactions (effective for annual periods beginning on or after 1 January 2018),
- **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),
- **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 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 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).

OTP MORTGAGE BANK LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED
31 DECEMBER 2017

NOTE 1: ORGANIZATION AND BASIS OF FINANCIAL STATEMENTS [continued]

1.2.2. New and revised Standards and Interpretations issued by IASB and adopted by the EU but not yet effective [continued]

The adoption of the above presented Amendments and new Standards and Interpretations would have no significant impact on the consolidated financial statements in the period of initial application except for IFRS 9 and IFRS 16.

Implementation of IFRS 16

The scoping and the assessment of IFRS 16 standard's financial effect has been started. The overwhelming majority of the expected financial effect can be related to the office building and branch office rentals. Based on the preliminary estimations of the financial effect, we expect significant material change in the consolidated financial position, while the effect in the Consolidated Statement of Profit or Loss is expected to be insignificant. The analysis and estimating quantitative effects are still in progress during the preparation of these Consolidated Financial Statements.

Under IFRS 16 a lessee recognises a right-of-use asset and a lease liability. The right-of-use asset is treated similarly to other non-financial assets and depreciated accordingly. The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease if that can be readily determined. If that rate cannot be readily determined, the lessee shall use their incremental borrowing rate. As with IFRS 16's predecessor, IAS 17, lessors classify leases as operating or finance in nature. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. Otherwise a lease is classified as an operating lease. For finance leases a lessor recognises finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the net investment. A lessor recognises operating lease payments as income on a straight-line basis or, if more representative of the pattern in which benefit from use of the underlying asset is diminished, another systematic basis.

Implementation of IFRS 9

The Group analysed the estimated impact of the application of IFRS 9 in accordance with IAS 8, paragraph 30-31 and is presented in the Group's consolidated financial statements the following way.

IFRS 9 "Financial Instruments" replaces IAS 39 "Financial Instruments: Recognition and Measurement" for annual reporting periods commencing on or after 1 January 2018. It contains changes to the requirements relating to the recognition and measurement, impairment, derecognition and hedge accounting.

The Group started its preparation for IFRS 9 actively in 2016 led by the OTP Bank's Risk Management and Finance Divisions, and during 2017 the most of the preparation was finalized. The preparations covered the key challenges that the Group faces with the new standard.

The identification of gaps between its currently developed methodologies and the IFRS 9 requirements in classification and measurement, impairment and hedge accounting was completed in recent months, with various harmonizing processes required in respect of a measuring a significant increase in credit risk (SICR). Finalisation of most of these activities is planned for the first half of 2018, some of them may not be finalised by the end of 2018 for the insignificant portfolios.

OTP MORTGAGE BANK LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED
31 DECEMBER 2017

NOTE 1: ORGANIZATION AND BASIS OF FINANCIAL STATEMENTS [continued]

1.2. Base of Accounting [continued]

1.2.2. New and revised Standards and Interpretations issued by IASB and adopted by the EU but not yet effective [continued]

Classification and measurement

IFRS 9 introduced a new approach for the classification of financial assets driven by cash flow characteristics and the business model in which an asset is held. The Group recognizes the financial liabilities on amortized cost except in those cases when the standard requires otherwise, or according to the fair value option the entity chose to recognize the financial instrument on the fair value through profit or loss. Preliminary analyses of the business models and contractual cash flows on the Group's significant portfolios were performed to determine by product segments those financial instruments that would be measured at amortised cost, at fair value through profit or loss or at fair value through Other Comprehensive Income.

Hedge accounting

IFRS 9 introduced a substantially revised model for hedge accounting, with enhanced disclosures about risk management activity. The new model aligns accounting treatment with risk management activities, having enabled entities to better reflect these activities in their financial statements. In addition, users of the financial statements are provided with better information about risk management and the effect of hedge accounting on the financial statements. OTP Bank has already started to implement the requirements of IFRS 9 for the hedge accounting.

Impairment

IFRS 9 introduced an expected-loss impairment model instead of the previously applied incurred loss model that requires a more timely recognition of credit losses. The standard requires entities to account for expected credit losses from the moment when financial instruments are first identified.

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

The increased credit-impairment is identified by transactions on the basis of predetermined conditions and beyond this the estimation is made on portfolio level. Assets where no significant increase of credit risk (excluding purchased or originated credit-impaired financial assets) was identified remains to be provisioned based on a 12-month expected loss methodology.

For purchased or originated credit-impaired financial assets the same lifetime expected loss methodology was extended in order to be able to capture the cumulative changes in lifetime expected credit losses since the initial recognition as a credit-impaired instrument.

The Group chose the using of the simplified impairment approach for trade receivables and contract assets.

The Group started to further improve its risk management definitions, processes and methodological analysis in line with the expectations of IFRS 9. The Group has started developing the methodology – using the behavioural scoring model - for the identification of significant increase of credit risk and the calculation of expected credit losses through the use IFRS 9 compliant risk parameters.

Based on the gap analyses and the changes in methodology the main principles regarding the IT solutions for IFRS 9 implementation were laid down. Preliminary specifications were prepared and IT implementation was completed mostly in 2017 although there are ongoing aspects such as rating/scoring models for significant portfolios where the developments have not yet been finished.

The estimation of quantitative impact of IFRS 9 is based on the best estimation of our management as of the date of the issue of these consolidated financial statements. However the management of the Group consider uncertainties exist in respect of certain aspects of the methodology described above, together with interpretations of the standard, and evolving industry practice, and these uncertainties could result in these initial estimates varying to what is ultimately adjusted as of 1 January 2018, and the amount of the variance could be significant.

Effect of transition to IFRS 9 on CET1 capital is not significant in case of the consolidated financial statements.

OTP MORTGAGE BANK LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED
31 DECEMBER 2017

NOTE 1: ORGANIZATION AND BASIS OF FINANCIAL STATEMENTS [continued]

1.2. Base of Accounting [continued]

1.2.2. New and revised Standards and Interpretations issued by IASB and adopted by the EU but not yet effective [continued]

<i>Amounts in HUF million before tax</i>	Opening balance according to IAS 39 as at 1 January 2018	Remeasurement due to reclassification	Remeasurement due to impairment and provisions	Opening balance according to IFRS 9 as at 1 January 2018
Placements with other banks	75,340	-	(92)	75,248
Loans	985,532	-	(6,824)	978,708
Securities	11,291	-	(14)	11,277
Off- balance sheet items	<u>(118)</u>	<u>-</u>	<u>(1,182)</u>	<u>(1,300)</u>
Total	<u>-</u>	<u>-</u>	<u>(8,112)</u>	<u>-</u>

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

- **IFRS 14 “Regulatory Deferral Accounts”** (effective for annual periods beginning on or after 1 January 2016) - the European Commission has decided not to launch the endorsement process of this interim standard and to wait for the final standard,
- **IFRS 17 “Insurance Contracts”** (effective for annual periods beginning on or after 1 January 2021),
- **Amendments to IFRS 9 “Financial Instruments”** - Prepayment Features with Negative Compensation (effective for annual periods beginning on or after 1 January 2019),
- **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 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 IAS 40 “Investment Property”** - Transfers of Investment Property (effective for annual periods beginning on or after 1 January 2018),
- **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)
- **IFRIC 22 “Foreign Currency Transactions and Advance Consideration”** (effective for annual periods beginning on or after 1 January 2018),
- **IFRIC 23 “Uncertainty over Income Tax Treatments”** (effective for annual periods beginning on or after 1 January 2019).

OTP MORTGAGE BANK LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED
31 DECEMBER 2017

NOTE 1: ORGANIZATION AND BASIS OF FINANCIAL STATEMENTS [continued]

1.2.3. New and revised Standards and Interpretations issued by IASB and adopted by the EU but not yet effective [continued]

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 financial statements, if applied as at the balance sheet date.

The adoption of the above presented Amendments and new Standards and Interpretations would have no significant impact on the consolidated financial statements in the period of initial application.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Significant accounting policies applied in the preparation of the accompanying financial statements are summarized below:

2.1. Basis of presentation

These consolidated financial statements have also been prepared under the historical cost convention with the exception of certain financial instruments, which are recorded at fair value. Revenues and expenses are recorded in the period in which they are earned or incurred.

The presentation of consolidated financial statements in conformity with IFRS as adopted by the European Union requires management of the OTP Bank to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities (see Note 3) as at the date of the financial statements and their reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Future changes in economic conditions, business strategies, regulatory requirements, accounting rules and other factors could result in a change in estimates that could have a material impact on future financial statements.

2.2. Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into HUF at exchange rates quoted by the National Bank of Hungary ("NBH") as at the date of the financial statements. Income and expenses arising in foreign currencies are converted at the middle rate of exchange quoted by OTP Bank Plc. on the transaction date. Resulting foreign exchange gains or losses are recorded to the Consolidated Statement of Profit or Loss.

2.3. Consolidated financial statements

See Note 2.4 for the description of the method of accounting for investments in subsidiaries and associated companies in these consolidated financial statements. The consolidated financial statements and the separate financial statements are published on the same date. As the ultimate parent, the Mortgage Bank is preparing consolidated financial statements of the Group of the Bank. The Ingatlanpont Ltd is also part of a larger consolidation, which is made by OTP Bank, as a parent company managing the group.

2.4. Investments in subsidiaries

Investments in subsidiaries comprise those investments where the Group, through direct and indirect ownership interest, controls the investee. Control is achieved when the Group has power over the investee, is exposed or has rights, to variable returns from its involvement with the investee and has the ability to use its power to affect its returns.

Investments in subsidiaries are recorded at the cost of acquisition, less impairment for permanent diminution in value, when appropriate. After initial measurement investments in subsidiaries are measured at cost.

Impairment is determined based on the future economic benefits of the subsidiary and macroeconomic factors.

OTP MORTGAGE BANK LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED
31 DECEMBER 2017

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES [continued]

2.5. Securities and other financial assets

The Group classifies its financial assets into the following categories: fair value through profit or loss (either held for trading or assets initially classified as fair value through profit or loss), held-to-maturity loan and receivables and available-for-sale. Securities that are acquired principally for the purpose of generating profit from short-term fluctuations in price are classified as securities held for trading. Investments in financial assets (other than those which meet the definition of loans and receivables) with fixed maturity that the management has the expressed intention and ability to hold to maturity are classified as held-to-maturity. Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale.

The Group had no securities classified as held for trading or held-to-maturity as at 31 December 2017 and 2016.

2.5.1. Securities available-for-sale

Investments in securities are accounted for on a settlement date basis and are initially measured at fair value. Available-for-sale investments are measured at subsequent reporting dates at fair value. Unrealised gains and losses on available-for-sale financial instruments are recognized in other comprehensive income, unless such available-for-sale security is part of an effective fair value hedge. Such gains and losses will be reported when realised in profit and loss for the applicable period. The provision for impairment is calculated based on discounted cash-flow methodology for debt instruments and calculated based on fair value on equity instruments, using the expected future cash-flow and original effective interest rate if there is objective evidence of impairment based on significant or prolonged decrease on fair value.

