



FHB MORTGAGE BANK PLC

**CONSOLIDATED ANNUAL REPORT FOR YEAR 2012
ACCORDING TO IFRS**



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CONSOLIDATED MANAGEMENT REPORT FOR 2012
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I. OVERVIEW OF FHB GROUP

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 and Act XXX of 1997 on Mortgage Loan Companies and on Mortgage Bonds 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 and its subsidiaries are jointly referred to as the Group or Banking 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 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 2012 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 2012. Majority (55.8%) of FHB shares is owned by domestic institutional investors.

FHB Group's shareholder structure as of 31 December 2012:

Investor category	31 December 2011		31 December 2012	
	Number of shares	Ownership share	Number of shares	Ownership share
Domestic institution/company	48,585,278	73.62%	36,795,859	55.76%
Foreign institution/company	12,216,058	18.51%	14,509,484	21.98%
Domestic and foreign individuals	2,430,773	3.68%	4,118,847	6.24%
MNV Ltd.	2,714,300	4.11%	4,724,833	7.16%
FHB Mortgage Bank Plc.	53,601	0.08%	53,601	0.08%
Other investors	0	0.00%	5,797,386	8.78%
Total	66,000,010	100.00%	66,000,010	100.00%

**Not identified shareholders*

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.

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.

On 31 March 2009 – because of the severe liquidity problems on capital markets - the Bank was granted a state loan of EUR 400 million with the aim to ensure the availability of mortgage loans for retail customers.

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.

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 left FHB Group, which had a positive impact on the Group's capital adequacy according to Hungarian standards. In the Group's books by IFRS 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.

To strengthen its capital position FHB Mortgage Bank issued subordinated bonds during private placement subscriptions two times in 2012. The subordinated bonds issued in June 2012 with face value amounted to HUF 15 billion and EUR 50 million can be treated as incremental capital but the subordinated bonds issued in December 2012 with face value amounted to EUR 102 million can be treated as subordinated Tier 1 capital. After the successful bonds issue in December, the subordinated bonds issued in June were redeemed and withdrawn in February 2013 with the permission of the Hungarian Financial Supervisory Authority.

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

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 SME business, then in 2010 investment services.

Allianz Bank merged into FHB Commercial Bank as of 1 April 2011. The merger boosted the number of employees, number of branches and financial assets, as well. Product portfolio broadened due to the acquisition.

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.

In September 2012, FHB Mortgage Bank (as owner) decided to improve capital position of the Bank. As a result of the 6 billion HUF capital increase, registered capital of Commercial Bank grew by 900 million HUF and 5.1 billion HUF was accounted as capital reserves.

According to Hungarian Accounting Standards, total assets of FHB Commercial Bank were 433.6 billion HUF in 31 December 2012 showing 8.6% growth compared to 2011, loan portfolio contributed to it 50.4%. In 2012, volume of gross loans according to Hungarian Accounting Standards was 218.5 billion HUF declining by 4.5% compared to 2011. Corporate loans amounted to 55.7 billion HUF having 25.5% shares among total loan portfolio.

At the end of 2012 FHB Commercial Bank owned 46 branches in Hungary. The number of retail and corporate accounts managed by the Commercial Bank was 162.4 and 7.6 thousand as of 31 December 2012 and 121.3 thousand retail and 4.5 thousand corporate banking cards related to these accounts. Both number of accounts and cards represented significant growth in 2012. Volume of retail deposits decreased by 24.6%, while corporate deposits grew by 14.5% compared to 2011. Total volume of deposits decreased by 3.9% year-on-year and amounted to 152.3 billion HUF as at 31 December 2012. FHB Commercial Bank's balance sheet profit was 3.8 billion HUF loss in 2012. The capital adequacy ratio (according to HAS) was 10.00% as at 31 December 2012.

FHB Real Estate Ltd.

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.

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. Compensating operational losses, share capital was increased in all years from 2007 to 2009.

In 2009, FHB Mortgage Bank purchased FHB Services share and became the sole owner of the company. On 21 December 2010, the owner of the company decided further capital increase, which was registered on 20 January 2011.

Besides significantly low level of real estate transactions and lending due to the crisis, the Company realised losses in 2012. FHB Real Estate Ltd. registered capital was 65 million HUF on 31 December 2012, shareholders equity amounted to 24.1 million HUF.

FHB Real Estate Ltd. owns 100% share of "Wodomus 54" Property Development Ltd. established on 11 February 2011 with a share capital of 500,000 HUF 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 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 Plc.

FHB Life Annuity Ltd.

FHB Life Annuity Real Estate Investment Ltd. was founded on 9 June 2006 with a registered capital of 100 million HUF. 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. In 2007 the shareholders increased the company's capital by 350 million HUF. As of March 2009 FHB Mortgage Bank became the sole owner of the company.

Next time the shareholders increased registered capital by 10 million HUF and capital reserves by 89 million HUF on 23 December 2011, related to share purchase agreement of FHB Real Estate Leasing Ltd. FHB Services Ltd sold its share in FHB Real Estate Leasing Ltd. to FHB Life Annuity Ltd. on 17 November 2011. After the sales transaction, Life Annuity Ltd. increased the registered capital of Real Estate Leasing Ltd. by 360 million HUF.

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.

As of 31 December 2012 the company's registered capital was 160 million HUF with an additional 439 million HUF capital reserve. Retained earnings and balance sheet profit of 2012 decreased the shareholder's equity by 3.866 million HUF.

FHB Real Estate Lease Ltd.

The private limited company FHB Real Estate Lease Ltd. (formerly Central European Credit Ltd.; the new name became effective as of 31 December 2010) 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's share capital is comprised of 1,000 registered ordinary shares of 50,000 HUF face value each. 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 leasing. As had been the case in previous years, FHB Real Estate Lease Ltd. offered mortgage products solely on a real estate collateral basis to retail and corporate customers in 2010. The legislative changes enacted in 2010 led to the cessation of the collateral based mortgage loans business. Since the fourth quarter of 2010 the company shifted its focus on selling lease products.

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. Pursuant to the HFSA's order dated 29 June 2009 following the application filed by FHB Mortgage Bank Plc., FHB Real Estate Lease Ltd. is subject to supervision on a consolidated basis.

FHB Mortgage Bank – as parent company exercising ownership rights on investments of FHB Services Ltd. and FHB Life Annuity Ltd. –decided to increase company's capital three times in 2011. Total capital increase amounted to 850 million HUF, including 30 million HUF increase of registered capital 820 million HUF capital reserves.

In 2012, there was no further capital increase. Shareholder's equity of the Company according to HAS amounted to 108.1 million HUF as at 31 December 2012, registered capital was 90 million HUF and capital reserves amounted to 1.0 billion HUF.

As at 31 December 2012, the consolidated loan volume of FHB Real Estate Lease Ltd. reached 8.3 billion HUF. In 2012, lease financing disbursement amounted to 1,002 million HUF (411 million HUF in Q1 and Q2 2012, as well and 131 million HUF in Q3, 49 million in Q4). Leasing portfolio reached 3.3 billion HUF as of 31 December 2012. The quarterly change was 17.6% decrease (from 4.0 billion HUF as of 30 September 2012), while the year-on-year fall was 8.9% (from 3.6 billion HUF as of 31 December 2011).

As of 31 December 2010 FHB Real Estate Lease Ltd. held 100% of the shares of two companies active in financial mediation (Portfolio Money Pénzügyi Közvetítő Zrt. and Portfolio Money FBK Kft.), as well as of two Croatian subsidiaries (Central European Credit d.d. and Central European Leasing d.d.). On 30 September 2011 Real Estate Leasing Ltd. sold Portfolio Money FBK Ltd. One of the Croatian subsidiaries (CEL d.d.) is under liquidation. Portfolio Money Ltd. continues its operation since 1 February 2012 under the name of FHB DWH Services Ltd. with modified activity providing data processing and web hosting services.

Ownership structure of FHB Group members as at 31 December 2012:

Subsidiaries	Shareholders					Total
	FHB Mortgage Bank Plc.	FHB Life Annuity Ltd.	FHB Real Estate Ltd.	FHB Real Estate Leasing Ltd.	FHB DWH Ltd.	
FHB Commercial Bank Ltd.	99.998%	-	-	0,002%*	-	100.00%
FHB Life Annuity Ltd.	100.00%	-	-	-	-	100.00%
FHB Real Estate Lease Ltd.	-	100.00%	-	-	-	100.00%
FHB Real Estate Lease Ltd. Croatian subsidiaries	-	-	-	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%

* FHB Real Estate Lease Ltd. owned 1 piece of shares of FHB Commercial Bank Ltd. on 31 December 2012

II. MACROECONOMIC ENVIRONMENT IN 2012

The Hungarian economy in 2012¹

Figures	2010	2011	2012*
GDP increase (%)	1.3%	1.6%	-1.7%
Industrial production growth (%)	10.6%	5.4%	-1.7%
Consumer prices (%)	4.9%	3.9%	5.7%
Unemployment rate (%)	11.2%	10.9%	10.7%
Budget deficit (billion HUF)	-870	-1,734	-607
Current balance of payments (million EUR)	1,225	910	780
National Bank of Hungary base rate (% , end of the year)	5.75%	7.00%	5.75%
EUR exchange rate (by the end of the year)	278.8	311.1	291.3

* expected for 2012

Source: Central Statistical Office (CSO), National Bank of Hungary (NBH)

After increased in 2011, the preliminary GDP of Hungary shows decrease of 1.7 %. Same decline is expected in industry products as in GDP growth. Performance of the building industry continued to decline falling by 5.9% year-on-year processing industry performance decreased by 1.6%.

Consumer price index grew by 5.7% compared to the previous year, representing 1.8%-point growth. In 2012, primarily alcoholic drinks and tobacco prices rose, but price increase of households' energy, food and other products were above the average, as well.

NBH decreased the base rate several times in 2012. The 2011 closing base rate of 7.00% fell to 5.25%, as a result of five decreases by 25 basis points from August to December. Interbank rates performed similar trend during the year. The exchange rate of the forint continuously sank, from HUF/EUR 311.13 to HUF/EUR 291.29 by the end of the year. In domestic lending important Swiss franc remained above HUF 200 in the whole year and climbed from HUF/CHF 222.68 HUF at the end of 2010 to HUF/CHF 255.91 till the end of 2012, opening 255.91HUF/CHF exchange rate fell to 241.06 HUF/CHF.

The unemployment rate is slightly below figures of 2011. Small reduction compared to 2011 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

¹ Based on reports and statistics of NBH and CSO

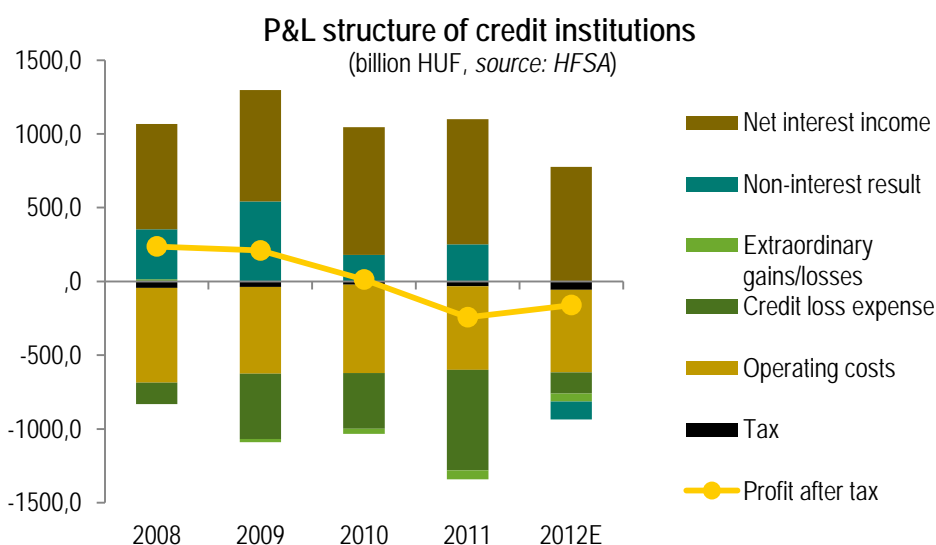
financial products. Average number of employees was 3,878 thousand representing 66 thousand growth compared to 2011. The average gross income of employees was 4.6% higher than a year before, while net average salaries rose by 2.0% year-on-year.

Balance of government budget improved, general government deficit decreased compared to the last year representing 607 billion HUF deficit at the end of 2012. Export and import rose by 3.8% and 4.0%, respectively, but calculated in EUR, volumes showed no substantial change year-on-year. Balance of foreign trade was 2,003 billion HUF generating 24 billion HUF growth compared to 1,979 billion HUF surplus in 2011. Growing exports and considerable lag in imports resulted in a positive balance.

10,560 new residences have been built in 2012, by 17% less than a year before. 10,600 residential building permits were issued in 2012, 15% less than in 2011. In Budapest these figures showed even higher fall, 48% and 32%, respectively. Ratio of enterprises and buildings for sale among newly built houses continue to decrease, accordingly ratio of family houses and larger houses has been growing.

The banking sector in 2012²

Based on preliminary report of HFSA, credit institutions made losses in 2012 such as previous year. Preliminary loss amounted to 159 billion HUF, by 36.6% lower than last year. Cumulated profit after tax of banks expected to reach 161 billion HUF losses, representing 34.0% improvement compared to 2011.



Gross loans of credit institutions decreased by 12% in 2012. Lending of banks declined 11.7% year-on-year. Volume of household's loans decreased continuously during the year, representing 11.9% fall. After the fixed-rate final repayments, volume change was 12.1%. The balance sheet total in banking industry was down by 8.7% in the last 12 month, of which both corporate and retail loans declined over 10%.

² Based on reports and statistics of HFSA

**Cumulative balance sheet total and loans of
Plc. credit institutes**
(billion HUF, source: HFSA)



State interest rate subsidies could not enhance significantly the lending activity, material disbursement had been realised in the first quarter only thanks to redemption loans related to fixed-rate final repayments.

Quality of loan portfolio (loans to household's and non-financial corporations) deteriorated further in 2012; share of loans past due more than 90 days grew to 16.5% from 13.8% in 2011. Non-performing loan (NPL) ratio of retail mortgages was 17.3% and 19.3% at FX denominated mortgage loans. NPL level of the end of the year already shows the positive impact of government home protection measures. As of 30 June 2012, NPL ratio of retail mortgages reached 18.2%, while NPL from FX mortgage loans peaked at 19.6%. Quality of corporate loans also deteriorated, NPL ratio grew from the level of 14.9% at the end of 2011 to 18.3% as of 30 June 2012, and as a result of portfolio management actions, it moderated to 17.2% as of 31 December 2012.

In 2012, share of client's deposits from liabilities of the banks grew against direct foreign funding, representing 47% as at 31 December 2012, compared to 42% in 2011. Volume of total deposits increased moderately and amounted to 12,323 billion HUF. Household's deposits still represented 70% of this amount.

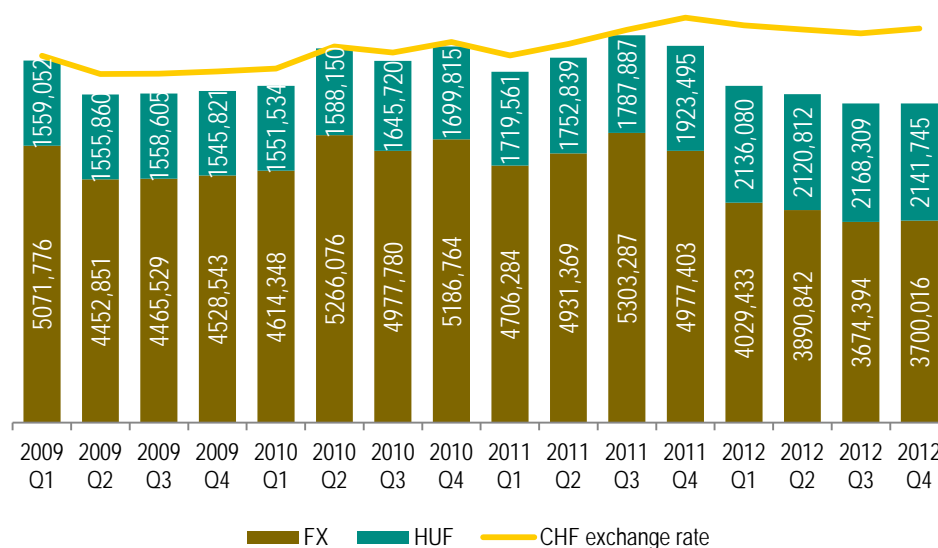
Mortgage lending in 2012

Retail customers' demand for loans still showed low level in 2012. Beside low disbursement level, regulatory changes – primarily fixed-rate final repayments in January and February – had significant impact on volumes.

