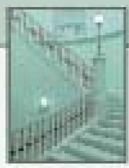
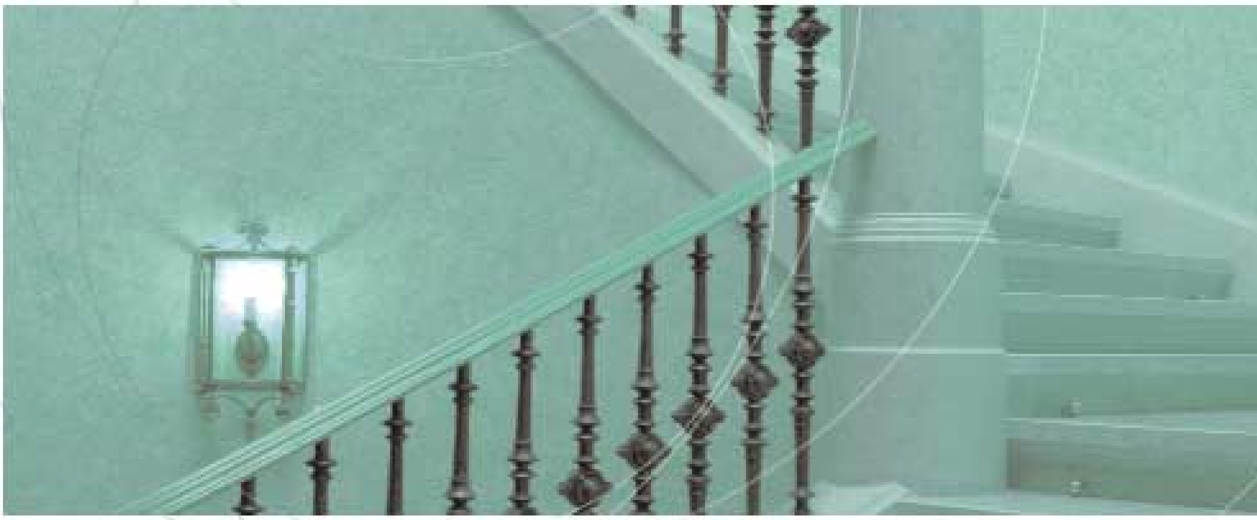
JELZÁLOGBANK

2003

2003 Annual Report



OTP MORTGAGE BANK LTD.



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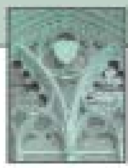

Annual Report 2003

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MESSAGE FROM THE CHAIRMAN AND CHIEF EXECUTIVE OFFICER

Looking back on a decade of low-key investment into housing, the government has introduced a series of measures since 2000 to aid recovery and to improve the conditions of home ownership. The first step involved the introduction of interest subsidies on loans extended to finance new homes and was followed by expanding the arrangement to cover used homes through mortgage bonds. The real breakthrough in the market of home loans arrived when state-owned mortgage banks lost their prerogative of exclusive access to mortgage bond subsidization.

Upon the creation of the statutory framework, OTP Bank passed a resolution dated March 2001 on incorporating OTP Mortgage Bank Ltd., its fully owned subsidiary with equity capital at HUF 3 billion. Setting up a mortgage bank served two purposes: to make OTP Bank eligible for extending cheap housing loans drawing on subsidized funds and simultaneously, to give new momentum to lending and to the increase of market share.

OTP Bank Ltd. and OTP Mortgage Bank Ltd. extend subsidized syndicated home loans collectively, which has strengthened the overall role of the OTP Group in housing finance. In competing for customers, OTP Mortgage Bank can expect to rely on the traditional role of its parent bank in housing finance, which involves market awareness and professional expertise accumulated in the network of branches. The housing loans business rests on confidence between customer and bank. The traditions of OTP Bank Ltd. also provide good references in that respect. The strong capital base, traditions and reliability of the OTP Banking Group also help sales. OTP Mortgage Bank may multiply these advantages by utilizing the benefits intrinsic to the Banking Group through expanding the portfolio of home loans on offer.

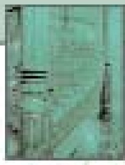
OTP Mortgage Bank Ltd. started operating on February 1, 2002. The first business year passed under the aegis of developing and optimizing bank-like operations, automating and rationalizing processes. The main goal called for ensuring and maintaining a key role for OTP Mortgage Bank in a market that counted only three mortgage banks as participants. After the expansion of subsidization and the launch of syndicated lending in April 2002, the former monthly volume of lending grew from HUF 3-6 billion to reach, and remain permanently above, HUF 30 billion. The closing portfolio of home loans extended by the company came to HUF 186.7 billion at year-end 2002.

Despite increasing legal austerity and the weakening economic environment, OTP Mortgage Bank managed to develop its business portfolio dynamically in 2003. The volume of home loans more than tripled to reach HUF 604.7 billion.

Realistically, OTP Banking Group sought to retain its leading position in the market of home loans. Pursuing its business in the past two years, OTP Mortgage Bank managed to acquire a 64% share of the market of home loans by December 31, 2003.

The Bank conducted its program of issuing covered mortgage bonds with equal success. The first issues were placed privately and were subscribed by OTP Bank. As the portfolio of outstanding loans increased, the Bank progressed to placing mortgage bonds publicly and diversified its pool of investors to include other members of the Banking Group as well as domestic institutional investors. Simultaneously, the mortgage bonds of OTP Mortgage Bank were listed on the Budapest Stock Exchange in December 2002.

OTP Mortgage Bank issued HUF 177.1 billion worth of covered mortgage bonds in the first year of operation and had reached the leading market share of 61.4% by year-end 2002. In 2003, the value of mortgage bonds on issue grew by HUF 421.9 billion to bring the total portfolio of outstanding bonds to HUF 599.0 billion and market share to 65%.



OTP Mortgage Bank keeps statutory compliance in sharp focus and has always attached high priority to prudential operations. Ensuring the coverage for mortgage bonds and protecting investors are kept high on the agenda. The coverage for mortgage bonds is guaranteed by a system resting on three pillars, including first of all the security of real property collateralizing the home loans, which is evaluated and controlled in line with HDFS-approved principles, secondly, the government guarantee backing the loans with supplementary interest rate subsidization, which make up one-fifth of the portfolio, and thirdly, the unlimited commitment by OTP Bank to repurchase sub-standard receivables. To complement the three pillars, the trustee (PWC) keeps supervising the coverage of mortgage bonds.

Investors enjoy additional security through the ratings prepared by Moody's Investors Service Ltd. of the operations of the Bank and the quality of its mortgage bonds. The Agency classified OTP Mortgage Bank as a category A2 issuer and classified its mortgage bonds as A1.

The performance of our Bank has been outstanding since we started up. Profit before tax grew from HUF 651 million to HUF 8,548 million in the first two business years. At 46.7% in 2003, return on average equity (ROAE) was superior even in the domestic banking sector.

The business positions occupied, competitive products and the system of mature operations developed by OTP Mortgage Bank Ltd. lay the foundations for future successes in business, which I sincerely hope the Bank will confirm.

Zsolt Oszlányi
Chairman-CEO

I. MARKET ENVIRONMENT

I. 1. Macroeconomic Conditions

Clashes over fiscal and monetary policy and a variety of events in the money market dominated economic policy in 2003. Neither internal nor external economic processes fulfilled expectations.

Wage outflows kept soaring high throughout the year and worked to propel consumption dynamically. All in all, the economic growth in the first half of the year was owing to internal demand triggered by fiscal loosening.

The second half of the year brought a slow turnaround. Responding to a government initiative mid-year, the National Bank of Hungary shifted the band of floatation of the currency by 2.36% in the weaker direction to prevent further appreciation the HUF rate and took three consecutive steps to increase central bank rate by a total of 600 basis points in the second half of the year.

