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Moderator: PAUL FORMANKO
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Operator: This is conference # 956215.

Thank you for standing by, and welcome to the OTP Bank Q3 2015 results conference call.

At this time, all participants are in a listen only mode. There will be a presentation followed by a question and answer session, at which time, if you wish to ask a question, you will need to press star and one on your telephone keypad.

I must advise you that this conference is being recorded today, Friday the 13th of November, 2015.

And I would now like to hand the conference to your first speaker today, Paul Formanko. Please go ahead, sir.

Paul Formanko: Good afternoon, all. This is Paul Formanko, from J.P. Morgan. Thank you very much for joining us for third quarter results of OTP Bank. From Budapest it is Laszlo Bencsik, Chief Financial and Strategic Officer calling in. Laszlo, over to you, please.

Laszlo Bencsik: Thank you, Paul. Good afternoon or good morning, depending where you are, and welcome to OTP Group's third quarter results conference call.

Hopefully, you've been able to download the presentation from the website which is available there. And as usual, I'm going through briefly the presentation, and then you will have chances to ask your questions.

Starting on page 2, you see the third quarter results. The accounting result was minus HUF3.7 billion; a very rare event, again, that we had a quarter overall negative. And this negative result was caused by three one-off items. Two out of the three, we have already communicated to you through announcements.

The first one was related to the finalization of the settlement and conversion of Hungarian retail FX loans, and this HUF6.5 billion refers to the amounts related to the settlement of HUF loans and also the conversion of consumer loans, most dominantly the car loans which are at Merkantil Bank in Swiss franc. We are converting them into local currency, as well. And parallel to the conversion, we are providing a discount to customers, which will be also subsidized by the government. So, all in all, this is going to equal HUF6.5 billion minus, in the third quarter.

The actual conversion is going to happen at the end of November/first of December, but we have already purchased the equivalent amounts of FX currencies. And as in the previous case with the mortgage conversion, the central bank provided the necessary FX liquidity so it did not disturb the markets.

So, by doing so, we are basically done with all the FX retail loans in Hungary, and this is now the past.

The second item is something which we have already flagged in an announcement. It's related to the new legislation in Croatia which forces the banks to provide customers the opportunity to exchange their Swiss franc mortgage loans into euros.

And - assuming each and every customer will take this opportunity - the expected after-tax loss is HUF6.3 billion all together. So, we booked conservatively the potential losses in the third quarter.

And the last, the third big item here is something new, which we have not talked about, but you might have been anticipating it given the developments in Romania. In Romania, we have a Swiss franc mortgage portfolio, and we have experienced several problems with this.

Most importantly, there's an ever-increasing amount of court cases against banks that have these types of loans, including us, and the pressure is mounting quite heavily on the Bank. And we are losing fast these court cases, which are related to similar situations what we had in Hungary, i.e. the unilateral changes in conditional terms.

And therefore, unless we do something we expect a quite sizable loss in the portfolio through these court cases. Now, the problem with the court cases is that when they happen, we've paid cash to customers and the loans remain in Swiss francs. So, we don't solve the problem; we just have a one-off cost.

Now, the other reason why we decided to move on this subject was that the National Bank and also the legislature and the government flagged the CHF issue and actually the Romanian National Bank published a guideline in which it strongly advised the banks in Romania having Swiss mortgages to provide discounts to their customers to relieve, or to lessen, their loan payment requirements and also to convert these loans and reduce the exchange rate.

The third reason why we decided to do this was that we anticipate future increasing risk costs due to the weaker currency and therefore the higher burden on these customers.

And the last reason was that we closely monitored what happened to Banca Transilvania, who executed a very similar program on a much larger volume, by the way. Their defaults were in the previous Volksbank Swiss mortgage volumes – Volksbank was acquired by Banca Transilvania earlier this year – and they provided their customers a similar structure, which was very successful and created a very positive reputation for that bank. Our reputation, on the contrary started to erode, so to say, due to the Swiss mortgage problem in Romania. So, all in all, this is what we decided to do.

The program is going to start in December and will last until February, during which time we approach customers with individual offers. And we actually provisioned for 100 percent take-up rate, which is potentially too conservative. Usually, not all customers take the opportunity in these situations.

The experience so far, as we understand, in case of Banca Transilvania was 80- 85 percent participation rate from customers. So, at the end, it might happen that we won't spend the entire amount what we have provisioned so far.

Leaving behind the one-offs, on page 3 you see the results of the normal business operation. There are a few items which I think, important here.

One is the corporate tax, which is much lower in the third quarter. There's the usual moving part related to the HUF/EUR rate and the differences between the IFRS and the local accounting standards, which resulted now in OTP Hungary and the OTP Core a much lower tax rate than in the second quarter when the currency moved into the opposite direction.

If we look at the operating profit in the lower part of the page, then there was 2 percent increase quarter on quarter, with stable revenues and slightly decreasing operational costs. And risk cost actually increased, but that's mostly due to the Ukrainian actual provisioning, which was also indicated on the previous conf.call: we were expecting this to happen to some extent in the third quarter.

If you go to page 4, then you see this previous trend to continue. So, we continue to make increasing amounts of money in the Central Eastern European countries, while at the same time we are making losses in Russia and in Ukraine. And due to Ukraine, this loss actually increased in the third quarter compared to the second quarter.

