FHB MORTGAGE BANK PLC

CONSOLIDATED ANNUAL REPORT FOR YEAR 2013
ACCORDING TO IFRS

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CONSOLIDATED BUSINESS REPORT FOR 2013
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Budapest, April 2, 2014.

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1 OVERVIEW OF FHB GROUP

1.1 FHB MORTGAGE BANK PLC.

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

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

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

On 31 October 2003 the Hungarian Financial Supervisory Authority (HFSA) granted permission for FHB Mortgage Bank to issue a prospectus to introduce its shares to the Budapest Stock Exchange. Following a public and private placement of the Bank's shares, a total of 2,500,000 ordinary shares were sold in the context of public offering along with an additional 1,324,899 ordinary shares sold to institutional investors in the context of private placement. A total of further 588,570 voting preference shares were sold to the Bank's priority strategic partners in the context of private placement. The ordinary shares were listed on the Budapest Stock Exchange on 24 November 2003.

The Board of Directors of the Bank accepted a strategic plan in February 2006 focusing on the expansion of the banking activity and branch network as a midterm target. In the framework of this, the Bank set up new subsidiaries besides the already existing FHB Services Ltd., specifically FHB Commercial Bank Ltd., FHB Real Estate Trading and Valuation Ltd., and FHB Life Annuity and Real Estate Investment Ltd. At the same time the Bank changed its name to FHB Mortgage Bank Plc. Mortgage Bank is the parent company of the group. (The Bank, its subsidiaries and the jointly controlled companies are together referred to as the Group or Banking Group.)

On 29 August 2007 the Hungarian Privatization and State Holding Company (ÁPV Ltd.) formerly holding a 54.11% majority share in the Bank sold its packet of Series "A" ordinary shares of 50% + 1 vote in the Hungarian and international capital market in the context of accelerated book building. The transaction was administered by HSBC Plc. investment service company. As a result of the sale ÁPV's share in the Bank dropped to 4.11% held exclusively in the form of Series "B" preference shares. The Series „B" preference shares were converted into ordinary shares in 2009.

In 2013 FHB Mortgage Bank Plc. had solely series "A" ordinary shares listed on Budapest Stock Exchange. Besides trading shares on stock exchange no other event modified ownership structure in 2013. Majority (57.6%) of FHB shares is owned by domestic institutional investors.

FHB Group's shareholder structure as of 31 December 2013:

Investor category	31/12/2012		31/12/2013	
	Number of shares	Ownership %	Number of shares	Ownership %
Domestic institution/company	36,795,859	55.76%	38,040,017	57.64%
Foreign institution/company	14,509,484	21.98%	14,297,742	21.66%
Domestic and foreign individuals	4,118,847	6.24%	5,136,154	7.78%
MNV Ltd.	4,724,833	7.16%	4,724,833	7.16%
FHB Mortgage Bank Plc.	53,601	0.08%	53,601	0.08%
Other investors	5,797,386	8.78%	3,747,663	5.68%
Total	**66,000,010**	**100.00%**	**66,000,010**	**100.00%**

During the period between 2008 and 2009 the activities, products and services provided were expanded continuously by the Group, in accordance with the Strategic Plan. The Commercial Bank launched the branch for private company clients and the Netbank service on Internet and provided new services related to the bank accounts and bankcards for the retail customers. In 2010 the Commercial Bank's activities were extended with investment services business.

In April and June 2009 the Bank increased the Group by the acquisition of Central European Credit Ltd. (CEC, named to FHB Real Estate Lease Ltd. effective from 31 December 2010) and the three companies of POMO group (Portfolio Money Ltd., Portfolio Money FBK Ltd. and Hitelunió Ltd.).

The expanding of FHB Group continued in 2010 by acquiring the Allianz Bank Ltd and by entering a long-term strategic and co-operation agreement with Allianz Hungary Insurance Ltd. Allianz Bank was merged into FHB Commercial Bank on 1 April 2011.

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

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

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

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

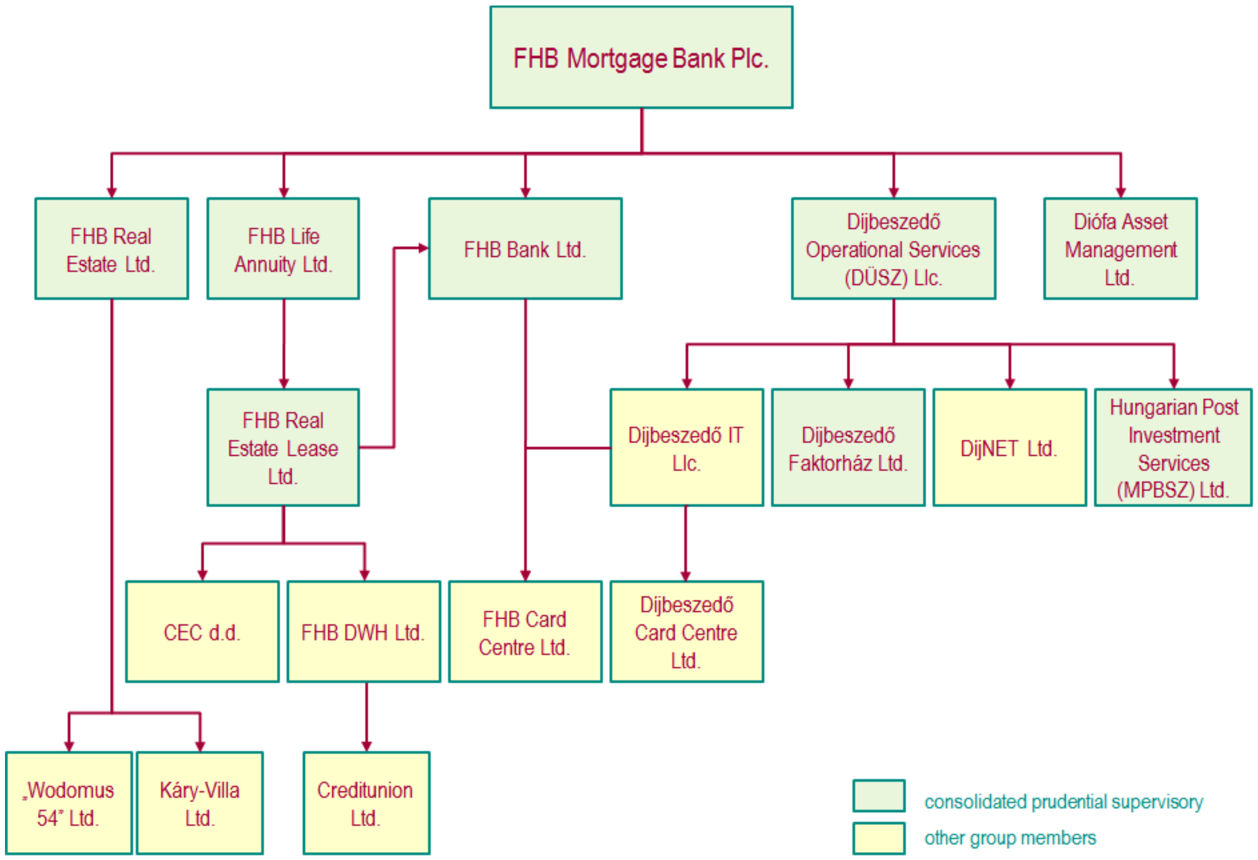
Related to the transaction of the business shares, FHB and the Magyar Posta (Hungarian Post) entered into a strategic cooperation, and in the scope of that they cooperate in the ownership and control of DÜSZ Llc., DBH and the jointly controlled companies, furthermore in course of the harmonization of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

Based on the Agreement between FHB Group and Magyar Posta, DÜSZ Llc. acquired 50% of shares of Magyar Posta Befektetési Zrt. (Hungarian Post Investment Services Ltd., hereinafter MPBSZ Ltd.) by exchange of 24% shares of DíjNET Zrt. and additional share price to be paid in next years. This transaction closed on December 5, 2013. Beforehand the acquisition of qualifying holding was authorized by National Bank of Hungary (NBH), or its predecessor, the Hungarian Financial Supervisory Authority.

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

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

***Structure of FHB Group at the end of 2013*[1]**



1.2 FHB COMMERCIAL BANK LTD.

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

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

On 30 November 2011, before selling FHB Service Ltd., FHB Commercial Bank bought notable amount of its assets (most of all implemented at branches) and FHB Service's financial services related activities – such as loan administration, collection and data processing – and employees were moved to FHB Commercial Bank Ltd. Commercial Bank also provide this kind of services to FHB Mortgage Bank in a framework of agency agreement.

[1] DÜSZ Llc., Díjbeszedő Faktorház Ltd. and Magyar Posta Investment Services Ltd. are under consolidated supervision according to the NHB resolution received on 24 January 2014.

At the end of 2013 the Board of Directors of FHB Mortgage Bank decided to change the capital structure of the Commercial Bank, meaning that FHB Bank Ltd. bought back 8,179 ordinary shares from Mortgage Bank. At the same time, the Mortgage Bank granted subordinated loan amounting HUF 10 billion to Commercial Bank.

In November 2013 the Bank established FHB Card Centre Ltd. of which activity is linked to card related electronic payment platform services.

The Commercial Bank's total assets in accordance with Hungarian Accounting Standards (HAS) amounted to HUF 530.9 billion as of 31 December 2013, which surpassed by 22.5% the previous year figure (HUF 433.6 billion). Gross loan portfolio of Commercial Bank amounted to HUF 223.9 billion according to HAS, representing 2.5% increase since the end of the year 2012, thanks to the growth of corporate loans. Volume of corporate loans excluding intra-group transactions was HUF 65.2 billion at the end of the period. The Bank's deposit portfolio increased nearly by 150% over the past year, also due to larger contribution of corporate business. Retail deposits grew by close to HUF 2 billion, volume of corporate deposits increased by close to HUF 63 billion.

FHB Commercial Bank's balance sheet profit was HUF 930 million losses in 2013, its shareholders' equity at year end was HUF 30.4 billion and capital adequacy ratio (according to HAS) was 10.69% as at 31 December 2013.

1.3 FHB REAL ESTATE LTD.

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

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

In 2009, FHB Mortgage Bank purchased FHB Services share and became the sole owner of the company.

Due to easing the effects of the crisis slight increase of real estate sales and lending activities was experienced as a result the Company closed the year 2013 with HUF 33 million profits. After capital increase amounting HUF 120 million the Company's registered capital was HUF 70 million and shareholders' equity HUF 177 million at the end of the year.

FHB Real Estate Ltd. owns 100% share of "Wodomus 54" Property Development Ltd. established on 11 February 2011 with a share capital of HUF 500,000 as a project company to finalize and sale 54 flats of real estate located in Csepel (Rákóczi Ferenc str. 144). Real Estate Ltd. set up also Káry-Villa Property Development Ltd. on 11 February 2011 with a share capital of HUF 500,000 HUF aiming utilization of the property located in Budapest, Dózsa György str. 74. This property was sold in 2012, settling of related loan transaction and financial results of the deal accounted at FHB Mortgage Bank. "Wodomus 54" sold all the flats of the condominium located in Csepel in September 2013.

1.4 FHB LIFE ANNUITY LTD.

FHB Life Annuity Real Estate Investment Ltd. was founded on 9 June 2006 with a registered capital of HUF 100 million. Upon foundation, 95% of the company's shares were held by FHB Mortgage Bank Plc., and 5% by FHB Services Ltd. Actual operation of FHB Life Annuity Ltd. started on 6 November 2006. As of March 2009 FHB Mortgage Bank became the sole owner of the company.

FHB Annuity Ltd. sells two products: an annuity product that is sold directly to senior citizens, and a reverse mortgage product. The reverse mortgage product is offered through FHB Annuity Ltd. as an agent of the Mortgage Bank. The reverse mortgage scheme is a product of FHB Mortgage Bank Plc.; consequently, the contracts concluded through FHB Annuity are reported in the balance sheet of FHB Mortgage Bank Plc.

At 3 June 2013, the Parliament accepted amendment in the Act LX of 2003 on Insurance Companies and Insurance Activities. Hence the alterations for profit annuity services could only be pursued according to the Act from 1 of January 2015. The scope of law does not apply to contracts signed until 31 December 2014

Since the foundation of the Company until 31 December 2013 740 annuity contract were signed, that represents 624 contracts alive and HUF 10.5 billion real estate volumes (and same amount of total contracted value) after closing 116 contracts amounted to HUF 1.7 billion of the real estate portfolio (this is the total value of annuity contracts as a whole).

FHB Mortgage Bank carried out capital increase HUF 310 million in the Company in July 2013, in order to settle capital position of FHB Real Estate Lease Ltd. owned by the Company.

The Company's registered capital according to HAS was HUF 165 million at the end of 2013, additionally capital reserves amounted to HUF 744 million. Balance sheet profit (loss) of the year 2013 according to HAS decreased by HUF 900 million the shareholder's equity of Life Annuity Ltd.

1.5 FHB REAL ESTATE LEASE LTD.

The private limited company FHB Real Estate Lease Ltd. was established on 15 December 2004. The company started business on 28 August 2005 with an initial capital of 50 million HUF consisting solely of cash contributions. The company is a financial enterprise. Its HFSA license number is E-I-737/2005. According to the HFSA license, the company is authorized to undertake two types of business activities: mortgage lending and real estate financial leasing. As had been the case in previous years, FHB Real Estate Lease Ltd. offered financial lease product solely on a real estate collateral basis to retail and corporate customers.

The company joined FHB Group in 2009; its sole shareholder was FHB Services Ltd. On 17 November 2011 FHB Services Ltd sold its share in FHB Real Estate Leasing Ltd. to FHB Life Annuity Ltd.

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

As at 31 December 2013, the consolidated loan volume of FHB Real Estate Lease Ltd. reached HUF 7.2 billion. In 2013, lease financing disbursement amounted to HUF 767 million. Leasing portfolio reached HUF 3.4 billion as of 31 December 2013 representing 5.0% increase compared to the end of 2012.

FHB Mortgage Bank – as parent company exercising ownership rights on investments of FHB Life Annuity Ltd – decided to increase company's capital two times in 2013. Total capital increase amounted to HUF 310 million.

The Company closed the year 2013 with HUF 556 million losses. Shareholder's equity of the Company according to HAS amounted to HUF -137.7 million as at 31 December 2013; registered capital was HUF 110 million and capital reserves amounted to HUF 1.3 billion.

1.6 DIÓFA ASSET MANAGEMENT LTD.

Diófa Asset Management Ltd. had been established by Évgyűrűk Pension Fund in February 2009. Initially, Diófa focused on dedicated wealth management for Évgyűrűk Pension Fund, later on the changing regulation in the private pension fund sector required a new sustainable business model.

The Company announced on 8th July 2013, that it signed a contract to buy 100% of the ordinary shares of the Diófa Asset Management Ltd. Pursuant the specified contractual conditions required for the effective transfer of the shares are satisfied by the parties on 2 September 2013, since then the 100% of the ordinary shares of the Asset Management company is owned by FHB Mortgage Bank Plc. After the change in ownership, Diófa Asset Management is a fully consolidated member of FHB Group and belongs to common supervision since September 2013.

Before the acquisition, Diófa Asset Management was focusing on real estate investments, pension fund wealth management and tailor made solutions for institutional clients. From September 2013 Diófa Asset Management Ltd. still sustains its former focus areas, in addition new retail funds have been launched in the branch network of FHB Banking Group. Sales volume of FHB Forte Short Bond Fund, FHB Money Market Fund and FHB Absolute Yield Fund reached close to HUF 5.3 billion in four months. Total net value of assets under management increased to HUF 23.8 billion from HUF 15.8 billion at December 31, 2012.

Asset Management Ltd. closed with HUF 23 million loss the year 2013 (of which pro rata loss of period after change in ownership was around HUF 4 million); subscribed capital amounted to HUF 135.4 million and shareholders' equity HUF 124 million.

1.7 DÍJBESZEDŐ OPERATIONAL AND SERVICE LLC.

The DÜSZ was established by demerge from Díjbeszedő Holding Ltd. on 30 September 2013. In course of the demerge DÜSZ own 51% of the shares of Díjbeszedő Faktorház Ltd., 75% of the shares of DíjNET Ltd. and 50% of Díjbeszedő Informatikai Ltd. In December 2013, DÜSZ Ltd. acquired 50% share of Magyar Posta Befektetési Zrt (Hungarian Post Investment Services Ltd.) by exchange of 24% shares of DíjNET Ltd. and additional share price to be paid in next years.

DÜSZ Ltd. is going to be subsidiary of FHB Group dealing with facility management. The company's subscribed capital and shareholder's equity according to HAS was HUF 636 million and HUF 1.3 billion, respectively, as of 31 December 2013.

Ownership structure of FHB Group members as at 31 December 2013:

Subsidiaries	Shareholders								
	FHB Mortgage Bank Plc	FHB Bank Ltd.	FHB Life Annuity Ltd.	FHB Real Estate Ltd.	FHB Real Estate Leasing Ltd.	FHB DWH Ltd.	Díjbeszedő Operational and Service Llc.	Díjbeszedő IT Llc.	Total
FHB Commercial Bank Ltd.	84.353%	15.645%*	-	-	0.002%*	-	-	-	100.000%
FHB Life Annuity Ltd.	100.00%	-	-	-	-	-	-	-	100.00%
FHB Real Estate Lease Ltd.	-	-	100.00%	-	-	-	-	-	100.00%
Central European Credit d.d.	-	-	-	-	100.00%	-	-	-	100.00%
FHB Real Estate Ltd.	100.00%	-	-	-	-	-	-	-	100.00%
Káry-Villa Ltd.	-	-	-	100.00%	-	-	-	-	100.00%
Wodomus 54 Ltd.	-	-	-	100.00%	-	-	-	-	100.00%
FHB DWH Ltd.	-	-	-	-	100.00%	-	-	-	100.00%
Hitelunió Ltd.	-	-	-	-	-	100.00%	-	-	100.00%
Diófa Asset Management Ltd.	99.70%	-	-	-	-	-	-	-	99.70%
Díjbeszedő Operational and Service Llc.	100.00%	-	-	-	-	-	-	-	100.00%
Díjbeszedő Faktorház Ltd.	-	-	-	-	-	-	51.00%	-	51.00%
DíjNET Ltd.	-	-	-	-	-	-	51.00%	-	51.00%
Díjbeszedő IT Llc.	-	-	-	-	-	-	50.00%	-	50.00%
Magyar Posta Investment Services Ltd.	-	-	-	-	-	-	50.00%	-	50.00%
FHB Card Centre Ltd.	-	50.00%	-	-	-	-	-	50.00%	75.00%

** FHB Real Estate Lease Ltd. owned 1 piece of shares of FHB Commercial Bank Ltd. and FHB Commercial Bank Ltd. owned 8,179 pieces of own shares as at December 31, 2013.*

2 MACROECONOMIC AND MARKET ENVIRONMENT IN 2013

2.1 HUNGARIAN ECONOMY IN 2013[2]

After decreasing in 2012, GDP of Hungary shows increase of 1.1%. Same growth is expected in industrial production (+0.9%) as in GDP growth. Performance of the building industry showed for the first time after seven years shrinkage. The growth is supported by the increase in the portfolio of construction contracts (expanded by 26% in the January-November period).

	2011	2012	2013*
GDP growth (%)	1.6%	-1.5%	1.1%
Industrial production growth (%)	5.4%	-1.5%	0.9%
Consumer prices (%)	3.9%	5.7%	1.7%
Unemployment rate (%)	10.9%	10.5%	9.3%
Budget deficit (billion HUF)	-1,734	-692	-929
Current balance of payments (million EUR)	910	613	2,300
National Bank of Hungary base rate (%, end of the year)	7.00%	5.75%	3.00%
EUR exchange rate (end of the year)	311.1	291.3	296.9

** expected for 2013*
Source: NSA, National Bank of Hungary

Consumer price index grew by 1.7% compared to the previous year, representing 4.0%-point decline. In 2013, primarily alcoholic drinks and tobacco prices had been raised by more than 10%. Other commodities, fuel prices grew by 0.5%, the price level of financial services increased by 36%, but household's energy costs decreased by 8.5%.

NBH decreased the base rate several times in 2013. The 2012 closing base rate of 5.75% fell to 3.00%, as a result of eleven cuts by 25 and 20 basis points from January to December 2013. Interbank rates performed similar trend during the year. The exchange rate of the forint against euro continuously sank, from HUF/EUR 292.96 to HUF/EUR 296.91 by the end of the year. In domestic lending important Swiss franc remained above HUF 200 in the whole year. The exchange rate was HUF/CHF 242.40 HUF at the beginning of 2013 and was HUF/CHF 242.14 at the end of 2013.

The unemployment rate is below figures of 2012. Small reduction (1.2%) compared to 2012 is due to special regulation (public work and 90 working days per year required to cost-of-living allowance) having no influence on demand for financial products. Average number of employees was 3,979 thousand representing 88 thousand growth compared to 2012. The average gross income of employees was 3.8% higher than a year before, while net average salaries rose by 5.3% year-on-year.

Balance of government budget deteriorated compared to the last year representing HUF 929 billion deficit at the end of 2013. Export and import rose by 4.5% and 4.4%. Balance of foreign trade was EUR 7 billion; this means EUR 446 million growths compared to year 2012. Growing exports and considerable lag in imports resulted in a positive balance on current account (EUR 2.3 million).

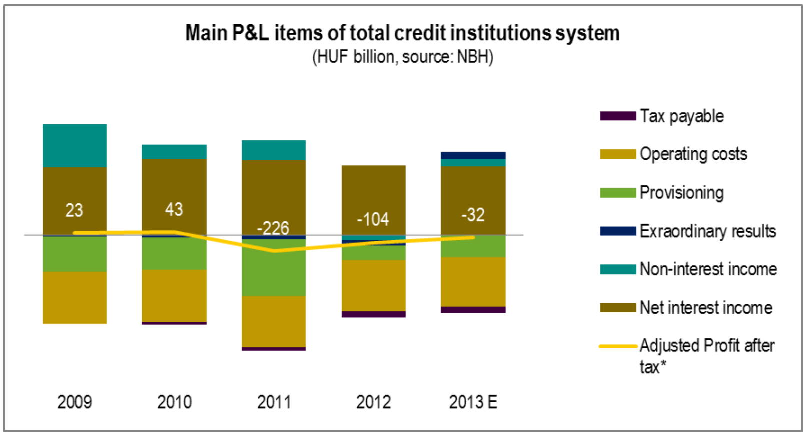
Positive indicators achieved by the building industry are not supported by the number of dwelling construction permits issued and new housing constructions. 7,536 residential building permits were issued in 2013, 29% less than in 2012. The largest decline was in villages and small towns by 40%. In contrast, building permits issued in the county seats were only down by 11.4% to 2,123. The number of new homes planned in Budapest reduced by 27.5% to 1,430 similarly to the yearly average-change.

The number of new homes built reduced to 7,293 from 10,560 in 2012. In particular, the share of homes built by firms increased from 31% to 40% (2.924), share of homes built by individuals decreased from 68%to 57% (4.167). As a consequence of the rearrangement in the composition of builder, average floor area of dwellings was 101 m^2 in 2013, which is 6 m^2 less than in the previous period.

[2] Based on reports and statistics of NBH and HCSO

2.2 CREDIT INSTITUTIONS SECTOR IN 2013[3]

Total assets of credit institutions amounted to HUF 31,156 billion at the end of 2013, 0.9% lower than at the end of 2012. In 2013, the cumulative pre-tax profit was HUF 155.2 billion, significantly exceeded the HUF 91 billion loss of 2012. The 2013th year's positive result is mainly due to the unique exceptional items, the majority of the sector is still closed at a loss. The pre-tax profit of the joint-stock credit institutions was HUF 126.3 billion (of which the extraordinary profit was HUF 99 billion) and of co-operative credit institutions was HUF 2.8 billion.