Monetary policy tools alone are insufficient to solve the problems of unbalance emanating from economic processes, balance needs to be strengthened through fiscal austerity. While preparing the budget for 2004, the need for savings measures was identified. The government submitted a savings package of HUF 76 billion to Parliament, including more stringent rules of home subsidization and the requirement that forced publicly funded institutions to curb costs by 2.5%. The short-term effect of these measures is quite modest, as changing the system of home subsidization can only yield results of merit in the medium term.

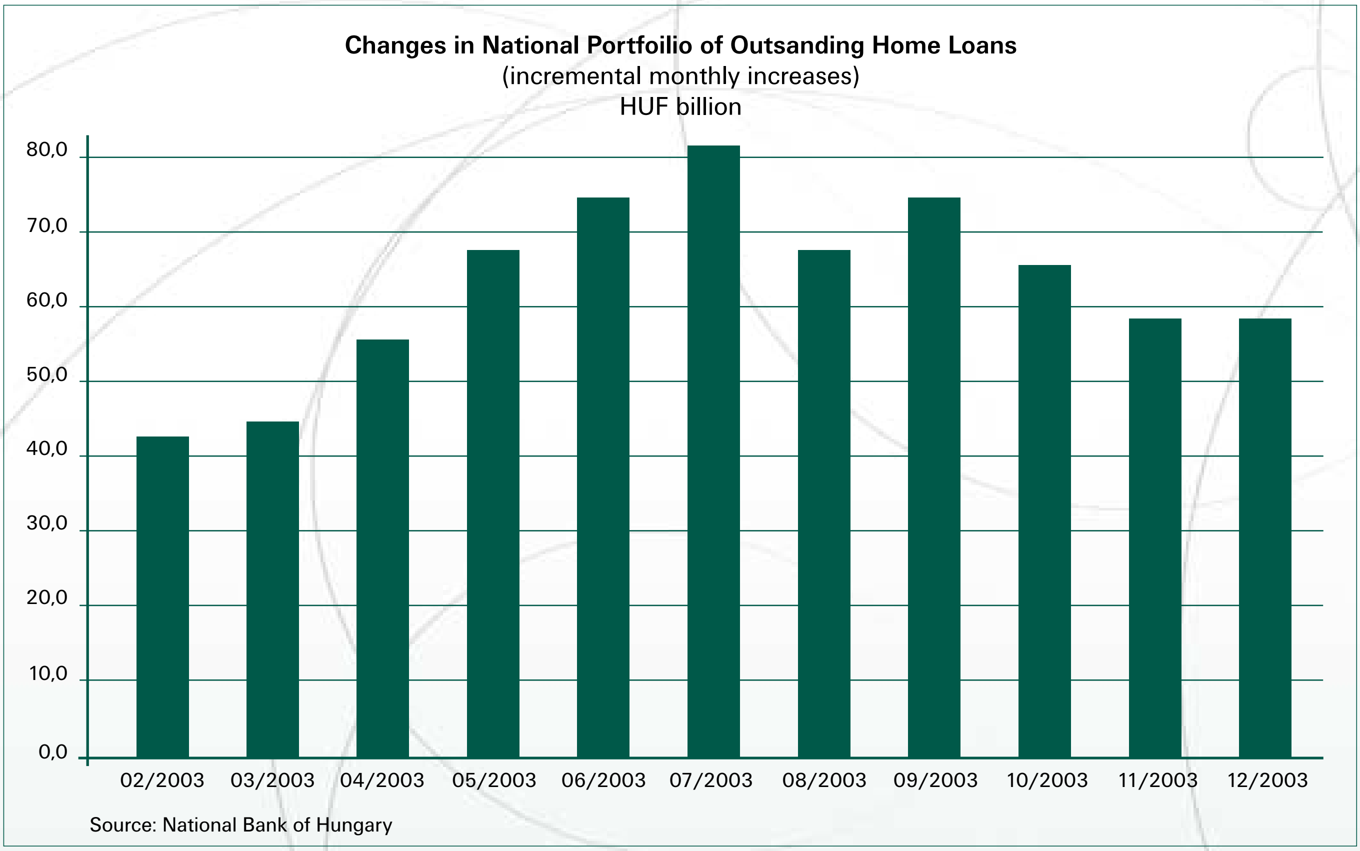
As regards the real processes of the economy, domestic economic growth rebounded from the low it plummeted to in the first half of the year in the wake of the onset of long-awaited international recovery. The new trend is based on the disadvantageous expansion of the export-oriented branches of the processing sector, whilst corporate capital expenditures take the limelight among the components driving demand. Favorable real economic processes coupled with the worsening of the essential ratios of financial equilibrium (balance of foreign trade and on current account, the position of household savings, the balance of the consolidated budget of the public sector, the structure of raising foreign funds) worsened in the second half of the year.

I. 2. Household Income and saving Processes

Households responded by a spending spree to the drastic change in their income trends in the course of 2002 and 2003 and spent almost all of the rapidly increasing incremental income on consumption or invested it into housing. Despite the higher income, the propensity to save was much lower, which turned households into net borrowers in the second quarter. Property loans continue to be the main driver of the increasing indebtedness. About 66% of the total increase of credit involves home loans. The attenuating demand for home loans early on in the year flared up again upon receiving the news of the introduction of a more stringent system of housing subsidies. Bank home loan placements rose to a record height in the third quarter and topped HUF 222 billion.

Demand for housing loans was created artificially in the household sector in 2003 as home construction projects and steps to purchase homes were brought forward in response to the introduction of tougher financing conditions in the housing market.

All in all, the process of households becoming indebted has accelerated in the past three years. The ratio of total debt to total financial assets rose from 11% in 2001 to 15.4% by late 2002 and by an additional 5% to 20.7% in 2003. An essential question of the future in the housing loans sector concerns the rate at which households will continue to submerge into indebtedness taking into account the expected development of real wages and interest rate levels. We expect dwindling growth in the volume of credit taken out by the household sector in 2004.



I. 3. Regulatory Environment

The system of subsidies earmarked for housing in effect from February 1, 2001 discontinued the non-market-conform practice of restricting the access to government support for mortgage bond covered home loans to state-owned mortgage lending institutions.

The amendments of the relevant Act in 2001 and 2002 brought added support for mortgage loans and mortgage bonds. Contrarily, two consecutive amendments enacted (on June 16 and December 22) in 2003 introduced severe restrictions. The modifications embarked on in June failed to hold back the demand for loans as only a few customers were affected by the restrictions set forth by the amendment. In the majority of cases, however, the new law specified a lower amount in loan charges, which contributed to an additional increase of demand for loans. Although the amendments enacted in December contained more stringent restrictions, the related effects were hardly if at all evident in 2003.
As a result of the changes, the demand for home loans accelerated before each took effect, bringing the portfolio of housing related loans in the banking system slightly over HUF 1,500 billion by the end of the year.

I. 4. Major Factors Influencing the Mortgage Lending Market

At present, there are three operating mortgage lending institutions in Hungary: the partially state-owned Land Credit and Mortgage Bank Ltd. (FHB), HVB Mortgage Ltd., which is owned by HVB Bank Hungary Ltd., and OTP Mortgage Bank Ltd., which is the subsidiary of OTP Bank Ltd.

The core business of all the three mortgage-lending institutions involves first of all the extending mortgage loans taken out to finance homes by individuals and purchasing such loans.

