Strategy and Finance Division

Investor Relations & DCM

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Transcript

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P R E S E N T A T I O N

Operator

Dear ladies and gentlemen, welcome to the OTP Bank's Third Quarter 2021 Conference Call. This conference will be recorded. (Operator Instructions)

May I now hand you over to László Bencsik, Chief Financial and Strategic Officer. László, please go ahead.

László Bencsik – Chief Financial and Strategic Officer

Thank you very much. Good morning or good afternoon, depending where you are, and thank you for joining us today on OTP Group's 2021 third quarter interim results presentation. We are going to conduct this event in the usual way a presentation followed by Q&A. But there's a new element we are going to introduce today_ my dear colleague, Gergely Pókos, Green Program Director, the Head of our Green Project's Directorate, who is leading the ESG initiatives within the group, is going to give you an update, or maybe the first formal communication to you about our ESG strategy and organization, how we tackle this very important objective on the group level. I think we have made quite substantial progress, so this is the right time to inform you about what we are doing and introduce you to Gergely, who's leading all these efforts across the group.

Starting with the third quarter results and the first 9 months results, we had a quarterly adjusted profit quite similar to the second quarter. It was only slightly lower. I guess it's probably better to give you some more detail on the coming slide, which shows the one-off items. We had quite some one-off items in the third quarter. The biggest one related to the moratorium. You have seen that this has been an important feature of the operations in Hungary since the COVID situation hit us in the second quarter last year. There were some recent events in the third quarter but also in October, related to the development of the moratorium.

First of all, in September the government decided to extend it by 1 month. That extension implied an additional one-off loss we had to book in the amount of HUF 2.7 billion. Additionally, they also extended the program until end of June next year, but now with very different features than it used to be: retail and corporate clients had to apply for participation in the moratorium, and they had to declare that they fulfill the criteria which enable them to join the moratorium.

We already know this number because they had the chance to apply till the end of October. So altogether, 4.2% of the total Hungarian volumes applied for the extension of the moratorium. I will give you some further detail on this during the course of the presentation. That also implied HUF 2 billion accounting loss. It's not provisioning, it's actually an adjustment on the asset side on the loans outstanding.

Thirdly, there was another matter by the government: retrospectively we had to recalculate those loans, the accrued interest on those loans, which participated in the moratorium and were either credit cards or overdrafts. So for these loans, we had to recalculate the accrued interest rates for the period of participation in the moratorium to a lower level than the original APRs. We had to use the unsecured retail cash loan average level of APR for these loans.

So, all these 3 together added up HUF 9.2 billion after tax negative adjustment.

Then we had the usual acquisition or post acquisition-related charges. Then there was an adjustment in the share swap with MOL, the Hungarian Oil company, due to changes in the expected dividend payments of these entities, and it was favorable for us in this quarter.

If we move forward one more page, then we see the details, the P&L without adjustments. In the third quarter the adjusted after-tax profit was HUF 127.3 billion. If you look at the components, then there are 2 important factors here. One is that on a quarter-on-quarter basis, operating profits grew 10%, which is, I think, considerable and due to the fact that we had a strong income growth, driven primarily by loan volume growth in previous periods plus a relatively strong economic activity in the third quarter, which translated into higher net fees and commissions, and that's the positive side. The negative side is that we had to book higher provisions in the third quarter than in the second quarter. Well, I might phrase it differently, that probably in the second quarter, we booked an unusually low level of provisions. But in a good way, I think this 23 basis points, which is the year-to-date risk cost rate, I think on average that was representative for the first 3 quarters of this year in terms of the level of risk is what we have.

Now year-on-year, obviously, if you compare the first 9 months' numbers, then the trend is different in risk cost because year-on-year there's a substantial decrease. However, the operating profit growth and the total income growth year-on-year is a little more visible 20% year-on-year operating profit increase, which from management perspective, I think, is a good result.