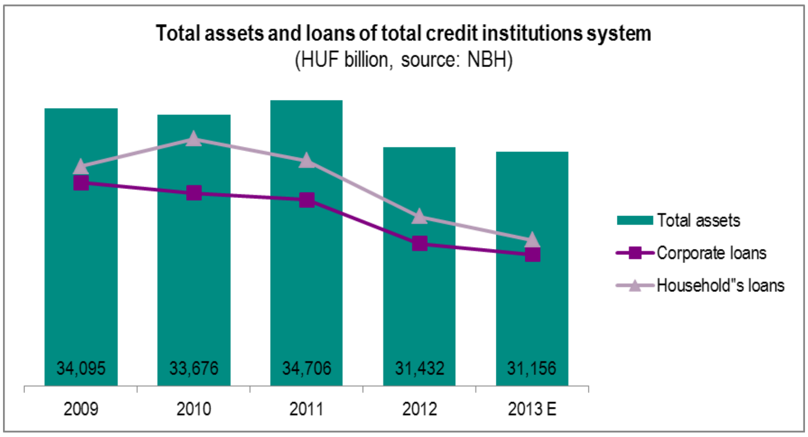


Credit institution branches made HUF 17.8 billion and the three specific specialized credit institutions made HUF 8.3 billion pre-tax profit.

Gross loan portfolio of credit institutions decreased by 6% in 2013. Lending of banks declined 6.8% year-on-year. Volume of household's loans decreased continuously during the year, representing 7.5% fall.

23.4% (HUF 4.188 billion) of total loan portfolio (HUF 17.865 billion) was past due loans. Quality of loan portfolio (loans to household's and non-financial corporations) deteriorated further in 2013, share of loans past due was 29% (at the end of 2012 was 28.6%) and share of loans past due more than 90 days grew to 17.5% from 17.1% in 2012.

The restructured loans amounted to HUF 2,885.8 billion at the end of the year that exceeded 13.3% of the 2012th year-end level. The restructured HUF loan portfolio rose by 49%, and restructured FX loans grew by 5.9% in 2013.



The share of deposits of the bank's customers liabilities increased in 2013, the share of deposits of the funding of the sector grew in 2013 (47.7% from 46.6% in 2012) amounted to HUF 14,865 billion. Household's deposits represented 47% of total deposits.

2.2.1 Retail savings

According to the statistics of National Bank of Hungary, households' financial savings were HUF 19.699 billion as of December 31, 2013, which is 5.6% more (HUF 1,000 billion higher) than a year ago. The structural rearrangement of savings - thanks to declining deposit interest rates - has intensified over the year: households preferred securities instead of savings deposits. Accordingly, the ratio of deposits in the structure of savings deposits changed from 45% to the end of the year 2013, 38%. The investment funds and other securities present the 33% of total savings, compared with the 26% of at year-end 2012. Volume of deposits reduced by 9% in 2013; while investment funds grew by 40% and other securities increased by 24.3%.

Within the deposits, the volume of current account deposits increased dynamically, by 18.7% year on year; as a result its proportion rose to nearly 31%. Other deposits reduced by 17.8% to HUF 5,212 billion. The share of HUF deposits of

[3] Based on reports and statistics of NBH and HCSO
* Adjusted by extraordinary results

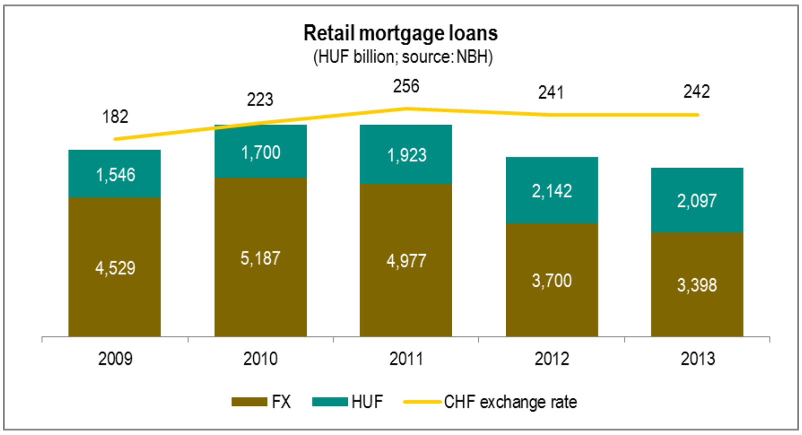
retail deposits was 87%, and FX deposit was 13% at the end of 2013 representing the same distribution as one year ago.

2.2.2 Retail mortgage lending

Retail customers' demand for loans still showed low level in 2013. Although the disbursement of retail mortgage loans shows slight increase, the total disbursement was only HUF 200 billion. This volume is significantly lower than in 2012. If the disbursement in 2012 is cleaned from the disbursement of redeemed loans (related to early repayment of FX loans), the yearly disbursement of retail mortgage loans shows an approximately 35% increase.

2.2.2.1 Mortgage loan volumes

Based on data published by National Bank of Hungary, volume of retail mortgage loans amounted to 5,495 billion HUF as at 31 December 2013. Volume decreased by HUF 347 billion compared to year-end data of 2012 (5,842 billion HUF). Volume of FX loans fell by 8.2%, and HUF denominated loans also decreased despite of growing disbursement of subsidized loans by 2.1%, total volume of mortgage loans decreased by 5.9%.



Volume of housing loans amounted to HUF 3,336 billion as of 31 December 2013, representing yearly decrease of HUF 199 million. HUF loans declined by HUF 49 billion, while FX housing loans fell down by HUF 149 billion.

General-purpose mortgage loans amounted to 2,158 billion HUF as of 31 December 2013 with a 148 billion HUF year-on-year decline. Growth of HUF-denominated general-purpose loans was 5 billion HUF, at the same time FX-based general-purpose loans were down by 153 billion HUF.

As a combined effect of revaluation of FX loans and repayments, proportion of FX mortgage loans decreased from 62.9% in 2012 to 61.8% as of 31 December 2013.

2.2.2.2 Home protection measures

The problem of foreign currency loans was also a priority issue in 2013. There were no new measures introduced in the home protection frame, but the conditions of the exchange rate protection scheme and the National Asset Management Ltd. (NET) that may be offered properties are also changed over the years, have significantly broadened the circle of those entitled.

Exchange rate protection scheme

Based on the Act LXXV of 2011, on “the fixation of the instalments' exchange rate of loans denominated in foreign currencies and the rules for the forced sale of properties” and the governmental order 57/2012 (III.30) debtors with FX loans not overdue of more than 90 days are eligible to participate in the new scheme offering payment of instalments at reduced rates. The period for the participation in the buffer accounts scheme is limited (5 years but latest the due date of the last instalment before 30 June 2017).

During this period only the differences between the market spot rate and the fixed rate on the principal part of the instalment will be transferred to the buffer. Whereas the State and the Bank share the loss on the interest repayments due to the off-market fixed exchange rate on a 50%-50% basis when exchange rates moves in 180-270 CHF/HUF or 250-340 EUR/HUF or 2.5-3.3 JPY/HUF band. In the event of exchange rate levels exceeding CHF/HUF 270, EUR/HUF 340 and JPY/HUF 3.3 respectively, exchange rate risks are entirely borne by the State.

At the beginning of November, the Parliament passed the modification of act on measures needed to protect FX loan debtors, which stepped into effect after its publication, on 9 November 2013. The law introduced essentially immediate moratorium on evictions until 30 April 2014, and decided on the extension of range of debtors entitled to participate in FX rate protection scheme. According to the new regulation:

- also debtors with more than 90 days delay can apply for buffer account, including clients, who's real estate bothered with more than one of such mortgage;
- participation in client support program is not disqualifying;
- previous 20 million HUF limit were abolished, so clients with loans over 20 million HUF original value can also apply;
- conditions of state guarantee behind buffer accounts opened after modification coming into effect became more stringent:
    - in case of newly opened buffer accounts, state provide guaranty solely if outstanding loan volume not exceeds 95% of collateral real estate value;
    - Banks can exercise the guaranty if buffer accounts past due over 180 days and the bank terminates the contract because of that.

Until 31 December 2013, banks opened nearly 162 thousand new buffer accounts, in 2013 there were opened more than 51 thousand new buffer accounts.

National Asset Management Ltd.

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

Government assumed to ensure the background for National Asset Management Company to buy 25,000 properties until the end of 2014 according to the following schedule: 8,000 properties in 2012, 15,000 until the end of 2013 and 25,000 until end of 2014. As the Government accepted the modification of regulation of social conditions of NET program, the range of entitled clients became wider in four steps December 2012, January 2013, July 2013 and October 2013.

Until the end of 2013, financial institutions offered more than 15 thousand real estates to NET which means HUF 35 billion arranged mortgage loans from HUF 16 billon resources from the State budget.

2.2.3 Other retail loans

Consumer loans of households have been decreasing in 2013, as well. The 6.2% volume decrease was generated by declining FX loans, while HUF denominated consumer loans grew by 1.6% last year. Concerning total consumer loan portfolio, home equity loans representing majority of the volume with 76.4% share; contribution of personal loans reached 12%.

2.2.4 Corporate loans and deposits

Loans granted by credit institutions to non-financial corporations fell in 2013, the year-end closing stock of HUF 6,686 billion, 3.7%. Within the total stock of loans foreign currency loans decreased by 12.9% to HUF loans grew by 8.3%, thanks to the Lending for Growth Scheme.

The Central Bank of Hungary announced the Lending for Growth Scheme in April 2013, with the total of HUF 750 billion. The first two pillars of the program is designed for small and medium-sized enterprises to facilitate access to HUF loans and thereby strengthen financial stability. The placement of the loans was possible between June-August 2013. During this period credit institutions signed loan agreement to 93.5% of the total amount, which is almost HUF 701 billion, and about 10 thousand contract.

Loan received under the first pillar could only be used for financing new investment, working capital, EU transfers own contribution or for replacement of SME loan or financial lease granted for similar purposes.

The loans obtained from pillar II. could be used for replacement of SME customers foreign currency-denominated loans and financial leases granted by domestic credit institution until 31 March 2013 to domestic currency loans.

In pillar I the new loans ratio indicated 61% with great proportion of investment loans, which is beyond expectations. The pillar II. was also mainly used for redemption of investment loans.

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

Corporate deposits grew 14% year over year to HUF 5,019 billion. 57% is the ratio of current account deposits. The share of foreign currency deposits of corporate deposits is 32.4% at 31 December, 2013.

3 REPORT ON THE BUSINESS ACTIVITIES IN 2013

3.1 MAJOR FINANCIAL INDICATORS

in HUF billion	31/12/2012	31/12/2013	Change
Balance sheet total	752.6	737.5	-2.0%
Book value of loans (refinanced and own lending)	536.9	491.7	-8.4%
Mortgage bonds issued	231.8	172.8	-25.5%
Bonds issued	107.9	99.5	-7.8%
Shareholders' equity	77.5	76.1	-1.9%
Capital adequacy ratio (IFRS, %)	22.56%	13.82%	-8.7%-pt
Profit before tax	-3.4	-5.0	47.4%
After tax profit	-4.5	-4.7	4.5%
After tax profit excluding special banking tax and final repayment	-2.4	-1.3	-47.8%
Average net interest margin (%)	2.36%	2.51%	0.1%-pt
Cost/income ratio (%)	72.7%	91.2%	18.5%-pt
EPS (HUF)	-70.4	-70.9	0.7%
ROAA (return on average assets, %)	-0.57%	-0.63%	-0.1%-pt
ROAA excluding special banking tax and final repayment (%)	-0.31%	-0.17%	0.1%-pt
ROAE (return on average equity, %)	-6.8%	-6.1%	0.7%-pt
ROAE excluding special banking tax and final repayment (%)	-3.7%	-1.6%	2.0%-pt

FHB Group's consolidated balance sheet total calculated according to International Financial Reporting Standards (IFRS) was HUF 737.5 billion as of 31 December 2013, which is 2.0% and HUF 15.1 billion less than a year before. In the last year, primarily the volume changes of refinanced and own loans generated the decline of balance sheet total as new disbursements could not compensate the repayments. Net amount of loans decreased by HUF 45.8 billion or 9.2% in one year, of which decline in refinanced loans reached 19%. On the liability side volume of issued mortgage bonds decreased significantly exceeding the shrinkage of loan volume, but the former were compensated by 46% raise in deposits.

Consolidated profit after tax for 2013 was HUF 4.7 billion losses; net interest income amounted to HUF 18.7 billion. Net interest margin on average assets was 2.51%, by 15 basis points up year-on-year.

The Group's cost to income ratio was 91.2% (or 77.9% calculated without special banking tax) compared to 72.7% in the reference period of 2012. The decline of cost/income ratio was generated both by decrease of incomes and increase of costs.

The shareholders equity decreased 1.9% to 76.1 billion during the year. The Bank according to IFRS standards records subordinated Tier 1 capital with nominal value of EUR 112 million as an element of shareholders' equity. The accumulated losses amounted to HUF -4.7 billion. The capital adequacy ratio was 13.82% at the end of the year.

3.2 RETAIL AND CORPORATE LENDING

The volume of gross loans of FHB Group amounted to HUF 358 billion as of 31 December 2013. Year-on-year decrease was 3.7%. Decrease was due to lower figures in disbursements and maturity of existing loans despite of participation of Funding for Growth Scheme (NHP) of National Bank of Hungary.

The rate of FX loans of total outstanding loan portfolio was 51.3% as of 31 December 2013, which is lower than the 55.7% figure in previous year, thus the Lending for Growth Scheme started by the NBH. The share of FX loans in retail loans was 57.2% which actually shows no change to the previous year.

Retail loans continued to dominate within the loan portfolio with a contribution of 78.3% (81.5 % on 31 December 2012). Changes in the composition of the loan portfolio are a result of the retail loan portfolio showed decrease of HUF 22.8 billion (-7.5%) year on year, while the volume of corporate loans grew by 12.9%, increasing by nearly HUF 9 billion.

The composition of the loan portfolio of 31 December 2013:

in HUF million	31/12/2012	31/12/2013	Change
Retail loans	**303,042**	**280,228**	**-7.5%**
Housing loans	152,348	141,480	-7.1%
Other mortgage loans	139,618	128,305	-8.1%
Consumer loans	6,348	6,471	1.9%
Loans for employees	1,935	1,568	-19.0%
Retail leasing	2,793	2,404	-13.9%
Corporate loans	**68,889**	**77,776**	**12.9%**
Corporate loans	67,962	76,788	13.0%
Corporate leasing	927	988	6.6%
Total own lending, gross	**371,931**	**358,004**	**-3.7%**
Impairment	-37,348	-37,933	1.6%
Loans, net	**334,583**	**320,071**	**-4.3%**
Refinanced loans	164,990	133,692	-19.0%

During 2013, HUF 10.1 billion retail and HUF 38.5 billion corporate loan disbursements occurred, the latter being more than three times that of a year earlier, due to loans disbursed under the Lending for Growth Scheme started in June. Bank placed in the first phase of the program a total of HUF 29 billion to corporate clients. Within the retail loan disbursement, contribution of subsidized loans exceeded 55%.

In terms of residential mortgage loans disbursement FHB increased its market share in all segments, including outstanding 12.7% market share in case of subsidized loans (after 6.4% in 2012), while market share of the Group from the full-year mortgage loan disbursements reached 5.0% (compared to 3.3% in 2012).

3.3 REFINANCING

To 31 December 2013 consolidated volume of refinanced loans dropped by 19.0% in one year to HUF 133.7 billion. Decrease arises from contractual amortization of the stock the volume of new transactions was negligible.

3.4 CUSTOMER DEPOSITS, BANK ACCOUNT SERVICES

At the end of 2013 the Commercial Bank had 43 branches countrywide. The number of retail and corporate accounts managed by the Commercial Bank was close to 167 thousand and 9.4 thousand, respectively, to which belonged 124 thousand retail and 5.8 thousand corporate cards – both number of current accounts and number of cards increased compared to the previous year.

Volume of retail deposits increased by 3.3%, while corporate deposits grew by 116.1% compared to 2012. Total volume of deposits increased by 46.2% year-on-year and amounted to HUF 222.5 billion as at 31 December 2013. Volume of retail sight deposits reached HUF 24.5 billion, while corporate sight deposits amounted to HUF 38.1 billion, respectively at the end of the year, representing over 28% share of sight deposits from total deposits.

Under the agreement between FHB Mortgage Bank and the Hungarian Post Ltd (Magyar Posta Zrt.), the Company signed an order contract with Magyar Posta Zrt. for certain financial mediation services. According with the foregoing, the Hungarian Post Office network sells FHB Fixed deposit and FHB Lottery Deposit from early December 2013. The deposit volume sold by post offices was close to HUF 2 billion after a month.

3.5 INVESTMENT SERVICES

FHB Bank investment services business continued to grow in 2013. Due to successful customer acquisitions the term and long-term investment account openings showed a significant increase. The favourable market environment was beneficial for the sale of mutual funds and private bonds, which contributed to private and business customers registered accounts stocks market value exceeded HUF 34.6 billion by the end of the year 2013.

The number of securities accounts held by the Bank exceeded 15 thousand as at 31 December 2013. From the assets managed on investment accounts, securities issued by FHB Mortgage Bank represented the largest volume (HUF 15.2 billion), volume of investment funds amounted to HUF 18.2 billion, government securities HUF 2.5 billion, while market value of shares represented HUF 4.6 billion at the end of the year.

The most important of the distribution channels is still the Bank's branch network: the majority of the investment transactions were made via the branches' sales service focusing on bonds issued especially for private investors. In addition, the Bank also focuses on Internet sales, providing convenient functions: more and more people opt for completing their daily investment dealings on NetBróker, mainly in case of investment fund and stock exchange transactions.

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

The Diófa Asset Management began its cooperation with the Commercial Bank after entering FHB Group. Within this framework, from October 2013, two new investment funds were launched in the branch network of FHB Banking Group. By the end of December, sales volume of FHB Money Market Fund neared to HUF 3.8 billion, while FHB Forte Bond Fund volume reached HUF 1.3 billion. Net asset value FHB Absolute Yield Fund managed on client accounts exceeded HUF 21 million.

3.6 SECURITY ISSUES

3.6.1 Mortgage and Senior bond issues

In 2013 FHB Bank issued 16 distinct series and repurchased 11 series by 27 transactions contrary to the 32 transactions in 2012.

In 2013, the Bank has HUF 60.3 billion (euro funds calculated in the issuance of euro exchange rate) new capital market funds, excluded the EUR 10 million Tier 1 bond, the incoming liabilities was HUF 57,4 billion. The face value of issued bonds amounted to HUF 8.1 billion and EUR 15 million as of mortgage bonds, HUF 42.9 million and EUR 16 million (without Tier 1 bond amounted EUR 6 million) unsecured bonds were issued.

In 2013, the Bank repurchased HUF 2 billion and EUR 11.3 million mortgage bonds and HUF 1 billion and EUR 0.8 million unsecured bonds.

At the end of December 2013, the three national mortgage banks' aggregated mortgage bond volume amounted to HUF 1,192 billion, share of FHB represented 18.9% of that.

3.6.2 Mortgage bond coverage[4]

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

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

The net collateral value of real estate covering mortgage bonds issued by the Bank was HUF 463.4 billion as of 31 December 2013, 18.2% less than the figure as of 31 December 2012 (HUF 566.6 billion).

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

Value of mortgage bonds and assets involved as collateral as of 31 December 2013

in HUF million	31/12/2012	31/12/2013	Change
Outstanding mortgage bonds in circulation			
Face value	304,041	225,601	-25.8%
Interest	74,691	53,899	-27.8%
Total	**378,732**	**279,500**	**-26.2%**
Value of the regular collateral			
Principal	356,290	308,444	-13.4%
Interest	210,290	154,922	-26.3%
Total	**566,580**	**463,366**	**-18.2%**

As of 31 December 2013, the present value of ordinary collateral was HUF 350.7 billion and the present value of mortgage bonds was HUF 261.3 billion, thus the present value of collateral exceeded that of CMBs (Collateralised Mortgage Bond) in circulation not yet repaid. The combined present value of collateral to the combined value of mortgage bonds in circulation was 134.2% in the same period.

As of 31 December 2013 net value of ordinary and supplementary collateral principal to the unpaid face value of mortgage bonds in circulation was 136.7%, and the net ordinary and supplementary collateral principal to the unpaid interest on mortgage bonds in circulation was 287.4%.

4 LIQUIDITY MANAGEMENT

In accordance with the Group's strategy the Mortgage Bank ensures the entire Group's liquidity through regular business relations with other Group companies. Liquidity of the Group was stable throughout 2013. The Mortgage Bank always made funds available to Group members as needed. The Bank supported the management in making quantitative and scheduling decisions related to short-term and long-term financing with continuous liquidity planning during the entire period.

As of 31 December 2013 the Bank had HUF 34.5 billion NBH bonds. The nostro accounts closed with HUF 615 million. There were no margin deposits in HUF. The Bank had a EUR 17.5 million interbank net lending position, margin deposits amounted to EUR 49.9 million (approximately HUF 14.8 billion).

Beside of two-weeks NBH bonds showing 50% decrease year-on-year, as of 31 December 2013, consolidated securities portfolio (due to liquidity and risk management) contained government bonds (HUF 6 billion and EUR 47.8 million), treasury bills (HUF 126.8 billion) and other securities guaranteed by the state (HUF 3.4 billion and EUR 15.2 million). Free liquid securities amounted to HUF 105.1 billion in addition to the NBH bonds.

5 RISK MANAGEMENT PRINCIPLES

5.1 RISK MANAGEMENT POLICY

The risks inherent in the Group's business are managed on group level. The primary purpose of risk management is to protect the Group's financial strength and goodwill, and to support the deployment of capital in competitive business activities, which contribute to the increase of shareholder value. The Group applies uniform risk management principles for the parent bank and the subsidiary bank as well as the subsidiary companies.

Risk management identifies, evaluates and analyses the exposure of the Group and its members. It processes the information gained and develops risk guidelines and acceptable exposure limits, and operates risk management systems.

As of HFSA's request FHB takes part in indicators' monitoring defined by Basel III. Semi-annual Practices had been coordinated by Risk Management Department and implemented by Controlling, Data Service, Liquidity and Risk Analysis

Departments. Consultations with Ministry for National Economy and NBH have been continued in terms of Basel III. Standards described in EU Directives and Regulations.

During the year the Bank started to prepare for the implementation of CRD IV and CRR since 1st of January, 2014. Therefore there were new workgroups developed at the Group, to interpret the legislation, to test the impact of FHB and to measure the responsibilities associated with the data service. In September, 2013 has completed the first phase of the annual SREP supervision and the process continued from November of 2013 by the NBH (which also perform the authority of the Hungarian Banking System).

In addition, the competent areas of expertise of the Bank made the Bank's Recovery Plan with participation of the risk management which called for the preparation of the NBH in accordance with the European legislation. The plan was discussed by the Mortgage Bank's Board of Directors, has been approved and submitted to the NBH.

5.2 CREDIT RISK

The most important of risk management tasks related to retail business of the Bank, was the comprehensive revision and rationalization of the non-mortgage loan products and its processing process.

Terms of the risk of products have been standardized to the extent possible and reasonable. The basic purpose of the product terms to simplify, harmonize, expedite the turnaround time and to reduce the proportion of individual case administration. The risk management also had a major role in the development of Lombard risk conditions (acceptable collateral, collateral odds, customer rating).

The risk management had more task related to the higher activity in the residential mortgage loans business because there were more transaction which required participation of risk management. The business area and the risk management had reviewed the topics of submitting of the risk taking concerned to corporate clients. Compared to the past it has been put together a more streamlined, the decision points even more focused, even more clearly structured presentation the scheme managers for decision-makers.

The Growth Loan Program (launched by NBH) concerned more tasks in the risk management of corporate clients. The preliminary design of financing structure (client level), the preparation of the risk management expertise and the risk management tasks of contracting and disbursement of loans required the maximum capacity of risk management of corporate clients. The preparation of the participation in the next phase of the NHB's Growth Loan Programme began in September.

In the second quarter the risk management has reviewed the IRB capital calculation implementation schedule, on which the schedule and the methodology need to be amendments. The application for amendment after approval by the Board of Directors of FHB Mortgage Bank authorization submitted to the Authority, which was adopted. .To strengthening the role of risk management in the monitoring process a new corporate credit monitoring regulations has been adjusted in the fourth quarter. Also in the fourth quarter the validation of the banking certification system has been taken place, as well as the bank's annual re-certification and review of the limits.

5.3 MARKET RISK

Due to the nature of its business as a mortgage bank and to the special legal regulation relating to it, FHB Plc. has a distinctive asset and liabilities structure within the Hungarian banking system as its assets and liabilities are essentially long-term and raise most of its funds on the capital markets. In terms of liquidity and market risk, as leading member of the Group, it is the Bank's duty to provide the necessary funds and manage risks for the Group as a whole and for each Group company.