The domestic market of mortgage lending and issuing mortgage bonds has been completely realigned in the past two years. Relying on its banking parent while competing with specialized mortgage lending institutions, OTP Mortgage Bank soon became the largest participant of the market. In 2003, it retained its position of market leadership and acquired new market share in both the mortgage loans and mortgage bonds business lines. By the end of the year, its share in the mortgage bonds market had reached 65%.

II. BUSINESS REPORT

As OTP Mortgage Bank and OTP Bank have formed a lending syndicate and offer a joint home loan product, the strategic goals of OTP Bank and the Banking Group also determine the plans of OTP Mortgage Bank.

The OTP Banking Group has been a leader of the housing loans market for a long time with OTO Mortgage Bank carrying the heaviest emphasis within the group due to the more favorable system of subsidizing mortgage loans. The strategic goal of the banking group calls for bringing the joint market share of OTP Bank and OTP Mortgage Bank in the area of approved home loans permanently over 55%.

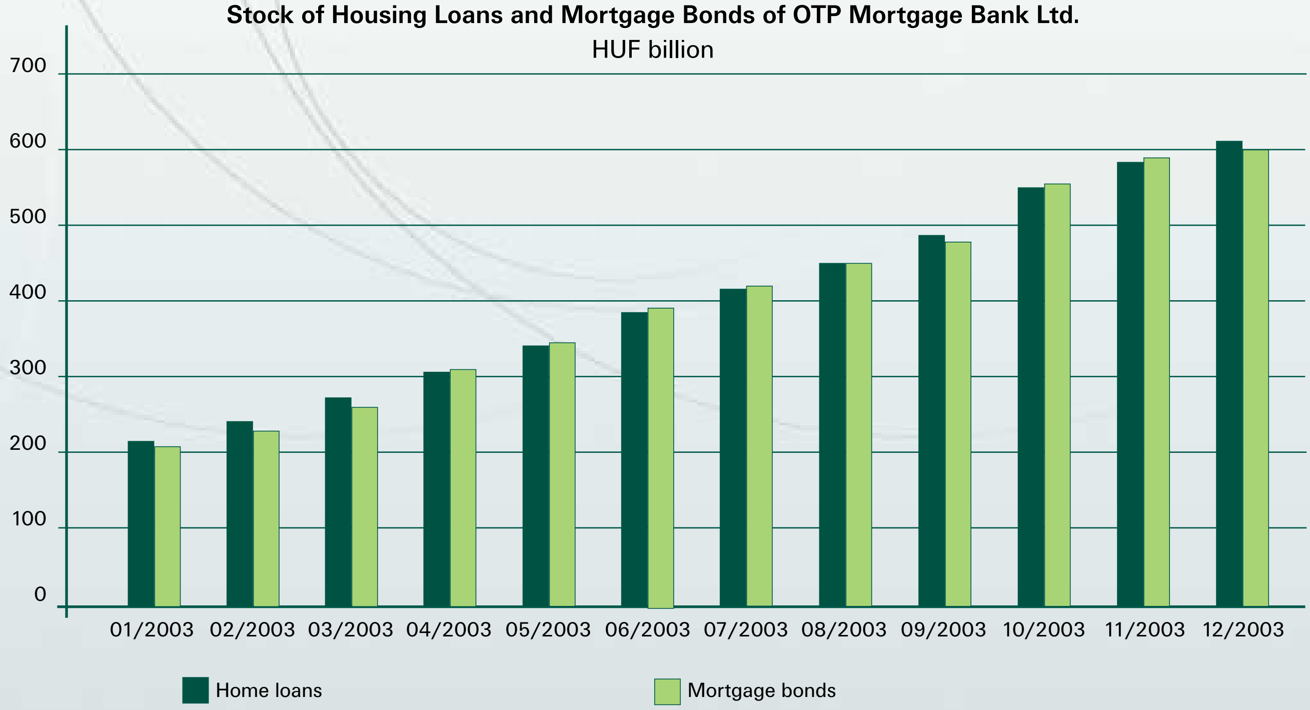
In line with the medium-term strategy it approved for the period between 2002 and 2005, OTP Mortgage Bank took major steps in 2002 to develop modern banking operations and increasing competitiveness, efficiency and profitability. Responding to changes in market conditions, OTP Mortgage Bank and OTP Bank made it possible for their clientele to have access to subsidized home loans with preferential terms.

II. 1. Loan Portfolio: Development and Composition

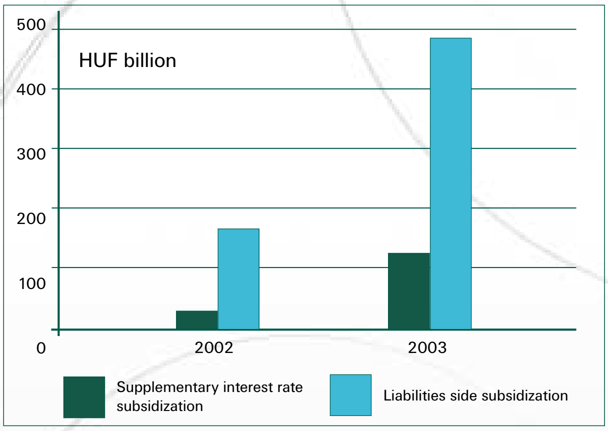
OTP Mortgage Bank extends and purchases subsidized home loans only. The development of its portfolio of loans is the outcome first of all of the cooperation with OTP Bank, its partner in the syndicate, which operates a network of more than 400 branches. There was a close match between the application for and the disbursement of home loans and the changes in the degree of subsidization. The portfolio of loans on hand at OTP Mortgage Bank grew by HUF 30-40 billion monthly in 2003 to reach HUF 604.7 billion by the end of the year, including close to 140 thousand loan transactions and corresponding to an increase of 224% over the portfolio of loans a year earlier. That brought the market share of the Bank to 63.9% in a mortgage market that counted only three participants.

Stock of Housing Loans and Mortgage Bonds of OTP Mortgage Bank Ltd.

HUF billion



Close to 70 percent of the loans have been disbursed to finance used home purchases, modernization and expansion, whilst 30 percent financed building and purchasing newly constructed homes. Subsidization brought the ratio of loans OTP Mortgage Bank could disburse to customers to finance the purchase and construction of new homes with supplementary interest rate subsidization and liabilities side subsidization from 17.7% at the beginning of the year to 19.4% at year end.



Before the amendment of the decree on subsidization, products on offer included both variable and fixed rate arrangements (the latter with a repricing regime of 5 years). After June, the Bank only offered fixed rate loans (with a repricing regime of 5 years) due to the specific terms of the modified decree. To meet customer requirements, loans can be tailored to include a life assurance product of OTP-Garancia Insurance, or a home savings fund product of OTP-LTP. Loans with dual subsidization may be taken out to mature in as long as 35 years, whilst the longest potential maturity of loans with liabilities side subsidization is 25 years. Average maturity, however, is close to 18 years.

II.2. Loan Portfolio: Quality

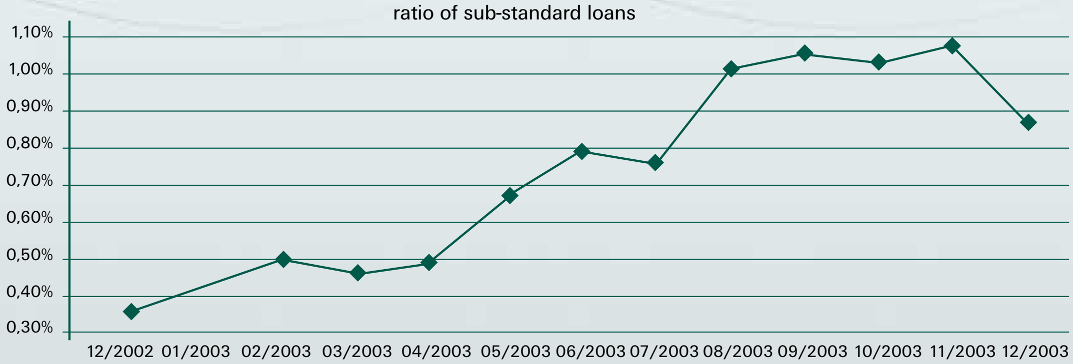
A security system containing three components is used to safeguard the lending business of OTP Mortgage Bank and to minimize exposures to risk:

– The risks of the mortgage lending business is mitigated and its safety is enhanced by the legal environment, which provides that loans can only be extended against a specific collateral of real property and with certain legal assurances.
– The government guarantees the repayment of 80% of the loans disbursed with supplementary interest rate subsidization.