Mortgage loan volumes

Based on data published by National Bank of Hungary, volume of retail mortgage loans amounted to 5,842 billion HUF as at 31 December 2012. Volume decreased by 1,059 billion HUF compared to year-end data of 2011 (6,901 billion HUF). Volume of FX loans fell by 25.7%, in contrast HUF denominated loans increased due to redemption loans by 9.7%, total volume of mortgage loans decreased by 15.6%.

Retail mortgage loans
(billion HUF)



Volume of housing loans amounted to 3,535 billion HUF as of 31 December 2012, representing yearly decrease of 708 million HUF. HUF loans (including redemption loans) increased by 39.5 billion HUF, while FX housing loans fell down by 747.4 billion HUF as a result of final repayments and other regulatory measures.

General-purpose mortgage loans amounted to 2,307 billion HUF as of 31 December 2012 with a 351 billion HUF year-on-year decline. Growth of HUF-denominated general-purpose loans was over 179 billion HUF, at the same time FX-based general-purpose loans were down by 530 billion HUF.

As a combined effect of revaluation of FX loans and fixed-rate final repayments, proportion of FX mortgage loans decreased from 71.4% in 2011 to 62.9% as of 31 December 2012.

Home protection measures

After 2011, during 2012 further important legal changes were implemented to protect FX mortgage loan holders.

1. Exchange rate protection

In early March 2012 the Government and the Hungarian Banking Association reached an agreement on the renewal of the 'protection for the loans denominated in foreign currencies' 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.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. 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 account which will bear interest of 3M BUBOR. 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. Under the specified terms, one of the conditions for eligibility is that the loan should not be higher than HUF 20 million. Application for the buffer account loan scheme is open from 1 April 2012 until 30 March 2013 (instead of the previously accepted 31 December 2012).

Until 31 December 2012, banks opened over 102 thousand new buffer accounts, so more than 22% of entitled clients already participated in the program.

2. *HUF conversion and release of claims*

Also based on the December 2011 agreement between the State and the Banking Association, the Act LXXV of 2011 on the fixation of the exchange rate of the instalments of the loans denominated in foreign currencies and the rules for the forced sale of properties and its modification the Act XVI of 2012 provide details about the conditions of the conversion into HUF and the release of the receivables.

According to the regulation, Banks needed to convert the loan into HUF and release 25% of the outstanding liability if clients met the regulatory conditions. Based on the legislation the conversion rate was HUF/EUR 298.55 and HUF/CHF 248.55 (the average of the exchange rates of the NBH in the period between 15 May 2012 and 15 June 2012).

3. *National Asset Management Ltd. (NET)*

Among the steps of the 'Home Protection Action Plan' can be found the establishment of the National Asset Management Ltd. 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. Until the end of October 2012, financial institutions offered more than 1,100 real estates to NAM.

As the Government accepted the modification of regulation of social conditions of NET program, the range of entitled clients is wider since 1 January 2013.

Other loans in 2012

Consumer loans of households have been decreasing in 2012, as well. The 15.3% volume decrease was generated by declining FX loans, while HUF denominated consumer loans grew by 15.5% last year. Concerning total consumer loan portfolio, home equity loans representing majority of the volume with 76.6% share; contribution of personal loans reached 13%.

Loans to non-financial corporations decreased by 10.6% in 2012 and amounted to 6,544 billion HUF. Within the corporate loan portfolio, FX loans decreased by 16.9%, loans in HUF by 0.5%, of which overdrafts grew by 10.9% compensating decline in other HUF loans.

Deposits in 2012

According to the statistics of National Bank of Hungary, aggregated volume of retail and corporate deposits amounted to 12,097 billion HUF as of 31 December 2012, falling by 0.8% in one year. Composition of deposits is almost the same as last year: FX deposits represented one-fifth of the total. Retail deposits contributed 63.6% of total banking deposits, as in 2011.

From retail deposits, 86.3% were HUF and 13.7% were FX deposits as of 31 December 2012, approximately the same as in 2011.

Volume of corporate deposits didn't change essentially in 2012, amounted to 4,399 billion HUF. FX deposits contributed 32% to total corporate deposits.

As of 31 December 2012, sight deposits contributed by 34.7% to total deposits, as in 2011. Term deposits amounted to 7,903 billion HUF.

III. REPORT ON THE BUSINESS ACTIVITIES IN 2012

Major financial indicators

Data in HUF billion	31 December 2011	31 December 2012	Change, %
Balance sheet total	816.11	752.63	-7.8%
Book value of loans	647.15	536.92	-17.0%
Mortgage bonds issued	337.97	231.85	-31.4%
Bonds issued	100.56	107.90	7.3%
Shareholders' equity	53.38	77.54	45.3%
Capital adequacy ratio (IFRS, %)	10.4%	22.6%	12.2%-pt
Profit before tax	-7.31	-3.41	-
After tax profit	-5.62	-4.46	-
After tax profit excluding special banking tax and final repayment	7.29	-2.40	-
Average net interest margin (NIM, %)	2.54%	2.36%	-0.18%-pt
Cost/income ratio (CIR, %)	59.9%	72.7%	12.9%-pt
EPS (HUF)	-85.2	-70.4	-17.3%
ROAA (return on average assets, %)	-0.67%	-0.57%	0.10%-pt
ROAA excluding special banking tax and final repayment (%)	0.86%	-0.31%	-1.17%-pt
ROAE (return on average equity, %)	-10.0%	-6.8%	3.2%-pt
ROAE excluding special banking tax and final repayment (%)	13.0%	-3.7%	-16.7%-pt

FHB Group's consolidated balance sheet total calculated according to International Financial Reporting Standards was 752.6 billion HUF as of 31 December 2012, which was 7.8% and 63.5 billion HUF less year-on-year; and 1.2 billion HUF or 0.2% up to the previous quarter. 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 108.5 billion HUF or 17.8% in one year, of which decline in refinanced loans was over 27%. On the liability side volume of issued mortgage bonds decreased significantly in line with loan volume, but deposits were also lower than a year before.

Consolidated profit after tax for 2012 was 4.5 billion HUF loss; net interest income amounted to 18.5 billion HUF. The average net interest margin (NIM) was 2.36%, by 18 basis points down year-on-year.

The Group's cost to income ratio (CIR) was 72.7% (or 66.8% calculated without special banking tax) compared to 59.9% in the reference period of 2011 (when special banking tax had no impact on the results). The decline of CIR was generated by decrease of incomes: operating costs declined by nearly 2 billion HUF year-on-year, but drop of incomes was higher.

Despite losses, capital position of FHB Group improved significantly in 2012 due to two subordinated bond issues in private placements. HUF denominated bonds of 15 billion HUF and EUR denominated bonds of 50 million EUR issued in June 2012 shall represent so-called subordinated loan capital (Tier 2 (alárendelt kölcsöntőke)); while EUR denominated bonds with face value of 102 million EUR issued in December constitutes subordinated (Tier 1) capital (alapvető kölcsöntőke). Capital adequacy ratio was 22.56% at the end of the year. With the permission of the Hungarian Financial Supervisory Authority, in February series of Tier 2 subordinated bonds were repurchased and each of these series was cancelled with an effective date of 21 February 2013.

Retail and corporate lending

The volume of gross loans of FHB Group amounted to 371.9 billion HUF as of 31 December 2012, by 11.5% down to the 31 December 2011 figure (420.3 billion HUF). Year-on-year decline is attributed mainly to fixed rate final repayments, that couldn't have been compensated by 11.0% increase of corporate loans. Compared to 30 September 2012 (371.1 billion HUF) volume didn't change.

Retail loans continued to dominate within the loan portfolio with a contribution of 81.5% (85.2% on 31 December 2011). As of 31 December 2012, 57.3% of outstanding loans were denominated in FX, 90 bp up to Q3 of 2012, and as a result

of fixed rate final repayments significantly lower than 62.7% share a year before. Retail loans were by 15.4% (or 55.2 billion HUF) down to the figures of 31 December 2011.

in HUF million	31/12/2011	31/12/2012	Change 2012/2011
Retail loans	358,192	303,042	-15.4%
Housing loans	181,924	152,348	-16.3%
Other mortgage loans	163,543	139,618	-14.6%
Consumer loans and overdrafts	7,728	6,348	-17.9%
Loans for employees	2,244	1,935	-13.8%
Retail leasing	2,753	2,793	1.5%
Corporate loans	62,068	68,889	11.0%
Corporate loans	61,217	67,962	11.0%
Corporate leasing	851	927	8.9%
Total own lending, gross	420,260	371,931	-11.5%
Impairment	-39,033	-37,348	-4.3%
Loans, net	381,227	334,583	-12.2%

In terms of structure, housing loans as the largest volume contributed 41.0% and other mortgage loans contributed 37.5% to the loan portfolio. As of 31 December 2011, the contribution of the two dominant items was 43.3% and 38.9%, respectively. Reverse mortgages achieved 3.1 billion HUF as of 31 December 2012, while volume of consumer loans amounted to 6.3 billion HUF.

Volume of corporate loans rose from 62.1 billion HUF as of 31 December 2011 by 11.0% year-on-year to 68.9 billion HUF; quarterly volume growth was 5.6% generating 18.5% contribution of corporate loans to the total loans.

In 2012, 12.5 billion HUF of retail and more than 18 billion HUF of corporate loans have been disbursed, 40% of corporate loan disbursement occurred in Q4. Among retail loans, share of subsidized loans is growing, but since subsidised lending started, demand for non-subsidized housing loans increased, as well. In corporate segment, over the above mentioned loan disbursement FHB Group provided more than 11 billion HUF overdrafts and revolving credit line to its customers.

Since 1 April 2012, FHB Group has been collecting and managing the applications for the new buffer account scheme. Until the end of the year, 7,665 clients (40% of entitled ones) applied for the program and 4,251 contracts were already signed. Deadline for application was extended until 29 March 2013.

Refinancing

Consolidated volume of refinanced loans dropped by 27.3% in one year to 165 billion HUF. Final repayments also played a role in decrease of refinanced loans, but volume of newly refinanced loans was limited, as well. All the newly refinanced loans were HUF denominated in 2012.

Customer deposits, bank account services

The number of retail and corporate accounts managed by the Bank was 162.4 and 7.6 thousand as of 31 December 2012 and 121.3 thousand retail and 4.5 thousand corporate banking cards related to these accounts. Both number of accounts and cards represented significant growth in 2012.

Volume of retail deposits decreased by 24.6%, while corporate deposits grew by 14.5% compared to 2011. Total volume of deposits decreased by 3.9% year-on-year and amounted to 152.3 billion HUF as at 31 December 2012. Volume of sight deposits reached 42 billion HUF at the end of the year, representing 27.6% share of total deposits compared to contribution of 24.3% a year before.

Investment services

FHB's investment services developed further in 2012. Due to successful client acquisition, number of investment and long-term investment accounts increased significantly. Market environment stimulated demand for investment funds and own bonds generating more than 24 billion HUF assets managed on retail and corporate accounts.

Number of investment accounts was over 9,000 as at 31 December 2012. From managed assets, major part was represented by securities issued by FHB Mortgage Bank (10.3 billion HUF); investment funds represented 8.2 billion HUF, government securities 1.9 billion HUF and shares close to 3 billion HUF at the end of the year.

Branch network played important role in sale; bonds issued to retail investors were the most popular products among securities and major transactions occurred through the branch. Beside the branch higher emphasis was laid on online sale: demand for NetBróker service has been growing and even more investment fund and stock exchange transactions realised online.

FHB Bank makes market on secondary market for unsecured bonds and mortgage bonds issued by FHB Mortgage Bank on both retail and corporate side significantly improving liquidity of securities issued by the Group.

Security issues

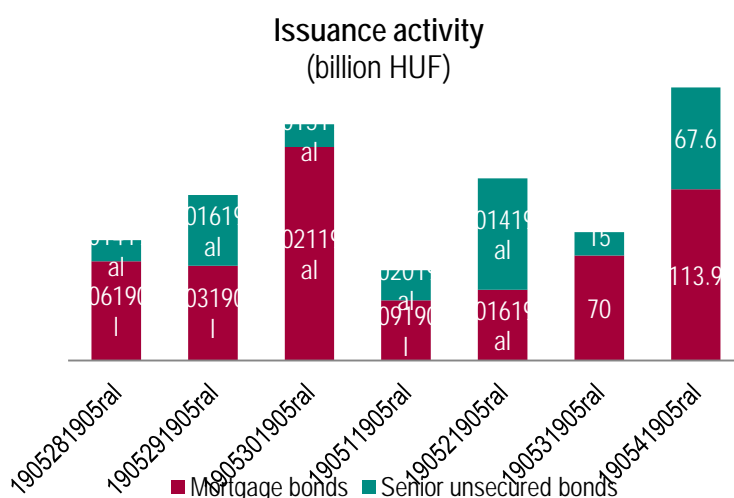
1. Mortgage and Senior bond issues

In 2012 FHB Bank managed 32 securities transaction, of which issued 21 distinct series and repurchased 11 series, compared to 27 transactions in 2011.

FHB Mortgage Bank issued altogether HUF 40.5 billion and EUR 255 million of unsecured bonds (including subordinated bonds), and HUF 67.6 billion of CMBs (Collateralised Mortgage Bonds) in 2012. In 2012 total new funding was over HUF 181.5 billion.

At the end of December 2012, the three national mortgage banks' cumulative mortgage bonds amounted to 1,447 billion HUF, share of FHB represented 21.0% of that.

In 2012 mortgage bonds of 45.7 billion HUF and 72.2 million EUR, and senior unsecured bonds of 11.8 billion HUF and state loan of 200 million EUR matured. In 2012 CMBs of 13.3 billion HUF and 211.3 million EUR, and senior unsecured bonds of 20 billion HUF and 50 million EUR were repurchased.



2. Mortgage bond coverage³

In accordance with the relevant statutory provisions the Bank has undertaken to keep a stricter mortgage bond coverage ratio, i.e. to ensure a principal-to-principal adequacy at all times. 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 566.6 billion HUF as of 31 December 2012, 17.4% less than the figure as of 31 December 2011 (685.8 billion HUF).

Value of mortgage bonds and assets involved as collateral as of 31 December 2012 (HUF millions)

Outstanding mortgage bonds in circulation (million HUF)	
Face value	304,041
Interest	74,691
Total	378,732
Value of the regular collateral	
Principal	356,290
Interest	210,290
Total	566,580
Value of assets involved as supplementary collateral	
Balance of the separate blocked account at the NBH - principal	0
Total	0

As of 31 December 2012, the present value of ordinary collateral was 400.2 billion HUF and the present value of mortgage bonds was 342.5 billion HUF, thus the present value of collateral exceeded that of CMBS in circulation not yet repaid. The combined present value of collateral to the combined value of mortgage bonds in circulation was 116.9% in the same period.

As of 31 December 2012 net value of ordinary and supplementary collateral principal to the unpaid face value of mortgage bonds in circulation was 117.2%, and the net ordinary and supplementary collateral principal to the unpaid interest on mortgage bonds in circulation was 281.6%.

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 2012. 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 2012 the Bank had a 4.3 billion HUF net interbank borrowing position, as well as 72 billion HUF NBH bonds. The nostro accounts closed with 2.5 billion HUF. There were no margin deposits in HUF. The Bank had a 24 billion HUF net lending position, margin deposits amounted to 78.9 million EUR (approximately 23 billion HUF).

Beside of two-weeks NBH bonds, as of 31 December 2012, consolidated securities portfolio (due to liquidity and risk management) contained government bonds (5.5 billion HUF and 87.2 million EUR), treasury bills (32.9 billion HUF) and other securities guaranteed by the state (3.8 billion HUF and 83.7 million EUR). Free liquid securities amounted to 66.8 billion HUF in addition to the NBH bonds.