As of asset/liability management Bank continues to apply natural hedge, minimizes level of open FX positions, enters hedging transactions and intensively manages asset-liability ratio to control risks.

5.4 LIQUIDITY AND MATURITY RISK

Maintaining liquidity is an essential element of banking. The Bank maintains its liquidity by coordinating the maturity of its receivables and payables. At the same time, it applies maturity transformation regulated by limits in order to improve profitability while maintaining solvency at all times. The Bank regularly reviews prepayments by clients prior to term and takes into consideration their impact on managing market and liquidity risks.

5.5 EXCHANGE RATE RISK

The Mortgage Bank is a specialized credit institution, which narrows the scope of business where exchange rate-related risks may arise. Moreover, the Bank's business policy is to keep exchange rate risk at a low level. The Bank strives to immediately hedge the exchange risks related to its core business, i.e. mortgage lending, refinancing and financing though mortgage bonds, as allowed by market circumstances. Therefore an open FX position can serve primarily for the purpose of liquidity management, settlements related to lending and refinancing, or active and passive accruals in currencies in which the Bank keeps a nostro account.

5.6 INTEREST RATE RISK, EXCHANGE RATE RISK

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

5.7 OPERATING RISK

The Bank manages risks related to its operations by developing and improving internal rules and regulations, by providing appropriate training to the staff involved in the work flows and by creating built-in control mechanisms. The management devotes extremely important role to feedback, verifying the efficiency of the measures to eliminate risks.

During the first quarter, the Bank Group's operational risk self-assessment is completed. Within the framework of the self-assessment workshops for the main processes carried out in the relevant departments involved in the process.

In addition, some departments have been assessed for their own activities. Based on these results the Bank's operational risk map could be assembled and could be defined the low-frequency events that causes large loss to the Bank. These impacts are measured by scenario analyses which were completed in the first quarter of the year.

The first quarter has been introduced to a program that lets The Bank collect information about the operational risk events in unified content. The application of the program contributes to the full data are available to the operating risk events and losses. From the beginning of the second quarter a new converted operational risk report was submitted to the governing bodies that more focused on the relevant information. In the fourth quarter began with the annual operational risk self-assessment and completed the KRI's review, and the Bank Group has begun the integration of Diófa Asset Management Ltd. in operational risk management system.

6 ORGANIZATIONAL CHANGES AND HEADCOUNTS

The organizational structure of FHB Mortgage Bank Plc changed on 1 February, 2013. According to change in management structure of the Bank, the previous two CEO model ceased. The Company is managed by Chief Executive Officer.

Range of areas under the direct control of the Chief Executive Officer expanded for the area of treasury, risk management, risk analysis and control and partner refinancing. The head of the business area as a deputy-CEO is responsible for the Bank and Group's business and product-development strategy and to reach the Bank's consolidated business plan figures and other goals. Deputy-CEO is also responsible for the Group's marketing and management of general public relations activities.

Beyond the above, several other changes occurred in the Group, especially in case of Commercial Bank in 2013, which aims to increase the efficiency of the affected areas in order to strengthen sales focus in the particular areas.

As of December 31, 2013, the consolidated full-time headcount was 773.5; by 3.4 (0.4%) more than headcount of 770.1 as of December 31, 2012.

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

	31/12/2012	31/12/2013	Change
FHB Mortgage Bank Plc.	170.3	172.2	1.1%
FHB Commercial Bank Ltd.	575.2	567.0	-1.4%
FHB Life Annuity Ltd.	7.3	5.8	-21.2%
FHB Real Estate Ltd.	8.1	7.4	-9.3%
FHB Real Estate Leasing Ltd.	9.2	9.8	6.0%
Diófa Asset Management Ltd.	-	11.4	-
FHB Group Total	**770.1**	**773.5**	**0.4%**

7 FINANCIAL ANALYSIS[5]

7.1 BALANCE SHEET STRUCTURE

in HUF million	31/12/2012	31/12/2013	Change
Cash on hand	2,164	2,039	-5.8%
Due from banks & NBH	33,981	32,739	-3.7%
Securities held for trading	7,815	41,950	-
Financial assets available for sale	158,848	151,873	-4.4%
Investment in associates (jointly controlled companies)		6,158	-
Derivate financial assets	4,344	3,579	-17.6%
Refinanced mortgage loans	164,990	133,692	-19.0%
Loans and advances to consumers	371,931	358,004	-3.7%
Impairment and provision	-37,348	-37,933	1.6%
Investment property	11,463	11,312	-1.3%
Tangible assets	5,961	5,625	-5.6%
Goodwill and other intangible assets	12,753	11,373	-10.8%
Deferred tax asset	6,396	7,421	16.0%
Other assets	9,326	9,682	3.8%
Total assets	**752,625**	**737,514**	**-2.0%**
Due to banks	92,781	116,847	25.9%
Issued securities	252,681	228,851	-9.4%
Mortgage bonds	191,897	143,250	-25.4%
Bonds	60,784	85,601	40.8%
Deposits from customers	152,206	222,501	46.2%
Derivative financial liabilities	23,184	15,365	-33.7%
Financial liabilities at fair value through profit or loss	104,888	61,460	-41.4%
Finance lease liabilities	11,029	9,292	-15.7%
Reserve for annuity payments	2,410	2,463	2.2%
Current tax liability	42	6	-85.9%
Deferred tax liability	643	503	-21.7%
Provisions	173	1,142	-
Other liabilities	3,922	3,012	-23.2%
Subordinated debt	31,126	0	-100.0%
Total liabilities	**675,084**	**661,442**	**-2.0%**
Share capital	6,600	6,600	0.0%
Share premium	1,709	1,709	0.0%
Treasury shares	-29	-29	0.0%
Subordinated Tier 1 capital	28,923	31,749	9.8%
Other reserves	-2	380	-
Retained earnings	44,986	40,340	-10.3%
Balance sheet profit	-4,646	-4,677	-
Total shareholders' equity	**77,541**	**76,072**	**-1.9%**
Total liabilities and shareholders' equity	**752,625**	**737,514**	**-2.0%**

[5] This financial analysis contains data and tables calculated from controlling point of view, therefore due to reclassification some figures can differ from data reported in other parts of the IFRS financial statements.

As of 31 December 2013, the Bank's consolidated balance sheet total by IFRS amounted to HUF 737.5 billion; by HUF 15.1 billion or 2.0% below the balance sheet total as of 31 December 2012. The decline on the assets side was the joint result of interbank deposits (due from banks) decreased by 3.7%, refinanced loans dropped by 19.0% and impairment and provision increased by 1.5%.

Liabilities decreased by 2.0% compared to the reference figures of 2012. Significant decrease was generated primarily by repayment of subordinated loan capital. Mortgage bonds and senior bonds[6] issued showed significant decline (-25.5% and -7.8%, respectively), while interbank borrowings rose by 21.9%. Deposits grew by more than 46% year-on-year.

Shareholders' equity decreased by HUF 1.5 billion or 1.9% year-on-year; in one hand as a result of top issue of additional Tier 1 capital, in the other hand loss of HUF 4.7 billion realised.

7.1.1 Interest earning assets

The Group's interest earning assets decreased from HUF 738.6 billion as of 31 December 2012 to HUF 719.4 billion as of 31 December 2013. Interest earning assets contributed 97.5% to the balance sheet total.

Interbank lending

NBH and other interbank lending decreased from HUF 34.0 billion HUF as of 31 December 2012 to HUF 32.7 billion as of 31 December 2013. The item contributed 4.6% to interest earning assets as of 31 December 2013, the same as a year before.

Securities

The value of Bank's securities available-for-sale decreased from HUF 158.8 billion as of 31 December 2012 to HUF 151.9 billion as of 31 December 2013. Contribution of securities available-for-sale to interest earning assets was 21.1%. Securities include NBH bonds amounting to HUF 10.3 billion, discount treasury bills amounting to HUF 108 billion and government bonds amounting to HUF 19.2 billion and other bank and corporate bonds for sale amounting to HUF 14.4 billion. As of 31 December 2013, the Bank held a portfolio of securities held for trading (HUF 42 billion), which contributed 5.8% to interest earning assets.

Loans

As of 31 December 2013, the volume of loans was 3.7% down year-on-year (or 3.9% adjusted by exchange rate). Impairment to cover loan losses increased from HUF 37.3 billion as of 31 December 2012 to HUF 37.9 billion as of 31 December 2013.

Volume of refinanced loans dropped by 19.0% to HUF 133.7 billion in one year. As of 31 December 2013, the contribution of refinanced loans and gross own lending was 68.3% in total assets; the same ratio was close to 73%.a year before.

The collateral value of real estate covering ordinary collaterals amounted to HUF 894.4 billion as of 31 December 2013, 10.3% down compared to 31 December 2012 (HUF 997 billion). The LTV ratio applicable for ordinary collateral was 34.3% as of 31 December 2013, lower than the 36.3% LTV as of 31 December 2012.

Portfolio quality

The ratio of non-performing loans continued increasing compared to the previous year, however, the growth moderated. Volume of non-performing loans was only 1% up compare to the end of 2012.

NPL ratio has been growing from 19.5% by 31 December 2012 to 20.4% as of 31 December 2013, influencing also by decrease in total loan volume. Coverage of non-performing loans was 52%, showing slight increase compared to the end of December 2012.

[6] Volume of items measured at amortised cost and at fair value together.

In 2013, FHB Group paid special attention to prevent further deterioration of the loan portfolio and cleaning of the portfolio, as well. Beside participation in the Government's home protection programs, the Bank also aimed to decrease volume of NPL through individual customer agreements.

Until 31 December 2013, 47% of entitled clients (37% of the total clients with FX loans) applied for FX rate protection scheme and 7,956 (30%) contracts were already signed. The volume of buffer account amounted to nearly HUF 500 million at the end of the year. Offering real estates of entitled clients to NET continued. Since the beginning of the program, more than 1,200 properties were offered by the Group for NET. Majority of that were purchased by NET and 905 loan contracts were closed in 2013.

7.1.2 Other assets

Tangible assets amounted to HUF 6 billion as of 31 December 2012 and decreased by HUF 336 million year-on-year to HUF 5.6 billion as of 31 December 2013. As of 31 December 2013, intangibles amounted to HUF 11.4 billion, by HUF 1.4 billion or 10.8% down year-on-year. Volume of intangible assets contains goodwill related to the acquisition of Diófa Asset Management Ltd.

Value of investment in jointly controlled companies consolidated by equity method amounted to HUF 6.2 billion as of 31 December, 2013, including goodwill related to the acquisition of DÜSZ.

Other assets amounted to HUF 9.7 billion as of 31 December 2013, increasing by 3.8% (HUF 356 million) year-on-year. Deferred tax assets reached HUF 7.4 billion while value of real estates reported as inventory represented 17.5% of other assets.

7.1.3 Interest bearing liabilities

Interest bearing liabilities decreased from HUF 644.7 billion as of 31 December 2012 to HUF 639 billion as of 31 December 2013, representing approximately 86.6% to the balance sheet total. Issued securities and customer deposits gave major part of interest bearing liabilities, together with increasing interbank liabilities.

Interbank funds

As of 31 December 2013, interbank funds amounted to 134.8 billion HUF showing 21.9% up year-on-year. Volume contains 2 years covered loan facility issued by Hungarian National Bank to stimulate corporate lending and also fund of disbursed loans within the framework of Funding for Growth Scheme (NHP). Contribution of interbank borrowings to interest bearing liabilities was 21.1% as of 31 December 2013.

CMBs and Bonds issued

The contribution of covered mortgage bonds –measured at amortised cost and at fair value – to the Bank's interest bearing liabilities was 27% as of 31 December 2013, lower than a year before. HUF 172.8 billion value of mortgage bonds as of 31 December 2013 was 25.5% down from figures of 31 December 2012 (HUF 231.8 billion). Decrease in the value of the CMB portfolio was HUF 59.0 billion year-on-year.

The book value of bonds (both measured at amortised cost and at fair value) was HUF 99.5 billion as of 31 December 2013. The year-on-year decline was 7.8% or HUF 8.4 billion.

Deposits

As of 31 December 2013, deposits amounted to HUF 222.5 billion increasing by 46.2% year-on-year. In the last year volume of corporate and retail deposits increased, as well. As retail deposits grew by 3.3%, corporate deposits increased by more than 116%. Retail deposits lost its dominant position among FHB Group's consolidated deposits as share of corporate deposits was around 56.2% at the end of the period. The sight deposit ratio grew from 27.6% to 28.1% in a year.

7.1.4 Other liabilities

The Bank reported among other liabilities the volume of liabilities generated in conjunction with settlements before due date with the amount of HUF 766.2 million; accounts payable of HUF 404.2 million as well as accruals with the volume of HUF 305.5 million. Deferred tax liabilities amounted to HUF 502.9 million, while volume of provisions stood at HUF 1.1 billion.

7.1.5 Shareholders' equity

Within one year, shareholders' equity decreased by 1.9% to HUF 76.1 billion as of 31 December 2013. In line with IFRS, the Bank reported the EUR 112 million Tier 1 subordinated bond as part of shareholder's equity. Balance sheet profit was HUF -4.7 billion.

7.2 PROFIT &LOSS STRUCTURE

in HUF million	2012 FY	2013 FY	Change
Interest income	76,670	66,175	-13.7%
Interest expense	-58,124	-47,464	-18.3%
Net interest income	**18,545**	**18,711**	**0.9%**
Fee and commission income	3,795	5,060	33.3%
Fee and commission expense	-1,203	-734	-39.0%
Net fee and commission income	**2,592**	**4,326**	**66.9%**
Profit/(Loss) from FX transactions	-1,392	1,223	-
Change in fair value of financial instruments	1,339	-2,072	-
Gains from securities	4,802	982	-79.6%
Net trading result	**4,749**	**133**	**-97.2%**
Other operating income	664	1,462	120.4%
Other operating expense	-3,315	-4,705	42.0%
Operating income	**23,235**	**19,927**	**-14.2%**
Provision for impairment on loan losses	-9,756	-6,789	-30.4%
General and administrative expense	-16,893	-18,171	7.6%
Loss before tax	**-3,415**	**-5,033**	**47.4%**
Income tax benefit/(expense)	-1,050	369	-
Loss for the period	**-4,464**	**-4,664**	**4.5%**

The Bank's consolidated loss for the year by IFRS amounted to HUF 4.7 billion in 2013 by 4.5% higher compared to 2012. Without the special banking tax, FHB Group's consolidated loss for the year by IFRS, as well, amounting HUF 1.3 billion, which is significantly lower than the adjusted loss in 2012.

Beside HUF 2.8 billion of special banking tax and payment obligation of HUF 588 million to compensate the lack of financial transaction levy, not-shifted financial transaction levy and losses related to the exchange rate protection scheme had negative impact on the result as extraordinary (one-off) items. Ignoring all these items, the adjusted consolidated profit after tax amounted to HUF 610 million losses.

7.2.1 Net interest income

Compared to net interest income of HUF 18.5 billion in 2012, the Banking Group realised somewhat higher net interest income of HUF 18.7 billion in 2013. The net figure emerged as a balance of HUF 66.2 billion interest income (13.7% down from the figure of 2012) and HUF 47.5 billion interest expense (18.3% less than in 2012).

Reduction of interest income was generated by fall in interest rates realised on loans (related to sloping yield curve and declining volume) and lower interest incomes from securities. Fall of interest expenses was due to lower interest expenses from issued securities, deposits and repayment of subordinated capital at the beginning of the year.

Net interest margin on average assets was 2.51% in 2013, showing 15 basis points increase compared to previous year.

Distribution of interest income and expenses shows the following table:

	2012 FY	2013 FY	Change
Interest income			
Loans	37.6%	37.9%	*0.4%-pt*
Refinancing	10.7%	10.8%	*0.2%-pt*
Mortgage bond interest subsidy	13.9%	14.1%	*0.2%-pt*
Supplementary interest subsidy	1.2%	1.4%	*0.1%-pt*
Securities and interbank activities	15.0%	13.2%	*-1.7%-pt*
Swap transactions	21.6%	22.5%	*0.9%-pt*
Interest expenses			
Bonds issued	51.2%	53.1%	*1.9%-pt*
Interbank activities	12.8%	10.9%	*-2.0%-pt*
State loan	1.7%	0.0%	*-1.7%-pt*
Customer deposits	16.0%	14.9%	*-1.1%-pt*
Derivatives	16.5%	19.0%	*2.4%-pt*
Other interest expense	1.8%	2.2%	*0.4%-pt*

7.2.2 Net fees and commissions

Net fees reached 4.3 billion HUF in 2013, representing close to 67% increase compared to 2012. In 2013, 18.1% of fee and commission income (HUF 5,060 million) contributed by loans related fees (34.1% in 2012) and 33.7% by accounts and card related banking charges (in 2012: 38.2%). Fee income related to the Strategic Cooperation Agreement with Allianz Insurance Company represented 10.4% of total fee income (15.6% in 2012). Also dynamically grew the volume of guarantee related fee income reaching close to HUF 172 million in the whole year.

On the expense side (HUF 734 million), agents' fees contributed 12.3% (in 2012: 32.4%), card related fees were 52.2% (30.2 % in 2012). Contribution of fees related to bond issues and investment services represented 10%.

Net fees and commissions without income related to financial transaction levy represented 28.6% growth compared to net fees a year before.

7.2.3 Net trading result

In 2013 the balance of financial transactions was approximately HUF 133 million profit that are lower by HUF 4.6 billion than in the same period of 2012.

Exchange rate volatility in the reported period and the effect of short term currency swaps resulted in HUF 1.2 billion gain, significantly favourable than result of 2012 (HUF 1.4 billion loss).

Changes in the fair value of financial instruments reported at fair value against earnings were HUF 2.1 billion loss, as against profit of HUF 1.3 billion in 2012.

In 2013, transactions of securities resulted in HUF 982 million profit. The figure emerged as a balance of exchange gains and losses on CMBs and bonds issued and repurchased during the year as well as that on bonds kept for sale.

7.2.4 Other income

In 2013, the balance of other operating income and expenditure was HUF 3.2 billion net expenditure; arising from HUF 1,462 million incomes and HUF 4,705 million expenditure. Other results are down by HUF 592 million than a year before. In 2013 real estate related income contributed 4.9%, HUF 71 million to other operating income; 15.7% came from sale of inventories and 15.2% from sales of leased assets.

72.7% of other expenditure was contributed by the special tax (HUF 2.8 billion), and payment obligation to compensate the lack of financial transaction levy (HUF 588 million). On the other expenditures side, 395.4 million HUF annuity payments were reported.

7.2.5 Operating expenses

Operating costs amounted to HUF 18.2 billion in 2013 which is 7.6% higher than in 2012. Growth was mainly generated by financial institution levy and other fees and taxes. Operating expenses in 2013 without financial transaction levy and credit institutions levy show 2.1% decrease compared to the previous year.

Cost-to-income ratio (CIR) was 91.2% in 2013 (as opposed to 72.7% in 2012). Adjusting special banking tax, CIR was 77.9% in 2013, while 66.8% in 2012.

The contribution of personnel expenses to total operating costs was 31.7% in 2013, 2.7%-points lower than in 2012 (34.3%).

Administrative expenses in 2013 (HUF 402.6 million) decreased considerably year-on-year. Expenses of business activity show significant change year-on-year. HUF 802 million expenses in 2013 are 32.9% higher than a year before.

Other taxes paid reported among operating costs amounted to HUF 2.2 billion in 2013, compared to HUF 691 million in 2012. Growth from the previous year is due to the change in financial transaction and credit institutions levy. Increase of credit institutions levy was related to the FX rate protection scheme, as total losses realised on exchange rate protection program are reimbursed by the state to the bank, than 50% of these amount is to be paid as credit institutions levy.

7.2.6 Impairment and loan losses

In 2013 impairment and loan losses amounted to HUF 6.8 billion, which is over 30% less than last year data. Close to HUF 3 billion decreases is primarily a result of slightly declining non-performing loan portfolio and decreasing level of expected losses.

7.3 CAPITAL POSITION

Risk-weighted assets (RWA) amounted to HUF 331.4 billion on 31 December 2013 (according to HAS), 6.6% higher than a year before. In line with that, FHB Group's capital requirement – excluding additional supervisory capital requirement (SREP) – increased by close to HUF 2 billion. Total capital requirements of the Group – including SREP – amounted to HUF 34.4 billion as of 31 December 2013.

At the end of the period, guarantee capital according to IFRS amounted to HUF 59.4 billion and capital adequacy ratio by IFRS was 13.82%.

8 POST-BALANCE SHEET DATE EVENTS

On February 3, 2014, FHB Mortgage Bank gained 25% direct share (25%+1 vote) in Magyar Takarék Befektetési és Vagyongazdálkodási Ltd. (MATAK Ltd.) through participating in the share capital increase decided by the general meeting of MATAK Ltd. with a payment at HUF 252 million nominal value.

On March 10, 2014 MATAK Ltd., MFB Magyar Befektetési Bank Zrt. (Hungarian Development Bank) and Magyar Posta Ltd. (Hungarian Post) contracted on the purchase of 929,301 pieces of equity shares of Magyar Takarékbank Ltd.

By the amount of purchased shares MATAK Ltd. gets around 54.8% ownership in Takarékbank Ltd. As a result of the transaction FHB Mortgage Bank acquires 13.75% indirect ownership in Takarékbank Ltd. According to the contractual will of the parties, but depending on the completion of several regular conditions the transaction shall be closed in the first half of 2014.

On 12 March, 2014 Moody's Investor Service announced the upgrade of the rating of the mortgage covered bonds issued by 15 European banks, among those issued by the FHB Plc's. The rating of the mortgage covered bonds issued by FHB Plc's, has been upgraded to „Ba2" from „Ba3". This rating action on FHB's covered bonds was prompted by the Moody's update of its covered bond rating methodology.

According to the decision announced on March 13, 2014, Financial Stability Board of National Bank of Hungary imposed fine for 35 financial institutions with a total amount of HUF 1.2 billon, which raised fees and charges for customers on unlawful way. Central Bank prohibited these financial institutions from continuing this practice and ordered to pay back the additional fee charges to clients. NBH imposed a fine of HUF 95 million on FHB Commercial Bank Ltd. Because of the unclarified questions of interpretation, the amount of the additional fee to be paid back has not been quantified yet, furthermore there is a possibility of appeal against the decision.

Budapest, April 2, 2014

Dr. Zoltán Spéder
Chairman of the Board of Directors

Gyula Köbli
Chief Executive Officer

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

FHB Mortgage Bank PLC.

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

31 December 2013

Consolidated Financial Statements in Accordance with the International Financial Reporting Standards adopted by the European Union – 31 December 2013

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Chairman of the Board of Directors

Dr. Zoltán Spéder

External Members of the Board of Directors

Dr. Christian Riener
Gabriella Balogh
Ákos Starcz

Internal Members of the Board of Directors

Gyula Köbli (Chief Executive Officer)
Tamás Foltányi (Banking and IT Deputy Chief Executive Officer)
Gábor Gergő Soltész (Deputy Chief Executive Officer)

Large Shareholders Liaison Officer and Secretary

Beáta Lendvai

Small Shareholders Liaison Officer

Béla Kappéter

Auditor

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Seat of the Bank, central office

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Registered by the Capital Court of Registration
Company Registration Number: 01-09-071057

INDEPENDENT AUDITORS' REPORT

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

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of FHB Mortgage Bank Plc. (the "Bank") and its subsidiaries for the year 2013, which financial statements comprise the consolidated statement of financial position as at December 31, 2013 – which shows total assets of 737,514 million HUF –, and the related consolidated statement of recognized and consolidated statement of comprehensive income – which shows a net loss for the year of 4,664 million HUF –, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with the Hungarian National Standards on Auditing and effective Hungarian laws and other regulations pertaining to audit. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of FHB Mortgage Bank Plc. and its subsidiaries as at December 31, 2013, and its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards as adopted by the European Union.

Other Reporting Obligation: Report on the Consolidated Business Report

We have examined the accompanying consolidated business report of FHB Mortgage Bank Plc. for the year 2013.

Management is responsible for the preparation of this consolidated business report in accordance with the Hungarian Accounting Act.