In the case of OTP Mortgage Bank, the shareholder, OTP Bank fortifies the aforementioned system of securities through its commitment to repurchase sub-standard loans at book value.

OTP Mortgage Bank managed to keep the ratio of loans with repayment problems below 1% of its closing credit portfolio of about HUF 605 billion in 2003 by employing prudent lending policies and professional credit rating before loan disbursement. But continuous loan monitoring helps the Bank keep even these problematic loans under control and prevent more serious consequences.

Rating the Load Portfolio of OTP Mortgage Bank Ltd.
ratio of sub-standard loans



II.3. Financing, Mortgage Bond Issues

The most important external resource that supports the purchase of loan receivables and helps maintain liquidity is the stock of outstanding mortgage bonds, but liquidity has also been managed through the deferred payment option relating to the purchase of receivables, the reliance on the credit facility granted by OTP Bank and the conclusion of repurchase transactions.

The cash OTP Mortgage Bank raised through its mortgage bond offerings have always been used for purchasing receivables or for meeting the obligations associated with maturing mortgage bonds.

Whenever mortgage bonds are offered, the following factors are given special emphasis:

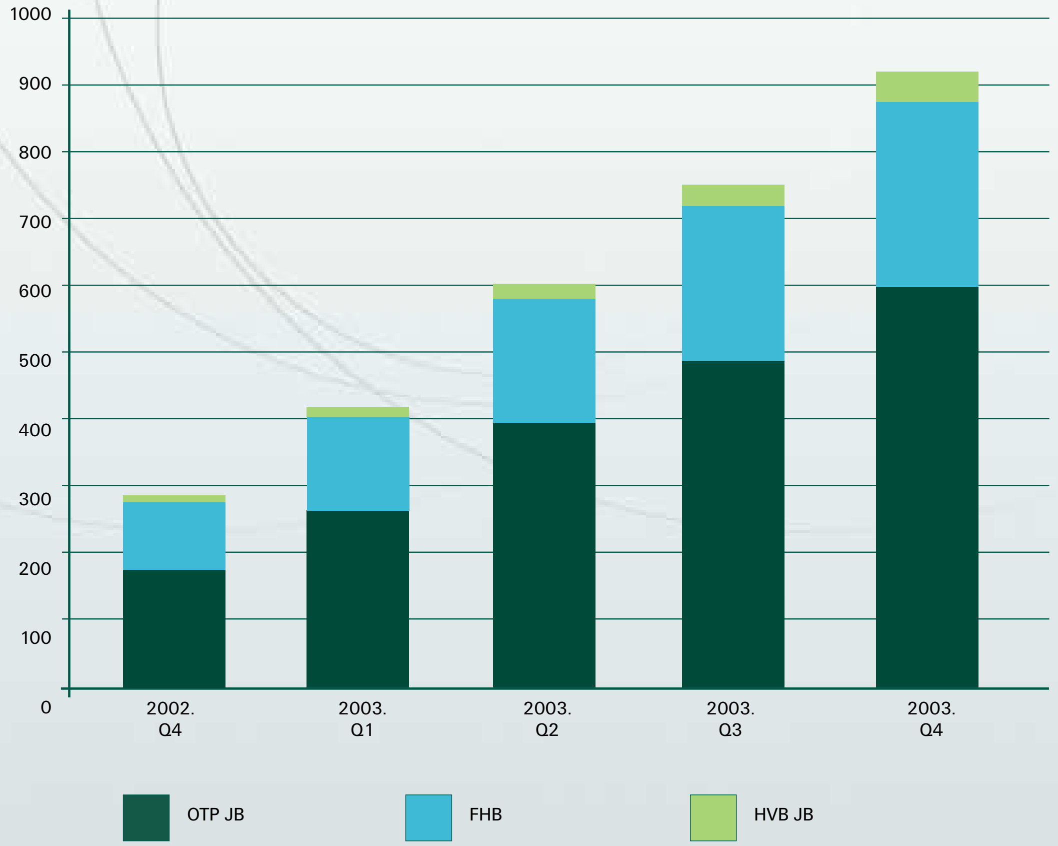
– matching the total face value of mortgage bonds outstanding and on offer with the unpaid principal balance of the credit portfolio of the Bank,
– managing long-term maturity matches and interest rate risk,
– constant compliance with the terms of being eligible for government subsidies,
– ensuring the coverage for mortgage bonds, and
– maximizing the income and earnings of OTP at Banking Group level.

Mortgage bond offerings have been managed in the form approved and controlled by HFSA. OTP Bank acted as lead manager of the bond offerings, while PriceWaterhouseCoopers conducted the audits of the coverage available for the offerings in its capacity of trustee.

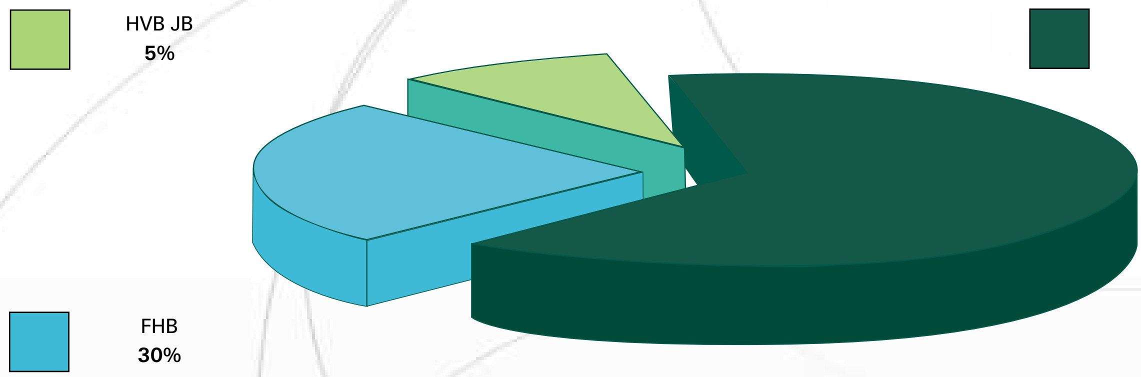
Offerings were held to keep pace with the expansion of the credit portfolio. A total of HUF 530.9 billion worth of mortgage bonds were issued in the year subject to this report, including bonds worth HUF 109.0 that matured in the same period. That increased the portfolio of outstanding mortgage bonds from HUF 177.1 billion to HUF 599.0 billion by the end of the year. Accordingly, market share reached 65.0%.

Development of the Market of Mortgage Bonds

HUF billion



Source: Hungarian Capital Market



The mortgage bonds offered for sale by OTP Mortgage Bank in 2003 were subscribed by and purchased by OTP Bank and to a lesser extent (HUF 12 billion) by independent market participants outside the Banking Group.