Interest received from available for sale securities are recognised as interest income in the Consolidated Statement of Profit or Loss. Such securities consist of bonds issued by the NBH and the Hungarian Government as at 31 December 2017.

Available-for-sale securities are re-measured at fair value based on quoted prices or amounts derived from cash flow models. In circumstances where the quoted market prices are not readily available, the fair value of debt securities is estimated using the present value of future cash flows and any unquoted equity instruments are calculated using the EPS ratio.

Those available-for-sale financial assets that do not have a quoted market price and whose fair value cannot be reliably measured by other models mentioned above are measured at cost, less provision for impairment when appropriate. This exception is related only to equity instruments. Impairment on equity AFS securities is accounted only if there is a significant or prolonged decrease in the market value. Impairment losses recognised in profit or loss for equity AFS securities is not reversed through profit or loss.

2.5.2. Derivative financial instruments

In the normal course of business, the Group is a party to contracts for derivative financial instruments, which represent a very low initial investment compared to the notional value of the contract and their value depends on value of underlying asset and are settled in the future. The derivative financial instruments used include interest rate forward or swap agreements and currency forward or swap agreements and options. These financial instruments are used by the Group to hedge interest rate risk and currency exposures associated with its transactions in the financial markets.

Derivative financial instruments are accounted for on a trade date basis and are initially measured at fair value and at subsequent reporting dates also at fair value. Fair values are obtained from quoted market prices, discounted cash flow models and option pricing models as appropriate. The Mortgage Bank adopts multi curve valuation approach for calculating the net present value of future cash flows – based on different curves used for determining forward rates and used for discounting purposes. It shows the best estimation of such derivative deals that are collateralised as OTP Bank has almost all of its open derivative transactions collateralised.

Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognized in profit or loss and included in the Consolidated Statement of Profit or Loss for the period. Each derivative deal is determined as asset when fair value is positive and as liability when fair value is negative.

The Group has certain swap and forward transactions, which are qualified as hedging instrument based on the Group's risk management policy. However these financial instruments are not qualified as hedging instrument based on IAS 39 *Financial Instruments Recognition and Measurement*, therefore the Group qualified these derivative financial instruments as held for trading, and fair value adjustment is recognised directly in the Consolidated Statement of Profit or Loss.

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NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES [continued]

2.5. Securities and other financial assets [continued]

2.5.2. Derivative financial instruments [continued]

The Group maintains strict control limits on net open derivative positions, i.e. the difference between purchase and sale contracts, by both amount and term. At any time the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Group (i.e. assets), which in relation to derivatives is only a small fraction of the contract or notional values used to express the volume of instruments outstanding. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market movements.

Foreign currency contracts

Foreign currency contracts are agreements to exchange specific amounts of currencies at a specified rate of exchange, at a spot date (settlement occurs two days after the trade date) or at a forward date (settlement occurs more than two days after the trade date). The notional amount of these contracts does not represent the actual market or credit risk associated with these contracts.

Foreign currency contracts can be used by the Group for risk management purposes. The Group's risk management foreign currency contracts were used to hedge against exchange rate fluctuations on loans and advances to credit institutions denominated in foreign currency.

Foreign exchange swaps and interest rate swaps

The Group enters into foreign-exchange swap and interest rate swap transactions. The swap transaction is a complex agreement concerning the swap of certain financial instruments, which usually consist of a prompt and one or more futures contracts.

Interest rate swaps obligate two parties to exchange one or more payments calculated with reference to fixed or periodically reset rates of interest applied to a specific notional principal amount (the base of the interest calculation). Notional principal is the amount upon which interest rates are applied to determine the payment streams under interest rate swaps. Such notional principal amounts are often used to express the volume of these transactions but are not actually exchanged between the counterparties. The Group's interest rate swaps were used for management of interest rate exposures and have been accounted for at mark-to-market fair value.

Cross-currency interest rate swap (CCIRS)

The Group enters into cross-currency interest rate swap (CCIRS) transactions which have special attributes, i.e. the parties exchange the notional amount at the beginning and also at the maturity of the transaction. Special types of these deals are the mark-to-market CCIRS agreements. At this kind of deals the parties – in accordance with the foreign exchange prices – revalue the notional amount during lifetime of the transaction.

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 Statement of Profit or Loss along with the corresponding change in fair value of the hedged asset or liability that is attributable to the specific hedged risk. The ineffective portion of the hedge is charged directly to the Consolidated Statement of Profit or Loss.

The conditions of hedge accounting applied by the Group are the following: formally designed as hedge, proper hedge documentation is prepared, effectiveness test is performed and based on it the hedge is qualified as effective.

Changes in fair value of derivatives that are designated and qualify as the effective portion of the cash flow hedges and that prove to be highly effective in relation to hedged risk are recognized as reserve in other comprehensive income. Amounts deferred in equity are transferred to the Consolidated Statement of Profit or Loss and classified as revenue or expense in the periods during which the hedged assets and liabilities affect the Consolidated Statement of Profit or Loss for the period. The ineffective element of the hedge is charged directly to the Consolidated Statement of Profit or Loss.

2.5.3. Derivative financial instruments designated as a fair-value or cash-flow hedge

The Group terminates the hedge accounting if the hedging instrument expires or is sold, terminated or exercised, or the hedge no longer meets the criteria for hedge accounting or the Group revokes the designation.

Certain derivative transactions, while providing effective economic hedges under the Group's risk management policy, do not qualify for hedge accounting under the specific rules of IAS 39 (Recognition and Measurement) and are therefore treated as derivatives held for trading with fair value gains and losses charged directly to the Consolidated Statement of Profit or Loss.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED
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NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES [continued]

2.6. Offsetting

Financial assets and liabilities may be offset and the net amount is reported in the statement of financial position when the Group has a legally enforceable right to set off the recognised amounts and the transactions are intended to be reported in the statement of financial position on a net basis.

The Group does not offset any financial assets and financial liabilities.

2.7. Embedded derivatives

Sometimes, a derivative may be a component of a combined financial instrument that includes a host contract and a derivative (the embedded derivative) effecting cash-flows or otherwise modifying the characteristics of the host instrument. An embedded derivative must be separated from the host instrument and accounted for as a separate derivative if, and only if:

- The economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract;
- A separate financial instrument with the same terms as the embedded derivative would meet the definition of a derivative as a stand-alone instrument; and
- The host instrument is not measured at fair or is measured at fair value but changes in fair value are recognised in other comprehensive income.

The Group has not had embedded derivatives in 2017 and in 2016.

2.8. Loans, placements with other banks and allowance for loan and placement losses

Loans and placements with other banks are accounted at amortised cost. Amortised cost contains the following items: the principal amounts outstanding including accrued interest, transaction costs, net of allowance for loan or placement losses. Transaction fees and charges should adjust the carrying amount at initial recognition and be included in effective interest calculation. Loans and placements with other banks are derecognised when the contractual rights to the cash-flows expire or they are transferred. Interest and amortised cost are accounted using effective interest rate method. When a borrower is unable to meet payments as they fall due or, in the opinion of the Management, there is an indication that a borrower may be unable to meet payments as they fall due, all unpaid interest becomes impaired.

According to IAS 39, initially financial assets shall be recognized at fair value which is usually equal to transaction value of loans and receivables. Initial fair value of loans and receivables lent at interest below market conditions is lower than their transaction price. As a consequence the Group is deferring the difference between the fair value at initial recognition and the transaction price relating to loans and receivables because input data for measuring the fair values is not available on observable markets.

The amount of allowance is the difference between the carrying amount and the recoverable amount, being the present value of the expected cash-flows, including amounts recoverable from guarantees and collaterals, discounted at the original effective interest rate.

Allowance for losses on loans and placements with other banks represent management assessment for potential losses in relation to these activities.

The allowances for loan and placement losses are maintained to cover losses that have been specifically identified. Collective impairment losses of portfolios of loans, for which no objective evidence of impairment has been identified on an individual basis, are maintained to reduce the carrying amount of the portfolios of financial assets with similar credit risk characteristics to their estimated recoverable amounts at the balance sheet date. The expected cash-flows for portfolios of similar assets are estimated based on historical loss experience. Historical loss experience is the basis for calculating the expected loss, which is adjusted by the loss confirmation period, which represents the average time lag between occurrence of a loss event and confirmation of the loss. This concept enables recognition of those losses that have occurred in the portfolio at the balance sheet date.

If the reason for provisioning is no longer deemed appropriate, the redundant provisioning charge is released into income. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss shall be reversed by adjusting an allowance account. The reversal shall not result in a carrying amount of the financial asset that exceeds what the amortised cost would have been had the impairment not been recognised at the date the impairment is reversed.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED
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NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES [continued]

2.8. Loans, placements with other banks and allowance for loan and placement losses [continued]

Write-offs are generally recorded after all reasonable restructuring or collection activities have taken place and the possibility of further recovery is considered to be remote. The loan is written off against the related account "Provisions for impairment on loan and placement losses" in the Consolidated Statement of Profit or Loss. If the reason for provisioning is no longer deemed appropriate, the redundant provisioning charge is released into income.

2.9. Liabilities from issued securities

Issued mortgage bonds are measured at amortized cost. The costs related to their issuance is included in the amortized cost of the issued securities and amortized over the term of the securities using effective interest method. Collateral of mortgage bonds are secured by the actual amount of loan receivables – involved by collateral inspector - and as required additional collateral – determined by law – registered in the Group's collateral register.

2.10. Property, equipment and intangible assets

Property, equipment and intangible assets are stated at cost, less accumulated depreciation and amortization and impairment, if any. The depreciable amount (book value less residual value) of the non-current assets must be allocated over their useful lives. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets based on the following annual percentages:

Intangible assets	
Software	33.3%
Property rights	33.3%
Property	6.0%
Office equipment and vehicles	14.5-33.3%

Depreciation and amortization on properties, equipment and intangible assets starts on the day when such assets are placed into service. At each balance sheet date, the Group reviews the carrying value of its tangible and intangible assets to determine if there is any indication that those assets have suffered an impairment loss. If such indication exists, the recoverable amount of the asset is estimated to determine the extent (if any) of the impairment loss. Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where the carrying value of property, equipment, other tangible fixed assets and intangible assets is greater than the estimated recoverable amount, it is written down immediately to the estimated recoverable amount.