³ Non-consolidated data of FHB Mortgage Bank Plc. only, according to HAS

Risk management principles

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

After several consultations with Hungarian Financial Supervisory Authority (HFSA) supervisory review has been completed (SREP) in Q2 2012.

2. Credit risk

In the first months of the year, consideration of redemption loans related to final repayment applications expected serious extra resources of the departments.

Connected to retail overdraft campaign of the Bank, risk management reviewed risk parameters of this products and defined conditions and implementation of client qualification and income approval methodology. On the same way, risk management participated in development of new personal loan product, launched in Q2 2012.

As a result of review and validation of client- and counterparty-rating systems in 2012, credit institutions rating systems have been modified slightly.

In second half of the year, the monitoring and management of the existing portfolio, including the entire process of collection of claims, was given priority. Besides previously launched tailor made collection methods, the Bank organised special campaigns to manage non-performing portfolio and participation in government home protection programs has had special attention.

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. Exposure of asset/liability and off-balance sheet items to maturity, interest rate and exchange rate risks are kept at a low level.

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.

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. 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 through 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.

Open FX position derived from fixed-rate final repayment had been secured by facility provided by NBH, therefore weakening and volatility of HUF at the end of the year had no impact for factors mentioned above.

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.

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.

Since 31 December 2011, and FHB Group received permission of Advanced Measurement Approach (AMA).

As a result of the full range operating risk self-evaluation, finished in Q1 2012, FHB synthesized its risk map. Launch and valuation of risk management measures identified by self-evaluation are in progress. In case of rare events with potentially serious losses, FHB made scenario analysis.

Organizational changes and headcounts

As of 31 December 2012, the consolidated full-time headcount was 770.1, 7.8% less than the 835.7 as of 31 December 2011.

Headcounts of the Group companies were as follows as of 31 December 2012 and 31 December 2011:

Divisions	31/12/2011	31/12/2012	Change 2012/2011
FHB Mortgage Bank Plc.	178.08	170.25	-4.4%
FHB Commercial Bank Ltd.	627.48	575.18	-8.3%
FHB Life Annuity Ltd.	6.70	7.33	9.4%
FHB Real Estate Ltd.	9.63	8.13	-15.5%
FHB Real Estate Leasing Ltd.	10.95	9.20	-16.0%
FHB Others*	2.75	0.00	-
FHB Consolidated	835.58	770.09	-7.8%

* Portfolio Money Ltd. 2.8 TMD

IV. FINANCIAL ANALYSIS

Balance sheet structure

HUF million	31/12/2011	31/12/2012	Change 2012/2011
Cash	2,554	2,164	-15.3%
Due from banks & NBH	65,045	33,981	-47.8%
Financial assets available-for-sale and held for trading at fair value	87,723	166,663	90.0%
Derivative financial assets	2,695	4,344	61.2%
Refinanced mortgage loans	226,890	164,990	-27.3%
Loans and advances to consumers	420,260	371,931	-11.5%
Impairment and provision	-39,033	-37,348	-4.3%
Tangible assets	6,300	5,961	-5.4%
Goodwill and other intangible assets	14,174	12,753	-10.0%
Other assets	29,506	27,186	-7.9%
Total Assets	816,114	752,625	-7.8%
Liabilities total	762,733	675,084	-11.5%
Due to banks	20,992	110,597	426.8%
Mortgage bonds	337,965	231,848	-31.4%
Senior unsecured bonds	100,558	107,905	7.3%
Deposits	161,105	152,206	-5.5%
State loans	62,694	0	-
Derivative financial liabilities at fair value	60,511	23,184	-61.7%
Leasing liability	10,060	11,029	9.6%
Reserves for annuity payments	2,265	2,410	6.4%
Other liabilities	6,582	4,779	-27.4%
Subordinated debt	0	31,126	-
Total shareholders' equity	53,382	77,541	45.3%
Share capital	6,600	6,600	0.0%
Share premium	1,709	1,709	0.0%
Treasury shares	-29	-29	0.0%
Cash-flow hedge reserve	201	0	-
Tier 1 subordinated capital bond	0	28,923	-
Other reserves	-86	-2	-97.2%
Retained earnings	50,604	44,986	-11.1%
Balance sheet profit	-5,618	-4,646	-17.3%
Total liabilities and shareholders' equity	816,114	752,625	-7.8%

As of 31 December 2012, the Bank's consolidated balance sheet total by IFRS amounted to 752.6 billion HUF, nearly the same as at the end of previous period, and by 63.5 billion HUF, or 7.8%, below the balance sheet total as of 31 December 2011.

The decline on the assets side, compared to the reference figures as of 31 December 2011, was the joint result of several factors. Interbank deposits dropped by 47.8% and refinanced loans by 27.3% that could be partly compensated by growth in securities held for sale and trading of 90.0%.

Liabilities decreased by 11.5% compared to the reference figures of 2011. Significant decrease was generated primarily by repayment of state loan, fair value of derivatives (-61.7%), and mortgage bonds (-31.4%), meanwhile interbank borrowings showed fourfold increase.

Shareholders' equity grew by 24.2 billion HUF year-on-year as Tier 1 subordinated bonds are reported as part of shareholder's equity.

1. Interest earning assets

The Group's interest earning assets decreased from 799.9 billion HUF as of 31 December 2011 to 737.6 billion HUF as of 31 December 2012. Interest earning assets contributed 102.0% to the balance sheet total.

Interbank lending

NBH and other interbank lending decreased from 65.0 billion HUF as of 31 December 2011 to 34.0 billion HUF as of 31 December 2012. The item contributed 4.6% to interest earning assets as of 31 December 2012.

Securities

The value of Bank's securities held for sale increased from 85.9 billion HUF as of 31 December 2011 to 158.8 billion HUF as of 31 December 2012; while the value of securities amounted to 153.2 billion HUF as of 30 September 2012. Contribution of securities held for sale to interest earning assets was 21.5% in Q4 2012. Securities include NBH bonds amounting to 71.9 billion HUF, discount treasury bills amounting to 31.5 billion HUF and government bonds amounting to 28.9 billion HUF and other bank and corporate bonds for sale amounting to 26.6 billion HUF. As of 31 December 2012, the Bank held a portfolio of securities held for trading (7.8 billion HUF), which contributed 1.1% to interest earning assets.

Loans

As of 31 December 2012, the volume of loans was 11.5% down year-on-year, quarterly no significant change was realised. Impairment to cover loan losses was down from 39.0 billion HUF as of 31 December 2011 to 37.3 billion HUF as of 31 December 2012; because of impairments for losses of fixed rate final repayments. Volume of provisions related to NPL increased by 5.1 billion HUF compared to the end of previous year.

The year-on-year decline in refinanced loans was 27.3% and there was also a 3.1% drop in this item over the last quarter. As of 31 December 2012, the contribution of refinanced loans and gross own lending was 72.8% in total assets.

The collateral value of real estate covering ordinary collaterals amounted to 977.3 billion HUF as of 31 December 2012, 3% down compared to 30 September 2011 (1,007 billion HUF) and 13.5% below the 31 December 2012 value (1,130 billion HUF). The LTV ratio applicable for ordinary collateral was 36.3% as of 31 December 2012, lower than the 38.6% LTV as of 31 December 2011.

Portfolio quality

The ratio of non-performing loans continued increasing in the last quarter, however, the growth rate decreased such as in the third quarter. NPL ratio has been growing to 19.5% by 31 December 2012 from 19.1% as of 30 September 2012. Coverage of non-performing loans was 51.6%, showing growth compared to Q3 2012.

In 2012, FHB Group paid special attention to prevent further deterioration of the loan portfolio. This meant, in one hand, actions to boost lending activity, and in other hand, a more intensive collection of claims, and participation in the Government's home protection programs.

After legislative changes in July, the Bank re-evaluated the non-performing portfolio to record real estate collaterals suitable for offering to NET and started to contact to these clients through the branches and call centre. Offering real estates to NET is in progress. Until 31 December 2012 410 properties were offered by the Group for NET. There are 655 loan contracts and HUF 2.5 billion outstanding loan amount in connection with these properties in the books of the Group. From these amounts until the year-end 171 properties were purchased by NET and 260 loan contracts were closed. As the Government accepted the modification of regulation of social conditions of NET program, the range of entitled clients is wider since 1 January 2013.

2. Other assets

Tangible assets amounted to 6.3 billion HUF as of 31 December 2011 and decreased by 338 million HUF year-on-year and by 136 million HUF quarter-on-quarter. As of 31 December 2012, intangibles amounted to 12.8 billion HUF, by 1.4 billion HUF or 10.0% down year-on-year and 252 million HUF (-10.0%) below the 30 September 2012 figure.

Other assets amounted to 27.2 billion HUF as of 31 December 2012, decreasing by 7.9% (2.3 billion HUF). Deferred tax assets reached 6.4 billion HUF. Real estates displayed among inventories contributed to other assets 26.8%.

3. Interest bearing liabilities

Interest bearing liabilities dropped from 683.3 billion HUF as of 31 December 2011 to 633.7 billion HUF as of 31 December 2012, contributing approximately 84.2% to the balance sheet total. The bulk of interest bearing liabilities was contributed by securities issued and deposits from clients.

Interbank funds

As of 31 December 2012, interbank funds amounted to 110.6 billion HUF showing nearly no change compared to previous quarter, but volume became four times higher than a year before containing also 2 years covered loan facility issued by Hungarian National Bank to stimulate corporate lending. Contribution of interbank borrowings to interest bearing liabilities was 17.5% as of 31 December 2012.

CMBs issued

The contribution of covered mortgage bonds to the Bank's interest bearing liabilities was 36.6% as of 31 December 2012. 231.8 billion HUF book value of mortgage bonds as of 31 December 2012 was 31.4% down from figures of 31 December 2011 (338.0 billion HUF). Decrease in the value of the CMB portfolio was 106.1 billion HUF year-on-year.

Data in HUF million	31/12/2011		31/12/2012	
	Book value	Face value	Book value	Face value
Non-listed mortgage bonds				
Fixed interest rate	105,800	105,599	66,038	65,868
Variable interest rate	566,695	566,695	291.29	291.29
Listed mortgage bonds				
Fixed interest rate	166,381	168,763	147,387	147,794
Variable interest rate	54,445	57,698	11,417	12,263
Total	327,193	332,626	225,134	226,216
Accrued interest	10,772	0	6,715	0
Mortgage bonds	337,965	332,626	231,849	226,216
Non-listed bonds				
Fixed interest rate	37,987	38,690	54,158	53,774
Variable interest rate	0	0	5,208	5,162
Subordinated loan				
Subordinated loan	0	0	29,565	29,565
Listed bonds				
Fixed interest rate	54,354	55,870	42,999	44,081
Variable interest rate	5,728	5,740	1,399	1,396
Total	98,069	100,300	133,329	133,979
Accrued interest	2,489	0	5,702	0
Bonds	100,558	100,300	139,031	133,979

Bonds issued

The book value of bonds was 139.0 billion HUF as of 31 December 2012. The year-on-year increase was 38.3% or 38.5 billion HUF.

Deposits

As of 31 December 2012, deposits amounted to 152.2 billion HUF dropping by 5.5% year-on-year, but quarterly no substantial change was realised. Decline ratio of retail and corporate deposits was the same.

Corporate deposit portfolio increased by 8.4% compared to Q3 of 2012. FHB Group's consolidated deposit portfolio is dominated by retail deposits with a contribution of approximately 61.4%. Sight deposits amounted to 42.0 billion HUF, representing 27.6% of deposits.

State loan received

State loan was fully repaid in Q4 2012 according to the contract.

4. *Other liabilities*

Other liabilities amounted to 4.8 billion HUF, within that liabilities generated in conjunction with settlements related to clients amounted to 908.7 million HUF. The Bank reported accounts payable (269.4 million HUF as of 31 December 2012), accruals (403.2 million HUF) and deferred taxes (642.5 million HUF).

5. *Shareholders' equity*

Within one year, shareholders' equity increased by 45.3% to 77.5 billion HUF as of 31 December 2012. In line with IFRS, the Bank reported the EUR 102 million Tier 1 subordinated bond issued in December as part of shareholder's equity, which is the main driver of the growth. Balance sheet profit was -4.6 billion HUF.

Profit & Loss structure

in HUF million	2011	2012	Change 2012/2011
Interest income	78,433	76,670	-2.2%
Interest expense	-56,935	-58,124	2.1%
Net interest income	21,498	18,545	-13.7%
Fee and commission income	3,661	3,795	3.7%
Fee and commission expense	-948	-1,203	27.0%
Net fee and commission income	2,713	2,592	-4.5%
Profit / (Loss) from foreign exchange transactions	2,465	-1,392	-
Change in fair value of financial instruments	2,987	1,339	-55.2%
Gains from securities	3,648	4,802	31.6%
Net trading result	9,100	4,749	-47.8%
Other operating income	1,030	664	-35.6%
Other operating expenses	-2,882	-3,315	15.0%
o/w special banking tax	0	-2,068	-
Other results	-1,852	-2,651	43.2%
Total non-interest income (with net fees)	9,962	4,689	-52.9%
Operating income	31,460	23,235	-26.1%
Credit loss expense	-19,944	-9,756	-51.1%
General and administrative expense	-18,831	-16,893	-10.3%
Profit / (Loss) before tax	-7,314	-3,415	-53.3%
Income tax benefit / (expense)	1,696	-1,050	-
Profit / (Loss) for the year	-5,618	-4,464	-20.5%

The Bank's consolidated loss for the year by IFRS amounted to 4.5 billion HUF in 2012 showing 20.5% improvement compared to 2011. Without the special banking tax, FHB Group's consolidated loss for the year by IFRS would have been 2.4 billion HUF, significantly lower than the adjusted loss in 2011.

1. *Net interest income*

Net interest income was 18.5 billion HUF in 2012, 13.7% down to the result achieved in the reference period. The net figure emerged as a balance of 76.7 billion HUF interest income (2.2% down from the figure of 2011) and 58.1 billion HUF interest expense (2.1% higher than in the same period of 2011). Fall of interest income is due to drop of interest income from loans, and incomes from increasing securities couldn't offset this reduce. Higher interest expenses compared to 2011 were generated by higher interests paid for deposits in H1 and by interest expenses for subordinated bonds in H2.

Decline of interest income in H1 was due to lower interest income from decreasing loan portfolio as a result of fixed-rate final repayments, while in H2 newly applied methods of IFRS estimations had negative impact on it. In 2012, FHB Bank

reviewed the methods of effective interest calculations, modified its estimations for so far accounted effective interest rate based on the remaining cash-flows of loans and considering wider range of initial loan costs. New estimations reduced interest income by 550 million HUF in 2012. Impact of modified cash-flow estimation for 2012 was accounted in December 2012.

Net interest margin on average assets was 2.36% in 2012, 18 basis points less, than a year before.

Distribution of interest income and expenses shows the following table:

	2011	2012	Change 2012/2011
Interest income	100.0%	100.0%	
Loans	39.3%	37.6%	-1.8%-pt
Refinancing	12.1%	10.7%	-1.4%-pt
Mortgage bond interest subsidy	16.6%	13.9%	-2.7%-pt
Supplementary interest subsidy	1.3%	1.2%	-0.1%-pt
Securities and interbank activities	7.3%	15.0%	7.6%-pt
Swap transactions*	23.3%	21.6%	-1.6%-pt
Interest expenses	100.0%	100.0%	
Bonds issued	57.7%	51.2%	-6.5%-pt
Interbank activities	1.9%	12.8%	10.9%-pt
State loan	6.6%	1.7%	-4.9%-pt
Additional interest expenses on state capital	3.1%	0.0%	-3.1%-pt
Customer deposits	11.7%	16.0%	4.3%-pt
Derivatives	18.8%	16.5%	-2.3%-pt
Other interest expense	0.2%	1.8%	1.6%-pt

* IRS, FXS, CCIRS

2. Net fees and commissions

Net fees reached 2.6 billion HUF in 2012, representing a 4.5% decrease compared to 2011. Net fee and commission income was 3,795 million HUF in 2012; 34.1% of this contributed by loans related fees (25.5% in 2011) and 41.9% by accounts and card related banking charges (in 2011: 44.1%). Fee income related to the Strategic Cooperation Agreement with Allianz Insurance Company represented 15.6% of total fee income (16.9% in 2011).