Now I won't bore you to be presenting each slide. There's a lot of detailed information on this which you might find useful. Just highlighting some topics, maybe Page 9, the net interest margin story. So on a group level, it was almost flat. This is good because now it's the third quarter where we are more or less at stable net interest margin on a group level. Then you see what contributed to this quarterly 1 basis point decline. It wasn't very conclusive. So basically, we have some noise. For instance, the Hungarian NIM actually declined, and that might be counterintuitive when you consider the increase in the benchmark and the rate levels. But the thing is that the third quarter deposit growth was very strong in Hungary, we had 8% just in one quarter. That meant that nominally we had 3x as much deposit growth as loan growth. In a way, this inflated the balance sheet in Hungary, and that created this slight decline in the net interest margin.

Then in some countries, notably Ukraine, we see already some improvement. DSK stabilized which is good. We had some slight erosion in countries like Croatia and Serbia and also in Slovenia. So overall, not a lot of excitement here on the NIM level other than that it's more or less stable. Just to remind you that, obviously, the benchmark - the increase in the benchmark and the impact of variable loans on the NII comes with a time delay. So it typically takes 1 or 2 quarters to price in the total effect of a given benchmark movement.

Now looking at the volumes, we had a quite strong quarter with 4% quarterly growth across the group. Hungary was particularly strong with 5%, led by consumer and housing loan growth. But if you look at some other countries like Ukraine, they continued to be very fast in terms of loan development. Russia started to show its potential. But in this quarter, it was mostly driven still by corporate growth. We had a healthy 7% growth just in one quarter in Romania. In the other countries, we had more or less good respectable performance, which actually resulted in 11% year-to-date volume growth.

And this fact, actually, I mean, we had to somewhat reconsider or update the guidance we've given before because the previous guidance was above 10% and due to the fact that we already reached 11% in 9 months, this warranted certain reconsideration of the expected volume growth. As you can see in our comment, if the trend that we see in the second and third quarter continues, then we can get the whole year to around 15%. Having said that, there's some level of uncertainty, especially due to the recent COVID development in the part of the world where we operate. In fact, the situation is quite critical in Romania, in Bulgaria and also starts to be really painful in Ukraine and Russia. In these 4 countries, the actual statistics show the worst ever situations since the outbreak of COVID in terms of fatalities and people hospitalized.

It's very difficult to assess what impact it might have on loan growth. Marginally, it's going to be negative, but how negative is difficult to tell. Maybe if August continues to go well, then we can get to this 15% level following similar growth that we had in the second and third quarters, but it might happen that actually growth rate slows down somewhat, and then we'll end up being somewhere below 15%. That's why we actually framed it in a way that probably around 15%. I think risks are more kind of downward than upward here just due to recent COVID developments.

Deposits, as I mentioned, were very strong in the third quarter, 6% nominally. Unfortunately, when I said in the second quarter that we reached the situation where nominal loan growth was stronger than deposit growth, this is no longer the case in the third quarter where we again had another quarter where deposit growth was much more than loan growth. Having said that, this is marginally positive: we do make money on these additional deposits, but not with the same rate as additional loans, therefore this strong deposit growth technically dilutes the overall margins, but it’s obviously positive in terms of NII. We interpret this as a strong signal that our clients trust us and are satisfied with our transactional services and therefore, continue to increase their savings with the bank.

Maybe a few words about the fee income, Page 14. We had another strong quarter, 7%. And we had the strongest growth in Croatia and also in Montenegro, which is not surprising given that these are the 2 countries with biggest exposures to tourism. July, August, September were really strong in terms of tourism, tourists coming and spending and therefore, generating substantial transactional revenues in these 2 countries. So that, especially the Croatian growth was a strong contributor to the overall group level improvement on a quarterly basis, but equally Hungary and Bulgaria was strong transaction-wise. In Hungary, we had a base effect as well.

A few words about Hungary. We seem to continue this now long-lasting trend of outperforming the markets in Hungary, both in retail and corporate. Our cash loan market share continued to increase. Our household savings market share continued to increase. There is a small decrease compared to the second quarter in mortgage flow market share. But overall, we continue to perform very strong, I think, compared to the market in Hungary. In general, the volumes and demand growth seems to be quite strong.

As you can see on Page 18, the subsidized retail products remained very popular. We continue to issue the famous baby loans, and we started to be very active and we are the dominant player in the newly introduced home renovation mortgage loan and cash loan and then also in this interest-free loan program for small businesses. I think we continue to perform well in Hungary, not just in retail, but also in corporate.