2.11. Interest income and interest expense

Interest income and expenses are recognised in profit or loss in the period to which they relate, using the effective interest rate method. Interest from loans and deposits are accrued on a daily basis. Interest income and expenses include relevant transaction costs and the amortisation of any discount or premium between the initial carrying amount of an interest-bearing instrument and its amount at maturity calculated on an effective interest rate basis. The Group recognises interest income when it assumes that the interest associated with the transaction will flow to the Group and the amount of the revenue can be reasonably measured. All interest income and expense arising from loans, placements with other banks, securities available-for-sale and amounts due to OTP Bank and other banks, liabilities from issued securities, subordinated bonds and loans are presented under these lines of the financial statements. Any fees received or paid related to the origination of the loan are an integral part of the effective interest rate and revenue is recognized with the effective interest rate that exactly discounts the estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset.

2.12. Fees and Commissions

Fees and commissions are recognised using effective interest method referring to provisions of IAS 39, when they relate and have to be included in the amortised cost model. Certain fees and commissions that are not involved in the amortised cost model are recognised in the consolidated statement of comprehensive income on an accrual basis based on IAS 18 *Revenue*.

OTP MORTGAGE BANK LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED
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NOTE 2: **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES [continued]**

2.13. Income tax

The annual taxation charge is based on the tax payable under Hungarian fiscal law, adjusted for deferred taxation. Deferred taxation is accounted for using the balance sheet liability method in respect of temporary differences between the tax bases of assets and liabilities and their carrying value for financial reporting purposes, measured at the tax rates that are expected to apply when the asset is realised or the liability is settled, based on tax rates that have been enacted at the date of the balance sheet. Deferred tax assets are recognized by the Group for the amounts of income taxes that are recoverable in future periods in respect of deductible temporary differences as well as the carry forward of unused tax losses and the carry forward of unused tax credits.

2.14. Government subsidies

The Group receives subsidies from the Hungarian government designed to compensate for the difference between the amount of interest charged to the customer, such interest being capped by legislation, and the interest charge on the issued mortgage bonds. Such subsidies are calculated on a monthly basis, are applicable over the life of the loan and are recognized among interest income in the Consolidated Statement of Profit or Loss in the period to which they relate.

2.15. Statement of Cash Flows

For the purposes of reporting cash flows, cash and cash equivalents include cash, amounts due from banks and balances with the NBH. Cash flows from hedging activities are classified in the same category as the item being hedged.

2.16. Segment reporting

The Group's main operation is mortgage lending to retail customers in Hungary, and the related value-appraisal services. Since the Group has only one main product (mortgage loan), revenues from external customers are reported aggregately. The management believes that the Group operates in a single business and geographical segment. The segment reporting is disclosed at a consolidated level in OTP Bank's consolidated financial statements. From 2011 the loan financing activity is widened with loan portfolio from OTP Bank Romania. The significant part of the total loan portfolio is from Hungary.

2.17 Comparative figures

There were no changes in prior period data due to either prior period error or change in accounting policies. In some notes certain amounts in the Consolidated Financial Statements for the year ended 31 December 2016 have been restructured within the particular note to conform with the current year presentation and these amounts are not significant.

OTP MORTGAGE BANK LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED
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NOTE 3: SIGNIFICANT ACCOUNTING ESTIMATES AND DECISIONS IN THE APPLICATION OF ACCOUNTING POLICIES

The presentation of financial statements in conformity with IFRS as adopted by the European Union requires the management of the Group to make judgements about estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as at the date of the financial statements and their reported amounts of revenues and expenses during the reporting period. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. The estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognized in the period. Actual results could differ from those estimates. Significant areas of subjective judgements include:

3.1. Impairment on loans and placements

The Group regularly assesses its loan portfolio for impairment. Management determines the adequacy of the allowances 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. Provisioning involves many uncertainties about the outcome of those risks and requires the Management of the Bank to make many subjective judgements in estimating the loss amounts. An impairment loss is incurred when there is objective evidence of impairment due to one or more events that occurred after the initial recognition of the asset („a loss event“), when the loss has a reliably measurable impact on the expected future cash flows from the financial asset or group of financial assets. Future cash flows are assessed by the Group on the basis of estimates based on historical parameters. The adopted methodology used for estimating impairment allowances is in line with the further possibilities of accumulation of historic impairment data from the existing information systems and applications. As a consequence, acquiring new data by the Group could affect the level of impairment allowances in the future.

3.2. Valuation of instruments without direct quotations

Financial instruments without direct quotations in an active market are valued using the valuation model technique. The models are regularly reviewed and each model is calibrated for the most recent available market data. While the models are built only on available data, their use is subject to certain assumptions and estimates (e.g. for correlations, volatilities, etc). Changes in the model assumptions may affect the reported fair value of the relevant financial instruments.

IFRS 13 *Fair Value Measurement* seeks to increase consistency and comparability in fair value measurements and related disclosures through a 'fair value hierarchy'. The hierarchy categorises the inputs used in valuation techniques into three levels. The hierarchy gives the highest priority to (unadjusted) quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions.

3.3. Provisions

Provision is recognized and measured based on IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The Group is involved in a number of ongoing legal disputes. Based upon historical experience and expert reports, the Group assesses the developments in these cases, and the likelihood and the amount of potential financial losses which are appropriately provided for. (See Note 13)

A provision is recognized by the Group when it has a present obligation as a result of a past event, 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.

Provision for off-balance sheet items includes provision for litigation and for commitments to extend credit.

OTP MORTGAGE BANK LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED
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NOTE 4: CASH, AMOUNTS DUE FROM BANKS AND BALANCES WITH THE NATIONAL BANK OF HUNGARY (in HUF million)

Amounts due from banks and balances with the NBH:

	2017	2016
Within one year		
in HUF	4,066	443
in foreign currency	<u>17</u>	<u>17</u>
Subtotal	<u>4,083</u>	<u>460</u>
Accrued interest	<u>3</u>	<u>-</u>
Total	<u>4,086</u>	<u>460</u>
From this: amounts due from OTP Bank	777	460
Compulsory reserve	10	10
Rate of the compulsory reserve	2%	2%

The main amount of cash due from banks shows the balance of the nostro accounts placed at OTP Bank of HUF 4,086 million and HUF 460 million as at 31 December 2017 and 2016, respectively. The remaining amounts represent the balances of the Group's clearing account placed at the NBH.

The amount of compulsory reserve is the multiplication of liabilities considered in compulsory reserve calculation and compulsory reserve rate, which determined by the NBH in a specific decree. The Group shall complete compulsory reserve requirements in average in the second month after the reserve calculation period, requirements with completed once a month on the last calendar day. The Group complies with the compulsory reserve requirements by the deposit of the adequate amount of cash as the calculated compulsory reserve on the bank account at NBH in monthly average.

NOTE 5: PLACEMENTS WITH OTHER BANKS (in HUF million)

	2017	2016
Within one year		
in HUF	25,912	2,580
Over one year		
in HUF	49,415	-
Subtotal	<u>75,327</u>	<u>2,580</u>
Accrued interest	<u>13</u>	<u>-</u>
Total	<u>75,340</u>	<u>2,580</u>
From this: amounts due from OTP Bank	75,340	2,580
Interest conditions on placements with other banks	2017	2016
in HUF	0.00%-0.90%	0.03%
in foreign currency	-	0.34%-3.15%
Average interest of placements with other banks	2017	2016
in HUF	0.25%	1.07%

OTP MORTGAGE BANK LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED
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NOTE 6: SECURITIES AVAILABLE-FOR-SALE (in HUF million)

	2017	2016
Hungarian government bonds	<u>10,947</u>	<u>11,390</u>
	<u>10,947</u>	<u>11,390</u>
Accrued interest	344	338
Total	<u>11,291</u>	<u>11,728</u>

The whole portfolio was denominated in HUF as at 31 December 2017.

Interest conditions and the remaining maturity of securities available-for-sale can be analysed as follows:

	2017	2016
Over one year, fixed interest	10,947	11,390
Interest conditions of securities available for sale	6.5%	6.5%

The valuation of the securities available-for-sale was as follows as at 31 December 2017:

	2017	
	Cost	Fair value
Hungarian government bonds	<u>10,644</u>	<u>10,947</u>
Total	<u>10,644</u>	<u>10,947</u>

The valuation of the securities available-for-sale was as follows as at 31 December 2016:

	2016	
	Cost	Fair value
Hungarian government bonds	<u>10,954</u>	<u>11,390</u>
Total	<u>10,954</u>	<u>11,390</u>

NOTE 7: LOANS, NET OF ALLOWANCES FOR LOAN LOSSES (in HUF million)

	2017	2016
Short-term loans (within one year)		
in HUF	81,988	52,702
in CHF	16	6
in EUR	124	4
in JPY	425	2
in foreign currency total	<u>564</u>	<u>12</u>
	<u>82,552</u>	<u>52,714</u>
Long-term loans (over one year)		
in HUF	908,237	917,542
in CHF	-	38
in EUR	-	296
in JPY	-	<u>553</u>
in foreign currency total	<u>-</u>	<u>887</u>
	<u>908,237</u>	<u>918,429</u>
Loans Gross Total	<u>990,789</u>	<u>971,143</u>
Provision for impairment	(8,888)	(14,235)
Accrued interest	3,631	5,436
Total	<u>985,532</u>	<u>962,344</u>

OTP MORTGAGE BANK LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED
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NOTE 7: LOANS, NET OF ALLOWANCES FOR LOAN LOSSES (in HUF million) [continued]

A significant part of the loans above are mortgage loans for purchasing real estate or for any purpose. OTP Mortgage Bank is the lien holder in the public property register in case of the mortgaged real estates. Such loans and their collaterals are registered in the Group's collateral registry. The Group also lends mortgage loans for purchasing agricultural lands since the beginning of 2006. The government grants interest subsidy directly to the debtors in case they fulfil the required conditions.

Interest conditions on loans, net of allowance for loan losses:

	2017	2016
Loans denominated in HUF with the maturity over one year	0.86%-16.84%	0.54%-18.15%
Average interest rate of mortgage loans denominated in foreign currency for purchasing real estate		
CHF	6.74%	7.02%
EUR	7.54%	7.54%
JPY	4.69%	4.76%
Average interest rate of mortgage loans denominated in foreign currency for any purposes		
CHF	6.99%	6.99%
EUR	7.98%	7.16%
JPY	4.83%	4.87%
Average interest rate of real estate development loans		
HUF	6.63%	8.02%
EUR	6.17%	6.18%

OTP Mortgage Bank Ltd. only provides loans with the original maturity over one year.