On page 5, you see the detailed numbers on after-tax adjusted profit of the most important Group members. Here, you see the CEE operation improving on a quarterly basis, driven by Hungary. Hungary was strong again, partially due to the lower tax. And also, we had a better income level, but that was other income, which you will see later on.

In Bulgaria, we had a quite spectacular growth quarter on quarter: almost 40 percent increase in profits due to strong revenues and also lower risk costs than in the second quarter.

The rest of the smaller banks did contribute, each of them, positively to the Group profit. So, we are happy about that.

And reaching the bottom of the page, you see that the Russian loss was actually less than in the second quarter, by 50 percent. So, this trend of decreasing losses in Russia continued again as previously expected. And hopefully, we are getting quite close to the Russian business breaking even.

In Ukraine, the second quarter was exceptionally strong due to then strengthening hryvnia compared to the first quarter. However, in the third quarter we made extra provisioning on the previously restructured corporate loans which had been originated before the crisis in 2008, thus the quarterly loss was big.

On page 6 and 7, you see a more detailed explanation of these one-off items in Hungary, Romania, Croatia, Ukraine, and also in Serbia. I pretty much covered them.

In Serbia, there was a small amount – just HUF100 million – in the third quarter, which is also related to new legislations there related to Swiss mortgages and the same issue as what we had in other countries. We have to pay compensation for the unilateral changes of conditional terms of these loans.

In Ukraine, we list this problem here because it's related to the FX mortgages in Ukraine, not particularly to the Swiss franc mortgages, which is a very small amount there, but more to the dollar mortgages, because there's a proposal in Ukraine from the National Bank – but it was consulted with the banking sector; so, it's pretty much a joint proposal – how to manage the socioeconomic problems related to dollar mortgages.

This proposal defines a segment of customers who are eligible for compensation and conversion with preferential terms. But, first of all, this draft legislation has not been passed the parliament and the president. Second, the expected impact on the Bank is marginal. So, we don't expect a big loss coming through from this in the future. And we also continue with our own conversion program, which is there pretty much business as usual. So, the financial impact of this, we actually show in the normal P&L numbers of the Ukrainian bank.

We included one page, page 8, trying to show the quite dramatic shift in our position related to Swiss franc denominated mortgages in all the countries. So, a year ago we had more than HUF750 billion equivalent of these type of mortgages. At that time this was more than EUR2.5 billion. And then, the exchange rate actually weakened. So, it would have become even more hadn't we done anything.

And then, on the other side, you see where we stand today. So, in Hungary, CHF exposures pretty much disappeared. There's technically nothing left. And in Romania, if everything could happen according to our plan and according to what we provisioned, then all the performing part of this portfolio will be converted to either local currency or euro, the only remaining part we are going to have in Romania is the non-performing volume which is around HUF10 billion equivalent.

And then, the rest is actually quite small. So, we have HUF5 billion in Serbia. I just said that related to this volume we had to book HUF100 million loss in the third quarter because the legislation changed. And there's a small amount in Russia and a small amount in Ukraine. And then, there are a few billions all around the place.

So, all together, assuming that everything goes according to plan in Romania, the actual economic exposure to the Swiss mortgages is alltogether HUF24 billion. And only HUF10 billion out of this is performing; the rest is non-performing.

So, this is a major shift in our risk profile, I believe, and I'm actually quite glad that this happened. Obviously, it was very painful, and it was very expensive, as well. But the fact that this structural risk is out of the portfolio is eventually a big positive.

On page 9, you see some details on how the total income developed quarter on quarter and year on year. Quarter on quarter, it was pretty much stable, with Hungary and Bulgaria improving.

And Russia was negative, but this was mostly due to the weakening of the ruble towards the HUF. So, if we exclude the impact of the FX exchange rate change, then the decline in Russia was only 4 percent.

Ukraine actually improved.

And then, the rest was rather positive than negative.

On the following page, net interest income story is somewhat similar, with probably one important – maybe the most important point in this is the Hungarian year-on-year decline, which on a quarterly basis was just HUF3 billion. And this is related to the settlement and conversion which we have discussed many times, the expected negative annual impact of this is around HUF10 billion. And on top of that, obviously, we have lower volumes in other products and we have a lower margin environment, as well, in Hungary.

Whereas in Bulgaria, we have an opposite direction, an improvement, and this is related to the repricing of deposits compared to last year.

Going to page 11, you see the net interest margins. They were stable at OTP Core quarter on quarter and almost stable in Bulgaria.

In Russia, you see a decline, but this is actually entirely technical. One part is what we actually tried to describe on the page. The 0.9 percentage point decline was due to the methodology change. We reduced somewhat the coverage on non-performing loans, and it also related to the coverage on accrued interest, as well, of these non-performing loans. And it had a positive impact in the interest income and, therefore, improved the margins.

So, without this change of methodology, we should have had 16.6 percent margin.

And the headline15.6 percent in the third quarter, the decline actually happened because of the exchange rate moving during the quarter. So, the average exchange rate during the third quarter was 15 percent less than in the second quarter. At the interest income part of this ratio, the numerator is calculated based on the average rate, but the closing rate also declined by 16 percent. Now, the denominator, i.e. the average assets, are calculated as starting- and ending-period averages. Therefore, the numerator decreased by 15 percent, but the denominator decrease was only 8 percent due to these FX changes.