The coverage of the loans and hence of mortgage bonds is a priority in the process of lending, and is also required by the principle of prudent operation and investors. OTP Mortgage Bank pays utmost attention to maintaining levels of coverage above the level required by the statutes all the time. Hence, the consolidated closing value of ordinary and supplementary coverage surpassed the minimum requirement by almost 47% at the end of the year.

Register of Coverage of Mortgage Bonds (December 31, 2003)	
Description	**Amount (HUF million)**
Unpaid principal balance of outstanding mortgage bonds	599 000
Unpaid interest of outstanding mortgage bonds	237 500
Unpaid principal balance of and interest on outstanding mortgage bonds	836 500
Value of ordinary coverage	1 082 166
Value of supplementary coverage	145 899
Consolidated value of ordinary and supplementary coverage	1 228 064
Coverage ratio of mortgage bonds	146,8 %

OTP Mortgage Bank uses a wide-ranging database and applies a process of multiple steps to control the value of mortgaged property held in security. The unpaid principal balance of home loans corresponds to less than 48% of the collateral value of mortgaged real property.

Major preparations have been made to widen the offering of mortgage bonds due to the dynamic expansion of the loans portfolio and the limitations of the institutional demand for bonds. To set the conditions for international offerings and offerings to the general public, the Bank took the initial steps in 2003 to have itself rated, which is an indispensable prerequisite of international offerings, and as a result Moody's Investors Service Ltd. classified OTP Mortgage Bank as a category A2 issuer and rated its mortgage bonds as A1.

III. FINANCIAL REPORT

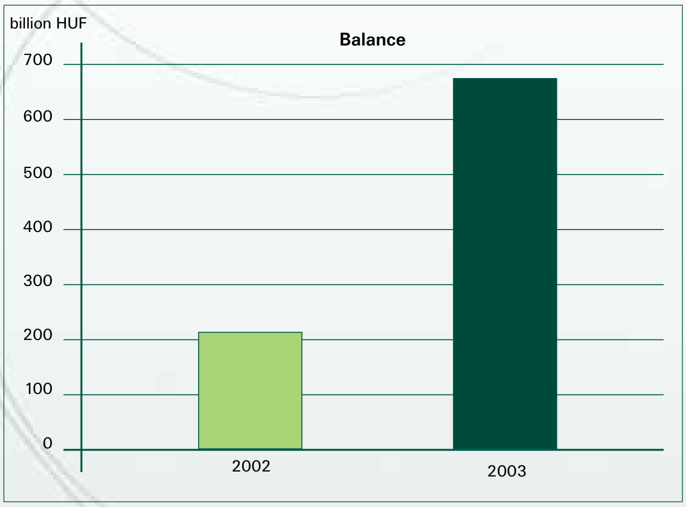
III.1. Management Performance

The financial performance of OTP Mortgage Bank was outstanding in the 2003 business year, which derives from both the favorable development of its portfolios and the strict and efficient management of costs.

The 2003 operating profit and major financial ratios of OTP Mortgage Bank are shown below.

– At HUF 674.2 billion on December 31, 2003, balance sheet total amounted to more than three times the value (HUF 213.4 billion) recorded at the end of the first business year on December 31, 2002.

The factor that propelled the growth of the balance sheet total in 2003 was the explosion of lending in the wake of the announcement of the system of home subsidies in 2001.
The news regarding the stricter new rules of the system of subsidies in 2003 fuelled demand even more, and the volume of disbursed loans surpassed every expectation by amounting to HUF 604.7 billion on December 31, 2003 as opposed to HUF 186.7 billion a year earlier.



– Liabilities also developed in harmony with the business requirements. OTP Mortgage Bank finances purchased loan receivables first of all by issuing mortgage bonds. Accordingly, the stock of outstanding mortgage bonds grew in tandem with the expansion of the loans portfolio. By December 31, 2003, the total face value of outstanding mortgage bonds had reached HUF 599 billion, including a parcel worth HUF 534.2 billion subscribed to by the shareholder, OTP Bank.

– The securities portfolio of OTP Mortgage Bank kept growing in 2003 and provided the supplementary coverage required for the mortgage bonds issued in consecutive series and liquid assets for the company. The stock of securities amounted to HUF 48.6 billion on December 31, 2003 and included nothing else but government bonds and treasury bills.

	Dec. 31, 2002		Dec. 31, 2003		Change	
	HUF m	share%	HUF m	share%	HUF m	%
Treasury Bills	2070	9,3	11 619	23,9	9 549	461,3
Hungarian Government Bonds	20 252	90,7	37 005	76,1	16 753	82,7
Total	**22 322**	**100,0**	**48 624**	**100,0**	**26 302**	**117,8**

– OTP Mortgage Bank made HUF 8.5 billion in profit before tax in 2003. The key component within the structure of income was the net interest rate margin, which moved closely in line with the jump of the loans portfolio and amounted to HUF 23.7 billion with interest received at 64.1 billion and interest paid at HUF 40.4 billion.

– Interest income has three major components: customer charges at HUF 20.6 billion, asset and liabilities side subsidies received from the central budget at HUF 40.6 billion and interest on the government securities portfolio at HUF 2.6 billion, coupled with HUF 0.3 billion worth of other interest income.

– The fundamental items of interest paid comprise HUF 32.4 billion in interest expense on outstanding mortgage bonds and HUF 8.0 billion in service charges paid to OTP Bank for account management.

Components of Net Interest Income

	Dec. 31. 2002		Dec. 31. 2003		Change	
	HUF m	share%	HUF m	share%	HUF m	%
Interest received						
From interbank accounts	11	0,2	225	0,4	214	1 945,5
From retail accounts	4 669	87,4	61 233	95,6	56 564	1 211,5
From securities	660	12,4	2 608	4,1	1 948	295,2
Total interest income	5 340	100,0	64 066	100,0	58 726	1 099,7
Interest paid					0	
To interbank accounts	426	15,0	546	1,4	120	28,2
Interest-like expense	565		7 403		6 838	1 210,3
To retail accounts						
Against securities	1 854	65,2	32 426	80,3	30 572	1 649,0
Total interest expense	2 845	80,1	40 375	81,7	37 530	1 319,2
Net interest income	2 495		23 691		21 196	849,5

Main components of P&L

	Dec. 31. 2002	Dec. 31. 2003	Change	
	HUF m	HUF m	HUF m	%
Net interest income	2 495	23 691	21 196	849,5
Total interest income	5 340	64 066	58 726	1 099,7
Total interest expense	2 845*	40 375	37 530	1 319,2
Net fees, commissions	-863	-11 663	-10 800	1 251,4
Fees and commission received	3 884	6 035	2 151	55,4
Fees and commission paid	-4 747	-17 698	-12 951	272,8
Net exchange rate gain/ loss on dealing in securities	72	-228	-300	-416,7
Other non-interest income	0	0	0	0,0
Total income	1 704	11 800	10 096	592,5
Non–interest expense	1 053	3 253	2 200	208,9
Operating profit	651	8 547	7 896	1 212,9
Income before tax	651	8 547	7 896	1 212,9
Tax liability	117	1 484	1 367	1 168,4
Profit after tax	534	7 063	6 529	1 222,7

* The table for year 2002 could not be reconciled to P&L because during 2003 Mortgage Bank Modified its Accounting Policy, that the fee payable to OTP Bank Ltd. In consideration for account managment shall be charged to interest paid and related expense in the profit and loss statement for 2003, unlike formerly, when it was recognized under general administrative costs. The table above shows comparable amounts in 2002, according to the modified Accounting Policy of 2003.

– OTP Mortgage Bank has paid extra attention to keeping the costs incurrent by its operations at a minimum level.