On the expense side (1,203 million HUF), agents' fees contributed 32.4% (in 2011: 30.8%), card related fees were 30.2% (34.3%). Contribution of fees related to bond issues and investment services represented 16.7% and related to bond repurchase and issuance in Q4 2012.

3. Net trading result

In 2012, the net result of financial transactions was 4.8 billion HUF profit, which is 4.4 billion HUF weaker than in the same period of 2011.

Exchange rate volatility in the reported period and the effect of short term currency swaps reduced earnings from FX transactions by 1.4 billion HUF in 2012. The overall achievement was considerably worse than the reference figure (2.5 billion HUF gain).

Changes in the fair value of securities reported at fair value against earnings was 1,339.2 million HUF profit in 2012, as opposed to the 2,987.2 million HUF gains achieved in the reference period of 2011. There was a change in the fair value of derivatives due to the fact that the Bank introduced a new model, which one is able to calculate the hedge effectiveness from July 1, 2012.

In 2012, transactions of securities resulted in 4.8 billion HUF 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.

4. Other income

In 2012, the balance of other operating income and expenditure was 2,651.0 million HUF loss, arising from 664 million HUF income and 3,315 million HUF expense. The balance of other operating income and expenditure was by 799 million HUF worse than the figure achieved in the reference period of 2011.

In 2012, real estate related revenues contributed 41.9% or 278 million HUF to other operating income and 18.2% came from rent of tangible assets. Within other operating expenditures, 395 million HUF was accounted for life annuity payments.

62.4% of other expenditure was contributed by the special banking tax (2,068.3 million HUF). In 2012, amount of special banking tax could be reduced due to losses realised on Home Protection Schemes (release of FX housing loans converted to HUF) and yearly growth of mortgage loans and real estate leasing portfolio.

5. *Operating expenses*

The Bank's operating costs amounted to 16.9 billion HUF, 10.3% less than costs in 2011.

In 2012 CIR was 72.7% (without special banking tax 66.8%) compared to 59.9% in 2011. Weaker figures are because of lower incomes – operating expenses declined year-on-year.

Personnel expenses represented 34.3% of total operating cost, while 36.0% in whole 2011 year. Personnel expenses were 14.5% lower than in 2011.

Contribution of material cost was 46.8% in 2012 and 47.2% in 2011. Volume of material costs was 11.1% less than in 2011 and amounted to 7.9 billion HUF. Within that, administrative expenses contributed to 24.9%, maintenance cost to 32.2%, real estate and other rental fees to 11.9%, experts' fees to 13.4%, advertising and marketing to 6.5%, insurance fees to 2.5%, information related expenses to 2.1% and other costs contributed to 6.6%.

6. *Impairment and loan losses*

In 2011 impairment and loan losses amounted to 9.8 billion HUF, which is less than half of last year data. More than 10 billion HUF decrease is a result of realised and expected losses on fixed-rate final repayments (12.9 billion HUF) accounted last year. Excluding impact of final repayments, risk cost increased by 2.7 billion HUF or 38.7% as a result of deteriorating portfolio quality (especially in H1 2012).

Capital position

Risk-weighted assets (RWA) amounted to 310.9 billion HUF on 31 December 2012 (according to HAS), 2.2% higher than RWA in Q3 2012 and 3.9% lower year-on-year. FHB Group's capital requirement amounted to 33.4 billion HUF as of 31 December 2012.

At the end of Q4 2012, guarantee capital according to IFRS amounted to 94.2 billion HUF and capital adequacy ratio by IFRS was 22.6% (10.4% on 31 December 2011).

Year-end guarantee capital includes both Tier 2 and Tier 1 subordinated bonds issued. In February, with the permission of the HFSA, series of Tier 2 subordinated bonds were repurchased and each of these series was cancelled with an effective date of 21 February 2013. Excluding these capital elements, guarantee capital would have been 64.6 billion HUF, capital adequacy ratio calculated on that basis would have reached 15.5%.

V. POST-BALANCE SHEET DATE EVENTS

From 31 January 2013, Mr László Harmati, CEO of FHB Group resigned from all his positions in all member companies, furthermore his employment as Chief Executive Officer of FHB Mortgage Bank terminated by mutual agreement. From 1 February 2013, the position of the CEO shall be held by the current CEO Mr Gyula Köbli alone. Position of the CEO of FHB Commercial Bank Ltd. shall be provided by Mr Gábor Gergő Soltész, the appointment has been approved by the Hungarian Financial Supervisory Authority. From 4 February 2013, Mr György Walter is employed as the Deputy General Manager of FHB Commercial Bank.

The Moody's Investor Service published on 14 February 2013, that it takes rating actions on 3 Hungarian Banks included the ratings of the FHB Mortgage Bank Co. Plc. The local and foreign currency long terms deposit rating of FHB Mortgage Bank changes from "Ba3/Not-Prime" to "B2/Not-Prime", and the standalone bank financial strength (BFSR) rating of "E+/b1" was downgraded to "E+/b3". All the above ratings remain on negative outlook. According to Moody's, the drivers

of the lower rating were the increasingly weak economic and operating environment in Hungary, even though Moody's affirmed Hungary's government bond rating on 8 February 2013.

On 15 February 2013, Moody's Investor Service announced the change of the rating of the mortgage covered bonds issued by FHB Plc.'s. The rating of the mortgage covered bonds issued by FHB has been changed from „Ba1” to „Ba3”.

With the permission of the Hungarian Financial Supervisory Authority, the Company repurchased in full prior to maturity the following privately issued series of Tier 2 subordinated bonds (alárándelt kölcstöke) on 20 February 2013: FA22ZV01 (ISIN: HU0000350038) HUF - denominated series with a total face value of HUF 15 billion and FA22ZV02 (ISIN: HU0000350046) EUR - denominated series with a total face value of EUR 50 million. Each of these series was cancelled with an effective date of 21 February 2013.

Budapest, 28 March 2013



Dr. Zoltán Spéder
Chairman of the Board of Directors



Köbli Gyula
Chief Executive Officer



FHB Mortgage Bank Public Limited Company

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

For the year ended 31 December 2012

**Consolidated Financial Statements in Accordance with the International Financial Reporting
Standards adopted by the European Union – 31 December 2012**

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GENERAL INFORMATION**Chairman of the Board of Directors**

Dr. Zoltán Spéder

External Members of the Board of Directors

Dr. Christian Riener

István Somkuti

Tamás Vojnits (until December 14, 2012)

Internal Members of the Board of Directors

Gyula Köbli (Chief Executive Officer)

Tamás Foltányi (Banking and IT Deputy Chief Executive Officer)

László Harmati (Business Chief Executive Officer) (until January 31, 2013)

Large Shareholders Liaison Officer and Secretary

Beáta Lendvai

Small Shareholders Liaison Officer

Béla Kappéter

Auditor

Deloitte Ltd.

Seat of the Bank, central office

Budapest.
Üllői út 48.
1082

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 2012, which financial statements comprise the consolidated statement of financial position as at December 31, 2012 – which shows total assets of 752,625 million HUF –, and the related consolidated statement of recognized and consolidated statement of comprehensive income – which shows a net loss for the year of 4,464 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, 2012, 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 Matters

The consolidated financial statements of the Bank for the year ended December 31, 2011 has been audited by a different auditor, who issued unqualified opinion related to those consolidated financial statements as at March 29, 2012.

Other Reporting Obligation: Report on the Consolidated Business Report

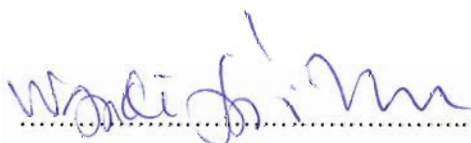
We have examined the accompanying consolidated business report of FHB Mortgage Bank Plc. for the year 2012.

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.

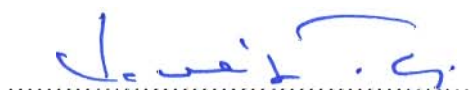
In our opinion, the consolidated business report of FHB Mortgage Bank Plc. for the year 2012. corresponds to the figures included in the consolidated financial statements of FHB Mortgage Bank Plc. for the year 2012.

Budapest, March 28, 2013



Nagyváradiné Szépfalvi Zsuzsanna

Deloitte Auditing and Consulting Ltd.
1068 Budapest, Dózsa György út 84/C.
000083



Horváth Tamás

registered statutory auditor
003449

Consolidated Statement of Recognized Income for the year ended 31 December 2012

	Notes	2012	2011
Interest income	4	76,670	78,433
Interest expense	4	(58,124)	(56,935)
Net interest income		18,546	21,498
Fee and commission income	5	3,795	3,661
Fee and commission expense	5	(1,203)	(948)
Net fee and commission income		2,592	2,713
(Loss)/Profit from foreign exchange transactions		(1,392)	2,465
Change in fair value of financial instruments	38	1,339	2,987
Gains from securities		4,801	3,648
Net trading result		4,748	9,100
Other operating income	6	664	1,030
Other operating expense	7	(3,315)	(2,881)
Operating income, net		23,235	31,460
Provision for impairment on loan losses	19	(9,756)	(19,944)
General and administrative expense	8	(16,893)	(18,830)
Loss before tax		(3,414)	(7,314)
Income tax (expense)/benefit	11	(1,050)	1,696
Loss for the year		(4,464)	(5,618)
Attributable to: loss of shareholders of the Bank		(4,464)	(5,618)
Earnings per share (HUF 100 face value)	34		
<i>Basic earnings per share (HUF)</i>		(70.45)	(85.21)
<i>Diluted earnings per share (HUF)</i>		(70.45)	(85.21)

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 Comprehensive Income for the year ended 31 December 2012

	Notes	2012	2011
Loss for the year		(4,464)	(5,618)
Other comprehensive income			
Change in Cash-flow hedge reserve		(249)	131
Change in fair value of financial assets available-for-sale		(3)	(62)
Foreign currency translation reserve		10	1
Deferred tax effect for other comprehensive income		48	7
Other comprehensive (loss)/income for the period net of taxes	12	(194)	77
Total comprehensive loss for the year, net of income taxes		(4,658)	(5,541)
Attributable to: loss of shareholders of the Bank		(4,658)	(5,541)

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 2012

	Notes	31 December 2012	31 December 2011
Assets			
Cash on hand		2,164	2,554
Balances with the National Bank of Hungary	13	5,117	8,707
Due from banks	14	28,864	56,338
Securities held for trading	15	7,815	1,832
Financial assets available-for-sale	16	158,848	85,891
Derivative financial assets	38	4,344	2,695
Refinanced mortgage loans	18	164,990	226,890
Loans and advances to customers	19	334,583	381,227
Investment property	21	11,463	11,311
Tangible assets	22	5,961	6,300
Goodwill and other intangible assets	20,23	12,753	14,174
Deferred tax asset	11	6,396	6,345
Other assets	24	9,327	11,850
Total assets		752,625	816,114

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 2012

	Notes	31 December 2012	31 December 2011
Liabilities			
Due to banks	25	92,781	20,992
Deposits from customers	28	152,206	161,105
Derivative financial liabilities	38	23,184	60,511
State loans	29	-	62,694
Issued securities	26	283,807	341,181
Financial liabilities at fair value through profit or loss, except derivatives	27	104,888	97,342
Finance lease liabilities	30	11,029	10,060
Reserve for annuity payments	31	2,410	2,265
Current tax liability		42	6
Deferred tax liability	11	643	710
Provisions	32	173	267
Other liabilities	33	3,922	5,600
Total liabilities		675,085	762,733
Shareholders' equity			
Share capital	34	6,600	6,600
Treasury shares	34	(29)	(29)
Retained earnings		40,341	44,986
Other reserves	34	30,628	1,824
Total shareholders' equity		77,540	53,381
Total liabilities and shareholders' equity		752,625	816,114

Budapest, 28 March 2013


Gyula Köbli
 CEO


Tamás Foltányi
 Deputy-CEO

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 2012

	2012	2011
Cash flow from operating activities		
Loss for the year	(4,464)	(5,618)
Non-cash adjustments to net profit from:		
Depreciation and amortization (Note 22,23)	2,496	2,454
Decrease in fair value of Investment property	80	106
Revaluation of investment properties	(60)	(46)
Provision for losses	(1,779)	15,204
Gain on tangible assets derecognized	29	1,411
Loss on intangible assets derecognized	-	(2,332)
Share-based payment reserve (Note 35)	(106)	(135)
Expenses related to share-base payment (Note 35)	-	163
Capitalized interest on loans and advanced to customers	(993)	(1,672)
Fair value adjustment of derivatives (Note 38)	(39,177)	(831)
Fair value adjustment on financial liabilities through profit or loss, except derivatives	1,329	9,433
Change in annuity reserve	540	263
Change in foreign currency translation reserve	11	1
Impairment of goodwill and intangible assets	-	1,126
Operating loss before change in operating assets	(42,094)	19,526
Decrease/(Increase) in operating assets:		
Securities held for trading	(5,983)	2,926
Financial assets available-for-sale	(72,960)	17,362
Refinanced mortgage loans	61,900	33,430
Loans and advances to customers	49,322	1,552
Other assets	2,473	(6,999)
Increase/(Decrease) in operating liabilities:		
Deposits from customers	(8,899)	48,365
Due to banks	90,389	(1,149)
Other liabilities	(1,708)	868
Net cash flow from operating activities	72,440	115,881

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 2012- continued

	2012	2011
Cash flow from investing activities		
Proceeds from sales of tangible assets	33	60
Purchase of tangible and intangible assets	(800)	(1,260)
Purchase of investment property	(313)	(10)
Sale of investment property	141	65
Paid from reserves on life annuity business	(395)	(377)
Net cash flow from disposal of subsidiaries (Note 17)	-	(6)
Net cash outflow from investing activities	(1,334)	(1,528)
Cash flow from financing activities		
Proceed from issued securities	125,221	26,201
Principal repayment on issued securities	(193,992)	(94,919)
Treasury shares purchased	-	(69)
Repayment of long term loans	(63,900)	(50,168)
Long term loan borrowings	219	233
Finance lease liabilities repayment	969	(4,140)
Issue of Capital Securities (additional tier 1 capital)	28,923	-
Net cash outflow from financing activity	(102,560)	(122,862)
Net decrease in cash and cash equivalents	(31,454)	(8,508)
Opening balance of cash and cash equivalents	67,599	76,107
Closing balance of cash and cash equivalents	36,145	67,599
Breakdown of cash and cash equivalents:		
Cash on hand	2,164	2,554
Balances with the National Bank of Hungary	5,117	8,707
Due from banks with a maturity of less than 90 days	28,864	56,585
Closing balance of cash and cash equivalents	36,145	67,599
<i>Supplementary data</i>		
<i>Income tax paid</i>	(1,429)	(1,245)
<i>Interest received</i>	76,639	76,322
<i>Interest paid</i>	(55,426)	(55,911)

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 Changes in Equity for the year ended 31 December 2012

	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	Shareholder's equity
1 January 2011		6,600	(123)	1,709	-	101	241	-	(187)	19	50,604	58,964
Loss for the year											(5,618)	(5,618)
Other comprehensive income						100			(25)	1		76
Purchase/(Sale) of treasury shares			94									94
Share-based payment							(161)					(161)
Change in share –based payment reserve							26					26
31 December 2011		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)
31 December 2012		6,600	(29)	1,709	181	-	-	28,923	(216)	31	40,341	77, 540

All figures in tables are in HUF million except otherwise noted

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

Notes to the Consolidated Financial Statements**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.

On 31 March 2009 – because of the severe liquidity problems on capital markets - the Bank was granted a state loan of EUR 400 million with the aim to ensure the availability of mortgage loans for retail customers.

All figures in tables are in HUF million except otherwise noted

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

Notes to the Consolidated Financial Statements

In April and June 2009 the Bank increased the Group by the acquisition of Central European Credit Ltd. (CEC, renamed to FHB Ingatlanlizing 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.