An analysis of the loan portfolio by type, before allowances for loan losses, is as follows:

	2017	2016
Mortgage loans	986,210 99.54%	967,027 99.58%
SME loans	2,495 0.25%	2,383 0.25%
Loans to medium and large corporates	2,084 0.21%	1,733 0.18%
Total	<u>990,789</u> <u>100.00%</u>	<u>971,143</u> <u>100.00%</u>

An analysis of the change in the provision for impairment on loan losses is as follows:

	2017	2016
Balance as at 1 January	14,235	25,894
Provision for the year	195	21,402
Release of provision	(5,552)	(33,061)
Reclassification	10	-
Balance as at 31 December	<u>8,888</u>	<u>14,235</u>

The Group sells non-performing non subsidised loans without recourse at estimated fair value to an OTP Group member, OTP Faktoring Ltd, in addition the Group sells non-performing subsidised loans without resource at estimated fair value to OTP Bank Plc.

NOTE 8: INVESTMENTS IN SUBSIDIARIES (in HUF million)

	2017	2016
Investments in subsidiaries	<u>45</u>	<u>45</u>
Total	<u>45</u>	<u>45</u>

In December 2016 the Mortgage Bank acquired 100% share in OTP Ingatlanpont Ltd., and then executed capital increase. The Bank's ownership was registered in January 2017 at the Registry Court.

OTP MORTGAGE BANK LTD.
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NOTE 9: **PROPERTY, EQUIPMENT AND INTANGIBLE ASSETS**
(in HUF million)

For the year ended 31 December 2017

<u>Cost</u>	Intangible assets	Property	Office equipment and vehicles	Construction in progress	Total
Balance as at 1 January 2017	1,817	7	201	-	2,025
Additions	113	1	73	34	221
Disposals	(281)	-	(31)	(29)	(341)
Balance as at 31 December 2017	<u>1,649</u>	<u>8</u>	<u>243</u>	<u>5</u>	<u>1,905</u>

**Accumulated Depreciation and
Amortization**

Balance as at 1 January 2017	1,605	1	172	-	1,778
Charge for the year	98	-	23	-	121
Disposals	(212)	-	(27)	-	(239)
Balance as at 31 December 2017	<u>1,491</u>	<u>1</u>	<u>168</u>	<u>-</u>	<u>1,660</u>

Net book value

Balance as at 1 January 2017	212	6	29	-	247
Balance as at 31 December 2017	<u>158</u>	<u>7</u>	<u>75</u>	<u>5</u>	<u>245</u>

For the year ended 31 December 2016

<u>Cost</u>	Intangible assets	Property	Office equipment and vehicles	Construction in progress	Total
Balance as at 1 January 2016	<u>1,450</u>	<u>-</u>	<u>85</u>	<u>-</u>	<u>1,535</u>
Additions from acquisition	293	7	115	-	415
Additions	129	-	3	-	132
Disposals	(55)	-	(2)	-	(57)
Balance as at 31 December 2016	<u>1,817</u>	<u>7</u>	<u>201</u>	<u>-</u>	<u>2,025</u>

**Accumulated Depreciation and
Amortization**

Balance as at 1 January 2016	<u>1,284</u>	<u>-</u>	<u>71</u>	<u>-</u>	<u>1,355</u>
Additions from acquisition	224	1	91	-	316
Charge for the year	97	-	10	-	107
Disposals	-	-	-	-	-
Balance as at 31 December 2016	<u>1,605</u>	<u>1</u>	<u>172</u>	<u>-</u>	<u>1,778</u>

Net book value

Balance as at 1 January 2016	<u>166</u>	<u>-</u>	<u>14</u>	<u>-</u>	<u>180</u>
Balance as at 31 December 2016	<u>212</u>	<u>6</u>	<u>29</u>	<u>-</u>	<u>247</u>

OTP MORTGAGE BANK LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED
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NOTE 10: **OTHER ASSETS (in HUF million)**

	2017	2016
Current income tax receivable	1,937	2,792
Trade receivables, other advances	1,027	1,338
Prepayments	60	44
Inventories	9	10
Receivables from the Hungarian Government	7	20
Derivative financial instruments designated as held-for-trading ¹	-	801
Other assets	<u>55</u>	<u>99</u>
	<u>3,095</u>	<u>5,104</u>
 Provision for other assets	 (120)	 (104)
 Total	 <u>2,975</u>	 <u>5,000</u>

Receivables from the Hungarian Government represent receivables from government subsidies on housing mortgage loans.

NOTE 11: **AMOUNTS DUE TO BANKS AND HUNGARIAN GOVERNMENT, DEPOSITS FROM THE NATIONAL BANK OF HUNGARY AND OTHER BANKS (in HUF million)**

	2017	2016
Within one year		
In HUF	571,012	513,877
In EUR	93	309
In JPY	425	530
In CHF	<u>16</u>	<u>40</u>
Total in foreign currency	<u>534</u>	<u>879</u>
	<u>571,546</u>	<u>514,756</u>
 Over one year		
in HUF	<u>11,759</u>	<u>11,760</u>
	<u>583,305</u>	<u>526,516</u>
 Accrued interest	 148	 719
 Total	 <u>583,453</u>	 <u>527,235</u>
 From this: amounts due to OTP Bank	 583,453	 527,235
 Interest conditions on amounts due to OTP Bank and other banks		
	2017	2016
In HUF	0.03%-2.04%	0.90%-4.39%
In foreign currency	(0.75%)-0.01%	(0.05%)-3.15%

¹ More information (including the type of derivatives) in Note 29.

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NOTE 12: LIABILITIES FROM ISSUED SECURITIES (in HUF million)

	2017	2016
Within one year:		
In EUR	—	<u>155,797</u>
	—	<u>155,797</u>
Over one year		
In HUF	<u>396,427</u>	206,453
	<u>396,427</u>	<u>206,453</u>
Subtotal	396,427	362,250
Accrued interest	<u>10,418</u>	<u>10,172</u>
Total	<u>406,845</u>	<u>372,422</u>

Issued mortgage bonds during the period (nominal value)	192,100	-
Mortgage bonds became due or repurchased during the period (nominal value)	155,500	156,011

Interest conditions on issued securities

	2017	2016
In HUF	0.63%-11.00%	9.00% - 11.00%
In foreign currency	-	0.34%

A reconciliation of the face value and the amortized cost is as follows:

	2017	2016
Nominal value of the issued securities	391,350	354,760
Unamortized premiums	5,077	7,200
Fair value hedge adjustment	—	<u>290</u>
Amortized cost	<u>396,427</u>	<u>362,250</u>

Face value and interest of mortgage bonds issued by OTP Mortgage Bank shall not exceed registered normal and additional collaterals (face value and interest). The Mortgage Bank keeps record of loans, normal and additional collateral values which are shown separately. Independent property inspector monitors the availability of mortgage bond's collateral values in accordance with regulations, the registration of loans, and its pledges as collaterals as the normal collateral of the mortgage bonds, those property register data and the normal and additional collateral in the coverage register.

There was a maturing mortgage bond in amount of 155,5 HUF billion; mortgage bonds were issued in amount of 192,1 HUF billion in 2017.

The Bank issued the following mortgage bonds to the Budapest Stock Exchange in 2017: with a nominal value of HUF 122,1 billion maturing in 4 years with fixed interest rate, with a nominal value of HUF 40 billion maturing in 3 years with variable interest rate and with a nominal value of HUF 30 billion maturing in 5 years with variable interest rate.

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NOTE 12: LIABILITIES FROM ISSUED SECURITIES (in HUF million) [continued]

Issued securities denominated in HUF as at 31 December 2017 (in HUF million)

Name	Date of issue	Maturity	Nominal value in HUF million	Interest condition in % p.a.	Hedged
1 OJB 2019 I	17/03/2004	18/03/2019	31,517	9.48% fixed	not hedged
2 OJB 2019 II	31/05/2011	18/03/2019	7,733	9.48% fixed	not hedged
3 OJB 2020 I	19/11/2004	12/11/2020	5,503	9.00% fixed	not hedged
4 OJB 2020 II	31/05/2011	12/11/2020	4,497	9.00% fixed	not hedged
5 OJB 2020 III	23/02/2017	20/05/2020	40,000	0.63% floating	not hedged
6 OJB 2021 I	15/02/2017	27/10/2021	122,100	2.00% fixed	not hedged
7 OJB 2022 I	24/02/2017	24/05/2022	30,000	0.78% floating	not hedged
8 OJB 2025 I	31/07/2009	31/07/2025	150,000	11.00% fixed	not hedged
Total issued securities in HUF			<u>391,350</u>		
Unamortized premium			5,077		
Fair value hedge adjustment			-		
Total issued securities in HUF			<u>396,427</u>		
Accrued interest			10,418		
Total in HUF			<u>406,845</u>		

NOTE 13: OTHER LIABILITIES (in HUF million)

	2017	2016
Account payables	9,369	757
Other tax payables	1,280	690
Provision on off-balance sheet commitments and contingent liabilities	1,254	633
Accrued fees	856	1,087
Salaries and social security payable	187	47
Other	<u>1,026</u>	<u>1,065</u>
Subtotal	<u>13,972</u>	<u>4279</u>
Deferred tax liabilities	<u>557</u>	<u>832</u>
Total	<u>14,529</u>	<u>5,111</u>

NOTE 14: SUBORDINATED BONDS AND LOANS (in HUF million)

	2017	2016
With the maturity over one year denominated in CHF	-	4,876

On 30 January 2009, OTP Bank provided CHF 15 million subordinated loan to the Mortgage Bank with the maturity of 8 years. The loan is due at 30 January 2017. The interest of the loan is 3 month CHF LIBOR + 3.88%.

The CHF denominated subordinated loan is being hedged in fair value relationship. See Note 29 for further details of hedge accounting.

The Group repaid the subordinated loan at maturity date. Cross-currency foreign exchange swap as hedging instrument related to the subordinated loan was terminated at the same time.

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NOTE 15: SHARE CAPITAL (in HUF million)

All 27,000 shares are ordinary shares with a nominal value of HUF 100 thousand and are authorised and fully paid.

	2017	2016
Share capital (in HUF million)	<u>27,000</u>	<u>27,000</u>

NOTE 16: RETAINED EARNINGS AND RESERVES (in HUF million)

Based on the instructions of Act C of 2000 on accounting ("Act on Accounting") effective from annual periods beginning on 1 January 2017 financial statements of the Group are prepared in accordance with IFRS as issued by the IASB as adopted by the EU.

Dividends are recognised in the period in which they are approved by the owners. In 2017 the Group paid HUF 20,623 million dividend from the profit for the year 2016. Regarding to the net income for the year 2016 dividend is expected to be proposed by the management in amount of HUF 18,265 million.