Our responsibility is to assess whether the accounting information in the consolidated business report is consistent with that contained in the consolidated financial statements prepared for the same business year. Our work with respect to the consolidated business report was limited to assessing the consistence of the consolidated business report with the consolidated financial statements, and did not include a review of any information other than that drawn from the audited accounting records of the Bank.

In our opinion, the consolidated business report of FHB Mortgage Bank Plc. for the year 2013. corresponds to the figures included in the consolidated financial statements of FHB Mortgage Bank Plc. for the year 2013.

Budapest, April 2, 2014

....	....
Molnár Gábor	Horváth Tamás
Deloitte Auditing and Consulting Ltd. 1068 Budapest, Dózsa György út 84/C. 000083	registered statutory auditor 003449

Consolidated Statement of Recognized Income for the year ended 31 December 2013

	Notes	2013	2012
Interest income	4	66,175	76,670
Interest expense	4	(47,464)	(58,124)
Net interest income		**18,711**	**18,546**
Fee and commission income	5	5,060	3,795
Fee and commission expense	5	(734)	(1,203)
Net fee and commission income		**4,326**	**2,592**
Profit/(loss) from foreign exchange transactions		1,223	(1,392)
Change in fair value of financial instruments	38	(2,072)	1,339
Gains from securities		982	4,801
Net trading result		**133**	**4,748**
Other operating income	6	1,462	664
Other operating expense	7	(4,705)	(3,315)
Operating income, net		**19,927**	**23,235**
Provision for impairment on loan losses	19	(6,789)	(9,756)
General and administrative expenses	8	(18,171)	(16,893)
Loss before tax		**(5,033)**	**(3,414)**
Income tax benefit/(expense)	11	369	(1,050)
Loss for the year		**(4,664)**	**(4,464)**
Attributable to: loss of shareholders of the Bank		(4,664)	(4,464)
Earnings per share (HUF 100 face value)	34		
Basic earnings per share (HUF)		**(70,92)**	**(70.45)**
Diluted earnings per share (HUF)		**(70,92)**	**(70.45)**

All figures in tables are in HUF million except otherwise noted

Consolidated Statement of Comprehensive Income for the year ended 31 December 2013

	Notes	2013	2012
Loss for the year		(4,664)	(4,464)
Other comprehensive income			
Change in Cash-flow hedge reserve		-	(249)
Change in fair value of financial assets available-for-sale		459	(3)
Foreign currency translation reserve		(2)	10
Deferred tax effect for other comprehensive income		(87)	48
Other comprehensive income/(loss) for the period net of taxes	12	370	(194)
Total comprehensive loss for the year, net of income taxes		**(4,294)**	**(4,658)**
Attributable to: loss of shareholders of the Bank		(4,294)	(4,658)

All figures in tables are in HUF million except otherwise noted

Consolidated Statement of Financial Position as at 31 December 2013

	Notes	31 December 2013	31 December 2012
Assets			
Cash on hand		2,039	2,164
Balances with the National Bank of Hungary	13	11,469	5,117
Due from banks	14	21,270	28,864
Securities held for trading	15	41,950	7,815
Financial assets available-for-sale	16	151,873	158,848
Shares in associates and joint ventures		6,158	-
Derivative financial assets	38	3,579	4,344
Refinanced mortgage loans	18	133,692	164,990
Loans and advances to customers	19	320,071	334,583
Investment property	21	11,312	11,463
Tangible assets	22	5,625	5,961
Goodwill and other intangible assets	20,23	11,373	12,753
Deferred tax asset	11	7,421	6,396
Other assets	24	9,682	9,327
Total assets		**737,514**	**752,625**

All figures in tables are in HUF million except otherwise noted

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

Consolidated Statement of Financial Position as at 31 December 2013

	Notes	31 December 2013	31 December 2012
Liabilities			
Due to banks	25	116,847	92,781
Deposits from customers	28	222,501	152,206
Derivative financial liabilities	38	15,365	23,184
Issued securities	26	228,851	283,807
Financial liabilities at fair value through profit or loss, except derivatives	27	61,460	104,888
Finance lease liabilities	30	9,292	11,029
Reserve for annuity payments	31	2,463	2,410
Current tax liability		6	42
Deferred tax liability	11	503	643
Provisions	32	1,142	173
Other liabilities	33	3,012	3,922
Total liabilities		**661,442**	**675,085**
Shareholders' equity			
Share capital	34	6,600	6,600
Treasury shares	34	(29)	(29)
Retained earnings		35,664	40,341
Other reserves	34	33,837	30,628
Total shareholders' equity		**76,072**	**77,540**
Total liabilities and shareholders' equity		**737,514**	**752,625**

Budapest, 2 April 2014

Gyula Köbli
CEO

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

Gergő Gábor Soltész
Deputy-CEO, Business

All figures in tables are in HUF million except otherwise noted

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

Consolidated Statement of Cash Flows for the year ended 31 December 2013

	2013	2012
Cash flow from operating activities		
Loss for the year	(4,664)	(4,464)
Non-cash adjustments to net loss from:		
Depreciation and amortization (Note 22,23)	2,533	2,496
Decrease in fair value of Investment property	184	80
Revaluation of investment properties	57	(60)
Provision/(release) of provision for losses	1,554	(1,779)
Gain on tangible assets derecognized	25	29
Loss on intangible assets derecognized	(2)	-
Share-based payment reserve (Note 35)	-	(106)
Capitalized interest on loans and advanced to customers	(840)	(993)
Fair value adjustment of derivatives (Note 38)	(7,054)	(39,177)
Fair value adjustment on financial liabilities through profit or loss, except derivatives	(1,448)	1,329
Change in annuity reserve	361	540
Change in foreign currency translation reserve	(2)	11
Operating loss before change in operating assets	**(9 296)**	**(42,094)**
Decrease/(Increase) in operating assets:		
Securities held for trading	(34,135)	(5,983)
Financial assets available-for-sale	7,347	(72,960)
Refinanced mortgage loans	31,298	61,900
Loans and advances to customers	14,767	49,322
Other assets	(1,380)	2,473
Increase/(Decrease) in operating liabilities:		
Deposits from customers	70,295	(8,899)
Due to banks	24,263	90,389
Other liabilities	(1,088)	(1,708)
Net cash flow from operating activities	**102,071**	**72,440**

All figures in tables are in HUF million except otherwise noted

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

Consolidated Statement of Cash Flows for the year ended 31 December 2013- continued

	2013	2012
Cash flow from investing activities		
Proceeds from sales of tangible assets	6	33
Purchase of tangible and intangible assets	(696)	(800)
Purchase of investment property	(409)	(313)
Sale of investment property	319	141
Paid from reserves on life annuity business	(308)	(395)
Change in goodwill above net cash flow	(1,054)	-
Net cash flow from acquisition of subsidiaries (Note 17)	(5,254)	-
Net cash outflow from investing activities	**(7,396)**	**(1,334)**
Cash flow from financing activities		
Proceed from issued securities	77,184	125,221
Principal repayment on issued securities	(174,488)	(193,992)
Repayment of long term loans	(510)	(63,900)
Long term loan borrowings	683	219
Finance lease liabilities movement	(1,737)	969
Issue of Capital Securities (additional tier 1 capital)	2,826	28,923
Net cash outflow from financing activity	**(96,042)**	**(102,560)**
Net decrease in cash and cash equivalents	(1,367)	(31,454)
Opening balance of cash and cash equivalents	36,145	67,599
Closing balance of cash and cash equivalents	**34,778**	**36,145**
Breakdown of cash and cash equivalents:		
Cash on hand	2,039	2,164
Balances with the National Bank of Hungary	11,469	5,117
Due from banks with a maturity of less than 90 days	21,270	28,864
Closing balance of cash and cash equivalents	**34,778**	**36,145**
Supplementary data		
Income tax paid	*(960)*	*(1,429)*
Interest received	*65,168*	*76,639*
Interest paid	*(52,281)*	*(55,426)*

All figures in tables are in HUF million except otherwise noted

Consolidated Statement of Changes in Equity for the year ended 31 December 2013

	Notes	Share capital	Treasury shares	Share premium	General reserve	Cash flow hedge reserve	Share – base payment reserve	Additional tier 1 capital	Change in fair value of fin. assets available-for-sale	Foreign currency translation reserve	Retained earnings	Share-holder 's equity
1 January 2012		**6,600**	**(29)**	**1,709**	**-**	**201**	**106**	**-**	**(212)**	**20**	**44,986**	**53,381**
Change of general reserve	36				181						(181)	-
Loss for the year											(4,464)	(4,464)
Other comprehensive income	12					(201)			(4)	11		(194)
Additional tier 1 capital								28,923				28,923
Change in share –based payment reserve	34,35						(106)					(106)
1 January 2013		**6,600**	**(29)**	**1,709**	**181**	**-**	**-**	**28,923**	**(216)**	**31**	**40,341**	**77,540**
Change of general reserve	36				13						(13)	-
Loss for the year											(4,664)	(4,664)
Other comprehensive income	12					-			372	(2)		370
Additional tier 1 capital								2,826				2,826
Change in share-based payment reserve	34,35											
31 December 2013		**6,600**	**(29)**	**1,709**	**194**	**-**	**-**	**31,749**	**156**	**29**	**35,664**	**76, 072**

All figures in tables are in HUF million except otherwise noted

Notes to the Consolidated Financial Statements

1. DESCRIPTION OF THE BANK

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

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

On 31 October 2003 the Hungarian Financial Supervisory Authority (HFSA) granted permission for FHB Mortgage Bank to issue a prospectus to introduce its shares to the Budapest Stock Exchange. Following a public and private placement of the Bank's shares, a total of 2,500,000 ordinary shares were sold in the context of public offering along with an additional 1,324,899 ordinary shares sold to institutional investors in the context of private placement. A total of a further 588,570 voting preference shares were sold to the Bank's priority strategic partners in the context of private placement. The ordinary shares were listed on the Budapest Stock Exchange on 24 November 2003.

The Bank introduced its New Strategic Plan in February 2006 to expand its banking activity and branch network. The Bank set up new subsidiaries besides the already existing FHB Services Ltd., specifically FHB Commercial Bank Ltd., FHB Real Estate Ltd., and FHB Life Annuity and Real Estate Investment Ltd. At the same time the Bank changed its name to FHB Mortgage Bank Plc. FHB Mortgage Bank Plc. is the parent company of the group. The Bank and its subsidiaries are jointly referred to as the Group, Bank Group or FHB Group.

On 29 August 2007 the Hungarian Privatization and State Holding Company (ÁPV Zrt.) formerly holding a 54.11% majority share in the Bank sold its packet of Series "A" ordinary shares of 50% + 1 vote in the Hungarian and international capital market in the context of accelerated book building. The transaction was administrated by HSBC Plc. investment service company. As a result of the sale ÁPV's share in the Bank dropped to 4.11% held exclusively in the form of Series "B" preference shares (Note 34). The Series „B" preference shares were converted into ordinary shares in 2009.

During the period between 2008 and 2009 in accordance with the Strategic Plan the activities, products and services provided were expanded continuously by the Group. The FHB Commercial Bank launched the branch for private company clients and the Netbank service on Internet and provided for the retail customers new services related to the bank accounts and bankcards. In 2010 the FHB Commercial Bank's activities were extended with investment services business.

Pursuant to the decision of the Board of Directors of FHB Mortgage Bank Plc. passed at the beginning of March 2009 regarding transformation of FHB Real Estate Ltd. and FHB Life Annuity Ltd. into single-person companies, on 4 March 2009 FHB Mortgage Bank Plc. bought out the shares of FHB Services Ltd. in the two companies.

Notes to the Consolidated Financial Statements

In April and June 2009 the Bank increased the Group by the acquisition of Central European Credit Ltd. (CEC, renamed to FHB Ingatlanlízing Ltd. effective from 31 December 2010) and the three companies of POMO group (FHB DWH Ltd., Hitelunio Ltd., Portfolio Money FBK Ltd.).

The expanding of FHB Group continued in 2010 by acquiring the Allianz Bank Ltd and by entering a long-term strategic and co-operation agreement with Allianz Hungary Insurance Ltd. Allianz Bank was merged into FHB Commercial Bank on 1 April 2011.

In October 2011 FHB Mortgage Bank's Board of Directors passed a decision to sell FHB Services Ltd. to a buyer outside of the Group. The transaction was concluded on 1 December 2011. As a result of the transaction FHB Services Ltd. and its intangibles disposed FHB Group. In these consolidated financial statements the transaction is reported as finance lease.

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

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

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

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

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

Based on the Agreement between FHB Group and Magyar Posta, DÜSZ acquired 50% of shares of Magyar Posta Befektetési Zrt. (Hungarian Post Investment Services Ltd., hereinafter the “MPBSZ Ltd.”). by exchange of 24% shares of DíjNET Zrt. and additional share price to be paid in next years. This transaction closed as at 5 December 2013.

The consolidated financial statements for the year ended 31 December 2013 were authorized for issue in accordance with a resolution of the Board of Directors on 2 April 2014. The final approval on the consolidated financial statements is provided by the General Meeting.

2. ACCOUNTING POLICIES

2. 1. *Basis of preparation*

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

Statement of compliance

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

2. 2. *Change in accounting policies*

The effect of adopting new and revised International Financial Reporting Standards effective from 1 January 2013

The new and revised Standards and Interpretations effective from the current period

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

- **IFRS 13 "Fair Value Measurement"**, adopted by the EU on 11 December 2012 (effective for annual periods beginning on or after 1 January 2013),

- **Amendments to IFRS 1 "First-time Adoption of IFRS"** – Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters, adopted by the EU on 11 December 2012 (effective for annual periods beginning on or after 1 January 2013),

- **Amendments to IFRS 1 "First-time Adoption of IFRS"** – Government Loans, adopted by the EU on 4 March 2013 (effective for annual periods beginning on or after 1 January 2013),

- **Amendments to IFRS 7 "Financial Instruments: Disclosures"** – Offsetting Financial Assets and Financial Liabilities, adopted by the EU on 13 December 2012 (effective for annual periods beginning on or after 1 January 2013),

- **Amendments to IAS 1 "Presentation of financial statements"** – Presentation of Items of Other Comprehensive Income, adopted by the EU on 5 June 2012 (effective for annual periods beginning on or after 1 July 2012),

- **Amendments to IAS 12 "Income Taxes"** – Deferred Tax: Recovery of Underlying Assets, adopted by the EU on 11 December 2012 (effective for annual periods beginning on or after 1 January 2013),

- **Amendments to IAS 19 "Employee Benefits"** – Improvements to the Accounting for Post-employment Benefits, adopted by the EU on 5 June 2012 (effective for annual periods beginning on or after 1 January 2013),

- **Amendments to various standards "Improvements to IFRSs (cycle 2009-2011)"** resulting from the annual improvement project of IFRS (IFRS 1, IAS 1, IAS 16, IAS 32, IAS 34) primarily with a view to removing inconsistencies and clarifying wording, adopted by the EU on 27 March 2013 (amendments are to be applied for annual periods beginning on or after 1 January 2013),

- **IFRIC 20 "Stripping Costs in the Production Phase of a Surface Mine"**, adopted by the EU on 11 December 2012 (effective for annual periods beginning on or after 1 January 2013).

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

Amendments and new Standards and Interpretations to IFRS effective on or after 1 January 2014, which are adopted by the EU

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

- **IFRS 10 "Consolidated Financial Statements"**, adopted by the EU on 11 December 2012 (effective for annual periods beginning on or after 1 January 2014),

- **IFRS 11 "Joint Arrangements"**, adopted by the EU on 11 December 2012 (effective for annual periods beginning on or after 1 January 2014),

- **IFRS 12 "Disclosures of Interests in Other Entities"**, adopted by the EU on 11 December 2012 (effective for annual periods beginning on or after 1 January 2014),

- **IAS 27 (revised in 2011) "Separate Financial Statements"**, adopted by the EU on 11 December 2012 (effective for annual periods beginning on or after 1 January 2014),

- **IAS 28 (revised in 2011) "Investments in Associates and Joint Ventures"**, adopted by the EU on 11 December 2012 (effective for annual periods beginning on or after 1 January 2014),

- **Amendments to IFRS 10 "Consolidated Financial Statements", IFRS 11 "Joint Arrangements" and IFRS 12 "Disclosures of Interests in Other Entities"** – Transition Guidance, adopted by the EU on 4 April 2013 (effective for annual periods beginning on or after 1 January 2014),

- **Amendments to IFRS 10 "Consolidated Financial Statements", IFRS 12 "Disclosures of Interests in Other Entities" and IAS 27 (revised in 2011) "Separate Financial Statements"** – Investment Entities, adopted by the EU on 20 November 2013 (effective for annual periods beginning on or after 1 January 2014),

- **Amendments to IAS 32 "Financial instruments: presentation"** – Offsetting Financial Assets and Financial Liabilities, adopted by the EU on 13 December 2012 (effective for annual periods beginning on or after 1 January 2014),

- **Amendments to IAS 36 "Impairment of assets"** - Recoverable Amount Disclosures for Non-Financial Assets, adopted by the EU on 19 December 2013 (effective for annual periods beginning on or after 1 January 2014),

- **Amendments to IAS 39 "Financial Instruments: Recognition and Measurement"** – Novation of Derivatives and Continuation of Hedge Accounting, adopted by the EU on 19 December 2013 (effective for annual periods beginning on or after 1 January 2014).

Amendments and new Standards and Interpretations to IFRS effective on or after 1 January 2014, which are not yet endorsed by EU, not yet adopted

At present, IFRS as adopted by the EU do not significantly differ from regulations adopted by the IASB except from the following standards, amendments to the existing standards and interpretations, which were not endorsed for use in EU as at 2 April 2014 (the effective dates stated below is for IFRS in full):

- **IFRS 9 "Financial Instruments" and subsequent amendments** (effective date was not yet determined),

- **IFRS 14 "Regulatory Deferral Accounts"** (effective for annual periods beginning on or after 1 January 2016),

- **Amendments to IAS 19 "Employee Benefits"** - Defined Benefit Plans: Employee Contributions (effective for annual periods beginning on or after 1 July 2014),

- **Amendments to various standards "Improvements to IFRSs (cycle 2010-2012)"** resulting from the annual improvement project of IFRS (IFRS 2, IFRS 3, IFRS 8, IFRS 13, IAS 16, IAS 24 and IAS 38) primarily with a view to removing inconsistencies and clarifying wording (amendments are to be applied for annual periods beginning on or after 1 July 2014),

- **Amendments to various standards "Improvements to IFRSs (cycle 2011-2013)"** resulting from the annual improvement project of IFRS (IFRS 1, IFRS 3, IFRS 13 and IAS 40) primarily with a view to removing inconsistencies and clarifying wording (amendments are to be applied for annual periods beginning on or after 1 July 2014),

- **IFRIC 21 "Levies"** (effective for annual periods beginning on or after 1 January 2014).

2.3 Currency of the consolidated financial statements

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

2.4 Basis of Consolidation

The consolidated financial statements comprise the financial statements of the Bank and all its subsidiaries as at 31 December 2013.
Control is presumed to exist where the Bank holds, directly or indirectly, more than 50% of the registered capital or where the Bank can exercise more than 50% of the voting rights or where the Bank can appoint or dismiss the majority of the members of the Board of Directors.
Consolidation involves all of the subsidiaries as of the day of acquisition of control. Control signifies the ability to manage a company's financial and business policies in the interest of acquiring the proceeds from the controlled company's operation.
The effects of all material intercompany balances and transactions are eliminated.

In 2012 the Bank had ten (including the branch) fully owned (directly and indirectly) subsidiaries, nine of them registered in Hungary and one branch in Germany (FHB Commercial Bank Ltd. Niederlassung Frankfurt). The expanding of FHB Group continued in 2013 by acquiring the DÜSZ Group and the Diófa Alapkezelő Ltd. and by founding the FHB Kártyaközpont Ltd. The list of the subsidiaries, associates and joint ventures of the Bank as at 31 December 2013 is the following:

Companies included in the consolidation	Shareholder	Core business	Relation-ship *
FHB Commercial Bank Ltd.	FHB Mortgage Bank Plc. 100%	Universal banking services	S
FHB Real Estate Ltd.	FHB Mortgage Bank Plc. 100%	Real estate valuation services primarily in conjunction with the Group's business; real estate agency and sales	S
FHB Life Annuity and Real Estate Investment Ltd.	FHB Mortgage Bank Plc. 100%	Annuity products to senior clients	S
Díjbeszedő Üzemeltetési és Szolgáltatási (Operating and Servicing) Ltd.	FHB Mortgage Bank Plc. 100%	Real estate management on group level	S
Diófa Alapkezelő Ltd.	FHB Mortgage Bank Plc. 99.70%	Fund and property management	S
FHB Kártyaközpont Ltd. (Card-center)	FHB Commercial Bank Ltd. 50% Díjbeszedő Informatikai Ltd. 50%	Providing services related to bank cards, and electronic payment systems	S
FHB Ingatlanlízing Ltd. (earlier Central European Credit Ingatlanhitel Ltd.)	FHB Life Annuity and Real Estate Investment Ltd. 100%	Lending and leasing	S
Central European Credit d.d. (Croatia)	FHB Ingatlanlízing Ltd. 100%	Lending	S

All figures in tables are in HUF million except otherwise noted

Companies included in the consolidation	Shareholder	Core business	Relation-ship *
FHB DWH Ltd.	FHB Ingatlanlízing Ltd. 100 %	Data processing and web-hosting	S
Hitelunió Ltd.	FHB DWH Ltd. 100 %	Financial advisory and intermediary services	S
Kary-villa Real Estate Investment Ltd.	FHB Real Estate Ltd. 100%	Sale of own properties	S
"Wodomus 54" Real Estate Investment Ltd.	FHB Real Estate Ltd. 100%	Sale of own properties	S
Díjbeszedő Faktorház Ltd.	Díjbeszedő Üzemeltetési és Szolgáltatási Ltd. 51%	Purchasing, handling and collection receivables of retail customers	JV
Díjbeszedő Informatikai Ltd.	Díjbeszedő Üzemeltetési és Szolgáltatási Ltd. 50%	Providing services related to bank card business unit and processing of bank card transactions	JV
Díjbeszedő Kártyaközpont Ltd.	Díjbeszedő Informatikai (IT) Ltd. 100%	Providing services related to bank cards, and electronic payment systems	JV
DÍJNET Ltd.	Díjbeszedő Üzemeltetési és Szolgáltatási Ltd. 51%	Providing electronic bill payment services	JV
Magyar Posta Befektetési Szolgáltató Ltd.	Díjbeszedő Üzemeltetési és Szolgáltatási Ltd. 50%	Selling investment products	JV

Relationship: "S"=subsidiary, "JV"= joint venture

2.5 Rounding

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

All figures in tables are in HUF million except otherwise noted

2.6 *Summary of significant accounting policies*

a) *Categories of financial instruments*

The Bank groups the recognised financial assets as follows:

- Cash and cash equivalents

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

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

- Finance lease receivables

- Financial assets available-for-sale

The Bank groups the recognised financial liabilities as follows:

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

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

- Off-balance sheet liabilities

b) *Cash and cash equivalents*

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

c) *Securities held for trading*

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

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

d) Financial assets available-for-sale

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

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

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

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

e) Refinanced mortgage loans

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

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

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

f) Loans and advances to customers

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

All loans and advances are recognized upon their disbursement.

g) Restructuring of loans

In cases of serious default the Bank favours renegotiating the loans to customers instead of foreclosure wherever possible. Renegotiated loans may be restructured by extending of the loan term and/or agreeing on new conditions.

The Bank management keeps track of renegotiated loans to ensure all terms and conditions are met and to secure future cash payments. Provision for impairment of restructured loans is set up on an individual as well as on a portfolio basis and with the application of the original effective interest rate of the loan.

Most of the lease contracts are restructured loans and therefore the provision is set up the same way as at a restructured loan. In case of renegotiated loans the classification of the clients (and eventually the provision) may improve if the clients start to pay their instalments as scheduled. The new buffer account scheme and the converted HUF loans (under the new State program, see note 2.9) were dealt with the same process like other refinanced mortgage loans in spite of the originated loan has not got any payment problem.

h) Impairment on loan losses

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

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

Impairment on a particular loan or a group of similar loans is recognized if their book value is greater than the estimated recoverable amount. The recoverable amount is the present value of expected future cash flows, including amounts recoverable from guarantees and collaterals, discounted based on the loan's original effective interest rate. The impairment for significant loans is assessed individually. For those loans that are of insignificant in their individual amounts the Bank assesses impairment on a portfolio basis, taking into consideration the type and the classification of the loan, non-performance history and losses.