If you look at the following slide, you can see that our market share stabilized above 18% in terms of Hungarian corporate lending. We continue to grow quite strong in micro and small corporates, 29% year-to-date growth. Similar to the retail situation, when we talk about the distribution of products sponsored by the national bank, then we seem to capture a much larger share from the market than we usually do. So our market share from this *Funding for Growth, Go!* scheme, which was developed specifically to tackle the context of the COVID situation in Hungary, we had, for instance, 28% market share.

The next slide is about the moratorium participation. As you can see, from November on, the volume-wise calculated participation level is 4.2% overall. It cannot increase, however, because there's no more new application or no way to enter this program. People cannot join. People can decide to step out from the moratorium. So this number is not going to be higher, but maybe lower until end of June. As you can see, there's a difference in retail and corporate. So in corporate, this is really small and minor. And in retail, it's 6.8%. But even this 6.8% is substantially lower than the previous numbers. It’s obvious that most of the people who participated before did not need it, and if they had to be proactive to actually participate, then they decided not to. Even the 6.8%, we don't think this is representative in terms of clients who actually have potential difficulties to pay. That number we estimate to be substantially lower than that, most probably less than 50% of this number.

Just a quick update on some further information on our digital service usage in Hungary. This is probably the only positive, if any, of the pandemic situation, that the digital services usage have increased drastically in most of the countries where we operate, but especially in Hungary. So for instance, our mobile phone application usage increased 43% year-on-year. Now we have 1.5 million active users in the population, which is less than 10 million. This is, I think, a very good number and the digitally active number of customers increased by more than 10% in 1 year. We have some very innovative features in terms of services where the usage rates have increased fast during the last year. Plus, we introduced our new digital banking and mobile banking platform with a drastically new and much improved user experience and service level, which seems to be also popular amongst our clients.

Portfolio quality-wise there hasn't been much development. So the Stage 3 ratio continues to decline, primarily due to the very strong growth of the denominator. We have not really modified our coverage ratios, so we have not released provisions which we created last year and we also don't so much intend, at least not short term, to do so. So, most of the risk cost increase for the quarter was related to various one-off items.

An interesting page is the following, the capital position. The Common Equity Tier 1 ratio declined, and this was due to the fact that we called back the convertible bond, the ICES bond, which was issued back in 2006 and lost its conversion feature in 2016. Since then, more or less, it has been treated as Tier 2, but due to changes in EU regulation, it was about to lose it as Tier 2 treatment from January next year. So therefore, it lost its usefulness in terms of being a capital element, and it's pretty expensive just for a plain funding, and we also don't need wholesale funding at all. So we decided to pay back and then we repossessed the shares, so we ended up having 14.5 million more treasury shares. So, this resulted in this decline in the Common Equity Tier 1 ratio.

Now the interesting element is that basically in the third quarter, the effect of risk weighted assets growth was just as much as that of the quarterly profit. The risk-weighted asset growth due to FX changes was canceled out by the similar changes in the capital.

Finally, I decided to talk about this before, so there's not much we can say in terms of expectations for this year, other than that we think that our previous guidance related to profitability is still likely, assuming that we don't have any unexpected risk event for the remaining part of the year. As I said, if this loan dynamics continues, what we have seen for the last 6 months, then we are likely to get close to 15%. However, there might be some downward risk to this coming from the COVID situation in the countries where we operate.

That was what I wanted to say, also saved some time for our second, equally important topic, the ESG strategy and developments update, which is going to be presented by Gergely Pókos, who is leading the Green Projects initiatives in the group. So please, Gergely join in and present these slides.

Gergely Pókos – Green Program Director

Thank you very much, László. It's a pleasure to be here. The reason why we wanted to have this update regarding ESG is that recently the bank's management decided on an ESG strategy for the banking group and also on the setup of an organizational solution for that. So I want to talk briefly about these and then share a couple of recent highlights with you regarding the program.

So first of all, about the organization. Now sustainable finance for ESG is a journey. It's much more of a marathon than a 100-meter dash. That's why we thought it's important to set a robust organization to oversee the ESG transformation of the bank, making sure that sustainability is taken into account in all different levels of the organization and the transformation run smoothly.