NOTE 17: INTEREST SUBSIDIES RELATED TO HOUSING LOANS

During 2017 5 types of interest subsidised loans were among OTP Mortgage Bank's portfolio:

- (i) loans granted before 16 June 2003
- (ii) loans granted between 16 June 2003 and 22 December 2003
- (iii) loans granted between 22 December 2003 and 30 June 2009
- (iv) loans granted after 1 October 2009
- (v) loans granted after 2012

Interest subsidised loans fulfil the following conditions

- granted for purchase, building of new property, or purchase, renovation, enlargement of existing property
- maximised interest rate
- interest subsidy fixed to the reference rate of the government bonds or to the reference rate of the issued mortgage bonds
- subsidy till the maturity of the loan, but maximum for 20 years, and loans granted after 2012 maximum for 5 years (except the subsidized mortgage loans of families with 3 children granted maximum 25 years).

Relevant elements of the currently available interest subsidised loans:

- the applicants can be dedicated people in the Government Regulation
- purpose of the loan:
 - o purchasing or building of new property
 - o purchasing or modernisation or enlargement of used property
- in case of building or purchasing of property the building costs or the purchase price without the building plot price shall not exceed the amount of HUF 30 million, in case of purchase of used properties the amount of HUF 20 million, in case of modernisation or enlargement shall not exceed the costs the amount of HUF 15 million
- loan amount shall not exceed in case of new properties the amount of HUF 15 million, and in case of used properties the amount of HUF 10 million.

The interest subsidy is determined in the per cent of government bonds' yields depending on the purpose of the loan, and it can be granted as a maximum for 5 years.

- Families with two or three children can apply maximum HUF 10 million loan for building or purchasing of property, next to the family housing allowance without building cost and purchase price limit, and interest payment subsidized by the State for the first 25 years of the term.

Due to the strict conditions the loan demand remains moderate. Loans granted during 2017 about HUF 7,714 million based on the conditions of 2009 and HUF 176,373 million based on conditions of 2012. Net closing amount of the loan with the conditions of 2009 was HUF 4,031 million and for the conditions of 2012 was HUF 150,778 million.

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NOTE 18: NET LOSS FROM FEES AND COMMISSIONS (in HUF million)

Income from fees and commissions

	2017	2016
Fees and commissions relating to lending	2,743	1,876
Other	<u>347</u>	<u>304</u>
Total	<u>3,090</u>	<u>2,180</u>

Expense from fees and commissions

	2017	2016
Fees and commissions relating to issued securities	184	95
Fees and commissions relating to lending	1,852	2,995
Valuator fees	1,107	-
Others	<u>485</u>	<u>-</u>
Total	<u>3,628</u>	<u>3,090</u>

Net loss from fees and commissions	<u>(538)</u>	<u>(910)</u>
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The other fees mainly consist of the cost of services in connection with lending activity and mortgage bond issues, which are not directly attributable to separate issuance.

NOTE 19: OTHER ADMINISTRATIVE EXPENSES (in HUF million)

	2017	2016
Taxes, other than income tax:		
Bank tax	1,048	4,007
Credit institution's contribution	-	1,806
Other taxes	<u>923</u>	<u>909</u>
Total taxes, other than income tax	1,971	6,722
Services	594	408
Professional fees	334	312
Rental fees	183	48
Material type expenses	50	21
Administration expenses	24	14
Advertising	<u>68</u>	<u>-</u>
Total	<u>3,234</u>	<u>7,525</u>

Taxes, other than income taxes are Credit institution's contribution that is payable by the Group on HUF denominated loans having interest subsidy from the Hungarian government, bank tax and other local taxes in 2016.

The total amount of the bank tax is HUF 1,048 million recognised as an expense thus decreased the corporate tax base.

Taxes, other than income taxes contain bank tax and other local taxes in 2017, Credit institution's contribution that is payable by the Group on HUF denominated loans having interest subsidy from the Hungarian government has expired since 1 January 2017.

NOTE 20: COMPENSATION OF KEY MANAGEMENT PERSONNEL (in HUF million)

	2017	2016
Key executives (Managing Director and Deputies)	63	44
Total	<u>63</u>	<u>44</u>

The remunerations of key management personnel include only short-term benefits.

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NOTE 21: INCOME TAX (in HUF million)

The Group is presently liable for income tax at a rate of 9% of taxable income.

A reconciliation of the total income tax charge for the years ended 31 December 2017 and 2016 is as follows:

	2017	2016
Current tax expense	490	1
Deferred tax (benefit)/expense	<u>(263)</u>	<u>732</u>
Total income tax expense/(benefit)	<u>227</u>	<u>733</u>

A reconciliation of the deferred tax liability as at 31 December 2017 and 2016 is as follows:

	2017	2016
Balance as at 1 January	(832)	(10)
Recognized in other comprehensive income as tax benefit/(expense)	12	(90)
Deferred tax benefit/(expense)	<u>263</u>	<u>(732)</u>
Balance as at 31 December	<u>(557)</u>	<u>(832)</u>

A reconciliation of deferred tax assets and liabilities as at 31 December 2017 and 2016 is as follows:

	2017	2016
Premium amortization for available-for-sale financial assets	38	56
Below market fair value adjustment in accordance with regulations related to customer loans	379	568
IBNR provision	<u>93</u>	<u>139</u>
Deferred tax assets	<u>510</u>	<u>763</u>
Fair value adjustment for available-for-sale financial assets	(27)	(39)
Fair value adjustment of other derivative financial instrument	(4)	(6)
Effect of using effective interest rate method	(1033)	(1,547)
Premium amortization for available for issued securities	(1)	(2)
One-off effect arising on transition to IFRS	-	-
Difference in depreciation and amortization	<u>(2)</u>	<u>(1)</u>
Deferred tax liabilities	<u>(1,067)</u>	<u>(1,595)</u>
Net deferred tax liabilities	<u>(557)</u>	<u>(832)</u>

A reconciliation of the effective tax rate as at 31 December 2017 and 2016 is as follows:

	2017	2016
Profit before income tax	22,899	22,858
Income tax at statutory tax rate (In 2017 9%, in 2016 19%)	2,061	4,343
<i><u>Income tax adjustments due to permanent differences are as follows:</u></i>		
Permanent differences due to local tax	97	(2,521)
Tax allowance for the year	(1,678)	(2,725)
Tax refund in accordance with Acts on customer Loans	(265)	755
Capital contribution	-	881
Other	<u>12</u>	<u>-</u>
Income tax	<u>227</u>	<u>733</u>
<i>Effective tax-rate</i>	<i>0.99%</i>	<i>3.21%</i>

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NOTE 22: EARNINGS PER SHARE

Earnings per share attributable to ordinary shares are determined by dividing Net profit for the year by the weighted average number of ordinary shares outstanding during the period. The Group has no preference shares and no options or other rights related to shares.

	2017	2016
Net profit for the year (in HUF million)	22,672	22,125
Weighted average number of ordinary shares outstanding during the year for calculating basic EPS (number of share)	270,000	270,000
EPS (in HUF) basic and diluted	<u>83,970</u>	<u>81,944</u>

NOTE 23: FINANCIAL RISK MANAGEMENT (in HUF million)

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial instruments may result in certain risks to the Group. The most significant risks the Group faces include¹:

23.1. Credit risk

The Group takes on exposure to credit risk, which is the risk that the counter-party will be unable to pay amounts in full when due. The risk of the mortgage lending activity is controlled and the safety is enhanced by the legal environment, which provides that loans can only be extended against a specific collateral of real property and with certain legal assurances.

In the treasury activity the Group structures the levels of credit risk it undertakes by placing limits to each counter-party. Actual exposures against limits are monitored daily.

Analysis by loan types

An analysis of the gross loan portfolio by loan types and DPD classes is as follows. The table consists of only on-balance sheet items.

As at 31 December 2017

Loan type	DPD 0-90	DPD 90-360	DPD 360+	Total carrying amount /allowance
Placements with other banks	75,340	-	-	75,340
Loans to medium and large corporates	2,078	17	-	2,095
Retail loans	980,919	7,910	989	989,818
SME loans ²	2,507	-	-	2,507
Gross loan portfolio total	<u>1,060,844</u>	<u>7,927</u>	<u>989</u>	<u>1,069,760</u>
Allowance Total	<u>(5,938)</u>	<u>(2,518)</u>	<u>(432)</u>	<u>(8,888)</u>
Net loan portfolio total	<u>1,054,906</u>	<u>5,409</u>	<u>557</u>	<u>1,060,872</u>
 Total placements with other banks				 75,340
Total loans				994,421
Total allowance				<u>(8,888)</u>
Total				<u>1,060,872</u>

¹ The management of liquidity risk related to financial instruments are shown in Note 28.

² Small and medium enterprises

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NOTE 23: FINANCIAL RISK MANAGEMENT (in HUF million) [continued]

23.1. Credit risk [continued]

As at 31 December 2016

Loan type	DPD 0-90	DPD 90-360	DPD 360+	Total carrying amount /allowance
Placements with other banks	2,580	-	-	2,580
Loans to medium and large corporates	1,732	11	-	1,743
Retail loans	953,744	14,470	4,226	972,440
SME loans	2,391	5	-	2,396
Gross loan portfolio total	<u>960,447</u>	<u>14,486</u>	<u>4,226</u>	<u>979,159</u>
Allowance Total	<u>(7,757)</u>	<u>(4,753)</u>	<u>(1,725)</u>	<u>(14,235)</u>
Net loan portfolio total	<u>952,690</u>	<u>9,733</u>	<u>2,501</u>	<u>964,924</u>
Total placements with other banks				2,580
Total loans				976,579
Total allowance				<u>(14,235)</u>
Total				<u>964,924</u>

Classification into risk classes

Exposures with small amounts are subject to **collective valuation** method, which is a simplified assessment. The exposures subject to collective valuation method are classified into five valuation groups which have been formed based on past due days from which three classes were presented (A: 0-90 days past due - DPD, B: 91-360 DPD, C: over 360 days past due).

The Group intends – where a great number of items and sufficient long-term historical data is available – to apply models on statistical basis. The impairment is calculated according to the possibility of listing the loan into default categories examined on the base of objective valuation criteria (delay of payment, change of exchange) and the expected recovery from the collecting. If the loss of the exposure can't be modelled reliably, the impairment is determined by expert keys.

Not impaired loan portfolio

As at 31 December 2017

Loan type	Not past due	DPD 0-90	DPD 90-360	DPD 360+	Total
Loans to medium and large corporates	1,625	432	8	-	2,065
Placements with other banks	78,299	-	-	-	78,299
Retail loans	847,442	120,453	-	-	967,895
SME loans	<u>1,754</u>	<u>740</u>	<u>-</u>	<u>-</u>	<u>2,494</u>
Total	<u>929,120</u>	<u>121,625</u>	<u>8</u>	<u>-</u>	<u>1,050,753</u>

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NOTE 23: FINANCIAL RISK MANAGEMENT (in HUF million) [continued]

23.1. Credit risk [continued]

As at 31 December 2016

Loan type	Not past due	DPD 0-90	DPD 90-360	DPD 360+	Total
Loans to medium and large corporates	1,495	211	-	-	1,706
Placements with other banks	2,580	-	-	-	2,580
Retail loans	825,734	109,857	-	-	935,591
SME loans	<u>1,627</u>	<u>751</u>	<u>-</u>	<u>-</u>	<u>2,378</u>
Total	<u>831,436</u>	<u>110,819</u>	<u>-</u>	<u>-</u>	<u>942,255</u>

Not impaired loan portfolio increased related to the prior period, mainly balance of placements. Not past due and past due composition changed insignificantly, the Group had DPD 90+ not impaired loan as at 31 December 2017.