The Bank writes off loss loans and advances when borrowers are unable to fulfil their obligations to the Bank and when relevant evidence has been obtained through the appropriate legal proceedings. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the statement of recognized income. The impairment of loans and advances are recognized as credit loss expenses. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a write-off is later recovered, the recovery is credited to the 'Credit loss expense'.

i) Leases

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

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

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

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

j) Acquisitions and goodwill

Business combinations are accounted for using the purchase method of accounting. This involves recognizing identifiable assets (including previously unrecognized assets) and liabilities (including contingent liabilities) of the acquired business at fair value. Any excess of the cost of acquisition over the fair value of identifiable net assets acquired is recognised as goodwill. A negative difference is recognised directly in the earnings for the year of the acquisition. Goodwill is measured as the excess of the sum of the consideration transferred the amount of any non-controlling interests in the acquire, and the fair value of the acquirer's previously held equity interest in the acquire (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed.
Initially goodwill is measured at cost. Following initial recognition, the Bank runs an impairment test annually and measures goodwill at cost less any accumulated impairment.
Identifiable asset can be the portfolio value, which represents the business potential of the loans of the acquired subsidiaries at acquisition date.
If the subsidiaries acquired are later disposed of, the difference between the selling price and the net assets plus cumulated translation difference and goodwill is recognized in the statement of recognized income.

k) Investment property

Investment properties are residual real estates for which longlife annuity payment contracts are signed. Original owners of these investment properties have lifelong use and usufruct, thus the sale of these properties is limited. FHB Life Annuity and FHB Real Estate Investment Ltd. undertakes maintenance of such investment properties until the time of their sale.

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

l) Tangible and intangible assets

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

Real estate	2%
Leasehold improvement	6%
Equipment and furniture	9% - 33%
Software	10% - 33%
Rights representing assets	3.5% - 16.7%
Portfolio value	Degressive
Hardware	33% - 50%
Vehicles	20% - 33%
Other fixed assets	9% - 14.5%

Intangible assets have a definite useful life, excluding goodwill.

m) Impairment of non-financial assets

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

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

All figures in tables are in HUF million except otherwise noted

n) Derivatives

A derivative transaction is a financial contract between two parties where payments are dependent upon movements in price in one or more underlying financial instrument, reference yield or index.

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

Derivatives include forwards, futures, swaps and options. From the second half of 2009 the Bank has had embedded options in structured deposits as well as purchased option to cover the risks of the embedded option. Derivatives embedded in other financial instruments are treated either as separate derivatives and recorded at fair value in the trading portfolio with changes in the fair value recognised in the statement in recognized income, or together with the host financial instrument, taking the relevant part of IAS 39, Recognition and Measurement.

o) Hedge transactions

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

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

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

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

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

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

There are no net investment hedges in foreign operations.

Changes in the fair value of derivatives that are designated and qualify as fair value hedges and that prove to be highly effective in relation to the hedged risk, are recorded in the Consolidated Comprehensive Income Statement along with the corresponding change in fair value of the hedged asset or liability that is attributable to the specific hedged risk. The ineffective portion of the hedge is charged directly to the Consolidated Statement of Recognized Income.

In relation to cash flow hedges, which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognized initially in the other comprehensive income item. The gains or losses on effective cash flow hedges recognized initially in other comprehensive income are either transferred to the statement of recognized income in the period in which the hedged transaction affects the statement in the recognized income, or are included in the initial measurement of the cost of the non-financial related asset or liability. The ineffective portion is recognized in the statement of recognized income.

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

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument recognized in other comprehensive income remains in other comprehensive income until the forecasted transaction occurs. Where the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognized in other comprehensive income is transferred to the net profit/loss for the period.

The following lines in the profit or loss statement contain the gains or losses in connection with the hedging instruments of hedges (swaps):

(a) Interest income or interest expense

(b) Gains or losses from foreign exchange transactions

(c) The remaining change from fair value adjustment in Change in fair value of derivatives

p) Current tax

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

q) Deferred taxes

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

r) Classification into financial liabilities or shareholders' equity

Financial liability is any liability that is:

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

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

s) Financial liabilities carried at amortized cost

The Bank has the following financial liabilities to finance its business: issued mortgage bonds, issued bonds, loans from the Hungarian state, interbank loans and customer deposits.

Financial liabilities, which are not designated at fair value through profit or loss, are classified as financial liabilities carried at amortized cost. At initial measurement, they are recognized at fair value. After initial measurement, they are carried at amortized cost using the effective interest rate. Amortized cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the effective interest rate.

t) Financial liabilities carried at fair value other than derivatives

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

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

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

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

u) Financial guarantee contracts

Financial guarantee contracts are those contracts that require a payment to be made to reimburse the holder for a loss incurred because the specified debtor fails to make a payment when it is due in accordance with terms of a debt instrument.

Financial guarantee contracts are initially recognised in the financial statements within 'Provisions' at fair value, adjusted for transaction costs that are directly attributable to the issuance of the guarantee. Subsequently, the liability is measured at the amount recognised less cumulative amortisation, and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

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

v) Derecognizing of financial instruments

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

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

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

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

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

w) Repurchase and reverse repurchase transactions

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

The Bank does not report securities provided to repo as a separate item in the balance sheet, only in the Notes. Securities received to repo is not reported in the consolidated statement of financial position.

x) Provisions

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

y) Short term employee benefits

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

z) Long term employee benefit plans- pensions

In the normal course of business the Bank pays fixed contributions into the Hungarian State and private pension funds on its employees, which is recognized in social security contributions (mandatory contribution) and other personnel expenses (voluntary contribution). The Bank itself does not offer a pension scheme or post-retirement benefit plan, and consequently has no legal or contractual obligation to make further contributions if the funds do not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

aa) Repurchased treasury shares

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

bb) Share -based payment

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

The Bank reports share option benefits extended in shares at the fair value on the day the benefit was approved by the Annual General Meeting (AGM), calculated by means of the methodology described in Note 35, in accordance with IFRS 2, Share-base Payment. The fair value of shares involved in the share option scheme but not yet delivered is recognized as expenditure (other personnel costs) as a separate line item against share option reserve under shareholders' equity for the period the benefit is earned.

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

The management share option scheme does not involve an allocation period; after the decision of the AGM, shares are allocated on a pre-determined day to those entitled to the share option for repurchased treasury shares. An individual involved in the scheme can only decide whether or not the person wants the share option; in other respects, the person has no right to decision. The preferential price is 25% of the face value of the shares.

Regarding the share-based payments for 2013 in 2014 the following rules come into force. The entitled person may exercise his option in the period of 3 years from the general meeting closing the business year given. In the first year of the entitlement the person shall be entitled to draw maximum 60% of the option, and one year after the first drawing, the person shall be entitled to draw maximum 20%, and after another year, the person shall be entitled to draw the 20% of the option left.

cc) Annuity payment reserve

An annuity contract is an insurance contract for regular annuity payments. In accordance with IFRS 4 the Bank sets up a reserve for the calculated value of future payments under annuity contracts (calculated at present value and in consideration of death statistics). The value of the reserve is determined on a monthly basis by using the actuary method. The change in the reserve is reported in the statement of recognized income (in other operating expense or income). Annuity payments made are recognized as expenditure. All fees, expenses and cost of funds with respect to the beneficiary of annuity contract or the real estate involved in the annuity contract are recognized as 'General and administrative expense' in the period they emerge.

dd) Income and expenditure

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

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

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

ee) Interest subsidy

State interest subsidy

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

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

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

Mortgage bond interest subsidy

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

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

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

Supplementary interest subsidy

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

ff) Contingent liabilities / contingent assets

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

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

gg) Post balance sheet events

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

hh) Segment information

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

The Bank takes the following factors into consideration when determining whether services are interconnected: nature of services, type or group of clients buying the services, methods applied in the course of service provision, and the regulatory environment. The Bank presents each segment whose contribution to (internal and external) revenue, earnings or balance sheet total is material, in consideration of other material provisions of IFRS 8 (Note 54). The data related to the business segments of own lending and refinancing, are separated in the balance sheet (under Notes 18 and 19) and in the statement of recognized income (under Note 4).
Geographical segmentation has also been analyzed. Since the revenue, earnings or balance sheet total of the German branch office and the Croatian subsidiaries are under 10%, no presentation of geographical segmentation has been made.

ii) Offsetting

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

jj) Foreign currency translation

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

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

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

kk) Trade date and settlement date accounting

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

ll) Bank tax

In August 2010 the Hungarian Parliament approved a new Act called the “bank tax”. Each financial institution that already had a closed financial year and related financial statements on 1 July 2010 was subject to assessment and payment of this bank tax in 2010. On 15 November 2010 the Hungarian Parliament approved an amendment to the Bank Tax Act applicable for 2011. The amendment practically splits into two payment titles the original bank tax payment obligation for banks only.

The basis and the rate of the new bank tax that establishes the tax payable in 2010 is different for the different types of financial institutions (in case of banks it is calculated on the adjusted balance sheet total, in case of financial enterprises - such as leasing companies - it is based on the net interest income and net commission income, etc.). For 2010 and 2011 the basis and rates are uniformly based on statutory reported financial data of the reporting entity as at and for the period ended 31 December 2009.

The respective tax rates are different for the different types of financial institutions: e.g. for credit institutions the tax rates are 0.15% of adjusted total asset value for the first HUF 50 billion; and 0.5% for the amount exceeds HUF 50 billion. In the amendment there are certain changes for banks regarding the basis for the tax and the tax rate for the adjusted total asset value exceeding HUF 50 billion was increased to 0.53% for the year 2011.

The legislation for the opportunity to decrease the Bank tax was accepted by the Hungarian Parliament on 29 December 2011. Based on this amendment:

- the amount of the Bank tax for 2011 can be decreased by the following amount: 30% of the loss incurred due to the repayment of foreign currency loans on a fixed rate accepted in the 2011 legislation for the Bank tax
- the amount of the Bank tax for 2012 can be decreased by the following amount: 30% of the loss incurred due to the release of the foreign currency loan or due to convert the foreign currency loans into HUF denominated loans

The maximum of the decreasing amount is the amount of the Bank tax of the year given.

The amount of Bank tax does not include any decreasing items in 2013.

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

2.7 Significant accounting judgements and estimates

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

Going concern

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

Fair value of financial instruments

In cases where the fair value of financial assets and liabilities are not measured at marked to market, other kind of assessment model is necessary to be used to determine fair value. Wherever possible, the input of these models is observable market data. Where such data are not available the Bank uses valuation model to determine fair value. (Note 38)

Share-based payment

When establishing the fair value of shares involved in the share option scheme the Bank assesses the allocation condition, the allocation price, and compliance with the trading and profit objectives. (Note 35)

Annuity payment reserve

The Bank sets up a reserve for the calculated value of future payments under annuity contracts (calculated at current value and in consideration of death statistics).

Deferred tax assets

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

Loan impairment test and its result

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

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

Impairment of other assets

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

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

Each asset is assessed annually (except stated otherwise), when any indication of a reversal or reduction of earlier impairment is assessed. If there is such an indication the Bank estimates the recoverable value of the asset.
For more details see Notes 22 and 23.

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

2.8 Reclassification and error

After the balance sheet date of the consolidated financial statements of 2012 there were no mistakes or errors discovered which are significant and affect the decision made by the users based on the financial statements.

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

Based on the Act LXXV of 2011 on “the fixation of the instalments’ exchange rate of loans denominated in foreign currencies and the rules for the forced sale of properties” and the governmental order 57/2012 (III.20) debtors with FX loans not overdue of more than 90 days are eligible to participate in the new scheme offering payment of instalments at reduced rates (CHF/HUF 180, EUR/HUF 250 and JPY/HUF 2 respectively), however the period for the participation in the buffer accounts scheme is limited (5 years but latest the due date of the last instalment before 30 June 2017). Whereas the State and the Bank share the loss on the interest repayments due to the off-market fixed exchange rate on a 50% (directly)- 50% (indirectly) basis. In the event of exchange rate levels exceeding CHF/HUF 270, EUR/HUF 340 and JPY/HUF 3.3 respectively, exchange rate risks are entirely borne by the State.

At the beginning of November, the Parliament passed the modification of act on measures needed to protect FX loan debtors, which stepped into effect after its publication, on 9 November 2013. The law introduced essentially immediate moratorium on evictions until 30 April 2014, and decided on the extension of range of debtors entitled to participate in FX rate protection scheme. According to the new regulation:

- also debtors with more than 90 days delay can apply for buffer account, including clients, who’s real estate bothered with more than one of such mortgage;
- participation in client support program is not disqualifying;
- previous 20 million HUF limit were abolished, so clients with loans over 20 million HUF original value can also apply;

- conditions of state guarantee behind buffer accounts opened after modification coming into effect became more stringent:
  - in case of newly opened buffer accounts, state provide guaranty solely if outstanding loan volume not exceeds 95% of collateral real estate value;
  - Banks can exercise the guaranty if buffer accounts past due over 180 days and the bank terminates the contract because of that.

Until 31 December 2013 9,548 clients represented their intention to participate in the 'exchange rate protection program' which is 46,5% of the entitled persons based on the legal conditions. From this amount 7,956 clients signed the contracts until the year-end.

Among the steps of the 'Homeprotection Actionplan' can be found the establishment of the National Asset Management Ltd. (NET) to purchase the properties of the most indigent debtors. The related Act CLXX of 2011 provides details about the criteria and the process of the purchase of the properties ensuring residence to the indigent debtors by the National Asset Management Ltd. After 20 June 2012 the properties can be offered for the National Asset Management Ltd. without marked as available for forced sale.

The followings are criteria for the eligibility related to the loan amount, the collaterals and the social position of the debtor:

- On or after 28 September 2011 the registered residence of the debtor or in case the property is not owned by the debtor the registered residence of the pledger needs to be the property which served as collateral for the loan.
- The mortgage loan contract was executed before 30 December 2009.
- The mortgage loan has only one collateral which is the residential property.
- On 1 January 2012 the outstanding overdue amount of the mortgage loan amounts to at least HUF 186,000 and is overdue at least from 180 days.
- At the execution of the mortgage loan contract the market value of the property did not exceed:
  - in Budapest or other city with county rights HUF 15 million or
  - in other towns HUF 10 million.
- At the execution of the mortgage loan contract the amount of the loan is:
  - between 25-80% of the market value of the property
  - in case of mortgage loan with state subsidy between 25-100% of the market value of the property.
- The debtor or the pledger has no right of use on other properties.
- The debtor or the pledger or his/her spouse living in the same household receives care allowance or pension.

Thanks to the modifications of the Act CLXX of 2011 in December 2012, and July 2013 was expanded the number of the entitled customers. The purchase price of the properties is determined by the Hungarian Property Management Ltd. as 35-55% of the original market value depending on the size of the town. The Bank spends the price received from the Hungarian Property Management Ltd. for the final repayment of the outstanding loan amount according to the Hungarian Accounting Standards, the Act on Taxation and in case of special terms the regulations of the Act on the Operation of the Hungarian Property Management Ltd.

Until 31 December 2013 1,236 properties were offered by the Group for the Hungarian Property Management Ltd. There are 2,066 loan contracts and HUF 6.2 billion outstanding loan amount in connection with these properties in the books of the Group. From these amounts until the year-end 727 properties were purchased by the Hungarian Property Management Ltd. and 1,165 loan contracts were closed, from these amounts 556 properties were purchased, and 905 loan contracts were closed during 2013.

Based on Paragraph 3 Section 10 of Act of CXXIII of 2013, Banking Group was charged by HUF 587.7 million payment obligations to compensate the lack of financial transaction levy, which was accounted as other expense.

In April 2013, the National Bank of Hungary announced the launch of the Bank's Funding for Growth Scheme (NHP) with total amount of HUF 750 billion. Under the Scheme, the NBH provides liquidity to credit institutions using its monetary policy instruments, in order to alleviate disruptions in lending to small and medium-sized enterprises. FHB disbursed close to HUF 30 billion corporate loans in the first phase of the program. Since October, 2013, the program continues with the second phase, and until the end of 2014, National Bank of Hungary provides HUF 500 billion source from the HUF 2,000 billion overall possible amount. From 2014, range of loan targets to be finance and enterprises entitled to participate widened, at the same time 90% of the available amount may be allocated exclusively for the provision of new loans, referred to notes 19.

3. CHANGE IN ESTIMATES

Since the economic crisis erupted, some currency pairs have been added a significant risk/liquidity premium (basis swap spreads). Since this risk premium has been significant from 2010, it is justified to incorporate it into the evaluation method of cross-currency interest rate swaps (CCIRS). The yield curve is adjusted with this premium. From 2012 the Bank applies risk premium in case of all cashfows except of EUR. The basis for this risk premium is derived from the basis swap market subscriptions between the given currency and EUR. The application of the appropriate risk premium enhances the accuracy of the fair value measurement. (Note 38).

Further clarification in case of FX swaps (FXS) that for every single transaction the basis of the valuation will be the market subscription of the given currency pairs which best fits the maturity of the transaction (forward swap points) instead of the discounted cash flow method of the CCIRS described above.

4. INTEREST AND SIMILAR INCOME AND EXPENSE

	2013	2012
Interest income		
Loans and advances to customers	29,677	34,035
Refinanced mortgage loans	12,843	14,567
Due from banks	557	652
Interest income on assets carried at amortised cost	*43,077*	*49,254*
Securities held for trading	2,083	471
Financial assets available-for-sale	6,109	10,350
Interest on derivative transactions	14,906	16,595
Interest income on assets carried at fair value	*23,098*	*27,416*
Total	**66,175**	**76,670**

Accrued interest receivable on impaired loans amounted to HUF 1,276 million (2012: HUF 859 million).

	2013	2012
Interest expense		
Mortgage bonds	14,412	14,659
Due to banks	4,335	6,598
Interest paid on deposits	7,064	9,299
Interest on bonds	5,032	7,135
Interest on state loans	0	976
Interest expense on leases	1,028	1,045
Interest expense on liabilities carried at amortised cost	*31,871*	*39,712*
Interest on derivative transactions	9,000	9,597
Mortgage bonds	2,484	5,041
Due to banks	816	853
Interest on bonds	3,293	2,921
Interest expense on liabilities carried at fair value	*15,593*	*18,412*
Total	**47,464**	**58,124**

The interest income from loans and refinanced mortgage loans includes HUF 9,356 million interest subsidy in 2013 (2012: HUF 10,659 million).

All figures in tables are in HUF million except otherwise noted

5. FEE AND COMMISSION INCOME AND EXPENSE

	2013	2012
Fee and commission income		
Mortgage loans of the Bank	591	559
Refinanced mortgage loans	228	606
Handling commission	157	177
Real estate appraisal fee	120	71
Deposit business	1,562	943
Agency fee income	599	591
Card business	979	549
Investment services	241	53
Other	583	246
Total	**5,060**	**3,795**

	2013	2012
Fee and commission expense		
Investment services	79	297
Agency fees and commissions	91	371
Card business	383	361
Fees and commissions to banks and to clearing house	155	167
Surety / guarantee fee	18	-
Other	8	8
Total	**734**	**1,203**

6. OTHER OPERATING INCOME

	2013	2012
Fair value change of the investment properties	71	278
Income from sold property	8	-
Income from sold inventory	452	-
Income from damages compensations received	184	19
Rental income on property	123	121
Invoiced expenses and services	135	66
Reversal of provision	5	160
Reversal of impairment on inventory	71	-
Income from expired liabilities	202	-
Other	211	20

All figures in tables are in HUF million except otherwise noted

Total	**1,462**	**664**

Recognition of investment property includes the cost of investment properties acquired, which then fair valued at the end of the month of acquisition.

7. OTHER OPERATING EXPENSE

	2013	2012
Bank tax (detailed in Note 7 below)	3,414	2,068
Annuity payments	395	395
Impairment of leasehold investment / improvement / assets	-	56
Provision for expected costs	-	25
Change in annuity reserve (Note 31)	296	151
Change in the effect of the recognition of the fair value of the investment property	-	146
Sold tangibles	-	25
Sold inventory	-	38
Donation	48	55
Tax penalty, late penalty	134	115
Supervisory and other fees	89	93
Write off of the leased assets	-	10
Other	329	138
Total	**4,705**	**3,315**

The amount of Bank tax booked for 2013 by group members is detailed in the following table:

	2013
FHB Mortgage Bank Plc.	1,824
FHB Commercial Bank Ltd.*	1,554
FHB Ingatlanlízing Ltd.	35
Diófa Alapkezelő Ltd.	1
Total	**3,414**

*Include the obiligation to compensate the lack of financial transaction levy, based on Paragraph 11 Section 3 of Act o CXVI. of 2012.

The special banking tax was reduced by the Group according to Act LIX of 2006 on the Special Banking Tax and Contribution Intended to Improve the Balance of Public Finances in 2012.
Based on the legislations there were two types of the bank tax decreasing items in 2012. The amount of the bank tax can be decreased by the released amount of the receivables due to the conversion of the non-performing loans into HUF and the tax base of the bank tax can be decreased by the amount of the increase in the mortgage loans and finance leases in the given year.

All figures in tables are in HUF million except otherwise noted

8. GENERAL AND ADMINISTRATIVE EXPENSES

	Note	2013	2012
Staff costs	9	5,752	5,795
Marketing and advertising		686	511
General and administrative costs		1,968	2,058
Rental fee	10	927	940
Depreciation	22	495	515
Amortisation	23	2,038	1,982
Consultancy fees		897	1,056
Maintenance costs		2,518	2,544
Other taxes		2,181	691
Insurance fees		107	199
Database system usage		147	168
Other		455	434
Total		**18,171**	**16,893**

9. STAFF COSTS

	2013	2012
Wages and salaries	4,126	4,229
Social security contribution	1,242	1,296
Other personnel related payments	384	376
Share option	-	(106)
Total	**5,752**	**5,795**

Social security contribution is payable by the Bank based on gross wages and salaries paid to employees. The average head count of the Bank in the period of reporting was 836 (2012: 867).

All figures in tables are in HUF million except otherwise noted

10. RENTAL FEE (OPERATING LEASE)

Non-cancellable operating leases

The operating lease agreement of the registered office expires on 31 December 2014.
The group has the option for another 5 years of lease. If the group does not exercise the option, penalty of up to HUF 86 million is to be paid.

	31 December 2013	31 December 2012
	Minimum lease payments	Minimum lease payments
Within 12 month	789	848
Between 1 and 5 years	973	1,640
Over 5 years	713	869
Total	2,475	3,357

	Minimum lease payments	Contingent rents	Sublease payments	Total
Expense in the period 2013	897	45	(15)	927
Expense in the period 2012	853	92	(6)	939

11. INCOME TAX

	31 December 2013	31 December 2012
Current income tax	**877**	**1,127**
Corporate income tax	3	138
Local business tax	758	858
Innovation contribution	116	131
Deferred tax benefit	**(1,246)**	**(77)**
Total	**(369)**	**1,050**

Reconciliation of expected tax based on book earnings and actual tax paid is presented as follows:
As of 1 January 2011 the tax rate is 10% up to HUF 500 million tax base and 19% above.
In 2011 the Hungarian Parliament accepted the modification of the Corporate Tax Act and the planned decrease of the corporate income tax rate was cancelled, the rule for the calculation remained the same, up to HUF 500 million the tax rate is 10%, above HUF 500 million the tax rate is 19%. Based on this information the Group calculated the deferred tax with the 19% tax rate in 2013 and 2012.