Now, if there were no FX changes, then we had had 16.9 percent NIM in Russia; so, basically, pretty much at the level where we were at the second quarter without this impact of the methodology change, even slightly higher.

Ukraine was somewhat better again because we did less restructuring there in the second quarter.

Page 12, you see the net loan to deposit ratio, which unfortunately declined further. This is not in line with management intentions. But nevertheless, it happens, which is related to the demand in some countries.

Hungary is below 50 percent. And I think it's quite good to know that Ukraine is below 100 percent. You might remember that a few years ago it was above 400 percent. So, this kind of balanced situation now in Ukraine is most welcome.

And pretty much there's only Romania which remains leveraged with its 150 percent net loan to deposit ratio.

On page 13, you see the loan volumes changes. And again, in the third quarter performing FX-adjusted loan development was negative. All the Group was minus 2 percent.

Hungary was, as well, negative. Here, you see the corporate volumes decreasing by 3 percent. Now, this is entirely due to one exposure being early repaid, and this exposure was to another financial institution, namely a real estate fund, for which we provided lending and then they early repaid the entire amount. If you take that out, then the difference between the third and the second quarter would have been zero. So, this caused minus 3 percent decline.

Bulgaria was slightly positive. And Russia and Ukraine continue to decline, which is actually in line with the environment there.

The rest of the Group was slightly positive or slightly negative, but nothing major event in those countries.

On page 14, you see the deposit volume development. Consolidated level of 3 percent increase quarter on quarter, is quite strong. And almost all countries were very strong despite the fact that we are pricing our deposits as much low as possible and typically much lower than the market; namely, in Hungary and in Bulgaria. But in both countries, we experienced deposit inflows.

On page 15, you see the operating cost development. Year on year, it was minus HUF6 billion, but this was mostly due to the FX impact: the ruble and the hryvnia weakening towards the HUF.

If you take the FX-adjusted number, then it was more by HUF2 billion year on year and 2 percent plus, partially due to Hungary. In Hungary, during the year there have been two items which were important for the operational costs.

One is this contribution to the different protection funds. There's the deposit protection fund, securities protection fund, and so on. And all together, we expect to pay HUF3.3 billion more this year than last year, and for the quarter it was HUF1.1 billion, the total impact of the cost increase.

So, this is a structural increase in our cost base in Hungary. And actually, from this year to next year, there's going to be another HUF3 billion increase in the contribution into these various funds. So, this is something we have to live with, and this is going to be incorporated in our cost base for a couple of years, actually.

And the other item is related to the cost of operationally executing the settlement with customers. We actually recalculated 1.2 million customers' last 10 years loan story, and we have sent out equal amount of letters, and these letters were 20 pages each. So, it has been a huge operational challenge and task, and it generated extra costs, obviously: postal cost, printing cost, IT cost, and so on and so on.

The good news is that this is not going to happen next year. The entire amount for this year will be roughly HUF1.2 billion, but this is not a recurring item.

In Russia, we managed to reduce the cost base nominally, which if you consider the level of inflation there, I think is quite an achievement. And we are hopeful that the results of this will show up soon in the profitable operation there.

And in Romania, the increase in OPEX was due to the acquisition and the incorporation of this newly acquired bank into the consolidated numbers there.

As usual, a few more detailed story, or words, about the largest, or most important Group members. First of all, OTP Hungary, the Core operation. On page 16, you see the P&L of OTP Hungary without one-offs. As you can see, the second quarter total income number was quite strong and increased by more than HUF3 billion; net interest income was flat and we managed to increase our FX and securities results.

This is probably not very sustainable. So, we shouldn't expect exactly the same numbers for each quarter. But certainly, the fact that we have managed to stabilize the net interest income is quite an achievement, and we are quite happy about this.

I already talked about the operating cost developments in Hungary and the reasons why we had the increase. It was partially due to our contribution to the funds and partially to the extra cost related to the settlement.

On page 17, you see some background figures related to our business activity. New mortgage origination is quite strong. The cumulative year-on-year growth was 33 percent, and if we just compare the third quarter this year to the third quarter last year, then the growth was 45 percent. Our market share is very stable.

In retail savings our market share continued to increase, and we continue to be quite active in corporate lending. We took our share in the Funding For Growth scheme, which, by the way, was extended to next year. It was meant to finish by the end of this year, but now, the National Bank announced that they continue it through next year with a smaller amount, equally split between HUF and euro lending opportunity at a preferential rate for SMEs, primarily.

Our SME volumes increased considerably, and the cumulative year-on-year growth has been 14 percent plus. So, this is quite strong, and this is the client segment where we see continuous growth opportunities in Hungary short term.

On page 18, you see the status of this process of settlement and conversion of FX retail loans. There's pretty much one last technical task left for the fourth quarter, and that is the actual conversion of the car loans and the FX consumer loans in Hungary. And we don't expect further negative financial impact coming from this story.

One slide on Bulgaria, page 19. As I said, operating profits went up due to strong income numbers and risk costs went down. So, these two items resulted in this quite strong growth in profits. Portfolio quality remained stable. And we are quite active in lending. As you can see on the bottom-right part of this chart, mortgage loan origination is quite strong. Having said that, part of it is refinancing existing loans. Consumer loans were strong, as well. The biggest actual volume growth is happening in corporate, where we had 42 percent increase in new issuance compared to last year.

