Guidelines of Risk Management

FHB Mortgage Bank Plc. developed its risk management strategy taking into consideration the regulations of prudent operation and aiming at keeping risks at a low level.

The main framework rules and methodological guidelines determining the methods of risk management are approved by the Board of Directors. The Board of Directors monitors the Bank's operation including its risk management activities and ascertains the level of risk undertaken through the statutory regular reports and relevant internal rules, regulations and instructions.

Risk management as an activity is kept separate from the organizational units of banking operation. The area is supervised by the Chief Executive Officer. Technical decisions are made and limits are set by the Committee of Assets and Liabilities.

Risk management is broken down to four major stages:

- o Risk identification
- o Risk evaluation
- o Risk management
- o Control and feedback

Risk identification involves exploration of material hazards relating to the business process, to transactions and day-to-day operation as fully as possible. The Bank applies different indicators, statistics, analyses and tests for the measurement of the risks identified. When developing the methodology, an effort is made to select the tools that are best suited to determine the actual level of risks. Regular review of methods is indispensable for efficient risk management.

Efficient risk management ensures risk taking to be a matter for conscious management decision taken in the interest of success in business. The process includes **determination of acceptable risk** necessary for successful business, **setting the limits** required, and selection of **applicable tools** for risk management.

It is very important to analyse the efficiency of transactions and risk management measures in terms of every risk type. The Bank applies various statistics and repeated exposure measurements for such analysis. In the short run feedback serves for finding the management method that is best suited for a particular type of risk; and in the long term it is aimed at enhancing the efficiency of risk management through corporate learning.

The Bank has identified risks rooted in changes of the international and Hungarian macro-economic environment as significant risk factors, which have a bearing on the volume and quality of FHB's loans portfolio on the one hand, and affect the demand for, and costs of, mortgage bonds regularly launched or to be launched by FHB on the Hungarian and international money markets to finance its activity.

Specialized essentially for home lending, FHB is affected by trends in the real estate market, specifically in the housing market. Changes in the price of homes have an influence on the demand for the Bank's loan products as well as securing the loans by appropriate collateral.

The Government's housing policy and the complex system of state subsidies are determining elements in the development of the housing loans market and the profit from housing loans that can be realized by banks working in this area of business including FHB and its partners.

In general, regulatory risks may have a significant influence on the Bank's operation and profitability. In this respect, on the liabilities side tying interest subsidies to the issue of mortgage bonds, and changes in the statutory provisions pertaining to the exclusive right of mortgage banks to issue mortgage bonds may have a particularly great impact.

Risk factors related to competition include keener competition as a result of the appearance of new mortgage banks and other financial institutions in the mortgage business; maintenance, expansion and concentration of refinanced partner banks; and maintenance of active cooperation.

Rating by the international mortgage bond rating institution, currently Moody's, has a major effect on the cost of the Bank's mortgage bonds, the groups of potential investors and the magnitude of their demand, and the price of the Bank's shares. A particularly important consideration of rating is the financial strength supporting the Bank's operation, and its ownership structure.

The Bank shapes its business strategy and policy taking the above risk factors into consideration.

Operative risk management guidelines of the Bank by risk type:

Lending risk:

Lending is the Bank's core business secured by mortgage liens on real estate, purchase of mortgage liens or by the State as aval.

The Bank's lending activity is focused on housing loans. Lending risk stems from risks related to borrowers, to coverage, or to partner risk involving partner banks refinanced through independent mortgage lien purchases.

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 the level of exposure compared to portfolio size.

The Bank implements simple and complex debtor rating prior to lending. A scoring system has been developed and applied to measure the creditworthiness of retail clients. When rating receivables FHB Plc. uses the classes and limits for loss in value and provisions set forth by law and the Bank's internal regulations.

The Bank applies stringent regulations relating to determining the scope of collaterals eligible for coverage, their valuation and coverage ratio. The collateral value of real estate covering mortgage loans is established by FHB also for the refinanced loans portfolio.

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

In the course of its business the Bank undertakes partner risk only vis-à-vis market agents that have been rated by the Bank and have a limit of exposure.

Market and liquidity 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 assets and liabilities structure within the Hungarian banking system. Interest-related risk is monitored on an ongoing basis by means of gap analyses and different indicators. Market risk can be most effectively managed mainly by natural hedging; however, the 100% approximation of the maturity of assets and liabilities is not possible. The shortcomings of natural hedging is compensated by active intervention, specifically by repurchase of mortgage bonds, swap transactions, and the extension of mortgage bond maturity.

The nature of the Bank's business as a specialized credit institution significantly narrows the scope of activities that may generate exchange rate risk. Moreover, in accordance with its business strategy the Bank intends to keep currency-related risk at a low level.

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.

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 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.

In addition to the above risk management guidelines the Board of Directors considers it important to draw investors' attention to the risk factors and their management described in the prospectus of the Bank's securities issued to the public.

FHB Mortgage Bank Plc.