All figures in tables are in HUF million except otherwise noted

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

	31 December 2013	31 December 2012
Loss before tax	**(5,033)**	**(3,414)**
Calculated corporate income tax (19%)	(956)	(649)
Local business tax and innovation contribution	876	990
Effect of local business tax and innovation contribution to the corporate income tax	(166)	(188)
Items modifying the Hungarian tax base	(40)	92
Subsidiaries' tax losses not to be carried forward	181	328
Reversal of general risk provision	-	502
Effect of other modifications	(264)	(25)
Total income tax (benefit)/expense	**(369)**	**1,050**

All figures in tables are in HUF million except otherwise noted

Deferred tax position

	31 December 2013				
	Deferred tax assets	Deferred tax liabilities	Deferred tax net position	Income statement effect	Deferred tax position in reserves
Disbursement fee	949	-	949	757	-
Revaluation of annuity related investment property	-	(1,024)	(1,024)	11	-
Annuity costs	-	521	521	129	-
Derivatives	114	-	114	430	-
Impairment	(828)	-	(828)	(151)	-
Suspended interest	(1,362)	-	(1,362)	(477)	-
Acquisition	(106)	-	(106)	5	-
Tax loss carried forward	9,798	-	9,798	300	-
Effect of consolidation	(1,113)	-	(1,113)	230	-
AFS securities	(71)	-	(71)	(18)	(87)
Finance leases	(9)	-	(9)	30	-
Deferred tax of foreign subsidieries (CEC d.d).	49	-	49	-	-
Net deferred tax position	**7,421**	**(503)**	**6,918**	**1,246**	**(87)**

All figures in tables are in HUF million except otherwise noted

	31 December 2012				
	Deferred tax assets	Deferred tax liabilities	Deferred tax net position	Income statement effect	Deferred tax position in reserves
Disbursement fee	192	-	192	244	-
Share-based payment	-	-	-	(20)	-
Revaluation of annuity related investment property	-	(1,035)	(1,035)	(38)	-
Annuity costs	-	392	392	103	-
Derivatives	(321)	-	(321)	109	-
Impairment	(677)	-	(677)	266	-
Suspended interest	(884)	-	(884)	(244)	-
Acquisition	(111)	-	(111)	4	-
State loan	-	-	-	(4)	-
Tax loss carried forward	9,498	-	9,498	431	-
Effect of consolidation	(1,345)	-	(1,345)	(689)	-
AFS securities	34	-	34	(33)	56
Finance leases	(39)	-	(39)	(44)	-
Deferred tax of foreign subsidieries (CEC d.d).	49	-	49	(7)	49
Net deferred tax position	**6,396**	**(643)**	**5,753**	**77**	**105**

All figures in tables are in HUF million except otherwise noted

12. OTHER COMPREHENSIVE INCOME

Components of other comprehensive income

	31 December 2013	31 December 2012
Other comprehensive income		
Cash-flow hedge reserve	-	(249)
including: change in fair value	-	(249)
including: reclassification to profit	-	-
Financial investment available-for-sale	459	(3)
including: change in fair value	376	96
including: reclassification to profit or loss	83	(99)
Foreign currency translation	(2)	10
Deferred tax effect	(87)	48
Total	**370**	**(194)**

Deferred tax effects relating to comprehensive income

	31 December 2013			31 December 2012		
	Before tax amount	Deferred tax	Net of tax amount	Before tax amount	Deferred tax	Net of tax amount
Other comprehensive income						
Cash-flow hedge reserve	-	-	-	(249)	47	(202)
Financial assets available-for-sale	459	(87)	372	(3)	2	(1)
Foreign currency translation	(2)	-	(2)	10	(1)	9
Total	**457**	**(87)**	**370**	**(242)**	**48**	**(194)**

All figures in tables are in HUF million except otherwise noted

13. BALANCES WITH THE NATIONAL BANK OF HUNGARY

The Bank is required to maintain a minimum average balance for the month equivalent to 2% of the Bank's total resident customer deposits, foreign customer HUF and currency (less than one year) deposits with the National Bank of Hungary, both in 2013 and 2012.

	31 December 2013	31 December 2012
Short term deposits	8,500	2,498
Nostro account at National Bank of Hungary	2,955	2,600
Accrued interest for the period	14	19
Total	**11,469**	**5,117**

14. DUE FROM BANKS

	31 December 2013	31 December 2012
Nostro accounts	1,808	1,629
Term deposits	19,448	27,225
Accrued interest for the period	14	10
Total	**21,270**	**28,864**

15. SECURITIES HELD FOR TRADING

	31 December 2013	31 December 2012
Hungarian Government bonds	5,436	3,203
Hungarian Treasury bills	35,356	1,120
National Bank of Hungary bonds, and treasury bills	200	-
Hungarian Development Bank bonds	-	1,058
Mortgage bonds	10	-
Investment notes	410	-
Student Loan Centre Ltd. bond	268	683
Bonds issued by MOL Plc.	270	1,751
Total	**41,950**	**7,815**

All figures in tables are in HUF million except otherwise noted

16. FINANCIAL ASSETS AVAILABLE-FOR-SALE

	31 December 2013	31 December 2012
Hungarian Government bonds	19,197	28,853
Hungarian Discount Treasury bills	107,992	31,477
National Bank of Hungary bonds	10,304	71,939
Mortgage bonds	12,260	23,971
Investment funds	358	351
Foreign bank bonds	901	1,470
Equity investments	861	787
Total	**151,873**	**158,848**

The main activity of the German branch office of FHB Commercial Bank Ltd. is to make borrowing deals covered by securities with the European Central Bank.

Equity investments include shares of BIF Ltd. for HUF 826 million (2012: HUF 752 million), shares of Garantiqa Creditgurantee Ltd. for HUF 30 million (2012: HUF 30 million) as well as SWIFT and VISA shares (2013: HUF 5 million; 2012: HUF 5 million). The investment in BIF Ltd. represents 10% stake, the other investments represent less than 1% stake in the companies. Shares of Garantiqa, SWIFT and Visa measured at cost according to IAS 39.46 (c).

17. SALE AND PURCHASE OF SUBSIDIARIES

Purchase of subsidiaries

On 2 September 2013 FHB Mortgage Bank Plc purchased 99,9% of the shares of Diófa Fund Manager Ltd for cash and took over control on the company. The acquisition was authorised by the Hungarian Financial Supervisory Authority. Diófa Fund Manager Ltd. provides fund and property management services.

The book value represents the fair value of Diófa Fund Manager as at 2 September 2013 under IFRS, which is the date of acquisition

	Fair value	Book value
Assets		
Dues from banks	12	12
Fair value of assets held-for-trading	18	18
Tangible assets	16	16
Intangible assets	21	21
Deferred tax asset	3	3
Other assets	79	79

All figures in tables are in HUF million except otherwise noted

	Fair value	Book value
Liabilities		
Provisions	5	5
Other liabilities	15	15
Net assets	**129**	**129**

Acquisition related cost have been excluded from consideration transferred and have been recognised as an expense in consolidated comprehensive income. Consideration paid in cash and goodwill on 2 September 2013 are as follows:

Goodwill arising on acquisition	
Consideration transferred	281
Less: fair value of identifiable net asset acquired	(129)
Goodwill arising on acquisition	**152**

Goodwill has been arisen in the acquisition because the consideration paid effectively included the amount of the benefit of expected synergies, revenue growth, and future market development. These benefits are not recognised separately from goodwill because they do not meet the recognition criteria for identifiable intangible asset.

Cash outflow	
Acquired cash	12
Consideration paid	(281)
Net cash outflow	**(269)**

On 29 November 2013 FHB Mortgage Bank Plc purchased 100% of DÜSZ shares for cash and contingent payment and took over control on the company. The acquisition was authorised by the Hungarian Financial Supervisory Authority. DÜSZ has real estate manager activities and was the owner of Díjbeszedő Faktorház Ltd. (total stake of 51%), DÍJNET Ltd. (total stake of 75%), and Díjbeszedő Informatika Ltd. (total stake of 50%) at the date of acquisition.

The book value represents the fair value of DÜSZ as at 29 November 2013 under IFRS, which is the date of acquisition:

	Fair value	Book value
Assets		
Dues from banks	265	265
Investment in joint venture companies	526	526
Net assets	**791**	**791**

All figures in tables are in HUF million except otherwise noted

Acquisition related cost have been excluded from consideration transferred and have been recognised as an expense in consolidated comprehensive income. Consideration paid in cash and goodwill on 29 November 2013 as follows:

Goodwill arising on acquisition	
Consideration transferred*	5,974
Less: fair value of identifiable net asset acquired	(791)
Goodwill arising on acquisition	**5,183**

*Consideration transferred includes the consideration paid in cash and the contingent consideration arrangement. The Group is required to pay additional amount in 2015 and 2016 if certain performance criteria of the companies are met. The contingent consideration amount represents the estimated fair value of this obligation at the acquisition date.

Goodwill has been arisen in the acquisition because the consideration paid effectively included the amount of the benefit of expected synergies, revenue growth, and future market development. These benefits are not recognised separately from goodwill because they do not meet the recognition criteria for identifiable intangible asset.

Cash outflow	
Acquired cash	265
Consideration paid	(5,250)
Net cash outflow	**(4,985)**

Sale of subsidiaries

During 2013, 2012 no subsidiaries were sold.

18. REFINANCED MORTGAGE LOANS

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

The Bank signed contracts with several major Hungarian commercial banks to refinance mortgage loans; hence state subsidized the mortgage loans are available through the entire network of these commercial banks. The balance as at 31 December 2013 includes loans disbursed to 48,632 customers (2012: 56,376). The refinanced mortgage loans are provided to eight partner institutions.

All figures in tables are in HUF million except otherwise noted

19. LOANS AND ADVANCES TO CUSTOMERS

	31 December 2013	31 December 2012
Housing loans	138,853	148,661
General purchase mortgage loans	125,923	136,239
Customer loans and overdrafts	6,471	6,348
Loans to employees	1,568	1,935
Finance lease to retail customers	2,404	2,793
Finance lease to companies	988	927
Loans to companies	71,289	67,962
Other loans	-	-
Loans gross subtotal	**347,496**	**364,865**
Fair value adjustment of hedged items	(594)	(223)
Accrued part of disbursed loans under Funding of Growth Scheme*	5,499	-
Accrued interest	10,164	7,871
Amortized origination cost	(4,561)	(582)
Loans gross total	**358,004**	**371,931**
Loan impairment	(37,933)	(37,348)
Loan portfolio reported	**320,071**	**334,583**

Loan impairment based on individual rating: HUF 12,724 million (2012: HUF 13,507 million), based on portfolio rating: HUF 25,187 million (2012: HUF 23,903 million).

*The disbursed loans under Funding for Growth Scheme started in June 2013. Related to Pillar 1 and Pillar 2, the Group contracted for outplacement of HUF 30 billion, of which 28 billion was disbursed till the end of the year. The Bank booked these disbursed loans and the liabilities to NBH at fair value at initial recognition, and accrued the difference between fair value and contractual value until the end of maturity in line with IAS 39 AG76.

All figures in tables are in HUF million except otherwise noted

Changes in impairment for credit losses:

	31 December 2013	31 December 2012
Impairment as at 1 January	37,348	39,033
Provision for impairment in the period	15,139	13,854
Exchange rate change of impairment	92	(1,905)
Reverse of impairment for the period	(13,245)	(13,214)
Derecognition due to sale of assets	(1,401)	(420)
Impairment as at end of period	**37,933**	**37,348**
Breakdown of the credit loss expense for the period		
Change of impairment in the period	1,893	641
Entries due to consolidation	496	-
Losses from the repayment of the loans at a fixed rate	6	7,048
Losses from the conversion of the foreign currency mortgage loans	-	711
Written-off loans	491	381
Loss on loans sold	3,801	875
Loss on terminated loans	13	(7)
Charge for commitments	89	107
Credit losses on loans and advances	**6,789**	**9,756**

The aggregate amount of non-performing loans was HUF 73,727 million as of 31 December 2013 (31 December 2012: HUF 72,912 million).
Within the total balance of mortgage loans 98.99% have maturity over five years (2012: 98.63%), exceeding the minimum level of 80% that is required by the Section 5(1) of Act XXX of 1997 on Mortgage Loan companies.

The total outstanding mortgage loan principle does not exceed 70% of the aggregate collateral value of real estate determined at loan disbursement that is required by the Section 5(3) of Act XXX of 1997 on Mortgage Loan Companies. As of 31 December 2013, loan to value is 39.08% (31 December 2012: 40.7%).

Finance Lease

	31 December 2013	31 December 2012
Gross investment in the lease	4,940	6,057
Minimum lease payments	4,940	6,057
Unguaranteed residual value	-	-
Net investment in the lease	2,566	3,689
Unearned finance income	**2,374**	**2,368**
Impairment on finance leases	(448)	(379)

All figures in tables are in HUF million except otherwise noted

Mostly lease agreements were the result of the restructuring actions performed by the Bank to strengthen the legal position by obtaining ownership on the collateral, rather than having only a mortgage on them.

The minimum lease payments receivable at 31 December 2013 for the following periods

	Within 12 month	Between 1 and 5 years	Over 5 years
Gross investment in the lease	310	1,213	3,417
Net investment in the lease	100	464	2,001
Unearned finance income	**210**	**749**	**1,416**

The minimum lease payments receivable at 31 December 2012 for the following periods

	Within 12 month	Between 1 and 5 years	Over 5 years
Gross investment in the lease	1,472	1,107	3,477
Net investment in the lease	1,280	417	1,991
Unearned finance income	**192**	**690**	**1,486**

20. GOODWILL

	31 December 2013	31 December 2012
Gross value		
Opening balance	-	-
Increase	-	-
Purchased through acquisition	152	-
Decrease	-	-
Closing balance	**152**	**-**
Impairment		
Opening balance	-	-
Increase	-	-
Closing balance	-	-
Net value	**152**	**-**

The goodwill is attributable to Diófa Fund Management Ltd.

HUF 5.183 million goodwill, which one is attributable to DÜSZ is classified among shares in associates and joint ventures (Notes 17).

All figures in tables are in HUF million except otherwise noted

21. INVESTMENT PROPERTY

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

	31 December 2013	31 December 2012
Gross value		
Opening balance	6,294	6,062
Increase	483	592
Decrease	(451)	(360)
Closing balance	**6,326**	**6,294**
Revaluation adjustment		
Opening balance	5,169	5,249
Increase	112	135
Decrease	(295)	(215)
Closing balance	4,986	5,169
Net value	**11,312**	**11,463**

The methods and significant assumptions applied in determining the fair value of investment properties were supported by market evidence, therefore they have been categorized as Level 2 instruments, as the Bank used similar assets' prices for valuation base from market obtainable inputs. FHB provides property price index to compare similar real estates in the market and the investment properties were revalued independently by relevant professional experts as at 31 December 2013. According to this valuation, it does not need any additional fair value modification – which might be relevant for non-financial instruments – on the investment properties (Note 2.7).
The following direct operating expenses were recognized from investment properties that do not generate rental income during 2013 and 2012, respectively:

	31 December 2013	31 December 2012
General and administrative expense		
• fee of property valuation	1	(3)
• general and administrative expenses	-	2
• maintenance expenses	17	19
• insurance fees	6	6
• information expenses	-	(1)
• other	-	1
Total	**24**	**24**

All figures in tables are in HUF million except otherwise noted

22. TANGIBLE ASSETS 31 December 2013

	Property and Leasehold improvement	Office equipment	Total
Gross value			
Opening balance	6,252	4,335	10,587
Increase	69	123	192
Decrease	(20)	(25)	(45)
Closing balance	**6,301**	**4,433**	**10,734**
Depreciation			
Opening balance	1,009	3,159	4,168
Annual depreciation	168	327	495
Decrease	(3)	(9)	(12)
Closing balance	**1,174**	**3,477**	**4,651**
Impairment			
Opening balance	447	11	458
Increase	-	-	-
Closing balance	**447**	**11**	**458**
Net value	**4,680**	**945**	**5,625**

TANGIBLE ASSETS 31 December 2012

	Property and Leasehold improvement	Office equipment	Total
Gross value			
Opening balance	6,169	4,241	10,410
Increase	83	154	237
Decrease	-	(60)	(60)
Closing balance	**6,252**	**4,335**	**10,587**
Depreciation			
Opening balance	843	2,810	3,653
Annual depreciation	166	349	515
Decrease	-	-	-
Closing balance	**1,009**	**3,159**	**4,168**
Impairment			
Opening balance	447	11	458
Increase	-	-	-
Closing balance	**447**	**11**	**458**
Net value	**4,796**	**1,165**	**5,961**

All figures in tables are in HUF million except otherwise noted

23. INTANGIBLE ASSETS 31 December 2013

	Software	Other intangible assets	Portfolio value	Agency cooperation	Total
Gross value					
Opening balance	16,904	524	-	645	18,073
Increase	316	190	-	-	506
Decrease	-	-	-	-	-
Closing balance	**17,220**	**714**	**-**	**645**	**18,579**
Amortisation					
Opening balance	4,854	402	-	64	5,320
Annual amortisation	1,987	22	-	29	2,038
Decrease	-	-	-	-	-
Closing balance	**6,841**	**424**	**-**	**93**	**7,358**
Impairment					
Opening balance	-	-	-	-	-
Increase	-	-	-	-	-
Reversal			-		-
Closing balance	**-**	**-**	**-**	**-**	**-**
Net value	**10,379**	**290**	**-**	**552**	**11,221**

INTANGIBLE ASSETS 31 December 2012

	Software	Other intangible assets	Portfolio value	Agency cooperation	Total
Gross value					
Opening balance	16,344	524	1,483	645	18,996
Increase	614	-	-	-	614
Decrease	(54)	-	(1,483)	-	(1,537)
Closing balance	**16,904**	**524**	**-**	**645**	**18,073**
Amortisation					
Opening balance	2,912	387	364	40	3,703
Annual amortisation	1,942	15	-	24	1,981
Decrease	-	-	(364)	-	(364)
Closing balance	**4,854**	**402**	**-**	**64**	**5,320**
Impairment					
Opening balance	-	-	1,119	-	1,119
Increase	-	-	-	-	-
Reversal			(1,119)		(1,119)
Closing balance	**-**	**-**	**-**	**-**	**-**
Net value	**12,050**	**122**	**-**	**581**	**12,753**

All figures in tables are in HUF million except otherwise noted

In the context of the impairment test of intangible assets the Bank reviewed projects in the course of construction but not yet capitalized by 31 December 2013. It was established that each project relating to intangible assets is progressing according to plan. Use of the products that are the expected outcome of the projects is certain, and none of the projects will be terminated without generating the expected outcome. In 2013 and 2012 no impairment was reported on intangible assets. The portfolio value was written off due to the sale of the company which realized the portfolio value.

24. OTHER ASSETS

	31 December 2013	31 December 2012
Prepaid expenses	216	232
Reclaimable taxes	914	1,115
Settlements with the Hungarian State	1,975	1,965
Repossessed collateral	1,358	1,532
Properties held for sale	332	971
Debtors	1,622	1,288
Deposits	1,122	1,037
Receivables from investment services	43	-
Other	2,100	1,187
Total	**9,682**	**9,327**

The balance of settlements with the Hungarian State includes two month's interest subsidy due from the State and not yet settled as of 31 December 2013 (two months in 2012).
Significant part of the deposits was provided to ensure the turnover on cards to Card companies.

In case of properties held for sale and repossessed collaterals the Group endeavours to sell the properties as soon as possible. In case of properties where the construction is still in progress the property will be offered for sale as soon as the construction will be completed.

25. DUE TO BANKS

	31 December 2013	31 December 2012
Long term loans received	22,847	82,475
Short term loans received	86,807	10,124
Accrued part of disbursed liabilities under Funding of Growth Scheme*	6,139	
Accrued interest	1,054	182
Total	**116,847**	**92,781**

* See Notes 19.

All figures in tables are in HUF million except otherwise noted

Notes to the Consolidated Financial Statements

26. ISSUED SECURITIES

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

	31 December 2013		31 December 2012	
	Net book value	Face value	Net book value	Face value
Non-listed mortgage bonds				
Fixed interest	29,370	29,226	66,038	65,868
Floating interest	-	-	291	291
Listed mortgage bonds				
Fixed interest	108,881	107,257	120,093	119,493
Floating interest	-	-	-	-
Total mortgage bonds	**138,251**	**136,483**	**186,422**	**185,652**
Non-listed bonds				
Fixed interest	29,377	29,369	31,779	31,774
Floating interest	7,100	7,043	5,207	5,162
Subordinated bonds	-	-	29,565	29,565
Listed bonds				
Fixed interest	39,538	42,458	19,452	21,018
Floating interest	6,712	6,715	1,398	1,396
Total bonds	**82,727**	**85,585**	**87,401**	**88,915**
Accrued interest (*mortgage bonds*)	4,999	-	5,475	-
Accrued interest (*bonds*)	2,874	-	4,509	-
Total issued securities	**228,851**	**222,068**	**283,807**	**274,567**

Mortgage bonds

All figures in tables are in HUF million except otherwise noted

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

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

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

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

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

Bonds

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

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

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

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

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

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

	31 December 2013		31 December 2012	
	Fair value	Face value	Fair value	Face value
Listed mortgage bonds				
Fixed interest	18,332	16,963	28,533	28,301
Floating interest	11,246	11,327	11,418	12,263
Total mortgage bonds	**29,578**	**28,290**	**39,951**	**40,564**
Non-listed bonds				
Fixed interest	-	-	22,543	22,000
Listed bonds				
Fixed interest	13,887	12,511	24,578	23,063
Total bonds	**13,887**	**12,511**	**47,121**	**45,063**
Due to banks	17,995	18,000	17,816	18,000
Total due to banks	**17,995**	**18,000**	**17,816**	**18,000**
Total Financial liabilities at fair value through profit or loss, except derivatives	**61,460**	**58,801**	**104,888**	**103,627**

28. DEPOSITS FROM CUSTOMERS

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

	31 December 2013	31 December 2012
Current accounts	62,538	41,989
Term deposits	159,503	108,002
Accrued interest	460	2,215
Total	**222,501**	**152,206**

All figures in tables are in HUF million except otherwise noted

29. STATE LOANS

In 2009 the Bank received a loan of EUR 400 million (HUF 108 billion) and a loan of HUF 30 billion from the Hungarian State.
The EUR 400 million loan was disbursed in two equals amount on 30 March 2009 and 30 April 2009, respectively. The interest payable on this loan equals to 3M EURIBOR + 2.5% or 3.45% depending on certain conditions and is payable quarterly. The principal is to be repaid in eight instalments in every three months starting from 11 February 2011. During 2011 the Bank paid back an instalment in amount of EUR 200 million. The remaining amount (EUR 200 million) was paid quarterly in 2012. Final maturity of the loan was 11 November 2012. The interest of the loan was determined based on market interest rates including the credit spread of FHB Bank therefore no government grant is connected to this loan.
The Bank recognizes the state loans in financial liabilities at amortized cost and the interest payable is recognized as interest expense.

30. FINANCE LEASE LIABILITIES

In the Group structure FHB Services Ltd. owned all of the IT assets and software which were used by the related parties. On 1 December 2011 after the sale of the FHB Services Ltd. the Group entered a lease contract with Exo-BIT Ltd. (the former FHB Services Ltd.) regarding the lease of the IT assets and software. The maturity of the contract is 7 years and there are no suspended rental fees, renewing conditions and options for purchase the leased assets included in the contract.

The book value of the leased assets is the following:

	31 December 2013		31 December 2012	
	Tangible assets	Intangible assets	Tangible assets	Intangible assets
Book value	717	9,214	863	11,088

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

	31 December 2013		31 December 2012	
	Minimum lease payments	Present value	Minimum lease payments	Present value
Within 12 month	2,834	2,435	3,143	3,000
Between 1 and 5 years	8,165	5,628	9,657	7,287
Over 5 years	-	-	1,343	775
Total	10,999	8,062	14,143	11,062
Less amounts representing finance charges	(2,937)	-	(3,081)	-
Present value of minimum lease payments	8,062	8,062	11,062	11,062

The present value of minimum lease payments is calculated by the Bank on a cash flow basis discounted by the valuation yield curve. This amount represents the present value of the minimum lease payments.
In 2013 there were no subleasing contracts and suspended rental fees regarding the leased assets.

All figures in tables are in HUF million except otherwise noted

31. RESERVE FOR ANNUITY PAYMENTS

	31 December 2013	31 December 2012
Opening balance	2,410	2,265
Increase	67	60
Change in fair value	(14)	85
Closing balance	**2,463**	**2,410**

32. PROVISIONS

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

2013	Loan risk provision	Contingent liabilities	Expected costs of legal cases	Total
Opening balance	150	-	23	173
Increase in the period	759	-	7	766
Increase from acqusition	-	874	-	874
Utilization in the period	(658)	-	(13)	(671)
Closing balance	**251**	**874**	**17**	**1,142**

The loan risk provision in 2013 is attributable to the off balance sheet items.
Contingent liabilities is attributable the acquisition.