On page 20, you see Russia. The decrease in the negative result was due to lower risk costs, as you can see on this page. And I think what is very important, again in the lower-right corner you see the risk cost rates in the three most important product segments. After many painful quarters and years, we actually see quite marked improvement in credit cards and in cash loans categories. So, the third quarter numbers were actually quite close to the 2013 numbers, and we are hopeful that this trend is going to continue through the coming quarters.

In terms of volumes, we are obviously lower than last year, as the market itself has declined. And on page 21, you see each segment how they developed.

And page 22, you see our new disbursement numbers, especially in POS. They are still by 19 percent lower than last year. Whereas credit cards, we started selling them with very low amounts. So, the cross-selling is not very active at the moment. We are quite cautious and conservative in our approach. And the cash loan disbursements, which was restarted in the second quarter, is also a quite moderate activity at the moment.

Here, on the lower-right corner, you see the deposit prices. One of the problems during the course of this year, especially in the first quarter, was the steeply increasing cost of deposits due to the rate hikes. And as you can see on the orange line here, which is the new term deposit rates, that on average they were down to 10.5 percent in the third quarter, whereas in the first quarter they were up by close to 15 percent.

As a result, we do see a quarterly decline in the total interest rate of deposits. The third quarter was 9.9 percent. So, this is another indicator which we hope will continue to improve over the coming quarters.

Ukraine, page 23. The biggest event in this quarter was this large provisioning which we did in an amount of UAH1.8 billion as you can see on the chart. The portfolio itself, by the way, didn't deteriorate, as you can see. So, there was no further deterioration. But this provisioning was more related to restructured corporate volumes.

The good news is that there was a further decrease in the funding to Ukraine, and therefore the Group level exposure decreased.

On page 24, I think the most important point is that our coverage ratio went up to 111 percent due to this big provisioning.

Now, I have to stop here and make one forward-looking remark, which we also included into the interim report itself. We would really like to provision as much in Ukraine as necessary and as much as would allow us to turn the bank into a profitable operation starting from next year.

Therefore, we are at the moment going through and revaluating and examining the exposures what we have in our factoring company in Ukraine, which deals with the non-performing loans, mostly the non-performing mortgages. So, this is exactly HUF19.8 billion net exposure what we have there, again mostly dollar-based mortgages.

And it might happen that during the fourth quarter we will provision a material amount for this exposure. This is in progress and under review, but our feeling, or our expectation, is that it might result in higher levels of provisions.

And this is in line with what I announced at the end of the second quarter on the conf.call that in Ukraine for the remaining part for the year, for the second half, we should expect higher levels of provisions.

Overall, the risk indicators you can see on page 25. Our coverage increased and the NPL ratio went up.

And on the following page, on 26, you actually see why the NPL ratio went up, and this is mostly due to a technical re-default which happened in Hungary. On this page, if you look at OTP Core, page 26, as you remember, in the first quarter there was a HUF39 billion improvement, i.e. a reduction in non-performing loans. This was related to the settlement with mortgage holders.

The settlement happened through principal reduction. So, in a number of cases, when the settlement was so much that it decreased the overdue amounts of a non-performing loan below three months, or 90 days overdue, it technically improved and went back to below 90 days. This is for the HUF 38 billion reduction.

A part of these customers actually started to pay and healed. But part of them did not start paying and, therefore automatically went back to non-performing. We see this in the third quarter numbers, because obviously 90 days had to pass in order for them to get there.

So, basically, out of the HUF36 billion deterioration in Hungary, HUF29 billion was related to this re-default of previously healed or improved mortgage loans. And the difference between the HUF38 billion and the HUF29 billion –i.e.HUF9 billion – is the amount which actually got healed and where the customers became performing.

To a smaller extent, you see the similar situation happening in Merkantil Bank, down in the bottom-right corner. In the second quarter, it was minus HUF7 billion, and in the fourth quarter it was plus HUF4 billion. Basically, this HUF4 billion is, again, the re-default part of the improvements which happened in the second quarter due to the settlement. So, the same settlement happened there in the second quarter, and part of the exposure re-defaulted. So, this HUF4 billion was due to that.

As a result, on the Group level, out of the HUF68 billion deterioration, actually HUF29 billion plus HUF4 billion – so, HUF33 billion – was related to these technical re-defaults. And therefore, if you took that out from the HUF68 billion, then we would have had only HUF35 billion deterioration in the third quarter.

The improvement came from Russia. If you look at the chart, in Russia the second quarter new inflow was HUF38 billion, and in the third quarter it was HUF24 billion. So, this is the first quarter actually where we see quite a remarkable improvement in the deterioration.

And again, we believe that this is structural and this will continue. So, this is not a one-off event, but it will last in the future and actually continue, hopefully.

If you look at the rest of the portfolio, there was virtually no material deterioration in any of the countries. So, the rest of the portfolio is quite stable.

So, just to summarize, the NPL ratio increase was due to these technical re-defaults in Hungary, which originally meant improvements related to the settlements, and now part of those loans re-defaulted in OTP Core and in Merkantil. Besides, there was a very strong improvement in Russia.