To strengthen its capital position FHB Mortgage Bank issued subordinated bonds during private placement subscriptions two times in 2012. The subordinated bonds issued in June 2012 with face value amounted to HUF 15 billion and EUR 50 million can be treated as incremental capital but the subordinated bonds issued in December 2012 with face value amounted to EUR 102 million can be treated as additional tier 1 capital (Capital Securities). After the successful bonds issue in December the subordinated bonds issued in June have been redeemed and withdrawn in February 2013 with the permission of the Hungarian Financial Supervisory Authority.

The consolidated financial statements for the year ended 31 December 2012 were authorized for issue in accordance with a resolution of the Board of Directors on 28 March 2013. 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).

Notes to the Consolidated Financial Statements

2.2. Change in accounting policies

The effect of adopting new and revised International Financial Reporting Standards effective from 1 January 2012

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

- **IFRS 7 (Amendment) “Financial Instruments: Disclosures”** - Transfers of Financial Assets, adopted by the EU on 22 November 2011 (effective for annual periods beginning on or after 1 July 2011).

The adoption of the above presented Amendments and new Standards and Interpretations had no significant impact on the financial statements.

Amendments and new Standards and Interpretations to IFRS effective on or after 1 January 2013, 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:

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

All figures in tables are in HUF million except otherwise noted

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

Notes to the Consolidated Financial Statements

- **IFRS 7 (Amendment) “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),
- **IAS 1 (Amendment) “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),
- **IAS 12 (Amendment) “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),
- **IAS 19 (Amendment) “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),
- **IAS 32 (Amendment) “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),
- **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 the above presented Amendments and new Standards and Interpretations would have no significant impact on the financial statements.

Amendments and new Standards and Interpretations to IFRS effective on or after 1 January 2013, which are not yet endorsed by EU, not yet adopted

- **IFRS 9 “Financial Instruments”** (effective for annual periods beginning on or after 1 January 2015),
- **IFRS 9 (Amendment) “Financial Instruments” and IFRS 7 (Amendment) “Financial Instruments: Disclosures”** – Mandatory Effective Date and Transition Disclosures,
- **IFRS 10 (Amendment) “Consolidated Financial Statements”, IFRS 11 (Amendment) “Joint Arrangements” and IFRS 12 (Amendment) “Disclosures of Interests in Other Entities”** - Transition Guidance (effective for annual periods beginning on or after 1 January 2013),
- **IFRS 10 (Amendment) “Consolidated Financial Statements”, IFRS 12 (Amendment) “Disclosures of Interests in Other Entities” and IAS 27 (Amendment) “Separate Financial Statements”** - Investment Entities (effective for annual periods beginning on or after 1 January 2014),
- **Amendments to various standards “Improvements to IFRSs (2012)”** resulting from the annual improvement project of IFRS published on 17 May 2012 (IFRS 1, IAS 1, IAS 16, IAS 32, IAS 34) primarily with a view to removing inconsistencies and clarifying wording (amendments are to be applied for annual periods beginning on or after 1 January 2013).

Notes to the Consolidated Financial Statements

The adoption of the above presented Amendments and new Standards and Interpretations would have no significant impact on the financial statements, except of the application of IFRS 9 and IFRS 10 which might have significant impact on the Group consolidated financial statements the Group will analyse the impact after the adoption of the standards by EU. The Bank plans to adopt the standards and interpretations when they become effective.

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 2012.

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 2010 the Bank had eleven (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). On 1 April 2011 Allianz Bank Ltd. was merged into the FHB Commercial Bank Ltd. FHB Services Ltd. was sold on 30th November 2011, Portfolio Money FBK Ltd. was sold on 30th September 2011. The Consolidated Statement of Recognized Income contains their profit or loss before their sale but they are not presented in the Consolidated Statement of Financial Position as at 31st December 2011. During 2011 the Group founded two new Companies: Kary-villa Real Estate Investment Ltd. and "Wodomus 54" Real Estate Ltd. The parent company of them is FHB Life Annuity and Real Estate Investment Ltd. The list of the subsidiaries of the Bank as at 31st December 2012 is the following:

Notes to the Consolidated Financial Statements

Companies included in the consolidation	Shareholder	Core business
FHB Commercial Bank Ltd.	FHB Mortgage Bank Plc. 100%	Universal banking services
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
FHB Life Annuity and Real Estate Investment Ltd.	FHB Mortgage Bank Plc. 100%	Annuity products to senior clients
FHB Ingatlanlízing Ltd. (earlier Central European Credit Ingatlanhitel Ltd.)	FHB Life Annuity and Real Estate Investment Ltd. 100%	Lending and leasing
Central European Credit d.d. (Croatia)	FHB Ingatlanlízing Ltd. 100%	Lending
Central European Leasing d.d. (Croatia)	FHB Ingatlanlízing Ltd. 100%	Leasing until September 18, 2012 (final liquidation)
FHB DWH Ltd.	FHB Ingatlanlízing Ltd. 100 %	Financial advisory on lending, insurance and investment products
Hitelunió Ltd.	FHB DWH Ltd. 100 %	Financial advisory and intermediary services
Kary-villa Real Estate Investment Ltd.	FHB Real Estate Ltd. 100%	Sale of own properties
"Wodomus 54" Real Estate Investment Ltd.	FHB Real Estate Ltd. 100%	Sale of own properties

2.5 Rounding

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

2.6 Summary of significant accounting policies

a) Categories of financial instruments

The Bank groups the recognised financial assets as follows:

- Cash and cash equivalents
- Financial assets at fair value through profit or loss:
 - Securities held for trading financial assets
 - Derivatives classified as held for trading

Notes to the Consolidated Financial Statements

- 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

Notes to the Consolidated Financial Statements

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 assets 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). 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 problem-free 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 leasing 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

Notes to the Consolidated Financial Statements

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.

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

Notes to the Consolidated Financial Statements

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.

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 Real Estate Investment Ltd. undertakes maintenance of such investment properties until the time of their sale.

Investment properties are initially reported at cost, transaction costs are reported initially in profit or loss. 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%

All figures in tables are in HUF million except otherwise noted

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

Notes to the Consolidated Financial Statements

Intangible assets have a definite useful life.

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.

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 income'.

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.

Notes to the Consolidated Financial Statements

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) Accrued interest in Interest income or interest expense
- (b) Accrued foreign exchange difference in Gains 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

Notes to the Consolidated Financial Statements

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:
 - o to deliver cash or another financial asset to another entity; or
 - o 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:
 - o 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
 - o 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;

Notes to the Consolidated Financial Statements

- 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 and not classified as the hedged item in hedging). 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

Notes to the Consolidated Financial Statements

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 EIR.

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 expected future liabilities 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

Notes to the Consolidated Financial Statements

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 s/he wants the share option; in other respects, s/he has no right to decision. The preferential price is 25% of the face value of the shares.

Regarding the share-based payments for 2011 in 2012 another rule prevails. 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 he/she shall be entitled to draw maximum 60% of the option, and one year after the first drawing, he/she shall be entitled to draw maximum 20%, and after another year, he/she 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.

Notes to the Consolidated Financial Statements

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 1st of 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.

Notes to the Consolidated Financial Statements

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) Offset

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 the Hungarian forint (HUF).

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 National Bank of Hungary rate on the balance sheet date. Items of the profit or loss statement are converted at the annual weighted National Bank of Hungary rate. The currency difference is reported in other comprehensive income. The currency difference is released from other comprehensive income and transferred to profit or loss when the foreign company is dissolved or sold.

Notes to the Consolidated Financial Statements

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” that is applicable for financial institutions for 2010-2012. 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 29th 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 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.

Notes to the Consolidated Financial Statements

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.

Notes to the Consolidated Financial Statements

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 2011 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

From 29 September 2011 till 29 February 2012 Act LXXV of 2011 authorized retail clients to apply for final repayment regarding their outstanding FX denominated mortgage loans or real estate leasing at discount rates of 180 HUF/CHF, 250 HUF/EUR and 2 HUF/JPY respectively. By the deadline of the application (31 December 2011) 12,880 clients of FHB Group expressed their intention for final repayment, from this 7,384 were settled, 3,944 in 2012.

The final repayment of the loans denominated in foreign currency had no additional impairment effect on the results in 2012 because the Bank charged some impairment due to the expected losses in 2011 however the outstanding loan amount decreased by more than HUF 27 billion compared to the closing amount at the year-end 2011, so there is indirect negative effect on the interest income.

In early March 2012 the Government and the Hungarian Banking Association reached an agreement on the renewal of the 'protection for the loans denominated in foreign currencies' 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.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. Under the specified terms, one of the conditions for eligibility is that the loan should not be higher than HUF 20 million. Application for the buffer account loan

All figures in tables are in HUF million except otherwise noted

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

Notes to the Consolidated Financial Statements

scheme is open from 1 April 2012 until 29 March 2013 (instead of the previously accepted 31 December 2012).

Until 31 December 2012 7,665 clients represented their intention to participate in the 'exchange rate protection program' which is 40% of the entitled persons based on the legal conditions. From this amount 4,251 clients signed the contracts until the year-end.

Also the December 2011 agreement between the State and the Banking Association, the Act LXXV. of 2011 on the fixation of the exchange rate of the instalments of the loans denominated in foreign currencies and the rules for the forced sale of properties and its modification the Act XVI of 2012 provide details about the conditions of the conversion into HUF and the release of the receivables. Criteria for the participation in the program:

- the loan denominated in foreign currencies was not converted into HUF previously
- the market value of the property or properties which served as collaterals when the loan was provided (and were burden with mortgage based on the loan contracts) does not exceed HUF 20 million
- the collateral property or at least a part of it is a residential property
- on 30 September 2011 at least HUF 78,000 from the loan amount is in arrears more than 90 days and this delay is still continuous
- there is no foreclosure procedure recorded in the property register related to the property or properties burdened with mortgage based on the loan contracts and
- the debtor needs to declare in writing to the Bank until 15 May 2012 that the reason for the delay was the significant, certifiable declension in his/her liquidity.

If all of the above mentioned criteria are met the Bank needed to convert the loan into HUF and release 25% of the outstanding liability. Based on the legislation the conversion rate was HUF/EUR 298.55 and HUF/CHF 248.55 (the average of the exchange rates of the National Bank of Hungary in the period between 15 May 2012 and 15 June 2012).

In August 2012 440 loan with the outstanding amount more than HUF 2,6 billion was converted into HUF. Due to the fact that these loans were already impaired and there is a possibility to decrease the bank tax due to the released loan amounts the effect of the conversion into HUF and the release of the receivables was not significant.

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.

Notes to the Consolidated Financial Statements

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.

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 2012 410 properties were offered by the Group for the Hungarian Property Management Ltd. There are 655 loan contracts and HUF 2.5 billion outstanding loan amount in connection with these properties in the books of the Group. From these amounts until the year-end 171 properties were purchased by the Hungarian Property Management Ltd. and 260 loan contracts were closed. Due to the fact that these loans were already impaired the sale of these properties to the Hungarian Property Management Ltd. has no significant effect on the result but the participation in this program is very preferential regarding the non-performing loan portfolio.

According to the Act CXVI of 2012 adopted in July the Group began the preparation for the tasks regarding the introduction of the new levy on financial transactions from 1 January 2013. Based on the promulgated text of law the notice about the changes in the fees was published by the Bank at 31 October 2012. After the parliamentary adoption of the amendment of the Act CXIV of 2012 and the deliberation of the effects of the changes this notice was modified effective from 1 February 2013. Within the legislative framework the Bank, considering its business interest and its competitive position, devolves the additional costs because of the levy on financial transactions to the clients.

In addition to the mentioned events, the unfavourable macroeconomic environment, especially; the volatility of forint, as well as the narrowing markets, particularly in retail mortgage lending, also affected the performance in 2012.

Notes to the Consolidated Financial Statements**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 cashflows 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.

Notes to the Consolidated Financial Statements
4. INTEREST AND SIMILAR INCOME AND EXPENSE

	2012	2011
<i>Interest income</i>		
Loans and advances to customers	34,035	37,163
Refinanced mortgage loans	14,567	17,251
Due from banks	652	1,192
<i>Interest income on assets carried at amortised cost</i>	49,254	55,606
Securities held for trading	471	46
Financial assets available-for-sale	10,350	4,522
Interest on derivative transactions	16,595	18,259
<i>Interest income on assets carried at fair value</i>	27,416	22,827
Total	76,670	78,433

Accrued interest receivable on impaired loans amounted to HUF 859 million (2011: HUF 764 million).

	2012	2011
<i>Interest expense</i>		
Mortgage bonds	14,659	21,674
Due to banks	6,598	1,106
Interest paid on deposits	9,299	6,645
Interest on bonds	7,135	3,440
Interest on state loans	976	5,502
Interest expense on leases	1,045	117
<i>Interest expense on liabilities carried at amortised cost</i>	39,712	38,484
Interest on derivative transactions	9,597	10,730
Mortgage bonds	5,041	3,093
Due to banks	853	-
Interest on bonds	2,921	4,628
<i>Interest expense on liabilities carried at fair value</i>	18,412	18,451
Total	58,124	56,935

The interest income from loans and refinanced mortgage loans includes HUF 10,659 million interest subsidy in 2012 (2011: HUF 13,000 million).

Notes to the Consolidated Financial Statements
5. FEE AND COMMISSION INCOME AND EXPENSE

	2012	2011
Fee and commission income		
Mortgage loans of the Bank	559	388
Refinanced mortgage loans	606	687
Handling commission	177	213
Real estate appraisal fee	71	97
Deposit business	943	844
Agency fee income	591	617
Card business	549	589
Other	299	226
Total	3,795	3,661

	2012	2011
Fee and commission expense		
Investment services	297	17
Agency fees and commissions	371	350
Card business	361	415
Payment transaction fee	-	20
Other	174	146
Total	1,203	948

6. OTHER OPERATING INCOME

	2012	2011
Book value of the investment properties	278	-
Change in annuity reserve (Note 31)	-	109
Income from sold property	-	60
Income from agent activity	-	221
Income from damages compensations received	19	22
Rental income on property	121	119
Invoiced expenses and services	66	107
Reversal of provision	160	216
Other	20	176
Total	664	1,030

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

Notes to the Consolidated Financial Statements
7. OTHER OPERATING EXPENSE

	2012	2011
Bank tax (detailed in Note 7 below)	2,068	-
Annuity payments	395	377
Impairment of goodwill and intangible assets	-	1,126
Impairment of leasehold investment / improvement / assets	56	639
Provision for expected costs	25	8
Change in annuity reserve (Note 31)	151	-
Change in the effect of the recognition of the fair value of the investment property	146	60
Compensation	-	92
Sold tangibles	25	35
Sold inventory	38	-
Donation	55	176
Tax penalty, late penalty	115	5
Supervisory and other fees	93	65
Decrease of the income from bargain purchase	-	53
Write off of the leased assets	10	85
Other	138	160
Total	3,315	2,881

The amount of Bank tax booked for 2012 by group members is detailed in the following table:

	2012
FHB Mortgage Bank Plc.	1,777
FHB Commercial Bank Ltd.	267
FHB Ingatlanlizing Ltd.	24
Total	2,068

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.

Pursuant to Act LIX of 2006 on the Special Banking Tax and Contribution Intended to Improve the Balance of Public Finances modified in accordance with the agreement between the Government and the Hungarian Banking Association signed in December 2011, 30% of the losses from final repayments can be deducted

Notes to the Consolidated Financial Statements

from the special banking tax; consequently, the Group reclaimed in 2011 the entire amount of special banking tax accounted in Q1 of 2011 (for the whole year).

8. GENERAL AND ADMINISTRATIVE EXPENSES

	Note	2012	2011
Staff costs	9	5,795	6,781
Marketing and advertising		511	812
General and administrative costs		2,058	2,833
Rent	10	940	1,331
Depreciation	22	515	585
Amortisation	23	1,982	1,869
Consultancy fees		1,056	1,232
Maintenance costs		2,544	1,830
Other taxes		691	700
Insurance fees		199	237
Database system usage		168	150
Other		434	470
Total		16,893	18,830

9. STAFF COSTS

	2012	2011
Wages and salaries	4,229	4,634
Social security contribution	1,296	1,425
Other personnel related payments	376	696
Share option	(106)	26
Total	5,795	6,781

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 867 (2011: 875).