2012	Loan risk provision	Future costs	Expected costs of legal cases	Total
Opening balance	234	25	8	267
Increase in the period	629	-	25	654
FX movement	(2)	-	-	(2)
Utilization in the period	(711)	(25)	(10)	(746)
Closing balance	**150**	**-**	**23**	**173**

All figures in tables are in HUF million except otherwise noted

33. OTHER LIABILITIES

	31 December 2013	31 December 2012
Taxes payable	678	564
Creditors	404	269
Accrued expenses	305	403
Liability from investments services	88	120
Customer loan prepayments	766	909
Liabilities to shareholders	-	202
Refinancing accounts	108	12
Cash in transit	20	62
Other	643	1,381
Total	**3,012**	**3,922**

34. SHARE CAPITAL

As of 31 December 2013 the Bank's share capital consists of 66,000,010 authorized, issued and fully paid ordinary shares of HUF 100 par value each.
The ownership structure of the Bank as at 31 December 2013 and 31 December 2012 was as follows:

	31 December 2013		31 December 2012	
Shareholder	Holding %	Number of shares	Holding %	Number of shares
Ordinary shares (Series "A")				
Domestic institutional investors	57.64	38,040,017	55.76	36,795,859
Foreign institutional investors	21.66	14,297,742	21.98	14,509,484
Private investors	7.78	5,136,154	6.24	4,118,847
Hungarian National Asset Management Ltd.	7.16	4,724,833	7.16	4,724,833
Treasury shares	0.08	53,601	0.08	53,601
Other	5.68	3,747,663	8.78	5,797,386
	100.00	***66,000,010***	***100.00***	***66,000,010***

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

All figures in tables are in HUF million except otherwise noted

Bank has no dilutive potential ordinary shares. Earnings per share figure therefore equals to the diluted earnings per share figure.

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

	31 December 2013	31 December 2012
Loss	(4,664)	(4,464)
Change of general reserve	(13)	(181)
Attributable profit	**(4,677)**	**(4,645)**
Weighted average number of shares	65,946,409	65,946,409

b) Treasury shares purchased

	31 December 2013	31 December 2012
Opening balance	29	29
Purchase	-	-
Used for acquisition	-	-
Share-based payments	-	-
Closing balance	29	29

c) Other reserves

	Note	31 December 2013	31 December 2012
Share premium		1,709	1,709
General reserves	36	194	181
Cash flow hedge reserve	38	-	-
Additional tier 1 capital	34	31,749	28,923
Share option reserve	35	-	-
Change in fair value of financial assets available-for-sale	34	156	(216)
Foreign currency translation reserve		29	31
Total other reserves		**33,837**	**30,628**

All figures in tables are in HUF million except otherwise noted

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

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

d) Financial assets available-for-sale reserve

	31 December 2013	31 December 2012
Opening balance	(216)	(212)
Net unrealised gains on available-for-sale assets	377	96
Net realised losses on available-for-sale assets	82	(99)
Deferred tax	(87)	2
Closing balance	**156**	**(216)**

35. SHARE-BASED PAYMENTS

Share options are granted to employees and also others providing similar services, it is difficult to estimate the fair value of those benefits that are coming from these services, therefore the Group measures the fair value by reference to the fair value of the equity instruments granted.

The Group has a two-year share based incentive scheme for 2013 built on four IFRS measured criteria for both 2013 and 2014: increase of the owner's equity, decrease of the proportion of the non-performing loans and increase in ROA and ROE. For all of these indicators there are minimum levels quantified by the General Meeting, every criterion is deemed to be met if the actual KPI exceeds the minimum level (in case of the proportion of the non-performing loans the actual KPI should be less). At least three out of the four criteria have to be met to be entitled to the share based payment. If the share option is realised, the payment will depend on the individual performance evaluations, so only a specific proportion of the total distributable volume will be paid. The preferential price of drawing the option is 25% of the average price on the Budapest Stock Exchange between 1 January of the subject year and the date of the General Meeting closing the business year in prior of the subject year weighted by the turnover. The share option regarding both years can be realised in the following 3 years based on the following rates 60%-20%-20%.

The expense recognised for share based payments during 2013 and 2012 is zero.

36. GENERAL RESERVE

In accordance with statutory requirements, the Bank and other credit institutions within the Group are required to set up a non-distributable general reserve equal to 10% of statutory profit after tax. Increases in the general risk reserve are separated from retained earnings, as calculated under Hungarian regulatory rules, and thus are not charged against income. According to the Section 13 (8) of the Government Decree No. 250/2000 (XII.24.) on the specifics of the annual reporting and bookkeeping tasks of investment companies are required to release the general reserve when loss after tax deduction occurs. The amount of the General reserve is HUF 194 million as at 31 December 2013.

All figures in tables are in HUF million except otherwise noted

37. COMMITMENTS

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

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

	31 December 2013	31 December 2012
Guarantees	15,905	3,601
Undrawn commitments	44,267	26,644
Total	**60,172**	**30,245**

38. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

The value of the HUF 35 million (2012: HUF 35 million) SWIFT and VISA membership share and shares of Garantiqua Creditguarantee Ltd. shares disclosed under investment are reported at cost, and the value of HUF 826 million BIF Ltd. shares disclosed (2012: HUF 752 million) under investment are reported at fair value.

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

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

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

The applied valuation model takes into account the following:

- The scheduled and calculated repayments, with certain restrictions
- The interest and interest type revenues until maturity, including the interest subsidies of the loans and their unique legal regulation;

All figures in tables are in HUF million except otherwise noted

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

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

	31 December 2013		31 December 2012	
	Gross book value	Fair value	Gross book value	Fair value
Refinanced mortgage loans	133,692	162,717	164,990	183,426
Loans and advances to customers	358,004	394,506	371,931	404,541

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

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

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

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

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

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

All figures in tables are in HUF million except otherwise noted

	31 December 2013		31 December 2012	
	Net book value	Fair value	Net book value	Fair value
Non-listed mortgage bonds				
Fixed interest	30,401	34,599	67,949	70,631
Floating interest	-	-	293	287
Listed mortgage bonds				
Fixed interest	112,851	118,253	123,656	125,048
Total mortgage bonds	**143,252**	**152,852**	**191,898**	**195,966**
Non-listed bonds				
Fixed interest	31,176	33,246	33,557	35,145
Floating interest	7,121	7,108	5,232	5,265
Subordinated bonds	**-**	**-**	**31,126**	**31,491**
Listed bonds				
Fixed interest	40,488	40,132	20,586	20,777
Floating interest	6,814	6,792	1,408	1,421
Total bonds	**85,599**	**87,278**	**91,909**	**94,099**
Total issued security	**228,851**	**240,130**	**283,807**	**290,065**

Gross value also includes the accrued interests.

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

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

d) Fair value of derivative transactions

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

All figures in tables are in HUF million except otherwise noted

	Fair value		Notional amount of liability	
	31 December 2013	31 December 2012	31 December 2013	31 December 2012
Derivatives designated as cash-flow hedges				
Positive fair value of cash flow hedges	179	-	6,164	-
Including: CCIRS	179	-	6,164	-
Swap deals classified as HFT				
Positive fair value of trading swaps	3,231	4,325	48,270	102,345
Including: CCIRS	2,870	2,745	41,580	35,520
Including: IRS	348	380	5,000	10,000
Including: FXS	13	1,200	1,690	56,825
Fair value hedge				
Positive fair value of CCIRS fair value hedge	166	10	6,712	3,894
Options				
Positive fair value of options	-	7	-	400
Forward deals				
Positive fair value of forward deals	3	2	69	753
Total derivative financial assets	**3,579**	**4,344**	**61,215**	**107,392**

	Fair value		Notional amount of liability	
	31 December 2013	31 December 2012	31 December 2013	31 December 2012
Swap deals classified as HFT				
Negative fair value of trading swaps	(11,187)	(16,838)	131,795	149,703
Including: CCIRS	(9,989)	(16,021)	70,787	116,907
Including: IRS	(755)	(804)	17,454	17,826
Including: FXS	(443)	(13)	43,554	14,970
Fair value hedge				
Negative fair value of CCIRS fair value hedge	(4,159)	(6,431)	64,994	85,940
Options				
Negative fair value of options	-	(2)	-	396
Forward deals				
Negative fair value of forward deals	(19)	(2)	548	753
Total derivative financial liabilities	**(15,365)**	**(23,184)**	**197,337**	**236,792**

All figures in tables are in HUF million except otherwise noted

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

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

Before 2010 the Bank has not used corrections to the valuation yield curves to evaluate swaps. However, since the economic crisis erupted, the currencies of developing markets have been added a significant risk premium, including HUF as well. Since this risk premium is significant and permanent from 2010, it is justified to incorporate it into the evaluation method of swaps. The yield curve is adjusted with the risk premium. The application of the appropriate risk premium enhances the accuracy of the fair value calculation (please also refer to Note 3) taking counterparty and own credit risk into amount (CVA/DVA) in accordance with IFRS 13.

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

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

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

e) Fair value hedge transactions

The Bank has various rate loans denominated in CHF and EUR currencies. These loans are exposed to fair value risk changes of foreign exchange risk. In order to hedge in foreign exchange risk the Bank entered into CCIRS swap transactions, when the risk of the payments from the loans are swapped to payments linked CHF Libor, EURIBOR resulting in a decrease in the foreign exchange rate fair value exposure of the loans to customers.

Due to the fact that the Bank introduced a new model, which one is able to calculate the hedge effectiveness from 1 July 2012 the gain or loss from these swap items are accounted the same method as the hedged items.

31 December 2013

Description of the hedging instrument	Types of hedged items	Fair value of the hedging instrument	Fair value of the hedged items	Gains on the hedging instrument	Losses on the hedged items
CCIRS	loans and advances to customers	(3,933)	67,420	594	(594)

31 December 2012

Description of the hedging instrument	Types of hedged items	Fair value of the hedging instrument	Fair value of the hedged items	Gains on the hedging instrument	Losses on the hedged items
CCIRS	loans and advances to customers	(6,332)	91,460	223	(223)

f) Amounts relating to cash flow (CF) hedge transactions reported in profit or loss or in other comprehensive income

	Net Income for the reporting period (interest and foreign exchange rate)	Change in ineffective portion in the reporting period (accounted for in earnings)	Reported in equity (movement in Cash Flow hedge reserve)	Cumulative balance of Cash Flow hedge reserve
31.12.2009	36	1	(281)	833
31.12.2010	1,682	2	(733)	101
31.12.2011	(829)	3	111	201

The CF hedge transaction has matured in 2012.

g) Fair value of financial instruments carried at fair value

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

All figures in tables are in HUF million except otherwise noted

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

	31 December 2013		
	Level 1	Level 2	Level 3
Assets			
Securities held for trading	41,950	-	-
Financial assets available-for-sale	151,873	-	-
Derivative financial assets	-	709	2,870
Total assets carried at fair value	**193,823**	**709**	**2,870**
Liabilities			
Derivative financial liabilities	-	5,376	9,989
Financial liabilities at fair value through profit or loss, except derivatives	-	61,009	-
Reserve for annuity payments (Note 31)	-	-	2,463
Total liabilities carried at fair value	**-**	**66,385**	**12,452**

	31 December 2012		
	Level 1	Level 2	Level 3
Assets			
Securities held for trading	7,815	-	-
Financial assets available-for-sale	158,848	-	-
Derivative financial assets	-	1,590	2,754
Total assets carried at fair value	**166,663**	**1,590**	**2,754**
Liabilities			
Derivative financial liabilities	-	822	22,362
Financial liabilities at fair value through profit or loss, except derivatives	-	104,888	-
Reserve for annuity payments (Note 31)	-	-	2,410
Total liabilities carried at fair value	**-**	**105,710**	**24,772**

All figures in tables are in HUF million except otherwise noted

h) Reserve for annuity payment

Reserve for annuity payment by contract is reported in liabilities.
The present value of open contracts is individually determined at the end of each month. When assessing the present value the calculated age of contracted clients at the time of assessment is taken into consideration, which is used in the internal demographic model for establishing the probability of mortality for each month. The demographic model applies the mortality statistics of the Central Statistical Office but also takes into consideration the deviation of contracted clients from the average Hungarian population (selectivity effect) as well as the expected future increase in life expectancy. The review of the demographic parameters performed in 2012 resulted that there is no need for any adjustments. Exchange rates do not affect the fair value assessment process.
There is some insurance risk associated with the reserve for annuity payment: the mortality risk (i.e. the length of the period of the contracts) and the risk of the future inflation perspective.
The annuities due in the future (not yet paid) are adjusted by the probability of mortality per contract. (In the case of inflation-linked annuities, which represent 44.5% of the total portfolio, the timeline is adjusted by the hypothetical inflation rates.) The fair value is the cumulative discounted cash flow of the expected annuities payable. Discount relies on the swap yield curve, which in the month of assessment is adjusted with the premium applied in the month when the amount of annuity was determined.
The Bank has made a stress test to estimate the effect of one base point increase in the yield curve. The test shows that the reserve for annuity payment decreases by HUF 1.3 million (2012: also HUF 1.3 million) if the yield curve is increased by one base point.
The Bank has recalculated the stress test to estimate the effect of ± 25 base point increase/decrease in the yield curve. The test shows that the reserve for annuity payment decreases by HUF 33 million if the yield curve is increased by 25 base point, and increases by HUF 34 million if the yield curve is decreased by 25 base point at 31 December 2013 (The corresponding values were HUF (32 million) and HUF 33 million in 2012).

i) Movement in Level 3 derivative instruments measured at fair value

According to the risk management policies the FHB Mortgage Bank and FHB Commercial Bank hold CCIRS portfolio both classified as held for trading and designated as fair value hedge, to hedge its foreign currency open position. The basis swap spread speculation caused previously unexpected high range in the bid-offer quotations and also volatility obtained in the market, which significantly differed from spreads on which the Bank could execute or terminate deals and therefore market quotations cannot be used for measuring the fair value of the Bank CCIRS portfolio.
For the above mentioned reasons, the Bank has classified these deals to Level 3 from Level 2 in the valuation of the financial instruments in IFRS, and applied non-market observable inputs as well, which resulted a more transparent presentation of CCIRSs and a more reliable valuation of them.

Sensitivity

The key risk factor for these deals is the spread. The net present value impact of ±10 basis point change of cross currency swap spreads on the EUR/HUF CCIRS portfolio, and ±5 basis point change of cross currency swap spreads on the CHF/HUF CCIRS portfolio are summarized in the table below:

	EUR		CHF
Fair value (PV)		**Fair value (PV)**	
Net fair value based on estimated inputs	2,837	Net fair value based on estimated inputs	(10,022)
Sensitivity (dPV)		**Sensitivity (dPV)**	
+10 bp	82	+5 bp	21
-10 bp	(75)	-5bp	(21)

The following table shows a reconciliation of the opening and closing amount of Level 3 financial derivative assets and liabilities which are recorded at fair value:

	Opening balance as at 31 December 2012	Transfer as at 1 January 2012	Movement of CCIRS (matured, entered. closed, revalued)	Closing balance as at 31 December 2013	Total gain as at 31 December 2013
Positive fair value of CCIRSs	2,754	-	116	2,870	116
Financial assets measured at fair value total	**2,754**	-	**116**	**2,870**	**116**
Negative fair value of CCIRSs	(22,362)	-	12,373	(9,989)	12,373
Financial liabilities measured at fair value total	**(22,362)**	-	**12,373**	**(9,989)**	**12,373**

All figures in tables are in HUF million except otherwise noted

39. RISK MANAGEMENT

a) Overview

The risks inherent in the Group's business are managed by the Group leading by the Bank. The primary purpose of risk management is to protect the Bank's financial strength and reputation, and to support the deployment of capital in competitive business activities, which contribute to the increase of the value of shares. The Bank applies uniform risk management principles for both the parent bank and the subsidiary bank as well as the subsidiary companies.

Risk management identifies, evaluates and analyses the exposure of the Bank and its subsidiaries. It processes the information gained and develops risk guidelines and acceptable exposure limits, and operates risk management systems. The Group is exposed to credit-, liquidity-, market- and operation risks.

In respect of the credit risk the main aim of 2013 was the improvement of the portfolio quality. In favor of the management of the non-performing loans all disposable tool was applied. Other aim of the Bank was to increase the portfolio of exposures with prudent and careful risk-taking.

To maintain a diversified liability structure in 2013 FHB obtained sources from the capital markets several times through security issue, which replaced the maturing liabilities with long term liabilities. The Bank expanded the investor structure to the retail customers with the securities issued through the branch offices and influenced the volume and maturity composition of the deposits with active pricing strategies. The bank disposed of significant amount of liquid assets during the year, mainly in form of government securities.

40. RISK MANAGEMENT STRUCTURE

Board of Directors

The Board of Directors is responsible for the Group's risk management policy and strategy. The Board of Directors develops the basic framework rules for risk management and guidelines of applicable methodologies.

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

Supervisory Board

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

Group Assets and Liabilities Management Committee (GALCO)

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

Department of Risk Management

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

Department of Risk Analysis and Control

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

Treasury

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

Internal Audit

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

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

Property supervisor

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

Risk evaluation and reporting system

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

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

41. RISK MITIGATION

Interest rate and exchange rate risks

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

Credit risk

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

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

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

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

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

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

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

Maximum credit risk exposure based on gross outstanding balances:

	31 December 2013	31 December 2012
Balances with the National Bank of Hungary	11,469	5,117
Dues from banks	21,270	28,864
Securities held for trading	41,950	7,815
Financial assets available-for-sale	151,873	158,848
Shares in associated and joint venture companies	6,165	-
Derivative financial assets	3,579	4,344
Refinanced mortgage loans	133,692	164,990
Loans and advances to customers	358,004	371,931
Other assets	9,682	9,327
Total	**737,684**	**751,236**
Off-balance sheet commitments	60,172	30,245
Total	**60,172**	**30,245**
Total credit risk exposure	**797,856**	**781,481**

42. CREDIT RISK

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

	Neither past due nor impaired	Past due or individually impaired	Assessed under collective impairment rules	Total
	31.12.2013	31.12.2013	31.12.2013	31.12.2013
Dues from banks and refinanced mortgage loans	154,563	-	-	154,563
Loans, commitments and guarantees	241,594	94,126	76,619	412,339
To corporate customers	107,096	16,317	-	123,413
To retail customers	134,498	77,809	76,619	288,926
Total	**396,157**	**94,126**	**76,619**	**566,902**

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

All figures in tables are in HUF million except otherwise noted

	Neither past due nor impaired	Past due or individually impaired	Assessed under collective impairment rules	Total
	31.12.2012	31.12.2012	31.12.2012	31.12.2012
Dues from banks and refinanced mortgage loans	195,671	-	-	195,671
Loans, commitments and guarantees	272,944	86,748	35,776	395,468
To corporate customers	70,657	18,640	20	89,317
To retail customers	202,287	68,108	35,756	306,151
Total	**468,615**	**86,748**	**35,776**	**591,139**

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

Class	*Historic default rate 31.12.2013 (%)*	*Uncovered 31.12.2013 HUF million*	*Total 31.12.2013 HUF million*
Class 1	0.00	155,557	155,557
Class 2	0.00	8,214	8,214
Class 3	0.01	14,816	107,708
Class 4	0.15	821	69,035
Class 5-7	9.03	54,409	330,348
Class	*Historic default rate 31.12.2012 (%)*	*Uncovered 31.12.2012 HUF million*	*Total 31.12.2012 HUF million*
Class 1	0.00	140,560	140,560
Class 2	0.00	10,156	10,156
Class 3	0.07	19,782	137,314
Class 4	0.34	12,736	82,693
Class 5-7	10.44	52,292	357,309

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

Age analysis of loans past due but not impaired

	5-90 days 2013	5-90 days 2012
Dues from banks and Refinanced mortgage loans	-	-
Loans	4,962	36,702
Corporate customers	606	421
Retail customers	4,356	36,281
Total	**4,962**	**36,702**

As of 31 December 2013 the Company has HUF 12,461 million collateral value for loans past due unimpaired (2012: HUF 59,215 million).

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

Forborne loans

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

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

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

Rating of forborne loans:

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

All figures in tables are in HUF million except otherwise noted

An analysis of forborne gross loan portfolio by loan types as 31 December 2013 and 2012

Loan type	31 December 2013	31 December 2012
Individual loans	87,692	70,444
Fx rate protection scheme (original loan)	50,765	28,479
Fx rate protection scheme (buffer account)	497	95
Corporate loans	3,481	3,533
Total	**91,173**	**73,977**

An analysis of impaired forborne loan portfolio by loan types as 31 December 2013 and 2012

Loan type	31 December 2013	31 December 2012
Individual loans	86,864	69,865
Fx rate protection scheme (original loan)	50,280	28,116
Fx rate protection scheme (buffer account)	485	86
Corporate loans	3,386	3,533
Total	**90,250**	**73,398**

An analysis of forborne loan portfolio by loan types and risk classes as 31 December 2013

Loan type	Not past due	1-30 DPD	31-60 DPD	61-90 DPD	91-360 DPD	360+DPD	Total
Individual loans	44,429	7,303	2,592	1,443	6,465	25,460	87,692
allowance	*268*	*255*	*212*	*364*	*2,739*	*13,293*	*17,131*
Corporate loans	2,335	11	-	-	730	405	3,481
allowance	*217*	*-*	*-*	*-*	*183*	*258*	*658*
Total capital of loans	**46,764**	**7,314**	**2,592**	**1,443**	**7,195**	**25,865**	**91,173**
Total allowance	***485***	***255***	***212***	***364***	***2,922***	***13,551***	***17,789***

All figures in tables are in HUF million except otherwise noted

An analysis of forborne loan portfolio impaired and not impaired by loan types and risk classes as 31 December 2013

Loan type	Not past due			Past due			Total
	Impaired	Not impaired	Total	Impaired	Not impaired	Total	
Individual loans	43,844	585	44,429	43,020	243	43,263	87,692
allowance	*268*	-	*268*	*16,863*	-	*16,863*	*17,131*
collateral	*62,651*	*2,442*	*65,093*	*49,336*	*233*	*49,569*	*114,662*
Corporate loans	2,250	85	2,335	1,136	10	1,146	3,481
allowance	*217*	-	*217*	*441*	-	*441*	*658*
collateral	*2,188*	-	*2,188*	*1,671*	-	*1,671*	*3,859*
Total capital of loans	**46,094**	**670**	**46,764**	**44,156**	**253**	**44,409**	**91,173**
Total allowance	***485***	**-**	***485***	***17,304***	**-**	***17,304***	***17,789***
Total collateral	***64,839***	***2,442***	***67,281***	***51,007***	***233***	***51,240***	***118,521***

An analysis of forborne loan portfolio by type of forbearance as 31 December 2013 and 31 December 2012

	31 December 2013		31 December 2012	
	capital	allowance	capital	allowance
Retail loans	70,444	10,526	87,692	17,131
bridge loan	*33,065*	*7,833*	*28,579*	*12,835*
Fx rate protection scheme (original loan)	*28,479*	*133*	*50,765*	*1,943*
Fx rate protection scheme (buffer account)	*95*	*5*	*497*	*42*
Fx housing loan converted to HUF	*2,070*	*881*	*1,778*	*745*
other	6,735	1,674	6,073	1,566
Corporate loans	3,533	967	3,481	658
Total	**73,977**	**11,493**	**91,173**	**17,789**

All figures in tables are in HUF million except otherwise noted

43. COLLATERALS AND OTHER MEANS FOR IMPROVING THE LOANS PORTFOLIO

Collaterals for lending risk applied by the Bank:

Real estate collateral
The Group accepts mortgage or purchase independent lien established mainly on such real estate that is registered in Hungary and have long live stable value. There are some mortgaged real estates registered in Croatia due to the operation of a subsidiary.

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

State guarantee
All instances of State guarantee accepted by the Bank involve joint and several liability set forth by law. The rules governing the guarantee are laid down in statutory provisions. The Bank applies this type of collateral in the following cases:

- Loans provided to private individuals employed in the public sector; and
- Housing loans extended to young clients partially covered by State guarantee,
- Loans denominated in foreign currency with buffer accounts (to this type of loans relates also simple guarantee /joint and several guarantee by third party).

Deposit
Deposit can take the form of cash or bank deposit, Government securities or debt securities issued by a credit institution.
The Bank accepts surety on bank accounts as collateral for housing and commercial property development project financing, and for loans disbursed with commercial real estate collateral.