Collateral

The collateral value held by the Group by types is as follows (**total collateral value**). The collateral coverloans as well as off-balance sheet exposures.

Types of collateral	2017	2016
Government guarantees	57,909	69,992
Mortgage	<u>2,575,385</u>	<u>2,229,161</u>
Total	<u>2,633,294</u>	<u>2,299,153</u>

The collateral value held by the Group by types is as follows (**to the extent of the exposures**). The collateral coverloans as well as off-balance sheet exposures.

Types of collateral	2017	2016
Government guarantees	57,650	69,680
Mortgage	<u>945,774</u>	<u>861,757</u>
Total	<u>1,003,424</u>	<u>931,437</u>

Non-qualified gross loan portfolio by countries

	2017	2016
Hungary	990,690	971,023
Romania	<u>99</u>	<u>120</u>
Total	<u>990,789</u>	<u>971,143</u>

Restructured loans

	2017		2016	
	Gross portfolio	Allowance	Gross portfolio	Allowance
Retail loans	7,057	467	10,842	2,084
Total	7,057	467	10,842	2,084

Restructured portfolio: it contains every loan which is relevant restructured and less than 91 days delinquent.

A loan is considered relevant restructured, if

- it was restructured in the last 12 months, or
- it was restructured more than 12 months ago, but the connected preferential period is not expired or expired in the last 12 months.

Hungarian FX mortgage loans in the fixed exchange rate scheme are not included.

In case of loans that have been restructured more than once the last restructuring is considered.

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NOTE 23: FINANCIAL RISK MANAGEMENT (in HUF million) [continued]

23.1. Credit risk [continued]

Available-for-sale securities as at 31 December 2017

		Baa3		Not rated	Total
Hungarian government bonds	10,947	100.00%	-	0.00%	10,947
Total	10,947	100.00%	-	0.00%	10,947

Accrued interest 344

Total **11,291**

23.2. Market risk

Market risks arise from positions taken in securities and other instruments. The Group takes no significant exposure to market risks. Market risks are generally monitored and controlled by the Asset and Liability Management function.

23.2.1. Interest rate sensitivity analysis¹

The sensitivity analysis below has been determined based on the exposure to interest rates for both derivatives and non-derivative instruments at the balance sheet date. The analysis is prepared assuming the amount of assets and liabilities outstanding at the balance sheet date were outstanding for the whole year. The analysis was prepared by assuming only the adverse interest rate changes. The main assumptions were as follows:

- Floating-rate assets and liabilities were repriced to the modelled benchmark yields at the repricing dates assuming the unchanged margin compared to the last repricing.
- Fixed-rate assets and liabilities were repriced at the contractual maturity date.
- As for liabilities with discretionary repricing feature by the Group were assumed to be repriced with two-weeks delay, assuming no change in the margin compared to the last repricing date.
- The assets and liabilities with interest rate lower than 0.3% assumed to be unchanged during the whole period.
- The sensitivity of interest income to changes in BUBOR is analysed.

The simulation was prepared by assuming two scenarios:

1. gradually decreasing BUBOR to 0.0%, HUF basic interest rate remains unchanged (probable scenario)
2. BUBOR decreasing with 0.5% and at the same time the HUF basic interest rate reduces to 3 months BUBOR level in the next year (alternative scenario)

The net interest income in a one year period after January 1, 2018 would be decreased by HUF 5 million (probable scenario) and HUF 70 million (alternative scenario) as a result of these simulation.

The effects of the parallel shifts of the yield-curves to the net interest income on a one-year period can be summarized as follows (in HUF million):

Description		Effects to the net interest income in one year period	
		2017	2016
HUF	(0.1%) parallel shift	26	56
HUF	0.1% parallel shift	(26)	(56)
Total		(26)	(56)

¹ Quantitative data on interest rate risk are shown in Note 27

OTP MORTGAGE BANK LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED
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NOTE 23: FINANCIAL RISK MANAGEMENT (in HUF million) [continued]

23.2. Market risk [continued]

23.2.2. Foreign exchange rate sensitivity analysis¹

The foreign exchange sensitivity analysis has been determined based on the net open position, taking into account both balance sheet exposure and off balance sheet exposure. The simulation was made on the assumption, that the price changes happens as a one off event, and neither does it take into consideration possible balance sheet dynamics, nor the potential increase or decrease of risk costs related to foreign exchange denominated assets.

The total net open position of OTP Mortgage Bank Ltd. was an amount of HUF 1 million short on 31 December 2016, which consisted of EUR exposure only. Since OTP Mortgage Bank has completed the conversion of foreign currency consumer mortgage loans into HUF, from its operation does not arise material FX exposures.

Potential losses from the foreign exchange denominated exposure are considerably low compared to surplus capital.

23.3. Capital management

The primary objective of the capital management of the Group is to ensure the prudent operation, the entire compliance with the prescriptions of the regulator for a persistent business operation and maximising the shareholder value, accompanied by an optimal financing structure.

The capital management of the Group includes the management and evaluation of the shareholder's equity available for hedging risks, other types of funds to be recorded in the equity and all material risks to be covered by the capital.

The basis of the capital management of the Group in the short turn is the continuous monitoring of its capital position, in the long turn the strategic and the business planning, which includes the monitoring and forecast of the capital position of the Group.

The Group maintains the capital adequacy required by the regulatory bodies and the planned risk taking mainly by means of ensuring and developing its profitability. In case the planned risk level of the Group exceeded its Core and Supplementary capital, the Group ensures the prudent operation by occasional measures including the owner of the Group.

Capital adequacy

The capital adequacy of the Group is supervised based on the financial statements data prepared in accordance with the International Financial Reporting Standards (IFRS) issued by International Accounting Standards Board (IASB) and accepted by the European Union, rulings and indicators defined by the Basel Committee.

The Group has entirely complied with the regulatory capital requirements for the year similar to prior years.

The capital adequacy calculations of the Group for the year 2017 are prepared based on the data of the audited financial statements prepared in accordance with IFRS. The Group uses the standard method for determining the regulatory capital requirements of the credit risk and market risk, and the alternative standard method in case of the operational risk. In 2017 the Mortgage Bank's solvency ratio is 13.5%. Regulatory capital is 57,242; the total required regulatory capital is 33,965.

In HUF million	2017 IFRS	2016 IFRS	2016
Core capital	57,242	52,835	44,430
Supplementary capital	-	71	71
Regulatory capital	57,242	52,906	44,501
Credit risk capital requirement	32,019	30,464	29,835
Market risk capital requirement	137	230	230
Operational risk capital requirement	1,809	2,382	2,382
Total required regulatory capital	33,965	33,076	32,447
Surplus capital	<u>23,277</u>	<u>19,830</u>	<u>12,054</u>
Solvency ratio	<u>13.5%</u>	<u>12.8%</u>	<u>10.97%</u>

¹ Quantitative data on foreign exchange rate risk are shown in Note 25

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NOTE 23: FINANCIAL RISK MANAGEMENT (in HUF million) [continued]

23.3. Capital management [continued]

Capital adequacy [continued]

The positive components of the Core capital are the following:

Issued capital, Retained earnings of the previous year, Retained earnings, Cumulative Comprehensive Income, Other Reserves

The negative components of the Core capital are the following:

Prudential filter, Intangible assets

NOTE 24: OFF-BALANCE SHEET ITEMS AND DERIVATIVE FINANCIAL INSTRUMENTS
(in HUF million)

Off balance sheet items

	2017	2016
Current litigations	1,574	1,668
Loan facilities	<u>28,339</u>	<u>14,465</u>
Contingent and future liabilities total	<u>29,913</u>	<u>16,133</u>

NOTE 25: NET FOREIGN CURRENCY POSITION AND FOREIGN CURRENCY RISK
(in HUF million)

As at 31 December 2017

	USD	CHF	EUR	JPY	Total
Assets	-	124	16	428	568
Liabilities	-	(106)	(16)	(425)	(547)
Off-balance sheet assets and liabilities, net	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net position	<u>-</u>	<u>18</u>	<u>-</u>	<u>3</u>	<u>21</u>

As at 31 December 2016

	USD	CHF	EUR	JPY	Total
Assets	-	64	421	534	1,019
Liabilities	(1)	(4,404)	(155,926)	(530)	(160,861)
Off-balance sheet assets and liabilities, net	<u>-</u>	<u>4,341</u>	<u>155,510</u>	<u>-</u>	<u>159,851</u>
Net position	<u>(1)</u>	<u>1</u>	<u>(13)</u>	<u>4</u>	<u>(9)</u>

Whilst the Group monitors its foreign exchange position for compliance with the regulatory requirements of the NBH and own limit system established in respect of limits on open positions. The measurement of the Group's open foreign currency position involves monitoring the VaR limit on the foreign exchange exposure of the Group.

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NOTE 26: RELATED PARTY TRANSACTIONS (in HUF million)

26.1. Outstanding balances/Transactions due from or due to OTP Bank Plc.

26.1.1. Outstanding balances in the Consolidated Statement of Financial Position related to OTP Bank Plc.

The Group had the following assets and liabilities due from, or due to the OTP Bank Plc.:

Assets	2017	2016
Cash, amounts due from OTP Bank	777	460
Placements with OTP Bank	75,340	2,580
Accrued receivables	60	43
Fair value hedge derivatives – positive fair value	-	801
Liabilities	2017	2016
Amounts due to OTP Bank and other banks	(583,453)	(527,235)
Face value of issued mortgage bonds held by OTP Bank	(391,350)	(225,948)
Accrued interest expense due to OTP Bank	(10,418)	(9,516)
Other liabilities due to OTP Bank	(544)	(967)

26.1.2. Transactions in the Consolidated Statement of Profit or Loss related to OTP Bank Plc.

	2017	2016
Interest income	10,653	2,679
Interest expense	(2,582)	(34,391)
Account handling fees paid to OTP Bank	10,741	12,629
Other fees and commissions relating to lending received from OTP Bank	483	312
Other fees and commissions relating to lending paid to OTP Bank	(175)	(97)
Revenue from the value appraisal activity from OTP Bank	474	309

26.1.3. Transactions of the Mortgage Bank's loan portfolio related to OTP Bank Plc.

	2017	2016
Performing loans purchased from OTP Bank	399	562
Book value of performing loans purchased from OTP Bank	447	565

26.2. Outstanding balances related to key management personnel

The management, the members of the Board of Directors and the Supervisory Board and their close relatives have loans of HUF 892,1 million as at 31 December 2017. These loans were covered by HUF 1,612.1 million mortgage.