Now, the remaining slides are describing further details related to portfolio quality and risk indicators. So, I don't think it's necessary to talk about them. You can obviously look at them if you are looking for this kind of information.

By this, I would like to end the formal presentation and open the floor for your questions. So, please, Operator, do so.

Operator: Thank you very much, sir. As a reminder, if you wish to ask a question, please press star and one on your telephone and wait for your name to be announced. That’s star and one on your telephone keypad, if you wish to ask a question. If you wish to cancel your request, you can press the hash key.

Your first question today is from the line of Gabor Kemeny. Please go ahead.

Gabor Kemeny: Hi. It's Gabor. My first question is, can you speak a little bit about the revenue outlook in Hungary? And particularly, I was wondering to what extent this huge excess deposit base could support your revenues if loan growth remains kind of modest? So, does this help you generate NII if you invest in Treasuries? Could this help you generate fee business? And how shall we think about revenues in 2016?

Laszlo Bencsik: A large increase in deposits, that's what you said? Sorry.

Gabor Kemeny: Your huge excess deposit base. How could this help you? Additional funding. How could this help you generate ...

Laszlo Bencsik: There's a positive margin on these deposits, because the average term deposit rates are 30 basis points and the base rate is 135. So, we do make money on these deposits. But this is already there in the third quarter numbers, and I don't expect similar continuous increase in deposit volumes.

Actually, at the moment there's a threat we might lose the municipal deposits to a state agency who plans to take over municipality account management, basically. We are not making much money on those deposits, by the way, because the spreads are really thin on these.

In general, our growing share in retail savings is obviously positive for the fee income, because this is related to transactions and cards and so on and so on. So, on the fee income side, we continue to expect improvement in the future.

We will lose some revenues related to the municipality business if it eventually happens. We don't know for sure, obviously.

And then, the question is how the market will evolve and how loan spreads will be stable or be compressed. So, this is very much up to our competitors, how tough they are going to be.

Gabor Kemeny: Yes.

Laszlo Bencsik: We don't expect base rate movements next year. So, we assume a stable base rate environment next year.

Gabor Kemeny: And would you expect your overall Hungarian revenues to remain roughly stable? Or, how shall we think about the evolution here?

Laszlo Bencsik: The net interest margin – if you look at the NIM on a quarterly basis, it was stable. And if everything goes well, then we can keep it as such, more or less.

Now, the big question is the volume trend. And we hope that the volume trend is going to turn around and next year we are going to see some loan growth. But obviously, this is again up to the environment and loan demand.

But unfortunately, if this doesn't happen, then with a declining loan volume we won't be able to sustain the revenues. But the baseline assumption is that we might have slight growth in terms of net volumes and the margin, in a good scenario, can remain stable. But there are downward risks, I must admit.

Gabor Kemeny: OK. That's helpful. And my second question is on Ukraine. You mentioned that you are reviewing up to HUF20 billion foreign portfolio which may have to be impaired. Is this a kind of fair indication for how much provisioning to expect in the fourth quarter? Or, do you think there could be some other corporate exposures, some modest FX mortgages? Can you help us size the potential of losses in the fourth quarter?

Laszlo Bencsik: This is a portfolio which is non-performing and already heavily provisioned. So, the gross exposure is equivalent of HUF180 billion-HUF190 billion.

Gabor Kemeny: OK.

Laszlo Bencsik: And we already provisioned a lot on this. And the remaining net amount which is not provisioned is HUF19 billion. We will not provision HUF19 billion. So, just be clear.

This is the theoretical total, but if we did so then we would have to assume that we won't be able to collect a single penny there, which is quite unrealistic given that these are actually covered or secured exposures, all of them. So, there are no consumer loans in this portfolio.

The actual provisioning will be somewhere definitely less than HUF19 billion, but quite probably more than zero for this portfolio.

For the rest of the Bank, I don't expect any negatives. So, it should actually get close to zero.

Gabor Kemeny: OK. That's interesting. And just lastly, on Russia, again on net interest income, you show in the presentation that the deposit costs are coming down.

Laszlo Bencsik: Yes.

Gabor Kemeny: But you also mentioned that the performing book is shrinking.

Laszlo Bencsik: Yes.

Gabor Kemeny: How much do you think the performing book could drop? And how shall we think about your core revenue here, going into 2016?

Laszlo Bencsik: Revenues continue to decline because of our subdued, so to say, activity in credit cards lending.

We are working on it at the moment, we have actually a very dedicated project on this. So, hopefully we can come up with a credit card product and structure which we believe is going to be profitable under the current circumstances.

Unfortunately, we have had very negative experience with our credit card portfolio in Russia, and most of the losses what the bank experienced there were related to credit card exposures. So, we are quite cautious restarting it.

But nevertheless, this is the biggest lever here, and we haven't really restarted this yet. So, certainly, during the fourth quarter we will see further decline in volumes. That's for sure. The credit card volumes will continue to decline, and the cash loan volumes will continue to decline, too.

On the other hand, the POS volumes we should be able to stabilize, because these are short-term loans. So, once the last year relatively high issuances go out of the picture, then the portfolio should stabilize there.

So, in essence, we do expect further decline in the performing loan portfolio, at least for the next three quarters.

Gabor Kemeny: Could it be double-digit?

Laszlo Bencsik: Sorry?