– Total operating costs amounted to HUF 13.7 billion in 2003, including HUF 12.3 billion directly relating to the size and the temporal development of the portfolio of loans. This charge includes fees paid to OTP Bank relating to operations and to assuming the risks associated with lending.
– Wages and wage related costs represent 4.2% within operating costs with headcount at 56 employees.
– The major items among other operating costs relate to the core business of the bank, such as fees paid to trustees, auditors and the supervisory authority. These cost increased in proportion to the expansion of operations. They represent a 4% share of the operating costs total.

III. 2. Capital Adequacy and Capital Structure

The portfolio of loans embarked on a steep curve of growth in October 2002, and the ratio of the bank's solvency would not have complied with the statutory minimum of 8% capital adequacy without the injection of additional capital. Consequently, capital was replenished already in 2002 when the shareholder, OTP Bank contributed a total of HUF 4.1 billion to increase the original amount of registered capital, which stood at HUF 3.0 billion.

By December 31, 2003 capital had been increased by adding a total of HUF 12.9 billion in several steps, of which the company court had not registered HUF 3.0 billion before balance sheet date. Consequently, the owner's equity figure recorded in the accounts fails to show this amount, which is nevertheless part of the bank's guarantee capital.

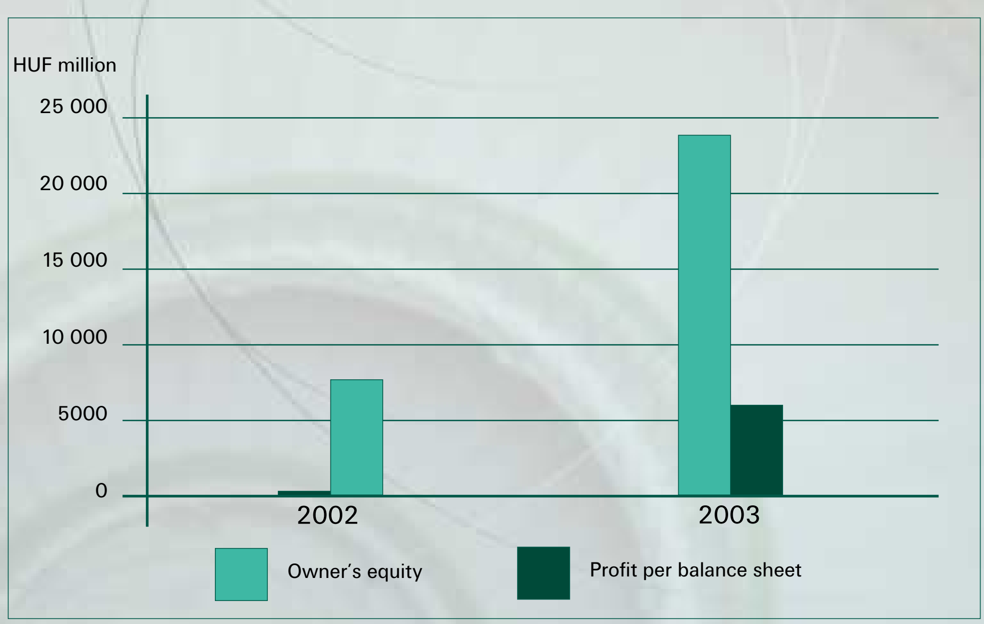
Over and above the capital contribution of the shareholder, the profit after tax of Q1-Q3 2003 could also be taken into account at a total of HUF 4.8 billion as part of guarantee capital, as the required interim audited balance sheets had been drawn up for each quarter. As the application of this method serves to reduce the amount of capital call burdening the shareholder directly, OTP Mortgage Bank intends to rely on the option to draw up interim audited reports and to offset interim profits against guarantee capital in the future, if uninterrupted compliance with prudential rules so requires.

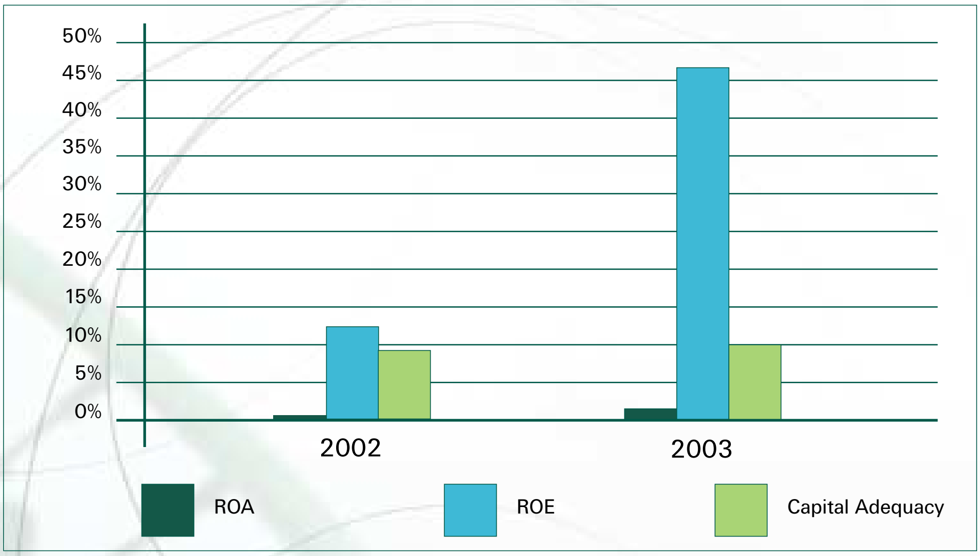
	Dec. 31. 2002		Dec. 31. 2002		Change	
	HUF m	share%	HUF m	share%	%	%
Registered Capital	4 900	88,2	17 000	68,8	12 100	246,9
General Reserve	65	1,2	772	3,1	707	1 087,7
Retained Earnings	108	1,9	288	1,2	180	166,7
Tied-up Reserve	0	0,0	300	1,2	300	0,0
Profit Per Balance Sheet	480	8,6	6 357	25,7	5 877	1 224,4
Owner's Equity	5 553	100,0	24 717	100,0	19 164	345,1

The increase of guarantee capital in 2003 originates from the capital increase effected by the shareholder OTP Bank at HUF 12.9 billion, from the profit per balance sheet at HUF 6.4 billion and from HUF 0.7 billion set aside as general reserve.

Taking into account the unregistered portion of capital increase at HUF 3,0 billion, guarantee capital amounted to HUF 27.4 billion on December 31, 2003, which brings the value of the banks capital adequacy ratio to 10.04%, which clears the statutory minimum (of 8%) safely.

	Dec. 31, 2002 HUF million	Dec. 31, 2003 HUF million	Change HUF million	%
I. Fundamental components of capital	7 753	27 717	19 964	257,5
A) Registered Capital	4 900	17 000	12 100	246,9
B) Unregistered portion of capital increase	2 200	3 000	800	36,4
B) Retained Earnings	108	288	180	166,7
C) Committed Reserves		300	300	0,0
D) General Reserve	65	772	707	1 087,7
E) Profit Per Balance Sheet	480	6 357	5 877	1 224,4
II. Adjustment to fundamental capital	13	357	344	2 646,2
A) Chargeable portion of intangible assets	13	57	44	338,5
B) IT CAPEX		300	300	0,0
III. Fundamental Capital (I-II)	7 740	27 360	19 620	253,5
IV. Solvency Capital (risk weighted)	7 740	27 360	19 620	253,5
V. Adjusted Balance Sheet Total	84 442	272 533	188 091	222,7
VI. Capital Adequacy Ratio	9,17	10,04		

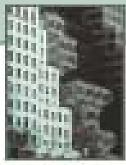




III. 3. Organization, Headcount

The structure of organization of OTP Mortgage Bank harmonizes with the convention developed with the shareholding OTP Bank in an effort to support lending operations in practice. In the area of financing homes, OTP Mortgage Bank relies on employees who have gathered decades of experience in the branch network of OTP Bank and on a small central management organization responsible for governance, organization and execution, comprising a team of highly qualified (degrees, track record, creativity, etc.) professionals with sound experience in economic affairs, especially finance and lending.