The main elements of these are that the Board is creating a new standing committee, an ESG committee, chaired by one of the members of the Board of OTP Bank. These members include, among others, all the Deputy CEOs, so there's a representation of all parts of the bank. This committee has a pass to review all ESG strategy-related issues. It meets on a regular basis. It's supported by an operating committee, a subcommittee, which oversee the day-to-day operation and the progress of the transformation. So, this is the committee level.

We've also included some changes in the actual working parts or executive parts of the bank related to risk management, business transformation and the control function. The Risk Management division has been given new tasks related to the definition and day-to-day management of ESG risks. The business transformation is steered by my function with the task of driving the sustainable transformation across the banking group. Quite importantly, the tasks of the compliance organization have been amended and a separate ESG control function has been added to this. As (inaudible) compliance reporting directly to the Board of Directors, they control that we perform according to the rules and regulations related to ESG. So this is the organizational framework within which we will continue to work, and we believe that this underlines the management's commitment to the sustainability transformation of the bank.

Now if we go to the next page, this is a big overview of the strategy that has been developed and was ratified by the management committee quite recently. Now a very short summary, one sentence summary of the strategy is as follows: *OTP Group is aiming to be the regional leader in financing a fair and gradual transition to a low-carbon economy and building a sustainable future through our responsible solutions*.

Now as you can see, this is a positive and business-driven strategy. We want to underline our commitment that we want to finance the transition, not exit areas of the economy but actually help our clients finance the investments they require to make the transition to a lower carbon economy. And we also want to underline our approach that we believe that the transition happen on a fair and gradual basis. There is no one size fits all. We don't need a specific approach for all the different economies in different parts of the industries that we are active in and it will happen over time.

In line with this strategy, there is a defined implementation time line and some KPIs. As for the time line, there are 3 horizons. Currently, we are in the planning phase. The set of frameworks develop our processes according to these goals and set targets for ourselves. I will talk about the targets in a second. The rollout of the transformation will happen over the coming 3 years, and basically from 2025 onwards, we believe that we will use these new processes as part of their business as usual operation. So it will be ingrained in the bank. It will not operate as a separate system.

Now in terms of KPIs, I should point out that on the right side of the slide, the KPIs set are only for Hungary for the time being. We are working on group level goals. But we define our goals according to the strategy and their KPIs are set accordingly, so most important is actually building the green book, which translates into financing the transition to lower carbon economy. By end of this year, we want to build 230 billion green credits in our portfolio, and grow that number by eightfold by 2025. Again, this is just for the Hungarian operation.

As of today, we have 5 products on the market. But obviously, we are working to develop a green product or a green product variant, in the relevant retail and corporate segments in terms of lending in the coming years.

Thirdly, we don't only want to talk the talk. We also want to walk the walk. So we have made some strong commitments in terms of our own emissions. By end of next year, the Hungarian operation, OTP Bank will be carbon neutral, and we are working towards carbon neutrality strategy for the whole group. I cannot fix a date for that just yet, but hopefully by the next update, we will have a clear date set for that also.

Last but definitely not least, there is a lot we have to do in terms of disclosures and transparency. One element of that is that we have become signatures of UN's Principles of Responsible Banking initiative, the first bank in Hungary to do so. In terms of the ambition, we have set ourselves a goal that by 2025, we want to be listed in the Dow Jones Sustainability ESG index, which is, we believe, quite ambitious, but we are working towards achieving that goal in the set path.

Now moving on. We are already being rated by ESG-rating agencies, and there is some positive development on that front also. Sustainalytics recently updated our score for 2021 to 20.3, which is an improvement of 3.2 points to our last rating. Most of the improvement was driven by our strong performance system and governance structure, and the management score also improved.

MSCI is holding our rating at A. They mainly underline our financial consumer protection and human capital development programs. We do invest a lot in teaching and financial literacy. And last but not least, since 2019, OTP Group is part of the voluntary CDP initiative. We are disclosing in that system also. Now the B rating is the current rating, but we have submitted our survey, and we are currently under review, and I hope to be reporting improvement on the next time we give you an update.

A couple of recent highlights of what we do on a day-to-day basis and how we are active on the market in terms of sustainable financing. OTP Mortgage Bank has been the first bank in Hungary to issue green mortgage bonds.