Gabor Kemeny: Could this maybe – can you give us an estimate, roughly? If we assume, kind of, 20 percent up for next year, is that kind of reasonable?

Laszlo Bencsik: Last quarter there was 3 percent decline. This is likely to continue in the fourth quarter.

Gabor Kemeny: That's helpful.

Operator: Thank you. Your next question is from the line of Andrzej Nowaczek. Please go ahead.

Andrzej Nowaczek: Good afternoon. Thank you for the presentation. I just wanted to ask a couple of general questions. First, we're not that many quarters away from 2017. How do you see your ROEs progressing towards your goals from now? Are you still confident in that 15 percent to 20 percent range?

Laszlo Bencsik: Yes.

Andrzej Nowaczek: And can you give you any color on what is going to drive the improvement from the current level, other than the bank tax cuts? So, that would be the first question.

Laszlo Bencsik: The strongest driver should be Russia and Ukraine turning from a large negative to a modest positive. And this is – we are progressing on that path – going to happen much earlier than 2017. So, as things look like today, we have every reason to suppose that Russia and Ukraine will be positive already next year.

Andrzej Nowaczek: Already next year. And probably more positive in ...

Laszlo Bencsik: Probably, yes. Very obviously, we are working hard on making it even more positive in 2017. And then, we should be able to get to that range. So far, nothing happened which changes our view on this 2017 forecast.

Andrzej Nowaczek: And as we all remember, one of the assumptions behind this target was core equity tier 1 ratio of 12.5 percent. We're still somewhat above it. Not much loan growth happening anywhere. How do we get to that 12.5 percent?

Laszlo Bencsik: That's a good question, and I don't have the answer right now. One way of getting there is through share buybacks. The other way of getting there is through acquisitions.

We definitely would like to improve our position in number of countries, and we are quite hopeful that we are going to find suitable targets at reasonable price. So, this would be the preferred way to get to that level.

Andrzej Nowaczek: OK. And finally, what can go wrong in Bulgaria in the coming quarters, if anything?

Laszlo Bencsik: Unfortunately, there is going to be a structural decline in the NIM, because – The current NIM level is, as you can see, quite high, above 5 percent; it's 5.5 percent-5.6 percent.

And this is due to the fact that we managed to quite rapidly reprice the deposit book, but there's not much room there anymore because we are getting to the bottom of technically possible deposit rates. Whereas the repricing of the asset side takes longer, and it's through basically refinancing, which is a longer process.

But we are going to see pressure on the NIM soon in Bulgaria, in the next year, I think.

Andrzej Nowaczek: Thank you so much, Laszlo.

Laszlo Bencsik: But this is not going to be an abrupt change. So, it's more a kind of quarter-by-quarter some erosion in the NIM. But other than that, I don't see any potential threat, so to say.

Andrzej Nowaczek: Thanks, again.

Operator: Your next question is from the line of Ivan Bokhmat. Please go ahead.

Ivan Bokhmat: Hello, good afternoon. I have a couple of questions. First, a relatively technical one. As a result of the Romanian Swiss franc loan conversion, what kind of a recurring income loss would you expect, if any?

Laszlo Bencsik: Good question. It's around HUF3 billion per year.

Ivan Bokhmat: HUF3 billion per year. And the second question, maybe a little more broad. Your Russian business, we have seen another change of management in the fourth quarter also. Can you maybe expand a little bit on why that happened and what, if any, changes of strategy we may expect? Was it related to some particular problems in the execution?

Laszlo Bencsik: First of all, we had a very difficult 12 months behind us because we went through a very drastic cost reduction program in Russia. If you look at the nominal cost numbers, we achieved quite a substantial decline in nominal terms, and this happened while the ruble depreciated and then very high inflation. So, it took quite a strain on the organization there, I would say.

There's no change in strategy. We have revisited various strategic opportunities in Russia, including divesting it, including stripping it down to a very focused organization. But at the end, we decided actually not to change the strategic direction of the bank. So, we'll pretty much continue with everything what we have had so far.

One strong element of our strategy there is the new online bank, Touch Bank. And at the moment, it's just a cost generator, but it started to acquire customers and hopefully the business volumes will appear soon both on deposits and the loan side. So, we are quite hopeful that this is going to work well.

And then, we are trying to fix those products which proved to be unprofitable in bad times; namely, the credit cards. And that's why we are actually not selling much credit cards at the moment, because we're still fixing the process and various parts of the value proposition in order to assure that what we sell in the future will be profitable, even when we have the downward part of the cycle, not just when we are growing.

So, all in all, there's no – we dropped the idea of trying to sell the bank. So, we are not going to do that. We keep it. We stay in Russia. And we continue with the strategy what we have had so far.

We only want to do it much better and make it even more resilient to the cycles, because Russia ultimately is a very volatile environment. It's a commodity country, and in a commodity country we are competing primarily in consumer lending. And consumer lending, out of the various banking product segments, is probably one of the most volatile.

So, in a volatile country we compete in a volatile segment, which then creates our operational environment quite volatile. So, we have to have a business model which is resilient and which provides stable returns over the cycle. And we should not get again into this rollercoster of having extremely high returns in the years when everything goes fine and then have serious losses when things go worse.

So, that's what we are working on, but that doesn't mean that we changed our strategy.