The closing headcount of OTP Mortgage Bank was 56 employees on December 31, 2003.



INDEPENDENT AUDITOR'S REPORT

Deloitte.

Deloitte Auditing and Consulting Ltd.
H-1051 Budapest, Nádor u. 21., Hungary
H-1438 Budapest, P.O.Box 270, Hungary

Tel: +36 (1) 428-6800
Fax: +36 (1) 428-6801
www.deloitte.com/hungary

INDEPENDENT AUDITORS' REPORT

To the Owner of OTP Mortgage Bank Ltd.

We have audited, in accordance with the Hungarian National Standards on Auditing, the unconsolidated financial statements of OTP Mortgage Bank Ltd. (the "Bank") for the year ended December 31, 2003, prepared in accordance with Hungarian accounting regulations, from which the accompanying summarized unconsolidated financial statements (balance sheet and profit and loss account), included on pages 21 to 27 of this Annual Report, were derived. In our independent auditors' report dated February 13, 2004, we expressed an unqualified opinion on the unconsolidated financial statements, prepared in accordance with the Hungarian accounting regulations, from which the accompanying summarized unconsolidated financial statements were derived.

In our opinion, the accompanying summarized unconsolidated financial statements are consistent, in all material respects, with the unconsolidated financial statements, prepared in accordance with Hungarian accounting regulations, from which they were derived.

For a better understanding of the Bank's unconsolidated financial position as at December 31, 2003 and the unconsolidated results of its operations for the year then ended, prepared in accordance with the Hungarian accounting regulations and of the scope of our audit, the accompanying summarized unconsolidated financial statements should be read in conjunction with the unconsolidated financial statements and the related notes from which the summarized unconsolidated financial statements were derived and our independent auditors' report thereon.

Budapest, August 10, 2004

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INCOME STATEMENT HIGHLIGHTS

	12.31.2002. (HUF million)	12.31.2003. (HUF million)	Change (HUF million)	(%)
Net interest income	2,495	23,691	21,196	850
Net fees, commissions	-863	-11,663	-10,800	1251
Net exchange rate gain/ Loss on dealing in securities	72	-228	-300	-417
Total income	1,704	11,800	10,096	592
Non interest expense	1,053	3,253	2,200	209
Operating profit	651	8,547	7,896	1,213
Income before tax	651	8,547	7,896	1,213
Profit per Balance Sheet	534	7,063	6,529	1,223
Profit after tax	480	6,357	5,877	1,224

BALANCE SHEET HIGHLIGHTS

	12.31.2002. (HUF million)	12.31.2003. (HUF million)	Change (%)
Assets total	213,368	674,221	216
Mortgage Loans	186,666	604,672	224
Government securities on hand	22,322	48,624	118
Liabilities againts outstanding mortgage bonds	177,100	599,000	238
Owner's equity	5,554	24,717	345

PERFORMANCE INDICATORS

	2002.	2003.
Expense to income, %	61,81	27,57
Return on average equity (ROAE), %	12,32	46,67
Return on average assets (ROAA), %	0,50	1,59
Capital adequacy ratio, %*	9,17	10,04
Balance sheet total per employee (HUF million)**	4 638	12 040
Total income per employee (HUF million)	39	133
Profit before tax per employee (HUF million)	15	96

MARKET SHARE

	2002.	2003.
Housing loans market %	62,0	63,9
Mortgage bond market %	61,4	65,0

*** Taking into account both the unregistered capital increase at HUF 3 billion and the audited profit of 2003**

**** on December 31**

ASSETS

(12.31.2003.)

Description	2002. 000 HUF	2003. 000 HUF
1. Cash in hand, Balances with Central Banks	45,973	2,571,202
2. Government Securities	22,322,362	48,623,631
a) held for trade	22,322,362	48,623,631
b) held as financial fixed assets		
3. Loans and advances to credit institutions	27,914	0
a) loans at sight		
b) from financial services	27,914	0
ba) short term	27,914	
bb) long term		
c) from investment services		
4. Loans and advances to customer	186,665,751	604,671,735
a) from financial services	186,665,751	604,671,735
aa) short term	12,224,488	37,772,085
ab) long term	174,441,263	566,899,650
b) from investment services	0	0
ba) receivables from investment service activities on the exchange		
bb) receivables from over-the-counter investment service activities		
bc) receivables from clients for investment service activities		
bd) receivables from clearing houses		
be) other		
5. Securities signifying a creditor relationship, including fixed-interest secure	0	0
a) securities issued by local government and state insitutions		
(except government securities)	0	0
aa) for trading purposes		
ab) for investing		
b) other	0	0
ba) for trading purposes		
bb) for investing		
6. Shares and other variable-yield securities	0	0
a) share, equity investment for trading purposes		
b) variable-yield securities	0	0
ba) for trading purposes		
bb) for investing		
7. Equity investments for investing purposes	0	0
a) equity investments		
Including: – participations in banks		
b) adjusted value of equity investments		
Including: – participations in banks		
8. Participations in associated company	0	0
a) participations in associated company		
Including: – participations in banks		
b) adjusted value of equity investments		
Including: – participations in banks		

9. Intangible assets	13,481	56,959
a) intangible assets	13,481	56,959
b) value adjustment of intangible assets		
10. Tangible assets	51,075	150,144
a) tangible assets for financial services	51,075	150,144
aa) real estates	16,389	15,364
ab) premises, equipment and vehicles	20,284	109,755
ac) construction in progress	14,402	25,025
ad) prepayments on construction in progress		
b) tangible assets not directly related to financial services	0	0
ba) real estates		
bb) premises, equipment and vehicles		
bc) construction in progress		
bd) prepayments on construction in progress		
c) value adjustment of tangible assets		
11. Treasury shares	0	0
12. Other assets	739,534	5,715,241
a) inventories		
b) other assets	739,534	5,715,241
13. Prepayments	3,502,301	12,431,938
a) accrued income	1,262,922	3,033,733
b) accrued expenses	2,239,379	9,398,205
c) deferred expenses		
TOTAL ASSETS:	**213,368,391**	**674,220,850**
Including:		
– CURRENT ASSETS (1.+2.a.+3.a.+3.ba.+3.c.+4.aa.+4.b.+5.aa.+5.ba.+6.a.+6.ba.+11.+12.)	35,360,271	94,682,159
– FIXED ASSETS (2.b.+3.bb.+4.ab.+5.ab.+5.bb.+6.bb.+7.+8.+9.+10.)	174,505,819	567,106,753

LIABILITIES AND EQUITY

(12.31.2003.)