The first issue was in August just after the National Bank launched its program, an issue of HUF 5 billion, which was then followed in early October by HUF 90 billion. We foresee further issues along the way.

Now besides this, we have also started to provide green refinancing to the retail with mortgages. I should say that the housing sector is one of the main drivers of the sustainability transformation all over the world, but especially in this region. So, a lot of our activity is and will be around mortgages and real estate development in terms of financing. According to that, as you can see, this program includes a preferential financing for anyone who purchases a house that has a high energy efficiency rating. The program is now launched at HUF 200 billion by commercial bank, and we expect to have a sizable market share in this.

Moving on to the corporate side. Obviously, sustainable finance has a lot to do with corporate lending. We have 4 green products on the market as we speak in terms of corporate lending. We believe that there are some priority sectors where the most of the early change will happen. Now these are renewable energy production, real estate development, agriculture and electro mobility. We are focusing on these sectors and providing preferential rates for credits in green investments in these industries. Our current book size is, as I said, about HUF 150 billion for the Hungarian market, and it is growing.

Last but not least, as I mentioned, just a few weeks ago in October, we have become a new signatory to the United Nation's Principles of Responsible Banking initiative. Now I don't necessarily have to introduce this framework to you, but we will be disclosing this framework in the coming years. Next summer, when we publish our sustainability report alongside with that, together with the UN initiative, we will also publish our detailed report using the UN PRB framework in terms of our environmental impact.

So these were our new organization setup, the strategy for ESG and some of our recent highlights. I thank you for your attention and look forward to your questions.

László Bencsik – Chief Financial and Strategic Officer

Thank you, Gergely, for the ESG update. So with this, we reach the end of the formal presentation part of this conference call. I'd like to ask you to ask your questions, should you have, and I'm sure you do have many very good questions, either to me or to Gergely regarding the ESG initiatives.

QUESTIONS AND ANSWERS

Operator

The first question is from Máté Nemes, UBS.

Máté Nemes – UBS Investment Bank

Hi, I have a few questions. Firstly, on deposit inflows in Hungary. It seems like the vast majority of these inflows came from the corporate side. I'm just wondering if you could give us a little bit more color on this, what's been driving this? Is this somewhat related to some of the subsidized program loans, is this basically the result of perhaps corporates holding off investment type of loans and then perhaps still holding a bit more liquidity? And then when do you think this could change?

Second question is on NIM, group NIM development. For a few quarters now I think you've been delivering very resilient net interest margin. If you could give us perhaps as an outlook, what we should expect in the next 3 quarters with the Hungarian rates rising in mind. And in this context, if you could also provide perhaps the latest rate sensitivity in Hungary?

László Bencsik – Chief Financial and Strategic Officer

Corporate deposits go up and down and there's some seasonality as well. I mean, municipality deposits are here. But in the third quarter, we have seen quite large treasury deposits, on which our margin is very, very small. So large ticket and few months term deposits with small margin. I don't see any tremendous irregularity here. Usually, there's a seasonality and municipalities being strong in the third quarter but also in the first quarter. And then there were some bigger treasury deposits from our clients, large corporate clients where margins are very thin.

The NIM development, especially the Hungarian benchmarks increased. So the BUBOR, the 3 month interbank rate is now close to 200 basis points, and this is the base rate for variable loans. This should have and going to have an impact. Most of that is still going to come. Part of that was present in the third quarter. But what happened during the summer is basically going to manifest more in the fourth quarter and first quarter next year. So assuming some further rate hikes, because if you listen to the Central Bank comments, they suggested that the rate increases will continue, and therefore, there will be some further increase in the reference rate.

Therefore, I think the fair expectation in Hungary is that the NIM might actually improve somewhat during the coming quarters. But here, obviously, the difference between deposit and loan growth would also have an impact. Having said that, that is not negative because albeit it's a small margin that we have on these additional deposits, but it does somewhat dilute the margin. So the expectation is that the Hungarian NIM might potentially show small improvement during the coming quarters.