Ivan Bokhmat: One view – and maybe I'm wrong here – considering the profile of your previous CEO having come from an online bank, a credit card player, would be that it would quite fit the priorities that you've just outlined, the Touch Bank, the better credit card product. And I don't know if we should read at all into this? Or, it was just personal?

Laszlo Bencsik: First of all, you have to understand that our online bank has its own management. So, the bank's management doesn't manage the online bank. The online bank operates under the license of the bank, but it's organizationally, operationally, IT-wise, and management-wise, and branding-wise, and product development-wise, and everything-wise fully independent from the bank.

So, we actually have two managements in Russia, and the CEO of the bank manages only the bank, the traditional bank. He does not manage the online bank. This is one point.

The other point is that actually the new CEO is a Russian gentleman, and he used to work with the GE subsidiary in Russia, focusing on consumer lending. He's a business guy, has a very strong background and experience in consumer lending. So, I think his profile is perfectly fitting the bank and where we want to develop the bank.

Ivan Bokhmat: OK. That's helpful.

Operator: Thank you very much. Your next question is from the line of Margarita Streltses. Please go ahead.

Margarita Streltses: Hi. Thank you very much for taking my question. Just a couple of follow-ups, and I'm sorry if I missed it previously. On Russia, the provisions have been down quite substantially on a quarter-on-quarter basis, but NPL ratio actually increased by 3 percent. So, would you consider the improvement in provisions a sustainable trend? Or, it will continue to be rather volatile?

And a second question on Hungary, whether – we've been expecting some recovery in the loan growth over the past few quarters, but of course it was not enough to offset the back book maturities. So, what is your outlook for the next few quarters? Do you expect to see a positive loan growth?

And also, maybe if you can give us some outlook on the net interest margin in Hungary? And whether you think the recovery that we've seen this quarter is actually sustainable, considering that all the FX measures have come through, basically?

Laszlo Bencsik: Provision trends in Russia, we expect them to continue. So, it wasn't a one-off event. We expect this improvement to continue. The NPL ratio increases because the total loan volume is going lower.

In Hungarian loan growth, we are hopeful that next year the trend is turning around, and we continue to be hopeful in that sense.

Hungarian NIM, I tried to elaborate on this previously. So, there are no structural changes which should lower the NIM, but certainly the risks are more downward than upward, definitely. So, if competition intensifies, then it can have a negative impact on the NIM.

Margarita Streltses: OK. Thanks a lot.

Laszlo Bencsik: You’re welcome.

Operator: Thank you. You appear to have no further questions at this time. As a reminder, if you do wish to ask a question today, please press star and one on your telephone keypad.

You appear to have another question from the line of Andrzej Nowaczek. Please go ahead.

Andrzej Nowaczek: I just wanted to ask a follow-up question on what I asked about earlier, when you said share buybacks could be one way of getting to a higher leverage ratio. There was an announcement today talking about 200,000 shares bought by OTP yesterday. I presume that's either for a customer or management share option plan. Can you comment on this?

Laszlo Bencsik: Yes. Indeed, this is related to management share option program and it is a self-governing automatic system here. We have to keep the number of shares for supporting this option program at a certain level. And once it drops below that level technically, then we buy this 200,000 number of shares. And this just happened yesterday.

So, it was not a decision of the management or a decision by anyone. This is an automated procedure which we have an approval for by the regulator and so on and so on. So, this is a set mechanism.

And you should not take any hints from this happening; it does not have any information value that this happened yesterday. It was just related to one employee who actually executed some of the options, and we had to replenish them.

Andrzej Nowaczek: That's what I thought. So, presumably a proper share buyback program would have to be voted on by an AGM?

Laszlo Bencsik: Sorry?

Andrzej Nowaczek: Would you have to have a vote at the AGM to decide on a share buyback?

Laszlo Bencsik: We do have a mandate from the AGM to buy back as much as 20 percent of our shares.

Andrzej Nowaczek: OK. That was years ago. I remember now. Yes. That's clear.

Operator: Thank you. Your next question is from the line of Victoria Cherevach. Please go ahead.

Victoria Cherevach: Hi. Could you please tell me what you're seeing in terms of new production cost of risk in Romania? And do I understand correctly that you don't believe that 70 bps that you saw this quarter is a sustainable level?

Laszlo Bencsik: Sorry. Somehow the line was not very strong. Can you repeat your question, I didn't get it.

Victoria Cherevach: Sure. I can repeat that. I was just wondering if you could tell us what you're seeing in terms of new production cost of risk in Romania, what levels you're seeing there? And also, if I understand correctly, that you don't believe that 70 bps that you saw this quarter is a sustainable level?

Laszlo Bencsik: In Romania?

Victoria Cherevach: Yes, please.

Laszlo Bencsik: In Romania, the third quarter the risk cost rate was 72 basis points.

Look, the highest-risk part of the Romanian portfolio is the Swiss mortgage book. If we succeed to convert this into euro or local currency, this is going to reduce the loan servicing needs of the customers and take out the currency risk.

So, if this is going to happen, then the 70 basis points or about is realistic; Romania can be similar to Hungary and Bulgaria, basically. And in Hungary and Bulgaria, we have risk cost rates on a quarterly basis between 50 and 100 basis points. So, this is the range where Romania should be in the future, assuming that we succeed with this conversion program.

Victoria Cherevach: Great. That's very clear.