Description	2002. 000 HUF	2003. 000 HUF
1. Liabilities to credit institutions	23,536,982	18,500,847
a) liabilities at sight		
b) fixed term liabilities	23,536,982	18,500,847
ba) short term	23,536,982	18,500,847
bb) long term		
c.) investment services		
2. Liabilities to customers	120	135
a) deposits	0	0
aa) liabilities at sight		
ab) short term		
ac) long term		
b) other receivables financial services		
ba) liabilities at sight	23,536,982	18,500,847
bb) short term		
bc) long term		
c.) investment services	0	0
ca) liabilities from exchange investment service activities		
cb) liabilities from over-the-counter		
cc) liabilities to clients from investment service activities		
cd) liabilities to clearing houses		
ce) other		
3. Bonds and other interest bearing securities issued	177,100,000	599,000,000
a) bonds	0	0
aa) short term		
ab) long term		
b) other securities	177,100,000	599,000,000
ba) short term		132,300,000
bb) long term	177,100 000	466,700,000
c.) securities point of accounting but non-securities in Act on Securities, document signifying a creditor relationship	0	0
ca) short term		
cb) long term		
4. Other liabilities	4,740,023	12,959,932
a) short term	4,740,023	12,959,932
b) long term		
5. Accrued expenses and deferred revenues		
a) deferred income	2,437,745	19,043,094
b) deferred expenses	77,249	2,246,608
c.) accrued income	2,360,496	16,796,486
6. Provisions	0	0
a) provision for old-age pension and lay-off pay	0	0
b) risk provisions for contingencies and future liabilities		
c) general risk provisions		
d) other provisions		
7. Subordinated debt	0	0
a) subordinated loan capital		
b) pecuniary contribution of member at credit institutions operating as credit cooperatives		
c) other subordinated loans		

8. Subscribed capital	4,900,000	17,000,000
Of which: – face value of treasury shares		
9. Registered yet unpaid issued capital (-)		
10. Capital reserve	0	0
a) premium (from share issue)		
b) other		
11. General reserves	65,352	771,684
12. Accumulated profit reserve (+)	107,813	288,169
13. Tied-up reserve		300,000
14. Revaluation reserve		
15. Balance-sheet profit or loss figure (+/-)	480,356	6,356,989
16. Difference resulting from translation (+/-)		
TOTAL LIABILITIES AND EQUITY:	**213,368,391**	**674,220,850**
Including:		
– SHORT TERM LIABILITIES (1.+2.a.+3.a.+3.ba.+3.c.+4.aa.+4.b.+5.aa.+5.ba.+6.a.+6.ba.+11.+12.)	28,277,125	163,760,914
– LONG TERM LIABILITIES (2.b.+3.bb.+4.ab.+5.ab.+5.bb.+6.bb.+7.+8.+9.+10.)	177,100,000	466,700,000
– SHAREHOLDER'S EQUITY (8.-9.+10.+11.±12.+13.+14.±15.)	5,553,521	24,716,842

OFF-BALANCE SHEET COMMITMENTS

1. Contingent liabilities	
Guarantees arising from banking activities	
Probable liabilities from unfinished legal action	
Confirmed letters of credit	
Commitments to extend credit	
Options	
Liabilities fom non-real sale and repurchase agreement	16,054,646
2. Future liabilities	
Forward purchase commitments, securities	
Forward purchase commitments, foreign exchange	
Repurchase agreements	

PROFIT AND LOSS ACCOUNT

(12.31.2003.)

Description	2002. 000 HUF	2003. 000 HUF
1. Interest received and interest – type income	5,340,386	64,065,904
a) interest received on fixed–interest securities signifying a creditor relationship	2,730,757	39,406,162
b) other interest received and interest–type income	2,609,629	24,659,742
from related parties	151	224,940
2. Interest paid and interest–type expenses	2,280,620	40,374,647
– to related parties	2,174,920	36,309,083
INTEREST DIFFERENCE (1.-2.)	3,059,766	23,691,257
3. Incomes from securites	0	0
4. Fees and Commission received	20	6,034,704
a.) revenues from other financial services	20	6,034,704
b.) revenues from investment services (except incomes from trading activites)		
5. Fees and Commission paid	451	5,347,004
a.) expenses on other financial services	451	5,347,004
– to related parties	243	5,346,948
b.) expenses on investment services (expect expenses from trading activites)		
6. Profit or loss from financial transactions (6.a.-6.b.+6.c.-6.d.)	-519,511	-1,628,489
a.) revenues from othe financial services	128,394	404,050
– from related parties	554	308,323
b.) expenses on other financial services	56,059	631,795
– to related parties	44,812	497,964
c.) revenues from investment services (except expenses from trading activites)		
Including: – reversal of loss on value of trading securities		
d.) expenses on investment services (expect expenses from trading activities)	591,846	1,400,744
– to related parties	581,558	1,357,897
Including: – loss on value of trading securities		
7. Other income	3,884,030	7
a) incomes from non financial and investment services		
b.) other revenues	3,884,030	7
– from related parties	178	
Including: – reversal of loss on value of inventory		
8. General administration expenses	1,910,104	13,679,739
a.) personnel expenses	177,769	573,568
aa.) wage costs	123,218	392,875
ab.) other payments to personnel	11,030	42,598
– social security expenses	4,356	17,201
– pension fund expenses	4,356	17,201
ac.) contributions on wages and salaries	43,521	138,095
– social security expenses	38,113	120,389
– pension fund expenses	22,706	72,041
b.) other administration expenses	1,732,335	13,106,171

9. Depreciation and amortization	10,467	24,770
10. Other expenses from business	3,852,394	497,393
a.) expenses from non–financial investment services		
b.) other expenses	3,852,394	497,393
– to related parties	3,788,552	
Including: – loss on value of inventory		
11. Loss on value of and provision for contingent and future liabilities	0	0
a.) loss on value of loans		
b.) provision for contingent and future (sure) liabilities		
12. Reversal of loss on value of loans and credit for contingent and future (sure) liabilities	0	0
a.) reversal of loss on value of loans		
b.) credit for contingent and future (sure) liabilities		
13. Loss on value of securities for investing purposes, signifying a creditor relationship, eqity investments in associated or other company		
14. Reversal of loss on value of securities for investing purposes, signifying a creditor relationship, and equity investmets in associated or other company		
15. Result of ordinary business activities		
Including: – RESULT OF FINANCIAL AND INVESTMENT SERVICES	650,889	8,548,573
(1.-2.+3.+4.-5.±6.+7.b.-8.-9.-10.b.-11.+12.-13.+14)	650,889	8 548,573
– RESULT OF NON–FINANCIAL AND INVESTMENT SERVICES		
(7.a.-10.a.)	0	0
16. Extraordinary revenues		
17. Extraordinary expenses		926
18. Extraordinary profit or loss	0	-926
19. Profit or loss before tax (±15.±18.)	650,889	8,547,647
20. Tax liabilities	117,160	1,484,326
21. Profit after tax	533,729	7,063,321
22. Formation and utilization of general reserves (±)	-53,373	-706,332
23. Use of accumulated profit reserve for dividens and profit–sharings		
24. Dividends and profit–sharings paid (approved)		
25. Balance–sheet profit or loss figure (±21.±22.+2.-24.)	480,356	6,356,989

MANAGEMENT
OF OTP MORTGAGE BANK LTD.

Board of Directors of OTP Mortgage Bank Ltd.:

Director:

Zsolt Oszlányi
CEO

Board:

Éva Hegedűs
(OTP Bank Ltd.
Retail Banking
Director)

Antal Kovács
(OTP Bank Ltd.
South TrasDanubian Region
Managing Director)

Csaba Lantos
(OTP Bank Ltd.
Retail Division
Deputy CEO)

Gábor Ljubičič
(OTP Bank Ltd.
Downtown Region
Managing Director)

Csaba Nagy
(OTP Mortgage Bank Ltd.
Deputy CEO)

Supervisory Board of OTP Mortgage Bank Ltd.:

Director:

László Senkár
(OTP Bank Ltd.
Central TrasDanubian Region
Managing Director)

Board:

Cecília Nádas
(OTP Bulding Society
Head of Department)

Ágota Selymesi
(OTP Bank Ltd.
Tax and Budgetary
Department
Head of Department)

Management of OTP Mortgage Bank Ltd.:

Zsolt Oszlányi
CEO

Zsófia Gyulai Zsakó
Deputy CEO

Csaba Nagy
Deputy CEO