Other
In addition to the above the Bank also accepts joint and several guarantee by third party (where the third party is other than the Hungarian State), as well as assigned claims, lien on claims, home savings assigned to the Bank; insurance (for example property and life insurance) assigned to the Bank, and lien, surety or option on holding or share possessed by the borrower giving the right to participate in company capital.

The table below shows the structure of the collaterals in 2013 and 2012:

	31 December 2013	31 December 2012
Mortgage	1,298,926	1,228,362
Warrant	12,278	2,993
Guarantee	31,204	38,464
Other collaterals	17,619	18,480
Total	**1,360,027**	**1,288,299**

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

All figures in tables are in HUF million except otherwise noted

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

44. MARKET RISK

Due to the nature of its business as a mortgage bank and to the special legal regulation relating to it, FHB has distinctive assets and liabilities structure within the Hungarian banking system as its assets and liabilities are essentially long-term and raise most of its funds in the capital market.
Regarding the liquidity- and market risk the Bank is responsible for raising the necessary funding sources and for the risk management both on Group level and on individual entity level. The Bank maintains low the maturity-, interest rate- and foreign exchange rate risk derive from the asset, liability and off balance sheet commitments.

45. INTEREST RATE RISK

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

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

	31 December 2013		31 December 2012	
	Average net A/L	Average interest rate %	Average net A/L	Average interest rate %
Interest earning assets				
Dues from banks and Balances with the National Bank of Hungary	32,031	1.18	40,425	1.48
Securities held for trading and available-for-sale	184,043	4.49	156,498	4.33
Refinanced mortgage loans	148,733	8.64	180,926	8.07
Loans and advances to customers	359,675	8.42	371,203	9.12
Total interest earning assets	**724,482**	**7.15**	**749,052**	**7.45**
Interest bearing liabilities				
Due to banks	147,582	2.98	76,655	7.64
Deposits	181,992	3.94	166,883	5.83
State loan	-	-	28,259	3.60
Issued securities and Financial liabilities at fair value through profit or loss, except derivatives	308,593	6.80	387,134	7.97
Total interest bearing liabilities	**638,167**	**5.10**	**658,931**	**7.20**

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

	Sensitivity of interest income 2013	Sensitivity of equity (2013)				
		0-6 months	6-12 months	1-5 years	Over 5 years	Total
HUF	(4.9)	(0.7)	(3.6)	(12.9)	(11.1)	(28.2)
EUR	5.6	(0.6)	0.3	6.2	7.4	13.2
CHF	5.7	(1.3)	(1.1)	5.9	53.2	56.7

	Sensitivity of interest income 2012	Sensitivity of equity (2012)				
		0-6 months	6-12 months	1-5 years	Over 5 years	Total
HUF	(5.0)	(0.4)	2.4	(21.4)	(27.7)	(47.1)
EUR	5.5	1.8	(1.0)	2.6	5.5	8.9
CHF	5.5	1.5	(1.5)	(0.2)	(4.8)	(5.0)

	Sensitivity of interest income 2013+10 bp	Sensitivity of interest income 2013 +25 bp	Sensitivity of equity (2013) +10 bp	Sensitivity of equity (2013) +25bp
HUF	(49)	(123)	(282)	(705)
EUR	56	140	132	330
CHF	57	143	567	1,418

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

Sensitivity of net income is the estimated effect of one base point increase in interest rates to net interest income realized in advance over a period of one year, based on floating rate financial assets and liabilities or those financial assets and liabilities to be re-priced next year carried as of the last day of the given year. It means that if interest increase by one basis point from the close of business 31 December 2013 net interest income would decrease by HUF 4.9 million in case of HUF, it would increase by HUF 5.6 million in case of EUR and would increase by HUF 5.7 million in case of CHF.
Sensitivity of equity means the re-valuation of all financial assets and liabilities and off-balance sheet positions based on tenors of maturity and/or repricing. Full-fledged sensitivity of shareholders' equity is based on the presumption that the yield curve moves in parallel, while analysis by maturity groups highlights sensitivity in each tenor segment. The net impact of such moves would cause the decrease of the capital by HUF 28.2 million in HUF, the increase of the capital by HUF 13.2 million in EUR , the increase the capital of by HUF 56.7 million in CHF.

46. EXCHANGE RATE RISK MANAGEMENT

The Mortgage Bank is a specialized credit institution, which narrows the scope of business where exchange rate-related risks may arise. Moreover, the Bank's business policy is to keep exchange rate risk at a low level.
The Bank strives to immediately hedge the exchange risks related to its core business, i.e. mortgage lending, refinancing and financing though mortgage bonds, as allowed by market circumstances. Therefore an open FX position can serve primarily for the purpose of liquidity management, settlements related to lending and refinancing, or active and passive accruals in currencies in which the Bank keeps a nostro account.

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

FX	Effect on earning before income tax (31 December 2013)	Effect on capital (31 December 2013)	Effect on earning before income tax (31 December 2012)	Effect on capital (31 December 2012)
EUR	10.8	(36.5)	142.4	(1.7)
CHF	(4.3)	130.4	180.1	272.6

All figures in tables are in HUF million except otherwise noted

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

Due to the Bank's currency position 1 percent increase in the exchange rate in case of EUR items the estimated net earnings before tax could increase with 10.8 HUF, in case of CHF items it could decrease with 4.3 million HUF. The similar effect for the capital could mean a decrease of 36.5 million in case of EUR items and 130.4 million HUF increase in case of CHF items. (The sensitivity of the equity means the re-evaluation of the all-currency financial assets and the off-balance sheet positions.)

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

31 December 2013	CHF	EUR	HUF	Total
Assets				
Cash	48	309	1,682	2,039
Balances with the National Bank of Hungary	-	-	11,469	11,469
Due from Banks	755	20,033	483	21,271
Securities held for trading	-	2,167	39,783	41,950
Financial assets available-for-sale	-	17,988	133,884	151,872
Shares in associated and joint venture	-	-	6,158	6,158
Derivative financial assets	-	-	3,579	3,579
Refinanced mortgage loans	58,359	426	74,907	133,692
Loans and advances to customers	121,932	25,890	172,249	320,071
Investment property	-	-	11,312	11,312
Tangible assets	-	-	5,625	5,625
Goodwill and other intangibles	-	-	11,373	11,373
Deferred tax asset	-	-	7,421	7,421
Other assets	111	888	8,683	9,682
Total assets	**181,205**	**67,701**	**488,608**	**737,514**
Nominal values of derivative assets	605	105,764	123,175	229,544
Total assets incl. derivatives	**181,810**	**173,465**	**611,783**	**967,058**

All figures in tables are in HUF million except otherwise noted

31 December 2013	CHF	EUR	HUF	Total
Liabilities				
Due to banks	2,316	2,723	111,808	116,847
Deposits	394	25,053	197,054	222,501
Derivative financial liabilities	-	-	15,365	15,365
Issued securities	-	39,147	189,704	228,851
Financial liabilities at fair value through profit or loss, except derivatives	-	18,617	42,843	61,460
Reserve for annuity payments	-	-	2,463	2,463
Leasing liability	-	-	9,292	9,292
Current tax liability	-	-	6	6
Deferred tax liability	-	-	503	503
Provisions	22	16	1,104	1,142
Other liabilities	283	2,623	106	3,012
Total liabilities	**3,015**	**88,179**	**570,248**	**661,442**
31 December 2013	**CHF**	**EUR**	**HUF**	**Total**
Shareholders' equity	**-**	**31,749**	**44,323**	**76,072**
Total liabilities and shareholders' equity	**3,015**	**119,928**	**614,571**	**737,514**
Nominal values of derivative liabilities	182,091	51,785	13,674	247,550
Total liabilities incl. derivatives	**185,106**	**171,713**	**628,245**	**985,064**
Position	3,296	(1,752)	16,462	18,007

Consolidated FX financial position of the group in terms of main currencies (31 December 2012):

31 December 2012	CHF	EUR	HUF	Total
Total assets incl. derivatives	**220,822**	**202,917**	**606,040**	**1,029,779**
Total liabilities incl. derivatives	**219,108**	**230,226**	**604,680**	**1,054,014**
Shareholders' equity	**-**	**28,923**	**48,617**	**77,540**
Position	**1,714**	**(27,308)**	**1,329**	**(24,235)**

47. PREPAYMENT RISK

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

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

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

All figures in tables are in HUF million except otherwise noted

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

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

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

Prepayment risk of the Bank:

	Effect on net interest income	Effect on equity	Effect on net interest income	Effect on equity
	31.12.2013	31.12.2013	31.12.2012	31.12.2012
	HUF million	HUF million	HUF million	HUF million
Loans	**(845)**	**(682)**	**(1,427)**	**(1,299)**
HUF	(612)	(525)	(310)	(226)
EUR	(108)	(70)	(18)	(9)
CHF	(125)	(87)	(1,099)	(1,064)
Refinanced mortgage loans	**(177)**	**9**	**(578)**	**(18)**
HUF	(76)	(18)	(109)	(52)
EUR	(1)	(1)	(2)	(1)
CHF	(100)	28	(467)	35
Total	**(1,022)**	**(673)**	**(2,005)**	**(1,317)**

48. LIQUIDITY AND MATURITY RISK

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

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

The Bank aims to decrease liquidity risk by diversifying the sources of financing that resulting in higher proportion of customer deposits besides using other capital market products. The Bank also maintains a high level of liquid asset portfolio consisting of mainly government securities.

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

Contractual maturities of undiscounted cash flows of financial liabilities as of 31 December 2013

	On demand	Within 3 months	3 - 12 months	1 –5 years	5 – 10 years	10 – 15 years	Total
Banking liabilities							
Due to banks	-	104,896	97	447	1,663	-	107,103
Deposits	62,297	107,258	48,346	7,150	11,247	-	236,298
Derivative financial liabilities	-	346	10,933	(4,086)	-	-	7,193
Issued securities	-	5,700	26,663	184,686	18,493	-	235,542
Financial liabilities at fair value through profit or loss, except derivatives	-	529	12,790	28,454	5,859	-	47,632
Off balance sheet commitments	-	16,540	18,194	11,476	75	26	46,311
Total banking liabilities	**62,297**	**235,269**	**117,023**	**228,127**	**37,337**	**26**	**680,079**

	On demand	Within 3 months	3 - 12 months	1 –5 years	5 – 10 years	10 – 15 years	Total
Receivables from derivatives	-	54,435	59,377	140,391	-	-	254,203
Liabilities from derivatives	-	10,904	64,925	140,878	-	-	216,707
Net value of derivatives	**-**	**43,531**	**(5,548)**	**(487)**	**-**	**-**	**(37,496)**

All figures in tables are in HUF million except otherwise noted

Contractual maturities of undiscounted cash flows of financial liabilities as of 31 December 2012

	On demand	Within 3 months	3 - 12 months	1 –5 years	5 – 10 years	10 – 15 years	Total
Banking liabilities							
Due to banks	-	7,603	2,762	82,289	186	-	92,840
Deposits	42,023	67,335	42,770	1,739	-	-	153,867
Derivative financial liabilities	-	1,561	6,600	15,022	-	-	23,183
Issued securities	-	8,220	96,517	178,844	15,087	-	298,668
Financial liabilities at fair value through profit or loss, except derivatives	-	8,587	42,801	58,054	7,137	-	116 ,579
Off balance sheet commitments	-	6,849	15,719	6,081	98	4	28,751
Total banking liabilities	**42,023**	**100,155**	**207,169**	**342,029**	**22,508**	**4**	**713,888**

	On demand	Within 3 months	3 - 12 months	1 –5 years	5 – 10 years	10 – 15 years	Total
Receivables from derivatives	-	67,060	85,242	184,243	-	-	336,545
Liabilities from derivatives	-	67,164	85,797	191,647	-	-	344,608
Net value of derivatives	**-**	**(104)**	**(555)**	**(7,404)**	**-**	**-**	**(8,063)**

All figures in tables are in HUF million except otherwise noted

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

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

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

Maturity analysis of assets and liabilities as of 31 December 2013

	Less than 12 months	Over 12 months
Assets		
Cash on hand	2,039	-
Balances with the National Bank of Hungary	11,469	-
Due from banks	4,163	17,107
Securities held for trading	40,408	1,542
Financial assets available-for-sale	138,806	13,067
Shares in associates and joint ventures	-	6,158
Derivative financial assets	259	3,320
Refinanced mortgage loans	10,821	122,871
Loans and advances to customers	37,575	282,496
Investment property	436	10,876
Tangible assets	-	5,625
Goodwill and other intangible assets	-	11,373
Deferred tax assets	-	7,421
Other assets	8,687	995
Total assets	**254,663**	**482,851**

All figures in tables are in HUF million except otherwise noted

	Less than 12 months	Over 12 months
Liabilities		
Due to banks	87,861	28,986
Deposits from customers	204,103	18,398
Derivative financial liabilities	11,279	4,086
Issued securities	25,672	203,179
Financial liabilities at fair value through profit or loss, except derivatives	27,147	34,313
Finance leases liabilities	-	9,292
Reserve for annuity payments	368	2,095
Current tax liabilities	6	-
Deferred taxes liabilities	-	503
Provisions	1,142	-
Other liabilities	3,012	-
Total liabilities	**360,590**	**300,852**

Maturity analysis of assets and liabilities as of 31 December 2012

	Less than 12 months	Over 12 months
Assets		
Cash on hand	2,164	-
Balances with the National Bank of Hungary	5,117	-
Due from banks	28,864	-
Securities held for trading	1,763	6,052
Financial assets available-for-sale	139,792	19,056
Derivative financial assets	1,312	3,032
Refinanced mortgage loans	11,525	153,465
Loans and advances to customers	41,154	293,429
Investment property	312	11,151
Tangible assets	-	5,961
Goodwill and other intangible assets	-	12,753
Deferred tax assets	-	6,396
Other assets	8,418	909
Total assets	**240,421**	**512,204**

All figures in tables are in HUF million except otherwise noted

	Less than 12 months	Over 12 months
Liabilities		
Due to banks	10,306	82,475
Deposits from customers	150,467	1,739
Derivative financial liabilities	7,453	15,731
Issued securities	89,876	193,931
Financial liabilities at fair value through profit or loss, except derivatives	39,697	65,191
Finance leases liabilities	-	11,029
Reserve for annuity payments	436	1,974
Current tax liabilities	42	-
Deferred taxes liabilities	-	643
Provisions	173	-
Other liabilities	3,923	-
Total liabilities	**302,373**	**372,713**

49. MANAGEMENT OF RISK FROM OPERATION

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

50. TREATMENT OF RISK CONCENTRATION

The Bank is significantly exposed to the status of real estate market regarding the high proportion of real estate in securities. This concentration risk is mitigated by applying conservative method in collateral values and cover rate and also by diversifying its product portfolio from collateral perspective (meaning to increase the proportion of other that real estate securities).

All figures in tables are in HUF million except otherwise noted

51. CALCULATION OF REGULATORY CAPITAL, CAPITAL ADEQUACY AND ROAE

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

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

The Hungarian Financial Supervisory Authority, later its successor the National Bank of Hungary has begun the supervisory review process (SREP) in September 2013, which has not finished until the end of year 2013. At the same time the Bank implemented several – prescribed or permitted by the Supervisory Authority – changes of methodologies, which caused the increasing of the additional capital requirement. The National Bank of Hungary – considering this fact and the reviewing petition of the Bank – prescribed a transitional SREP requirement for the Group, which can be implemented first time in the report for the end of the year as of 31 December 2013.

The Group's Tier 1 capital adequacy ratio calculated accordingly was 13.8% as of 31 December 2013 and 22.6% as of 31 December 2012. The Group applies the Hungarian accounting standards regarding consolidated risk-weighted assets and IFRS standards regarding Tier 1 items.

Based on the information above the elements of the regulatory capital are the followings: registered capital – repurchased own shares + capital reserve + general reserve + share option reserve + retained earnings – intangible assets – IRB losses. The amount of the capital adequacy ratio is calculated by dividing the amount of the regulatory capital by the total amount of capital requirement divided by 8%.

	31 December 2013	31 December 2012
Risk weighted assets		
Balance sheet items	316,071	301,642
Off-balance sheet items	15,406	8,121
Total risk weighted assets	**331,477**	**309,763**
Capital requirement of the credit risk	26,516	24,871
Capital requirement of the FX risk and market risk	625	519
Capital requirement of the operating risk	2,565	2,377
SREP capital requirement	4,694	5,609
Total capital requirement	**34,400**	**33,376**
Tier 1		
Share capital	6,600	6,600
Repurchased treasury shares	(29)	(29)
Share premium	1,709	1,709
Share-based payment	-	-
Additional tier 1 capital	31,749	28,923
Other reserves*	357	212
Retained earnings	35,664	40,340
Total Tier 1 capital	**76,050**	**77,755**

All figures in tables are in HUF million except otherwise noted

	31 December 2013	31 December 2012
Goodwill and other intangible assets	(16,467)	(12,753)
Subordinated capital	-	29,565
IRB (loss)/gain according to IFRS	(60)	(462)
Total regulatory capital	**59,523**	**94,105**
Capital adequacy (%)	**13.8**	**22.6**
ROAE (return on average equity %)	**(6.1)**	**(6.8)**

*other reserves consist of general reserve and foreign currency translation reserve

52. RELATED PARTY TRANSACTIONS

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

	31 December 2013	31 December 2012
Loans to executives, members of the Board of Directors and Supervisory Board	-	18
Gross remuneration		
Salary	82	98
Bonus	5	13
Honorarium	28	33
Total remuneration	**115**	**144**

All figures in tables are in HUF million except otherwise noted

Balances and transactions between the Group and its subsidiaries, which are related parties of the Group, have been eliminated on consolidation and are not disclosed in this note. Details of transitions in 2013 and 2012 between the Group and other related parties are disclosed below:

	31 December 2013 Parent	31 December 2012 Parent
Other assets	-	-
Total assets	**-**	**-**
Other liabilities	1	-
Total liabilities	**1**	**-**
Other operating income	-	-
Other operating expense	-	-
Operating income	**-**	**-**
Operating expense	(126)	(214)
Profit on transactions with related parties	**(126)**	**(214)**

All figures in tables are in HUF million except otherwise noted

53. NET GAINS

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

2013	Financial assets at fair value through profit or loss	Financial assets available-for-sale	Loans and advances	Financial liabilities at fair value through profit or loss	Financial liabilities at amortised cost	Not linked to financial instruments	Total
Interest income	16,988	6,109	43,078	-	-	-	66,175
Interest expense	-	-	-	(15,594)	(31,870)	-	(47,464)
Net interest income	**16,988**	**6,109**	**43,078**	**(15,594)**	**(31,870)**	**-**	**18,711**
Fee and commission income	-	-	1,747	-	2,541	772	5,060
Fee and commission expense	-	-	(91)	-	(387)	(256)	(734)
Net fee and commission income	**-**	**-**	**1,656**	**-**	**2,154**	**516**	**4,326**
Change in fair value of derivatives	371	-	-	(2,443)	-	-	(2,072)
Gains from securities	239	969	-	(51)	(191)	16	982
Other operating income	-	-	-	-	-	1,462	1,462
Other operating expense	-	-	(89)	-	(211)	(4,405)	(4,705)
Operating income	**17,598**	**7,078**	**44,645**	**(18,088)**	**(30,118)**	**(2,411)**	**18,704**

All figures in tables are in HUF million except otherwise noted

2012	Financial assets at fair value through profit or loss	Financial assets available-for-sale	Loans and advances	Financial liabilities at fair value through profit or loss	Financial liabilities at amortised cost	Not linked to financial instruments	Total
Interest income	17,065	10,350	49,255	-	-	-	76,670
Interest expense	-	-	-	(18,477)	(39,647)	-	(58,124)
Net interest income	**17,065**	**10,350**	**49,255**	**(18,477)**	**(39,647)**	**-**	**18,546**
Fee and commission income	-	-	1,456	-	1,492	847	3,795
Fee and commission expense	-	-	(371)	-	(360)	(472)	(1,203)
Net fee and commission income	**-**	**-**	**1,085**	**-**	**1,132**	**375**	**2,592**
Change in fair value of derivatives	396	-	-	943	-	-	1,339
Gains from securities	6	1,680	-	692	2,423	-	4,801
Other operating income	-	-	-	-	-	664	664
Other operating expense	-	-	-	-	(381)	(2 934)	(3,315)
Operating income	**17,467**	**12,030**	**50,340**	**(16,842)**	**(36,473)**	**(1,895)**	**24,627**

All figures in tables are in HUF million except otherwise noted

54. SEGMENT REPORTING BY BUSINESS SEGMENTS

The group distinguishes business segments. The reportable segments of the Group on the base of IFRS 8 are the following:
Retail, Corporate, Treasury, Refinancing, other.

The reported business segments of the Group are those components where:
- separated incomes and expenses, assets and liabilities can be identified and assignable to the segments
- transactions between the different segments were eliminated
- the main decisive management of the Group regularly controls the operating results
- separated financial information is available

Segment report , December 31 2013	Retail	Corporate	Treasury	Refinan-cing	Other*	Total
Net interest income	11,194	1,358	4,056	3,058	(955)	18,711
Other net income	39	1,007	(1,208)	(493)	(256)	(911)
Provision for impairment on loan losses	(7,296)	251	73	-	183	(6,789)
Direct expense	(11,930)	(1,626)	(703)	(649)	(1,136)	(16,044)
Operating result	(7,993)	990	2,218	1,916	(2,164)	(5,033)
Profit before tax	-	-	-	-	-	(5,033)
Segment assets	339,731	191,801	7,075	133,692	65,215	737,514
Segment liabilities and equity	339,490	191,780	7,075	133,692	65,477	737,514

Segment report , December 31 2012	Retail	Corporate	Treasury	Refinan-cing	Other*	Total
Net interest income	14,595	993	2,598	2,227	(1,867)	18,546
Other net income	1,894	854	4,024	612	(531)	6,853
Provision for impairment on loan losses	(7,848)	(662)	-	-	(1,246)	(9,756)
Direct expense	(6,938)	(659)	(210)	(68)	(1,645)	(9,520)
Operating result	1,703	526	6,412	2,771	(5,289)	6,123
Non allocated expense	-	-	-	-	(9,537)	(9,537)
Profit before tax	-	-	-	-	-	(3,414)
Segment assets	295,976	63,355	199,871	164,990	28,433	752,625
Segment liabilities	93,389	58,817	473,534	-	49,346	675,086

*Including the real estate services, life annuity services and real estate leasing

All figures in tables are in HUF million except otherwise noted

55. SIGNIFICANT EVENTS AFTER BALANCE SHEET DATE

On 3 February 2014, FHB Mortgage Bank gained 25% direct share in Magyar Takarék Befektetési és Vagyongazdálkodási Zártkörűen Működő Részvénytársaság (MATAK Zrt.) through participating in the share capital increase decided by the general meeting of MATAK Zrt. with a payment at HUF 252 million nominal value.

On 10 March 2014 MATAK Zrt., MFB Magyar Befektetési Bank Zártkörűen Működő Részvénytársaság (Hungarian Developement Bank) and Magyar Posta Zártkörűen Működő Részvénytársaság contracted on the purchase of 929,301 pieces of equity shares of Magyar Takarékbank Zártkörűen Működő Részvénytársaság.

By the amount of purchased shares MATAK Zrt. gets around 54.8% ownership in Takarékbank Zrt. As a result of the transaction FHB Mortgage Bank acquires 13.75% indirect ownership in Takarékbank Zrt. According to the contractual will of the parties, but depending on the completion of several regular conditions the transaction shall be closed in the first half of 2014.

On 12 March 2014 Moody's Investor Service announced the upgrade of the rating of the mortgage covered bonds issued by 15 European banks, among those issued by the FHB Plc's. The rating of the mortgage covered bonds issued by FHB Plc's, has been upgraded to „Ba2" from „Ba3". This rating action on FHB's covered bonds was prompted by the Moody's update of its covered bond rating methodology.

According to the decision announced on 13 March 2014, Financial Stability Board of National Bank of Hungary imposed fine for 35 financial institutions with a total amount of HUF 1.2 billon, which raised fees and charges for customers on unlawful way. Central Bank prohibited these financial institutions from continuing this practice and ordered to pay back the additional fee charges to clients. NBH imposed a fine of HUF 95 million on FHB Commercial Bank Ltd. Because of the unclarified questions of interpretation, the amount of the additional fee to be paid back has not been quantified yet, furthermore there is a possibility of appeal against the decision.

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