Notes to the Consolidated Financial Statements
10. RENT (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 2012	31 December 2011
	Minimum lease payments	Minimum lease payments
Within 12 month	848	941
Between 1 and 5 years	1,640	2,415
Over 5 years	869	1,011
Total	3,357	4,367

	Minimum lease payments	Contingent rents	Sublease payments	Total
Expense in the period 2012	853	92	(6)	939
Expense in the period 2011	1,183	152	(4)	1,331

11. INCOME TAX

	31 December 2012	31 December 2011
Current income tax	1,127	1,083
Corporate income tax	138	1
Local business tax	858	948
Innovation contribution	131	134
Deferred tax expense/(benefit)	(77)	(2,779)
Total	1,050	(1,696)

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

Notes to the Consolidated Financial Statements

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 2011 and 2012.

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. Without the one-off expenses (impairment regarding the final repayment of loans in foreign currency) the 2011 result of the Group would be also a profit. Based on the assumption the recognition of the deferred tax benefits is reasonable.

	31 December 2012	31 December 2011
Loss before tax	(3,414)	(7,314)
Calculated corporate income tax (19%)	(649)	(1,390)
Local business tax and innovation contribution	990	1,083
Effect of local business tax and innovation contribution to the corporate income tax	(188)	(206)
Items modifying the Hungarian tax base	92	(349)
Subsidiaries' tax losses not to be carried forward	328	541
Reversal of general risk provision	502	-
Effect of tax rate change	-	(1,227)
Effect of other modifications	(25)	(98)
Total income tax expense/(benefit)	1,050	(1,696)

All figures in tables are in HUF million except otherwise noted

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

Notes to the Consolidated Financial Statements

Deferred tax position

	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 subsidiaries (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

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

Notes to the Consolidated Financial Statements

	31 December 2011					
	Deferred tax assets	Deferred tax liabilities	Deferred tax net position	Allianz opening balance	Income statement effect	Deferred tax position in reserves
Depreciation difference from consolidation	-	-	-	-	10	-
Disbursement fee	(52)	-	(52)	-	22	-
Share-based payment	20	-	20	-	(14)	-
Revaluation of annuity related investment property	-	(995)	(995)	-	462	-
Annuity costs	-	289	289	-	191	-
Derivatives at fair value	(430)	-	(430)	-	(797)	-
Impairment	(943)	-	(944)	-	(483)	-
Suspended interest	(640)	-	(640)	-	(405)	-
Cash flow hedge	(41)	-	(41)	-	17	(47)
Acquisition	(114)	-	(115)	(5)	1,054	-
State loan	4	-	4	-	12	-
Tax loss carried forward	9,067	-	9,067	165	4,134	-
Effect of consolidation	(654)	-	(654)	(2)	(676)	-
AFS securities	66	-	66	-	170	55
Finance leases	5	-	5	-	5	-
Deferred tax of foreign subsidiaries (CEC d.d.)	55	-	55	-	-	-
Net deferred tax position	6,345	(710)	5,635	158	2,779	(8)

All figures in tables are in HUF million except otherwise noted

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

Notes to the Consolidated Financial Statements
12. OTHER COMPREHENSIVE INCOME
Components of other comprehensive income

	31 December 2012	31 December 2011
Other comprehensive income		
Cash-flow hedge reserve	(249)	131
including: change in fair value	(249)	129
including: reclassification to profit	-	2
Financial investment available-for-sale	(3)	(62)
including: change in fair value	96	116
including: reclassification to profit or loss	(99)	(178)
Foreign currency translation	10	1
Deferred tax effect	48	7
Total	(194)	77

Deferred tax effects relating to comprehensive income

	31 December 2012			31 December 2011		
	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)	131	(30)	101
Financial assets available-for-sale	(3)	2	(1)	(62)	37	(25)
Foreign currency translation	10	(1)	9	1	-	1
Total	(242)	48	(194)	70	7	77

All figures in tables are in HUF million except otherwise noted

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

Notes to the Consolidated Financial Statements
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 2012 and 2011.

	31 December 2012	31 December 2011
Short term deposits	2,498	7,700
Nostro account at National Bank of Hungary	2,600	983
Accrued interest for the period	19	24
Total	5,117	8,707

14. DUE FROM BANKS

	31 December 2012	31 December 2011
Nostro accounts	1,629	1,750
Term deposits	27,225	54,557
Accrued interest for the period	10	31
Total	28,864	56,338

15. SECURITIES HELD FOR TRADING

	31 December 2012	31 December 2011
Hungarian Government bonds	3,203	1,580
Hungarian Treasury bills	1,120	-
Hungarian Development Bank bonds	1,058	-
Mortgage bonds	-	252
Student Loan Centre Ltd bond	683	-
Company bonds issued by MOL Plc.	1,751	-
Total	7,815	1,832

All figures in tables are in HUF million except otherwise noted

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

Notes to the Consolidated Financial Statements
16. FINANCIAL ASSETS AVAILABLE-FOR-SALE

	31 December 2012	31 December 2011
Hungarian Government bonds	28,853	517
Hungarian Discount Treasury bills	31,477	6,694
National Bank of Hungary bonds	71,939	73,899
Mortgage bonds	23,971	887
Investment funds	351	-
Foreign bank bonds	1,470	2,565
Equity investments	787	1,329
Total	158,848	85,891

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. As of 31 December 2011 the aggregate nominal value of mortgage bonds available-for-sale under these transactions was HUF 3,111 million.

Equity investments include shares of BIF Ltd. for HUF 752 million (2011: HUF 1,294 million), shares of Garantiqa Creditguarantee Ltd. for HUF 30 million (2011: HUF 30 million) as well as SWIFT and VISA shares (2012: HUF 5 million; 2011: HUF 5 million). The investment in BIF Ltd represents 10% stake, the other investments represent less than 1% stake in the companies.

17. SALE AND PURCHASE OF SUBSIDIARIES
Sale of subsidiaries

During 2011 two subsidiaries (FHB Services Ltd. and Portfolio Money FBK Ltd.) were sold to buyers outside of the Group.

The sale of Portfolio Money FBK Ltd. concluded at 30 September 2011. The sale caused the following cash movements from Group point of view:

	Net book value 30 September 2011
<i>Assets</i>	
Due from banks	5
Other assets	2
<i>Liabilities</i>	
Other liabilities	-
Net assets	7

All figures in tables are in HUF million except otherwise noted

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

Notes to the Consolidated Financial Statements

	Net book value 30 September 2011
Consideration received	-
from this amount: cash	-
from this amount: securities	-
Cash outflow	
Received cash	-
Cash given	5
Net cash outflow	(5)

FHB Services Ltd. was sold at 30 November 2011 to a buyer outside the Group and the new owner changed the name of the company to EXO-BIT Ltd. The sale caused the following cash movements from Group point of view:

	Net book value 30 November 2011
<i>Assets</i>	
Due from banks	1
Loans	1
Tangible assets	252
Intangible assets	12,078
Other assets	177
<i>Liabilities</i>	
Due to banks	10,327
Income tax liability	5
Other liabilities	706
Net assets	1,470
Consideration received	1,470
from this amount: cash	-
from this amount: securities	1,470
Cash outflow	
Received cash	-
Cash given	1
Net cash outflow	(1)

The price of FHB Services Ltd. was based on its net asset as of 30 November 2011, which included its loss for 11 months in 2011 (HUF 2,197 million), therefore the Group accounted for no result on the sale.

During 2012 no subsidiaries were sold.

Notes to the Consolidated Financial Statements
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 2012 includes loans disbursed to 56,376 individual retail customers (2011: 65,462). The refinanced mortgage loans are provided to eight partner institutions.

19. LOANS AND ADVANCES TO CUSTOMERS

	31 December 2012	31 December 2011
Housing loans	148,661	178,377
General purchase mortgage loans	136,239	159,068
Customer loans and overdrafts	6,348	7,728
Loans to employees	1,935	2,244
Finance lease to retail customers	2,793	2,753
Finance lease to companies	927	851
Loans to companies	67,962	62,450
Other loans	-	54
Loans gross subtotal	364,865	413,525
Fair value adjustment of hedged items	(223)	-
Accrued interest	7,871	5,881
Amortized origination cost	(582)	854
Loans gross total	371,931	420,260
Loan impairment	(37,348)	(39,033)
Loan portfolio reported	334,583	381,227

Loan impairment based on individual rating: HUF 13,507 million (2011: HUF 12,837 million), based on portfolio rating: HUF 23,903 million (2011: HUF 26,196 million).

Notes to the Consolidated Financial Statements
Changes in impairment for credit losses:

	31 December 2012	31 December 2011
Impairment as at 1 January	39,033	23,178
Provision for impairment in the period	13,854	26,446
Exchange rate change of impairment	(1,905)	3,132
Reverse of impairment for the period	(13,214)	(12,005)
Derecognition due to sale of assets	(420)	(1,718)
Impairment as at end of period	37,348	39,033
Breakdown of the credit loss expense for the period		
Change of impairment in the period (without the impairment regarding the repayment of the loans at a fixed rate)	641	7,785
Impairment on the repayment of the loans at a fixed rate	-	6,658*
Losses from the repayment of the loans at a fixed rate	7,048	5,948**
Losses from the conversion of the foreign currency mortgage loans	711	-
Written-off loans	381	87
(Profit)/Loss on loans sold	875	(205)
Loss on terminated loans	(7)	144
Charge/(release) for commitments	107	(473)
Credit losses on loans and advances	9,756	19,944

* This expense was realised in January and February 2012

** This expense was realised in December 2011

The aggregate amount of non-performing loans was HUF 72,912 million as of 31 December 2012 (31 December 2011: HUF 59,574 million).

Within the total balance of mortgage loans 98.63% have maturity over five years (2011: 97.7%), 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 2012, loan to value is 40.7% (31 December 2011: 44.87%).

Notes to the Consolidated Financial Statements
Finance Lease

	31 December 2012	31 December 2011
Gross investment in the lease	6,057	5,611
Minimum lease payments	6,057	5,611
Unguaranteed residual value	-	-
Net investment in the lease	3,689	3,128
Unearned finance income	2,368	2,483
Impairment on finance leases	(379)	(476)

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 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

The minimum lease payments receivable at 31 December 2011 for the following periods

	Within 12 month	Between 1 and 5 years	Over 5 years
Gross investment in the lease	380	1,496	4,209
Net investment in the lease	160	714	2,729
Unearned finance income	220	782	1,480

20. GOODWILL

	31 December 2012	31 December 2011
Gross value		
Opening balance	-	257
Increase	-	-
Purchased through acquisition	-	-
Decrease	-	-
Closing balance	-	257
Impairment		
Opening balance	-	250
Increase	-	7
Closing balance	-	257
Net value	-	-

The goodwill and the impairment attributable to POMO Group was written off in 2011.

All figures in tables are in HUF million except otherwise noted

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

Notes to the Consolidated Financial Statements
21. INVESTMENT PROPERTY

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

	31 December 2012	31 December 2011
Gross value		
Opening balance	6,062	6,071
Increase	592	69
Decrease	(360)	(78)
Closing balance	6,294	6,062
Revaluation adjustment		
Opening balance	5,249	5,355
Increase	135	92
Decrease	(215)	(197)
Closing balance	5,169	5,249
Net value	11,463	11,311

The methods and significant assumptions applied in determining the fair value of investment properties were supported by market evidence. The investment properties were revalued by relevant professional experts at December 31, 2012 according to this valuation does not need additional fair value modification on the investment properties (Note 2.7).

The following direct operating expenses were recognized from investment properties that do not generate rental income during 2012 and 2011, respectively:

	31 December 2012	31 December 2011
General and administrative expense		
• fee of property valuation	(3)	-
• general and administrative expenses	2	2
• maintenance expenses	19	13
• insurance fees	6	6
• information expenses	(1)	-
• other	1	1
Total	24	22

All figures in tables are in HUF million except otherwise noted

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

Notes to the Consolidated Financial Statements
22. 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

TANGIBLE ASSETS 31 December 2011

	Property and Leasehold improvement	Office equipment	Total
Gross value			
Opening balance	5,547	4,431	9,978
Increase	664	1,455	2,119
Decrease	(42)	(1,645)	(1,686)
Closing balance	6,169	4,241	10,411
Depreciation			
Opening balance	814	2,752	3,566
Annual depreciation	179	406	585
Decrease	(150)	(348)	(498)
Closing balance	843	2,810	3,653
Impairment			
Opening balance	446	-	446
Increase	1	11	12
Closing balance	447	11	458
Net value	4,879	1,421	6,300

All figures in tables are in HUF million except otherwise noted

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

Notes to the Consolidated Financial Statements
23. 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

INTANGIBLE ASSETS 31 December 2011

	Software	Other intangible assets	Portfolio value	Agency cooperation	Total
Gross value					
Opening balance	15,530	777	1,483	645	18,435
Increase	913	99	-	-	1,012
Decrease	(99)	(352)	-	-	(451)
Closing balance	16,344	524	1,483	645	18,996
Amortisation					
Opening balance	4,307	385	92	8	5,052
Annual amortisation	1,554	11	272	32	1,869
Decrease	(2,949)	(9)	-	-	(2,958)
Closing balance	2,912	387	364	40	3,703
Impairment					
Opening balance	-	-	-	-	-
Increase	-	-	1,119	-	1,119
Closing balance	-	-	1,119	-	1,119
Net value	13,432	137	-	605	14,174

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

Notes to the Consolidated Financial Statements

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 2012. 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 2012 no impairment is reported (in 2011 impairment in amount of HUF 1,119 million 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 2012	31 December 2011
Prepaid expenses	232	2,363
Reclaimable taxes	1,115	3,257
Settlements with the Hungarian State	1,965	1,148
Repossessed collateral	1,532	463
Properties held for sale	971	1,675
Debtors	1,288	1,150
Deposits	1,037	1,129
Other	1,187	665
Total	9,327	11,850

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 2012 (one month in 2011).

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 2012	31 December 2011
Long term loans received	82,475	4,031
Short term loans received	10,124	16,782
Accrued interest	182	179
Total	92,781	20,992

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 2012		31 December 2011	
	Net book value	Face value	Net book value	Face value
Non-listed mortgage bonds				
Fixed interest	66,038	65,868	105,800	105,599
Floating interest	291	291	567	567
Listed mortgage bonds				
Fixed interest	120,093	119,493	139,907	139,172
Floating interest	-	-	34,485	34,488
Total mortgage bonds	186,422	185,652	280,759	279,825
Non-listed bonds				
Fixed interest	31,779	31,774	16,690	16,690
Floating interest	5,207	5,162	-	-
Subordinated bonds	29,565	29,565	-	-
Listed bonds				
Fixed interest	19,452	21,018	27,249	27,513
Floating interest	1,398	1,396	5,728	5,740
Total bonds	87,401	88,915	49,667	49,943
Accrued interest (<i>mortgage bonds</i>)	5,475		9,664	
Accrued interest (<i>bonds</i>)	4,509		1,091	
Total issued securities	283,807	274,567	341,181	329,768

Mortgage bonds

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

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

Notes to the Consolidated Financial Statements

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 (EIR). The change in fair value other than movement in portfolio or currency represents credit risk.

Notes to the Consolidated Financial Statements

	31 December 2012		31 December 2011	
	Fair value	Face value	Fair value	Face value
Listed mortgage bonds				
Fixed interest	28,533	28,301	27,577	29,592
Floating interest	11,418	12,263	19,965	23,210
Total mortgage bonds	39,951	40,564	47,542	52,802
Non-listed bonds				
Fixed interest	22,543	22,000	21,461	22,000
Floating interest	-	-	-	-
Listed bonds				
Fixed interest	24,578	23,063	28,339	28,357
Floating interest	-	-	-	-
Total bonds	47,121	45,063	49,800	50,357
Due to banks	17,816	18,000	-	-
Total due to banks	17,816	18,000	-	-
Total Financial liabilities at fair value through profit or loss, except derivatives	104,888	103,627	97,342	103,159

28. DEPOSITS FROM CUSTOMERS

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

	31 December 2012	31 December 2011
Current accounts	41,989	39,114
Term deposits	108,002	120,779
Accrued interest	2,215	1,212
Total	152,206	161,105

All figures in tables are in HUF million except otherwise noted

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

Notes to the Consolidated Financial Statements

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.