26.3. Outstanding balances/Transactions related to other related party¹

26.3.1. Transactions related to OTP Building Society Ltd.

	2017	2016
Face value of issued mortgage bonds held by OTP Building Society Ltd.	44,282	44,282
Accrued interest expense	(1,995)	(1,995)

26.3.2. Transactions of OTP Mortgage Bank's loan portfolio related to OTP Faktoring Ltd.

	2017	2016
Book value of non-performing loans sold to OTP Faktoring Ltd.	7,271	13,756
Selling price of the non-performing loans related to OTP Faktoring Ltd.	6,302	12,850

¹The Group has significant transactions with OTP Building Society Ltd., OTP Faktoring Ltd. and Merkantil Bank Ltd. in OTP Group, these transactions are highlighted.

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NOTE 26: RELATED PARTY TRANSACTIONS (in HUF million) [continued]

26.3.3. Transactions related to Merkantil Bank Ltd.

	2017	2016
Face value of issued mortgage bonds held by Merkantil Bank Ltd.	45,000	45,000
Accrued interest expense	(2,075)	(2,075)

26.3.4. Further Outstanding balances/Transactions related to other related party

	2017	2016
Other liabilities due to other related party	-	65
Other operating income from other related party	5	-
Revenue from the value appraisal activity from OTP Faktoring Ltd. and from other related party	964	168

Compensation of key management personnel is shown in Note 20.

In the normal course of the business the Group enters into other transactions with the entities within the OTP Group, the amounts and volumes of which are not significant to these financial statements taken as a whole. Only significant transactions were highlighted.

NOTE 27: INTEREST RATE RISK MANAGEMENT

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The length of time for which the rate of interest is fixed on a financial instrument, therefore, indicates to what extent it is exposed to interest rate risk.

The majority of the Group's interest bearing assets and liabilities are structured to match either short-term assets and short-term liabilities, or long-term assets and liabilities with repricing opportunities within one year, or long-term assets and corresponding liabilities where repricing is performed simultaneously.

In addition, the significant spread existing between the different types of interest bearing assets and liabilities enables the Group to benefit from a high level of flexibility in adjusting for its interest rate matching and interest rate risk exposure.

The following table presents the interest repricing dates of the Group. Variable yield assets and liabilities have been reported in accordance with their next repricing date. Fixed income assets and liabilities have been reported in accordance with their maturity.

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NOTE 27: INTEREST RATE RISK MANAGEMENT [continued]

31 December 2017	Within 1 month		within 3 months over 1 month		within 1 year over 3 months		within 2 years over 1 year		over 2 years		Non-interest – bearing		Total		Total
ASSETS	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	
Cash, amounts due from banks and balances with the National Bank of Hungary	1,111	-	2,972	-	-	-	-	-	-	-	3	-	4,086	-	4,086
<i>fixed interest</i>	1,111	-	2,972	-	-	-	-	-	-	-	-	-	4,083	-	4,083
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	3	-	3	-	3
Placements with other banks	75,327	-	-	-	-	-	-	-	-	-	13	-	75,340	-	75,340
<i>variable interest</i>	22,000	-	-	-	-	-	-	-	-	-	-	-	22,000	-	22,000
<i>fixed interest</i>	53,327	-	-	-	-	-	-	-	-	-	-	-	53,327	-	53,327
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	13	-	13	-	13
Securities available-for-sale	-	-	-	-	-	-	10,947	-	-	-	344	-	11,291	-	11,291
<i>fixed interest</i>	-	-	-	-	-	-	10,947	-	-	-	-	-	10,947	-	10,947
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	344	-	344	-	344
Loans, net of allowances for loan losses	178,699	289	341,762	275	115,384	-	62,605	-	282,887	-	3,629	2	984,966	566	985,532
<i>fixed interest</i>	-	-	-	-	-	-	-	-	948	-	-	-	948	-	948
<i>variable interest</i>	178,699	289	341,762	275	115,384	-	62,605	-	281,939	-	-	-	980,389	564	980,953
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	3,629	2	3,629	2	3,631

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NOTE 27: **INTEREST RATE RISK MANAGEMENT (in HUF million) [continued]**

31 December 2017	Within 1 month		within 3 months over 1 month		within 1 year over 3 months		within 2 years over 1 year		over 2 years		Non-interest -bearing		Total		Total
LIABILITIES	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	
Amounts due to OTP Bank and other banks	170,012	-	401,000	534	-	-	11,759	-	-	-	148	-	582,919	534	583,453
<i>fixed interest</i>	-	-	-	534	-	-	11,759	-	-	-	-	-	11,759	534	12,293
<i>variable interest</i>	170,012	-	401,000	-	-	-	-	-	-	-	-	-	571,012	-	571,012
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	148	-	148	-	148
Liabilities from issued securities	69,922	-	-	-	-	-	39,336	-	287,168	-	10,419	-	406,845	-	406,845
<i>fixed interest</i>	-	-	-	-	-	-	39,336	-	287,168	-	-	-	326,504	-	326,504
<i>variable interest</i>	69,922	-	-	-	-	-	-	-	-	-	-	-	69,922	-	69,922
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	10,419	-	10,419	-	10,419
NET POSITION	15,203	289	(56,266)	(259)	115,384	-	22,457	-	(4,281)	-	(6,578)	2	85,916	32	85,951

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NOTE 27: INTEREST RATE RISK MANAGEMENT (in HUF million) [continued]

31 December 2016	Within 1 month		within 3 months over 1 month		within 1 year over 3 months		within 2 years over 1 year		over 2 years		Non-interest – bearing		Total		Total
ASSETS	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	
Cash, amounts due from banks and balances with the National Bank of Hungary	443	17	-	-	-	-	-	-	-	-	-	-	443	17	460
<i>fixed interest</i>	443	17	-	-	-	-	-	-	-	-	-	-	443	17	460
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Placements with other banks	2,580	-	-	-	-	-	-	-	-	-	-	-	2,580	-	2,580
<i>fixed interest</i>	2,580	-	-	-	-	-	-	-	-	-	-	-	2,580	-	2,580
<i>variable interest</i>	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Securities available-for-sale	-	-	-	-	-	-	-	-	11,390	-	338	-	11,728	-	11,728
<i>fixed interest</i>	-	-	-	-	-	-	-	-	11,390	-	-	-	11,390	-	11,390
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	338	-	338	-	338
Loans, net of allowances for loan losses	194,989	140	342,552	228	66,024	497	93,580	-	258,898	-	5,433	3	961,476	868	962,344
<i>variable interest</i>	194,989	140	342,552	228	66,024	497	93,580	-	258,898	-	-	-	956,043	865	956,908
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	5,433	3	5,433	3	5,436
Derivative financial instruments	-	160,477	-	-	-	-	-	-	-	-	-	-	-	160,477	160,477
<i>fixed interest</i>	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
<i>variable interest</i>	-	160,477	-	-	-	-	-	-	-	-	-	-	-	160,477	160,477

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NOTE 27: INTEREST RATE RISK MANAGEMENT (in HUF million) [continued]

31 December 2016	Within 1 month		within 3 months over 1 month		within 1 year over 3 months		within 2 years over 1 year		over 2 years		Non-interest-bearing		Total		Total
LIABILITIES	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	HUF	Foreign currency	
Amounts due to OTP Bank and other banks	79,878	-	324,000	879	110,000	-	-	-	11,759	-	719	-	526,356	879	527,235
<i>fixed interest</i>	9,878	-	4,000	879	110,000	-	-	-	11,759	-	-	-	135,637	879	136,516
<i>variable interest</i>	70,000	-	320,000	-	-	-	-	-	-	-	-	-	390,000	-	390,000
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	719	-	719	-	719
Liabilities from issued securities	-	155,798	-	-	-	-	-	-	206,453	-	9,973	198	216,426	155,996	372,422
<i>fixed interest</i>	-	-	-	-	-	-	-	-	206,453	-	-	-	206,453	-	206,453
<i>variable interest</i>	-	155,798	-	-	-	-	-	-	-	-	-	-	-	155,798	155,798
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	9,973	198	9,973	198	10,171
Derivative financial instruments	159,676	-	-	-	-	-	-	-	-	-	-	-	159,676	-	159,676
<i>fixed interest</i>	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
<i>variable interest</i>	159,676	-	-	-	-	-	-	-	-	-	-	-	159,676	-	159,676
Subordinated bonds and loans	-	4,852	-	-	-	-	-	-	-	-	-	24	-	4,876	4,876
<i>fixed interest</i>	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
<i>variable interest</i>	-	4,852	-	-	-	-	-	-	-	-	-	-	-	4,852	4,852
<i>non-interest bearing</i>	-	-	-	-	-	-	-	-	-	-	-	24	-	24	24
NET POSITION	(41,542)	(16)	18,552	(651)	(43,976)	497	93,580	-	52,076	-	(4,921)	(219)	73,769	(389)	73,380

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NOTE 28: MATURITY ANALYSIS OF ASSETS AND LIABILITIES AND LIQUIDITY RISK (in HUF million)

Liquidity risk is a measure of the extent to which the Group may be required to raise funds to meet its commitments associated with financial instruments. The Group maintains its liquidity profiles in accordance with regulations laid down by the NBH.

The following tables provide an analysis of liabilities into relevant maturity groupings based on the remaining period from the balance sheet date to the contractual maturity date. It is presented under the most prudent consideration of maturity dates where options or repayment schedules allow for early repayment possibilities.

The contractual amounts disclosed in the maturity analyses are the contractual undiscounted cash flows like gross finance lease obligations (before deducting finance charges); prices specified in forward agreements to purchase financial assets for cash; net amounts for pay-floating/receive-fixed interest rate swaps for which net cash flows are exchanged; contractual amounts to be exchanged in a derivative financial instrument for which gross cash flows are exchanged; gross loan commitments.

Such undiscounted cash flows differ from the amount included in the statement of financial position because the amount in that statement is based on discounted cash flows. When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the end of the reporting period. For example, when the amount payable varies with changes in an index, the amount disclosed may be based on the level of the index at the end of the period.