Laszlo Bencsik: Sure, welcome.

Operator: Thank you. Your next question is from the line of Stefan Maxian. Please go ahead.

Stefan Maxian: Just one question, actually, left regarding to the short-term management guidance that you had in the last conference call pointing towards adjusted after-tax profit for 2015 below the 2014 level. You don't have this slide anymore in your current presentation. Does it mean that the guidance is not valid anymore?

Laszlo Bencsik: Certain – I think we are going to be close to that number, but probably higher. It seems that the underlying performance of our Russian and Ukrainian bank is actually getting better than we previously expected, but we're still going to have probably one bigger provisioning event in Ukraine, which I just explained, related to these portfolios which are already non-performing, which should have a negative impact on the quarterly result. So, usually, seasonally the last quarter is less strong than the rest of the year.

But looking at the third quarter, I would slightly modify that forecast, and it's actually quite probable that we will somewhat overshoot last year number.

Stefan Maxian: That's clear.

Operator: Thank you. Your next question is from the line of Marcin Jablczynski. Please go ahead.

Marcin Jablczynski: Yes. Good afternoon. Thank you for the presentation. My question is a follow-up to what Andrzej Nowaczek asked i.e. the buyback program. How much space do you think you have to buy back your shares? Your consolidated tier 1 ratio is 13.5 percent. We are seeing regulatory initiatives everywhere in the region, actually for banks to have higher rather than lower common equity tier 1 ratios and total capital adequacy ratios. So, what's the plan here?

Laszlo Bencsik: We don't have a plan, as such. So, we have not communicated a buyback strategy or program, and we don't have anything approved yet.

As I said, the preferred way of optimizing our capital structure, first of all, would be to acquire banks in countries where we don't have the required level of operational size. But having said that, obviously it's also possible that we divest some of these banks. So, this is not impossible.

But this would be the first. And then, we will see. Obviously, if the requirements go higher and if our peers start to target higher levels, then we might have to revisit the 12.5 percent. The 12.5 percent seemed to be a quite reasonable target at the time when we announced it at the AGM. In general, we say that we like to be somewhat higher than our immediate regional peers.

But you could argue the other way, as well, that the risk structure of the Group improved so much that we don't have Swiss retail exposures anymore and now that Ukraine is much smaller and Russia is turning into positive. So, you could have a counterargument, as well, that the risk profile improved a lot since we communicated this.

But what I said was only that these are the possible tools by which we can have an impact on this ratio, but I'm not implying that we have an approved and set strategy to buy back our own shares.

Marcin Jablczynski: That's very clear. And maybe one last follow-up on the banking tax cuts expected from next year. There was some news from, I think, yesterday, with Mr. Varga making certain comments about it. Do you expect the banking tax cuts to be conditional upon certain – achievement of lending levels, or not really? Because currently I think it's isn't.

Laszlo Bencsik: At the moment, there are two levels of bank tax deduction from this year to next year. One is related to the original agreement which was made between the government, us, and the EBRD at the beginning of the year. And that stipulates a certain level of bank tax deduction from this year to next year. And this is the one which we have calculated with and what we pretty much consider as certain.

I think it's unlikely that further conditions will be attached to this reduction of the bank tax.

On the other hand, in the current legislation you see a further deduction potential in the bank tax, with another HUF10 billion which was meant to be distributed between those banks where the corporate loan volumes increased since 2009. So, this conditionality is already there in the legislation, but this might result a further bank tax reduction compared to what was agreed at the beginning of the year.

So, there's already this conditionality, and I think most probably this is going to be the optimal structure. So, the original bank tax reduction stays as it is without any condition, just as today. There might be another form of further bank tax reduction for banks which do increase their activity.

This is what we have today, and actually it does make sense to have it this way. But indeed, yesterday, the Minister of Economics, Mr. Varga, said that they had a discussion with the EU and apparently Brussels was not very happy with this second part of the bank tax deduction which was related to corporate loan growth.

But I don't know the details. Obviously, we are not talking to Brussels. It's the government and Brussels. They talk to each other, and we only know from yesterday announcement what's happened. So, I'm sure there will be some discussion between the government and the banking association.

Reading the general mood here, I am quite optimistic. I believe that the government does want to reduce the bank tax, because they understand that this is not helping the economy. And I do understand that they want to stimulate lending. So, we have a number of initiatives mostly coming from the central bank trying to boost lending. It would fit into this overall picture very much.

Marcin Jablczynski: Thank you very much. And maybe lastly, what is the amount of VAT that you pay in Hungary? And potential sensitivity to potentially lower VAT rate?

Laszlo Bencsik: The rate is 27 percent; the exact amount I don't know. That we have to dig out. I don't know by heart. But the rate is 27 percent.

Marcin Jablczynski: Yes, but hopefully it will be going lower at some point?

Laszlo Bencsik: Yes, hopefully.

Marcin Jablczynski: OK.

Operator: You have no further questions at this time. Please continue.

Laszlo Bencsik: OK. Well, thank you very much. Thank you for listening to the conf call and thank you for your very good questions. I hope you will join us next time, I think on the 4th of March next year, when we report on the full-year numbers.

So, thank you, again, and wish you all the best. And goodbye.

Operator: Thank you very much, sir. That does conclude our conference for today. Thank you, everyone, for participating. You may now disconnect.

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