In 2009 the Bank issued Series "C" and Series "D" shares, which grant special dividend preferential and special right to veto, respectively. The shares were issued to the Hungarian State and had a combined value of HUF 30,000,099,350. The agreement concluded between the State and the Bank in respect of the shares included a call option for the Bank during the entire existence of such shares and a put option for the State after five years of initial issuance. Although such shares are reported as equity instruments according to Hungarian regulations, given these conditions these issued shares were recognized as financial liabilities rather than as equity in the financial statements as at 31 December 2009 in accordance with IAS 32.

With its decision dated 19 February 2010 the Board of Directors of the Bank approved to exercise its option granted by legislation (Section 12 of Act CIV of 2008 on Strengthening the Stability of the Financial Transfer System, hereto "Stability Act") and the agreement (concluded between the Hungarian State and the Bank on 31 March 2009 on capital increase and acquisition of shares by the State) to repurchase the Series "C" special dividend preferential shares.

Pursuant to the above Act and the Agreement and due to the fact that the Bank repurchased the special dividend priority shares, the special right to veto attached to the Series "D" share was cancelled by law. Furthermore the veto rights attached to the Series "D" shares owned by the Hungarian State have been cancelled in accordance with the Act as a consequence of the events detailed above. Following the repurchase these shares were cancelled by the Bank.

In consideration of the proceedings started by the European Commission, the Hungarian State and FHB signed a new agreement in mid-December in respect of the capital increase effected by the Hungarian State in 2009 and repaid by the Bank in 2010. According to the agreement, FHB Mortgage Bank paid to the Hungarian State additional consideration and late penalty related to the capital increase with the amount of HUF 1,744 million.

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 1st 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.

Notes to the Consolidated Financial Statements

The book value of the leased assets is the following:

	31. December 2012		31. December 2011	
	Tangible assets	Intangible assets	Tangible assets	Intangible assets
Book value	863	11,088	1,008	13,019

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

	31 December 2012		31 December 2011	
	Minimum lease payments	Present value	Minimum lease payments	Present value
Within 12 month	3,143	3,000	-	-
Between 1 and 5 years	9,657	7,287	10,958	8,215
Over 5 years	1,343	775	3,262	1,786
Total	14,143	11,062	14,220	10,001
Less amounts representing finance charges	(3,081)	-	(4,219)	-
Present value of minimum lease payments	11,062	11,062	10,001	10,001

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 2012 there were no subleasing contracts and suspended rental fees regarding the leased assets.

31. RESERVE FOR ANNUITY PAYMENTS

	31 December 2012	31 December 2011
Opening balance	2,265	2,379
Increase	60	46
Fair value of annuity reserve	85	(160)
Closing balance	2,410	2,265

All figures in tables are in HUF million except otherwise noted

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Notes to the Consolidated Financial Statements
32. PROVISIONS

Provisions are set up mainly for current and future 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).

2012	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

The risk provision in 2012 is attributable to the off balance sheet items.

The cost of compensation from terminated onerous contracts comprises the majority of the future costs. These amounts were mostly flow out in the first half of 2011.

2011	Risk provision	Expected future obligation	Future costs	Expected costs of legal cases	Total
Opening balance	677	165	75	-	918
Increase in the period	244	-	-	8	252
FX movement	58	-	-	-	58
Utilization in the period	(745)	(165)	(50)	-	(961)
Closing balance	234	-	25	8	267

Notes to the Consolidated Financial Statements
33. OTHER LIABILITIES

	31 December 2012	31 December 2011
Taxes payable	564	592
Creditors	269	783
Accrued expenses	403	320
Liability from investments services	120	9
Customer loan prepayments	909	1,904
Liabilities to shareholders	202	202
Refinancing accounts	12	250
Cash in transit	62	480
Other	1,381	1,059
Total	3,922	5,600

Liabilities to shareholders includes dividend due but not yet distributed to shareholders.

34. SHARE CAPITAL

As of 31 December 2012 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 2012 and 31 December 2011 was as follows:

Shareholder	31 December 2012		31 December 2011	
	Holding %	Number of shares	Holding %	Number of shares
Ordinary shares (Series "A")				
Domestic institutional investors	55.76	36,795,859	73.62	48,585,278
Foreign institutional investors	21.98	14,509,484	18.51	12,216,058
Private investors	6.24	4,118,847	3.68	2,430,773
MNV Zrt.	7.16	4,724,833	4.11	2,714,300
Treasury shares	0.08	53,601	0.08	53,601
Other*	8.78	5,797,386	-	-
	100.00	66,000,010	100.00	66,000,010

*non-identified investors

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. There were no potentially diluting securities in existence at 31 December 2011. Shares to managers on the context of the share-based payment are allocated from Treasury shares

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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 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 2012	31 December 2011
Profit	(4,464)	(5,618)
Change of general reserve	(181)	-
Attributable profit	(4,645)	(5,618)
Weighted average number of shares	65,946,409	65,935,485

b) Treasury shares purchased

	31 December 2012	31 December 2011
Opening balance	29	123
Purchase	-	69
Used for acquisition	-	-
Share-based payments	-	(163)
Closing balance	29	29

c) Other reserves

	Note	31 December 2012	31 December 2011
Share premium		1,709	1,709
General reserves	36	181	-
Cash flow hedge reserve	38	-	201
Additional tier 1 capital	34	28,923	
Share option reserve	35	-	106
Change in fair value of financial assets available-for-sale	34	(216)	(212)
Foreign currency translation reserve		31	20
Total other reserves		30,628	1,824

Other reserve includes the Capital Securities issued by the Bank in 2012. The Bank successfully closed a private placement subscription procedure and on December 20, 2012 issued a series of EUR denominated perpetual floating rate bonds with a total nominal value of EUR 102 million 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

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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 2012	31 December 2011
Opening balance	(212)	(187)
Net unrealised gains on available-for-sale assets	96	291
Net realised losses on available-for-sale assets	(99)	(178)
Deferred tax	2	(138)
Closing balance	(216)	(212)

35. SHARE-BASED PAYMENTS

The expense recognised for share based payments during the year is zero (2011: HUF 106 million). The opening amount (HUF 106 million) HUF was charged to the statement of recognized income, because of the KPIs are not achieved according to this Consolidated Financial Statements. The following table illustrates the number (No.) and weighted average exercise prices (WAEP) of, and movements in, share options during the year.

	31 December 2012		31 December 2011	
	No.	WAEP in HUF	No.	WAEP in HUF
Outstanding at the beginning of the year	136,023	777	178,000	1,356
Granted during the year	-	-	136,023	777
Exercised during the year	-	-	(178,000)	(909)
Cancelation, because non achieved KPI,s	(136,023)	(777)		
Outstanding at the end of the year	-	-	136,023	777
Exercisable at the end of the year	-	-	136,023	777

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.

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The Group has a two-year share based incentive scheme for 2011 built on four IFRS measured criteria for both 2011 and 2012: 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 model is based on simulation, generating pre-determined number of cases where the average of values from the individual cases will be the value of share based payment.

The model consists of two main parts:

1. The simulation of the four IFRS criteria
 - a. input data: estimation of experts (management) on the followings
 - i. the expected criteria
 - ii. dispersion
 - iii. correlation matrix
 - b. the program calculated the covariance matrix based on the correlation matrix and also the Cholesky-matrix
 - c. the program generates four independent standard normal indefinite number, using these figures it generates a simulated value on the expected criteria, dispersion and correlation matrix based on the Cholesky- matrix and expected criteria
 - d. the four criteria are assessed separately and are assumed to be fulfilled if at least three out of the four are met.

2. Simulation of FHB share price
 - a. input data:
 - i. FHB daily dispersion: based on 1 year historic data on FHB shares before the General Meeting of 2010
 - ii. FHB closing share price for the period 1 January 2010 - 20 April 2010
 - iii. zero-coupon yield curve on 20 April 2010
 - b. foreign exchange rate simulation for the period until 20 April 2015 using the CRR (Cox-Ross-Rubinstein) model
 - c. discount the calculated future share price to get the present value on 20 April 2011
 - i. $DF(1 \text{ year}) * (\text{currency}(\text{the year given} + \text{one year}) - \text{currency at the deal date} ((\text{the year given})) * 60\%$
 $DF(2 \text{ years}) * (\text{currency}(\text{the year given} + \text{two years}) - \text{currency at the deal date} ((\text{the year given})) * 20\%$
 $DF(3 \text{ years}) * (\text{currency}(\text{the year given} + \text{three years}) - \text{currency at the deal date} ((\text{the year given})) * 20\%$
 - ii. multiplied by the number of shares

Notes to the Consolidated Financial Statements

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 12(8) of the Government Order 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 181 million as at 31 December 2012.

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 2012	31 December 2011
Guarantees	3,601	1,930
Undrawn commitments	26,644	17,625
Total	30,245	19,555

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 amortised 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 (2011: HUF 35 million) SWIFT and VISA membership share and shares of Garantiqua Creditguarantee Ltd. and the value of HUF 752 million BIF Ltd. shares disclosed (2011: HUF 1,294 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.

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

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

The applied valuation model takes into account the following:

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

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

	31 December 2012		31 December 2011	
	Gross book value	Fair value	Gross book value	Fair value
Refinanced mortgage loans	164,990	183,426	226,890	241,546
Loans and advances to customers	371,931	404,541	420,260	452,686

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

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system calculates the yield curves for the different currencies and bond types (mortgage bond and several unsecured bonds).

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

	31 December 2012		31 December 2011	
	Net book value	Fair value	Net book value	Fair value
Non-listed mortgage bonds				
Fixed interest	67,949	70,631	110,891	107,982
Floating interest	293	287	582	568
Listed mortgage bonds				
Fixed interest	123,656	125,048	143,913	113,618
Floating interest	-	-	35,037	34,520
Total mortgage bonds	191,898	195,966	290,423	276,688
Non-listed bonds				
Fixed interest	33,557	35,145	16,758	14,672
Floating interest	5,232	5,265	-	-
Subordinated bonds	31,126	31,491	-	-
Listed bonds				
Fixed interest	20,586	20,777	28,150	27,011
Floating interest	1,408	1,421	5,850	5,807
Total bonds	91,909	94,099	50,758	47,490
Total issued security	283,807	290,065	341,181	324,178

Gross value also includes the accrued interests.

c) Fair value of the state loan

The fair value of state loan is calculated by the Bank on a cash flow basis. In the calculations the Bank identifies the cash flows of state loan recorded in the contract discounted by the bond yield curve (for the description of the yield curve please refer to point b) in this Note). The state loan was fully repaid in 2012.

	31 December 2012		31 December 2011	
	Book value	Fair value	Book value	Fair value
State loan	-	-	62,694	62,694

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Notes to the Consolidated Financial Statements
d) 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.

e) 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.

	Fair value		Notional amount of liability	
	31 December 2012	31 December 2011	31 December 2012	31 December 2011
Derivatives designated as cash-flow hedges				
Positive fair value of cash flow hedges	-	1,628	-	6,268
Including: CCIRS	-	1,628	-	6,268
Swap deals classified as HFT				
Positive fair value of trading swaps	4,325	1,004	102,345	79,320
Including: CCIRS	2,745	261	35,520	7,469
Including: IRS	380	135	10,000	11,500
Including: FXS	1,200	608	56,825	60,351
Fair value hedge				
Positive fair value of CCIRS fair value hedge	10	-	3,894	-
Options				
Positive fair value of options	7	8	400	900
Forward deals				
Positive fair value of forward deals	2	55	753	6,432
Total derivative financial assets	4,344	2,695	107,392	85,588

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	Fair value		Notional amount of liability	
	31 December 2012	31 December 2011	31 December 2012	31 December 2011
Swap deals classified as HFT				
Negative fair value of trading swaps	(16,838)	(60,390)	149,703	396,478
Including: CCIRS	(16,021)	(55,898)	116,907	289,139
Including: IRS	(804)	(592)	17,826	17,894
Including: FXS	(13)	(3,900)	14,970	89,445
Fair value hedge				
Negative fair value of CCIRS fair value hedge	(6,431)		85,940	
Options				
Negative fair value of options	(2)	(8)	396	823
Forward deals				
Negative fair value of forward deals	(2)	(113)	753	5,297
Total derivative financial liabilities	(23,184)	(60,511)	236,792	396,478

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).

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,

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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).

f) 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 July 1, 2012, the gain or loss from these swap items are accounted the same method as the hedged items.

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)

g) 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

In 2011 a profit of HUF 3 million was reported due to ineffectiveness of CF hedges (2010: HUF 2 million). The CF hedge transaction has matured in 2012.

Notes to the Consolidated Financial Statements
h) Fair value of financial instruments carried at fair value

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and

Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

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

	31 December 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

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	31 December 2011		
	Level 1	Level 2	Level 3
Assets			
Securities held for trading	1,832	-	-
Financial assets available-for-sale	85,891	-	-
Derivative financial assets	-	2,965	-
Total assets carried at fair value	87,723	2,965	-
Liabilities			
Derivative financial liabilities	-	60,511	-
Financial liabilities at fair value through profit or loss, except derivatives	-	97,342	-
Reserve for annuity payments (Note 31)	-	-	2,265
Total liabilities carried at fair value	-	157,853	2,265

i) 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 45.4% 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 (2011: HUF 1.2 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 32 million if the yield curve is increased by 25 base point, and increases by HUF 33 million if the yield curve is decreased by 25 base point at December 31, 2012.

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j) 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	2,504	Net fair value based on estimated inputs	(22,112)
Sensitivity (dPV)		Sensitivity (dPV)	
+10 bp	109	+5 bp	(187)
-10 bp	(108)	-5bp	(185)

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 December 31 2011	Transfer as at January 1 2012	Closing balance as at 31 December 2012	Total loss as at December 31 2012
Positive fair value of CCIRSs	-	2,754	2,754	(2,754)
Financial assets measured at fair value total	-	2,754	2,754	(2,754)
Negative fair value of CCIRSs	-	(22,362)	(22,362)	22,362
Financial liabilities measured at fair value total	-	(22,362)	(22,362)	22,362

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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 2012 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 the prudent and careful risk-taking.

To maintain a diversified liability structure in 2012 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. Because of the liquidity in CHF due to the repayment of the loans at the fixed exchange rate in the first quarter of 2012 there were only slightly need for renewal of CHF sources during the year.

Based on the permission of the Hungarian Financial Supervisory Authority FHB can calculate the capital requirements of the operational risk with the Advanced Measurement Approach (AMA) from 31 December 2011. Before the permission was granted the Group significantly improved the management of the operational risk during 2011.

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.

All figures in tables are in HUF million except otherwise noted

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

Notes to the Consolidated Financial Statements

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

Notes to the Consolidated Financial Statements

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.

Notes to the Consolidated Financial Statements
Maximum credit risk exposure based on gross outstanding balances:

	31 December 2012	31 December 2011
Balances with the National Bank of Hungary	5,117	8,707
Dues from banks	28,864	56,338
Securities held for trading	7,815	1,832
Financial assets available-for-sale	158,848	85,891
Derivative financial assets	4,344	2,695
Refinanced mortgage loans	164,990	226,890
Loans and advances to customers	371,931	420,260
Other assets	9,327	11,850
Total	751,236	814,463
Off-balance sheet commitments	30,245	19,555
Total	30,245	19,555
Total credit risk exposure	781,481	834,018

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
	31.12.2012	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

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. Most of these are loans final repaid in 2012 and other corporate loans which are impaired due to some regulations or other reasons.

Notes to the Consolidated Financial Statements

	Neither past due nor impaired	Past due or individually impaired	Assessed under collective impairment rules	Total
	31.12.2011	31.12.2011	31.12.2011	31.12.2011
Dues from banks and refinanced mortgage loans	283,475	-	-	283,475
Loans, commitments and guarantees	297,973	100,205	41,450	439,628
To corporate customers	60,001	16,860	605	77,466
To retail customers	237,972	83,345	40,845	362,162
Total	581,448	100,205	41,450	723,103

The carrying amount of restructured financial assets that would otherwise be past due, impaired or terminated is HUF 70,729 million (2011: HUF 51,710 million). The impairment and the provision of the restructured financial assets are HUF 12,320 million (2011 HUF 10,457 million).