As at 31 December 2017	Within 3 months	Within one year and over 3 months	Within 5 years and over one year	Over 5 years	Without maturity	Total
Cash, due from banks and balances with the National Bank of Hungary	4,086	-	-	-	-	4,086
Placements with other banks, net of allowance for placement losses	22,966	2,959	49,415	-	-	75,340
Securities available for sale	344	-	10,000	-	-	10,344
Loans, net of allowance for possible loan losses	25,215	59,695	313,615	586,899	-	985,424
Property and equipment	-	-	-	-	87	87
Intangible assets	-	-	-	-	158	158
Other assets	<u>2,975</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,975</u>
TOTAL ASSETS	<u>55,586</u>	<u>62,654</u>	<u>373,030</u>	<u>586,899</u>	<u>245</u>	<u>1,078,414</u>
Amounts due to banks and Hungarian Government, deposits from the National Bank of Hungary and other banks	682	571,000	11,759	-	-	583,441
Liabilities from issued securities	10,419	-	241,350	150,000	-	401,769
Other liabilities	<u>14,529</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>14,529</u>
TOTAL LIABILITIES	<u>25,630</u>	<u>571,000</u>	<u>253,109</u>	<u>150,000</u>	<u>-</u>	<u>999,739</u>
Commitments to extend credit	<u>296</u>	<u>963</u>	<u>27,080</u>	<u>-</u>	<u>-</u>	<u>28,339</u>
Off-balance sheet commitments	<u>296</u>	<u>963</u>	<u>27,080</u>	<u>-</u>	<u>-</u>	<u>28,339</u>

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NOTE 28: MATURITY ANALYSIS OF ASSETS AND LIABILITIES AND LIQUIDITY RISK (in HUF million) [continued]

As at 31 December 2016	Within 3 months	Within one year and over 3 months	Within 5 years and over one year	Over 5 years	Without maturity	Total
Cash, due from banks and balances with the National Bank of Hungary	460	-	-	-	-	460
Placements with other banks, net of allowance for placement losses	2,580	-	-	-	-	2,580
Securities available for sale	338	-	10,000	-	-	10,338
Loans, net of allowance for possible loan losses	5,882	3,555	57,073	885,992	-	952,502
Property and equipment	-	-	-	-	35	35
Intangible assets	-	-	-	-	212	212
Other assets	4,303	-	-	-	-	4,303
TOTAL ASSETS	<u>13,563</u>	<u>3,555</u>	<u>67,073</u>	<u>885,992</u>	<u>247</u>	<u>970,430</u>
Amounts due to banks and Hungarian Government, deposits from the National Bank of Hungary and other banks	14,596	500,879	11,759	-	-	527,234
Liabilities from issued securities	10,172	155,510	49,250	150,000	-	364,932
Other liabilities	3,894	-	-	-	-	3,894
Subordinated bonds and loans	4,876	-	-	-	-	4,876
TOTAL LIABILITIES	<u>33,538</u>	<u>656,389</u>	<u>61,009</u>	<u>150,000</u>	<u>-</u>	<u>900,936</u>
Receivables from derivative financial instruments designated as fair value hedge	137,259	23,059	-	-	-	160,318
Liabilities from derivative financial instruments designated as fair value hedge	(137,259)	(22,564)	-	-	-	(159,823)
Net position of financial instruments designated as fair value hedge	<u>-</u>	<u>495</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>495</u>
Net position of derivative financial instruments total	<u>-</u>	<u>495</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>495</u>
Commitments to extend credit	275	376	13,814	-	-	14,465
Off-balance sheet commitments	<u>275</u>	<u>376</u>	<u>13,814</u>	<u>-</u>	<u>-</u>	<u>14,465</u>

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NOTE 29: FAIR VALUE OF FINANCIAL INSTRUMENTS (in HUF million)

In determining the fair value of a financial asset or liability the Group in the case of instruments that are quoted on an active market uses the market price. In most cases market price is not publicly available so the Group has to make assumptions or use valuation techniques to determine the fair value of a financial instrument. See for more information about fair value classes applied for financial assets and liabilities measured at fair value in these financial statements.

To provide a reliable estimate of the fair value of those financial instrument that are originally measured at amortised cost, the Group used the discounted cash-flow analysis (loans, placements with other banks, amounts due to banks, deposits from customers). The fair value of issued securities and subordinated bonds is based on quoted prices (e.g. Reuters, Bloomberg). Cash and amounts due from banks and balances with the NBH represent amounts available immediately thus the fair value equals to the carrying amount.

The assumptions used when calculating the fair value of financial assets and liabilities when using valuation technique are the following:

- the discount rates are the risk free rates related to the denomination currency adjusted by the appropriate risk premium as of the end of the reporting period,
- the contractual cash-flows are considered for the performing loans and for the non-performing loans, the amortised cost less impairment is considered as fair value,
- the future cash-flows for floating interest rate instruments are estimated from the yield curves as of the end of the reporting period,
- the fair value of the deposit which can be due in demand cannot be lower than the amount payable on demand.

Fair value measurements – in relation to instruments measured not at fair value – are categorized in level 2 of the fair value hierarchy.

Fair value of financial assets and liabilities

	2017		2016	
	Carrying amount	Fair value	Carrying amount	Fair value
Cash, due from banks and balances with the National Bank of Hungary	4,086	4,086	460	460
Placements with other banks	75,340	75,340	2,580	2,580
Securities available-for-sale	11,291	11,291	11,728	11,728
Loans, net of allowance for loan losses ¹	985,532	1,203,623	962,344	1,273,098
Trade receivables, other advances	1,027	1,027	1,338	1,338
FINANCIAL ASSETS TOTAL	<u>1,077,276</u>	<u>1,295,367</u>	<u>978,450</u>	<u>1,289,204</u>
Amounts due to OTP Bank and other banks	583,453	583,766	527,235	529,289
Liabilities from issued securities	406,845	507,741	372,422	463,173
Subordinated bonds and loans	-	-	4,876	4,876
Account payables	9,369	9,369	757	757
FINANCIAL LIABILITIES TOTAL	<u>999,667</u>	<u>1,100,876</u>	<u>905,290</u>	<u>998,095</u>

¹ The difference between the carrying amount and the fair value derived from the interest subsidies related to housing loans.

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NOTE 29: FAIR VALUE OF FINANCIAL INSTRUMENTS (in HUF million) [continued]

Fair value of derivative instruments

	Fair value		Notional value, net	
	2017	2016	2017	2016
CCIRS designated as fair value hedge				
Positive fair value of CCIRS classified as fair value hedge	-	801	-	395
Negative fair value of CCIRS classified as fair value hedge	-	-	-	-
Derivative financial assets total	<u>-</u>	<u>801</u>	<u>-</u>	<u>395</u>
Derivative financial liabilities total	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Derivative financial instruments total	<u><u>-</u></u>	<u><u>801</u></u>	<u><u>-</u></u>	<u><u>395</u></u>

Hedge accounting

The Group regularly enters into hedging transactions in order to decrease its financial risks.¹

The summary of the hedging transactions of the Group are as follows:

As at 31 December 2016

Type of hedge	Description of the hedging instrument	Fair value of the hedging instrument	Type of the risk being hedged
1) Cash flow hedges	-	-	-
2) Fair value hedges	CCIRS	HUF 801 million	Interest rate, foreign exchange
3) Net investment hedge in foreign operations	-	-	-

¹ In 2016 the Bank had no derivatives held for trading

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NOTE 29: FAIR VALUE OF FINANCIAL INSTRUMENTS (in HUF million) [continued]

Fair value hedges - Issued securities

The cash-flows of the floating rate securities issued by the Group are exposed to the change in the EUR/HUF foreign exchange rate and the risk of change in the risk-free interest rates of EUR, HUF. The interest rate risk and foreign exchange risk related to these securities are hedged with HUF-EUR CCIRS transactions, where the floating EUR cash-flows were swapped to payments linked to 3 CHF or BUBOR, resulting a decrease in the interest rate and foreign exchange exposure of issued securities.

The fair value of the hedging instruments is 290 HUF million at 31 December 2016, the hedging instruments were closed in 2017.

As at 31 December 2016

Types of hedged item	Types of hedging items	Fair value of the hedged item	Fair value of the hedging instrument	Gain/ loss attributable to the hedged risk	
				hedging instrument	hedged item
Liabilities from issued securities	CCIRS	-	-	(514)	514
Liabilities from issued securities	CCIRS	155,976	290	(1,871)	1,871

Fair value hedges – Subordinated loans

The cash-flows of the variables interest rate of subordinated loan granted to the Group are exposed to the change in the CHF/HUF foreign exchange rate and the risk of change in the risk-free interest rates of CHF, HUF. The interest rate risk and foreign exchange risk related to these securities are hedged with HUF-CHF CCIRS transaction, where the payments linked to 3 month BUBOR are swapped to payments linked to 3 month CHF LIBOR, resulting a decrease in the interest rate and foreign exchange exposure of subordinated loan.

The fair value of the hedging instruments is 511 HUF million as at 31 December 2016 and in 2017 the Group do not have hedging instruments.

As at 31 December 2016

Types of hedged item	Types of hedging items	Fair value of the hedged item	Fair value of the hedging instrument	Gain/ loss attributable to the hedged risk	
				hedging instrument	hedged item
Subordinated loan	CCIRS	4,342	511	471	(471)

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NOTE 29: FAIR VALUE OF FINANCIAL INSTRUMENTS (in HUF million) [continued]

Fair value hierarchy

Methods and significant assumptions used to determine fair value of the different classes of financial instruments:

- 1st Level: quoted prices (unadjusted) in active markets for identical assets or liabilities;
- 2nd Level: inputs other than quoted prices included within Level 1, that are observable for the asset or liability either directly or indirectly;
- 3rd Level: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

As at 31 December 2017

	Total	Level 1	Level 2
Securities available for sale	10,947	10,947	-
Positive fair value of derivative financial instruments designated as fair value hedge	<u>=</u>	<u>=</u>	<u>=</u>
Financial assets measured at fair value total	<u>10,947</u>	<u>10,947</u>	<u>=</u>
Negative fair value of derivative financial instruments designated as fair value hedge	<u>-</u>	<u>-</u>	<u>-</u>
Financial liabilities measured at fair value total	<u>-</u>	<u>-</u>	<u>-</u>

As at 31 December 2016

	Total	Level 1	Level 2
Securities available for sale	11,390	11,390	-
Positive fair value of derivative financial instruments designated as fair value hedge	<u>801</u>	<u>-</u>	<u>801</u>
Financial assets measured at fair value total	<u>12,191</u>	<u>11,390</u>	<u>801</u>
Negative fair value of derivative financial instruments designated as fair value hedge	<u>-</u>	<u>-</u>	<u>-</u>
Financial liabilities measured at fair value total	<u>-</u>	<u>-</u>	<u>-</u>

There were no financial assets and liabilities at fair value in Level 3 respectively in 2017 and 2016.

NOTE 30: SIGNIFICANT EVENTS DURING THE YEAR ENDED 31 DECEMBER 2017

Relevant transactions related to issued securities

See details in Note 12.

NOTE 31: POST BALANCE SHEET EVENTS

Transition to application of IFRS 9

See details in Note 1.2.2.