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

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

Class	Historic default rate 31.12.2011 (%)	Uncovered 31.12.2011 HUF million	Total 31.12.2011 HUF million
CLASS_1	0.00	89,895	89,895
CLASS_2	0.00	32,224	32,224
CLASS_3	0.00	26,577	192,161
CLASS_4	0.12	2,631	124,900
CLASS_5-7	10.73	35,026	357,197

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.

Notes to the Consolidated Financial Statements

Age analysis of loans past due but not impaired

	5-90 days	5-90 days
	2012	2011
Dues from banks and Refinanced mortgage loans	-	-
Loans	36,702	41,450
Corporate customers	421	605
Retail customers	36,281	40,845
Total	36,702	41,450

As of 31 December 2012 the Company has HUF 59,215 million collateral value for loans past due unimpaired (2011: HUF 59,034 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.

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. It was not necessary to conclude guarantee agreements with the Hungarian State as the rules governing the guarantee are laid down in the relevant statutory provisions. The Bank applies this type of collateral in the following two cases:

- Loans provided to private individuals employed in the public sector; and
- Housing loans extended to young clients partially covered by State guarantee.

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.

Notes to the Consolidated Financial Statements

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 2012 and 2011:

	31 December 2012	31 December 2011
Mortgage	1,228,362	1,356,912
Warrant	2,993	6,466
Guarantee	38,464	56,455
Assignment	-	123,911
Other collaterals	18,480	26,543
Total	1,288,299	1,570,287

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

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

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.

Notes to the Consolidated Financial Statements

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

	31 December 2012		31 December 2011	
	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	40,425	1.48	64,351	1.45
Securities held for trading and available-for-sale	156,498	4.33	80,542	6.79
Refinanced mortgage loans	180,926	8.07	243,630	7.08
Loans and advances to customers	371,203	9.12	387,891	9.16
Total interest earning assets	749,052	7.45	776,415	7.62
Interest bearing liabilities				
Due to banks	76,655	7.64	37,439	3.26
Deposits	166,883	5.83	125,165	5.22
State loan	28,259	3.60	82,237	4.02
Issued securities and Financial liabilities at fair value through profit or loss, except derivatives	387,134	7.97	437,912	8.00
Total interest bearing liabilities	658,931	7.20	682,753	6.68

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

	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 2011	Sensitivity of equity (2011)				
		0-6 months	6-12 months	1-5 years	Over 5 years	Total
HUF	(2.2)	0.9	(2.6)	(2.5)	(28.8)	(33.0)
EUR	2.2	(2.4)	1.7	2.6	5.8	7.7
CHF	5.0	1.2	(0.3)	(0.3)	(2.9)	(2.3)

All figures in tables are in HUF million except otherwise noted

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

Notes to the Consolidated Financial Statements

	Sensitivity of interest income 2012 +10 bp	Sensitivity of interest income 2012 +25 bp	Sensitivity of equity (2012) +10 bp	Sensitivity of equity (2012) +25bp
HUF	(50)	(125)	(471)	(1,178)
EUR	55	138	89	223
CHF	55	138	(50)	(125)

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 2012 net interest income would decrease by HUF 5.0 million in case of HUF, it would increase by HUF 5.5 million in case of EUR and would increase by HUF 5.5 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 47.1 million in HUF, the increase of the capital by HUF 8.9 million in EUR and the decrease of the capital by HUF 5.0 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 through 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 2012)	Effect on capital (31 December 2012)	Effect on earning before income tax (31 December 2011)	Effect on capital (31 December 2011)
EUR	142.4	(1.7)	285.8	(18.4)
CHF	180.1	272.6	132.0	447.8

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.

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

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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 142.4 HUF, in case of CHF items it could increase with 180.1 million HUF. The similar effect for the capital could mean a decrease of 1.7 million in case of EUR items and 272.6 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 2012	CHF	EUR	HUF	Total
Assets				
Cash	141	245	1,778	2,164
Balances with the National Bank of Hungary	-	-	5,117	5,117
Due from Banks	298	26,176	2,390	28,864
Securities held for trading	-	3,311	4,504	7,815
Financial assets available-for-sale	-	46,308	112,540	158,848
Derivative financial assets	-	-	4,344	4,344
Refinanced mortgage loans	75,178	479	89,333	164,990
Loans and advances to customers	138,941	35,326	160,316	334,583
Investment property	-	-	11,463	11,463
Tangible assets	-	-	5,961	5,961
Goodwill and other intangibles	-	-	12,753	12,753
Deferred tax asset	-	-	6,396	6,396
Other assets	208	190	8,929	9,327
Total assets	214,766	112,035	425,824	752,625
Nominal values of derivative assets	6,056	90,882	180,216	277,154
Total assets incl. derivatives	220,822	202,917	606,040	1,029,779

31 December 2012	CHF	EUR	HUF	Total
Liabilities				
Due to banks	2,468	5,428	84,885	92,781
Deposits	192	45,528	106,486	152,206
Derivative financial liabilities	-	-	23,184	23,184
State loans	-	-	-	-
Issued securities	-	84,938	198,869	283,807
Financial liabilities at fair value through profit or loss, except derivatives	-	12,261	92,627	104,888
Reserve for annuity payments	-	-	11,029	11,029
Leasing liability	-	-	2,410	2,410
Current tax liability	-	-	42	42
Deferred tax liability	-	-	643	643
Provisions	60	-	113	173
Other liabilities	250	229	3,443	3,922
Total liabilities	2,970	148,384	523,731	675,085

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

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31 December 2012	CHF	EUR	HUF	Total
Shareholders' equity	0	28,923	48,617	77,540
Total liabilities and shareholders' equity	2,970	177,307	572,348	752,625
Nominal values of derivative liabilities	216,138	52,919	32,332	301,389
Total liabilities incl. derivatives	219,108	230,226	604,680	1,054,014
Position	1,714	(27,308)	1,329	(24,235)

Consolidated FX financial position of the group in terms of main currencies (31 December 2011):

31 december 2011	EUR	CHF	HUF	Total
Total assets incl. derivatives	274,921	326,437	587,430	1,188,788
Total liabilities incl. derivatives	253,491	336,990	598,865	1,189,346
Shareholders' equity	-	-	53,381	53,381
Position	21,430	(10,553)	(64,816)	(53,939)

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:

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.

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Prepayment risk of the Bank:

	Effect on net interest income	Effect on equity	Effect on net interest income	Effect on equity
	31.12.2012	31.12.2012	31.12.2011	31.12.2011
	HUF million	HUF million	HUF million	HUF million
Loans	(1,427)	(1,299)	(3,673)	(3,462)
HUF	(310)	(226)	(903)	(779)
EUR	(18)	(9)	(171)	(151)
CHF	(1,099)	(1,064)	(2,599)	(2,532)
Refinanced mortgage loans	(578)	(18)	(1,083)	(582)
HUF	(109)	(52)	(155)	(66)
EUR	(2)	(1)	3	4
CHF	(467)	35	(931)	(520)
Total	(2,005)	(1,317)	(4,756)	(4,044)

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.

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

Notes to the Consolidated Financial Statements
Contractual maturities of undiscounted cash flows of financial liabilities as of 31 December 2011

	On demand	Within 3 months	3 - 12 months	1 – 5 years	5 – 10 years	10 – 15 years	Total
Banking liabilities							
Due to banks	-	16,635	758	1,448	2,273	-	21,114
Deposits	39,220	77,022	46,499	377	-	-	163,118
Derivative financial liabilities	-	2,383	10,644	47,306	179	-	60,512
State loan	-	16,225	47,671	-	-	-	63,896
Issued securities	-	33,839	77,591	269,892	21,620	-	402,942
Financial liabilities at fair value through profit or loss, except derivatives	-	1,179	8,688	104,267	2,466	6,503	123,103
Off balance sheet commitments	-	4,901	12,078	2,398	157	21	19,555
Total banking liabilities	-	39,919	98,357	376,557	24,243	6,524	854,240

	On demand	Within 3 months	3 - 12 months	1 – 5 years	5 – 10 years	10 – 15 years	Total
Receivables from derivatives	-	88,230	82,886	246,943	1,613	-	419,672
Liabilities from derivatives	-	83,942	85,188	277,791	1,492	-	448,413
Net value of derivatives	-	4,288	(2,302)	(30,848)	121	-	(28,741)

All figures in tables are in HUF million except otherwise noted

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

Notes to the Consolidated Financial Statements

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 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

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

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	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

Maturity analysis of assets and liabilities as of 31 December 2011

	Less than 12 months	Over 12 months
Assets		
Cash on hand	2,554	-
Balances with the National Bank of Hungary	8,707	-
Due from banks	56,338	-
Securities held for trading	1,806	26
Financial assets available-for-sale	82,414	3,477
Derivative financial assets	932	1,763
Refinanced mortgage loans	14,453	212,437
Loans and advances to customers	17,431	363,796
Investment property	232	11,079
Tangible assets	-	6,300
Goodwill and other intangible assets	-	14,174
Deferred tax assets	-	6,345
Other assets	10,862	988
Total assets	195,728	620,386

All figures in tables are in HUF million except otherwise noted

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

Notes to the Consolidated Financial Statements

	Less than 12 months	Over 12 months
Liabilities		
Due to banks	17,271	3,721
Deposits from customers	160,804	301
Derivative financial liabilities	14,754	45,757
State loans	62,694	-
Issued securities	111,107	230,074
Financial liabilities at fair value through profit or loss, except derivatives	6,728	90,614
Finance leases liabilities		10,060
Reserve for annuity payments	348	1,917
Current tax liabilities	6	-
Deferred taxes liabilities	-	710
Provisions	267	-
Other liabilities	5,600	-
Total liabilities	379,579	383,154

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 than real estate securities).

Notes to the Consolidated Financial Statements
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.

After the consultations with the Hungarian Financial Supervisory Authority the supervisory review process (SREP) was closed in the first half of 2012. In its order dated to 27 June 2012 the Hungarian Financial Supervisory Authority prescribed a significantly higher additional capital requirement for the Group which needs to be maintained until the following review.

FHB Mortgage Bank issued subordinated bonds during private placement subscriptions two times in 2012. (See note 1.)

The Group's Tier 1 capital adequacy ratio calculated accordingly was 22,6% as of 31 December 2012 and 10.4% as of 31 December 2011. 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 2012	31 December 2011
Risk weighted assets		
Balance sheet items	301,642	317,300
Off-balance sheet items	8,121	6,080
Total risk weighted assets	309,763	323,380
Capital requirement of the credit risk	24,871	25,869
Capital requirement of the FX risk and market risk	519	738
Capital requirement of the operating risk	2,377	2,824
SREP capital requirement	5,609	2,090
Total capital requirement	33,376	31,521
Tier 1		
Share capital	6,600	6,600
Repurchased treasury shares	(29)	(29)
Share premium	1,709	1,709
Share-based payment	-	106
Additional tier 1 capital	28,923	-
Other reserves*	212	-
Retained earnings	40,340	44,986

All figures in tables are in HUF million except otherwise noted

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Notes to the Consolidated Financial Statements

Total Tier 1 capital	77,755	53,372
	31 December 2012	31 December 2011
Intangible assets	(12,753)	(14,174)
Subordinated capital	29,565	-
IRB (loss)/gain according to IFRS	(462)	1,940
Total regulatory capital	94,105	41,139
Capital adequacy (%)	22.6	10.4
ROAE (return on average equity %)	(6.8)	(10.0)

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

52. RELATED PARTY TRANSACTIONS

For the purpose of the financial statements, related parties include 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% (VCP Finanz Holding Ltd., A64 Trustee 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 please refer to Note 2.4.

	31 December 2012	31 December 2011
Loans to executives, members of the Board of Directors and Supervisory Board	18	23
Gross remuneration		
Salary	98	92
Bonus	13	57
Honorary	33	36
Shares	-	79
Total remuneration	144	264

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Notes to the Consolidated Financial Statements

The outstanding balances and transactions in 2012 and 2011 with related parties are detailed in the below table:

	31 December 2012 Parent	31 December 2011 Parent
Other assets	-	1
Total assets	-	1
Other liabilities	-	4
Total liabilities	-	4
Other operating income	-	-
Other operating expense	-	-
Operating income	-	-
Operating expense	(214)	(200)
Profit on transactions with related parties	(214)	(200)

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

Notes to the Consolidated Financial Statements
53. NET GAINS

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

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

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

Notes to the Consolidated Financial Statements

2011	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	18,304	4,522	55,607	-	-	-	78,433
Interest expense	-	-	-	(18,450)	(38,485)	-	(56,935)
Net interest income	18,304	4,522	55,607	(18,450)	(38,485)	-	21,498
Fee and commission income	-	-	1,415	-	1,433	813	3,661
Fee and commission expense	-	-	(350)	-	(431)	(167)	(948)
Net fee and commission income	-	-	1,065	-	1,002	646	2,713
Change in fair value of derivatives	(1,040)	-	-	4,027	-	-	2,987
Gains from securities	4	1,751	-	443	1,428	22	3,648
Other operating income	-	-	-	-	-	1,030	1,030
Other operating expense	-	-	(85)	-	(67)	(2,729)	(2,881)
Operating income	17,268	6,273	56,587	(13,980)	(36,122)	(1,031)	28,995

All figures in tables are in HUF million except otherwise noted

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

Notes to the Consolidated Financial Statements
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 2012	Retail	Corporate	Treasury	Refinancing	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)	0	0	(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

Segment report , December 31 2011	Retail	Corporate	Treasury	Refinancing	Other*	Total
Net interest income	22,274	1,276	(8,812)	6,963	(203)	21,498
Other net income	2,184	719	8,709	442	789	12,843
Provision for impairment on loan losses	(13,974)	207	0	0	(6,177)	(19,944)
Direct expense	(9,209)	(664)	1,024	(232)	11	(9,070)
Operating result	1,275	1,538	921	7,173	(5,580)	5,327
Non allocated expense	-	-	-	-	(12,641)	(12,641)
Profit before tax	-	-	-	-	-	(7,314)
Segment assets	350,170	63,301	146,756	226,890	28,997	816,114
Segment liabilities	98,732	62,373	520,026	-	81,602	762,733

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

In 2011 one-off items are reported in other segment, includes fixed rate final repayments.

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

Notes to the Consolidated Financial Statements**55. SIGNIFICANT EVENTS AFTER BALANCE SHEET DATE**

From January 31, 2013, Mr. László Harmati, CEO of FHB Group resigned from all his positions in all member companies, furthermore his employment as Chief Executive Officer of the Company terminated by mutual agreement. From February 1, 2013, the position of the CEO shall be held by the current CEO Mr. Gyula Köbli alone. Position of the CEO of FHB Commercial Bank Ltd. shall be provided by Mr. Gábor Gergő Soltész, the appointment has been approved by the Hungarian Financial Supervisory Authority. From February 4, 2013, Dr. György Walter is employed as the Deputy General Manager of FHB Commercial Bank.

The Moody's Investor Service published on 14 February 2013, that it takes rating actions on 3 Hungarian Banks, included the ratings of the FHB Mortgage Bank Co. Plc. The local and foreign currency long terms deposit rating of FHB Mortgage Bank changes from "Ba3/Not-Prime" to "B2/Not-Prime", and the standalone bank financial strength (BFSR) rating of "E+/b1" was downgraded to "E+/b3". All the above ratings remain on negative outlook. According to Moody's, the drivers of the lower rating were the increasingly weak economic and operating environment in Hungary, even though Moody's affirmed Hungary's government bond rating on February 8, 2013.

On 15 February 2013, Moody's Investor Service announced the change of the rating of the mortgage covered bonds issued by FHB Bank. The rating of the mortgage covered bonds issued by FHB has been changed from „Ba1” to „Ba3”. Rating action has no significant impact on the Groups financial position.

With the permission of the Hungarian Financial Supervisory Authority, the Company repurchased in full prior to maturity the following privately issued series of Tier 2 subordinated bonds on 20 February 2013: FA22ZV01 (ISIN: HU0000350038) HUF - denominated series with a total face value of HUF 15 billion and FA22ZV02 (ISIN: HU0000350046) EUR - denominated series with a total face value of EUR 50 million. Each of these series was cancelled with an effective date of 21 February 2013.