Regarding sensitivity to further benchmark rate increases: as we are entering a territory above 2%, we get to a territory where, at some point, deposits will start to reprice, which has not happened yet. So far, we have had 100% benefit from the base rate increase - it has not certainly built in into the P&L yet because of the time of repricing, but technically, the variable loan rates either have grown or are going to go up. But so far, we have not had to increase deposit rates.

This is not going to last forever, and at some point, we will have to start increasing deposit rates. Now this is an uncharted territory. We haven't ever been in this situation that we came from a very low rate environment, which was unheard of in Hungary basically before, into a kind of moderate rate environment level and how exactly deposits react in this environment - I'm talking about mostly about retail deposits because my previous comments that deposit rates not going up is only partially true because in large corporate deposits are benchmark based. So there, the cost of funding increased. But for the bulk of the deposits, for the large retail current account deposits, which dominate at the moment our deposits funding in Hungary, we have not increased the rates so far, and we have not seen a sizable movement from current accounts to term deposits.

When exactly it is going to start and how much and so on and so on, this is actually quite difficult to model. We believe that it's still marginally positive if there are further increases in the base rate or in the reference rate, more importantly. So potentially, the next 10 basis points would be another HUF 0.3-0.5 billion NII on an annual basis. But the certainty of this is less and less. And certainly, if it's a higher increase than 10 basis points, then we get into a territory which is difficult to model. I cannot tell you with high level of precision what's going to happen with NII, let's say if there is 50 basis point increase in the rate environment or 100 basis points. 100 basis points might actually be negative overall on the NII, if current account deposits start to move into term deposits. This is a very interesting question, and this is somewhat difficult to predict at the moment, what would happen if there's a further substantial increase in the rate environment.

If there's another 10, 20, 30 basis point increase, that's probably marginally positive. From then on, it's less clear. It was a rather long answer, but I think it's representative of the difficulty to answer this question.

Máté Nemes – UBS Investment Bank

Absolutely. And I appreciate the detailed answer. Just one clarification, perhaps. The HUF 0.3 billion, HUF 0.5 billion that you mentioned for the next 10 basis points, do I understand correctly that would already include or factor in some behavioral change? So some of the current accounts or current deposits shifting into term? Is that right?

László Bencsik – Chief Financial and Strategic Officer

Yes, but very small. So again, in retail, we have not seen this happening yet. What further complicates this situation is that retail clients have relatively high return investment opportunities. You have this MÁK Plus and Premium MÁK products, the retail government bonds and 1-year government bonds which are very liquid and offer quite high returns. And these instruments have been available for years. So those retail clients who were sensitive to returns, probably have already invested into those as opposed to keeping their money on current accounts. But this we don't know 100%. So it's a difficult picture.

Operator

The next question is from Hai Thanh Le Phuong, Concorde Securities.

Hai Thanh Le Phuong – Concorde Securities

Just one quick question from me. It feels that the participation in the extended moratorium in Hungary seems to be quite low. So I was wondering if this means that in the fourth quarter, we should see a drop maybe in Stage 2 ratio of loans? And also, do you think we should expect provision releases due to such a drop in the ratio?

László Bencsik – Chief Financial and Strategic Officer

I mean, obviously, this is a very new information to us as well. So it's the fourth working day after the end of the application period, so we're still analyzing the implications. Well, if we previously assigned a loan to Stage 2, then we cannot reclassify them to Stage 1 immediately, right? So there has to be a change in it. Because, so far we have based and we continue to base our stage classification on behavioral models and behavioral rating. And even if we see a rating improvement, there has to be a certain time period before we can change the classification or improve the classification. So that's the technicality part.

We don't intend to release provisions further this year. Obviously, we have to look at the data. But as much as we'll have room for extra conservatism or less conservatism, we will continue to be on a more conservative side. So my expectation is that we will probably keep the level of provisions, what we have created so far. So I don't expect releases year-end. And I'm sure the Central Bank will have something to say related to the new situation after the moratorium. We don't know it yet, but I'm sure they will have some guidance or expectation towards provisioning. I suspect they will be also on the more conservative side, but that we don't know yet. So all in all, just because of the last participation in the moratorium, I don't expect provision releases in Hungary.

Operator

The next question is from an attendee joined via phone. (Operator Instructions) May I ask your name and company, please?

Andrzej Nowaczek – HSBC

It's Andrzej here. My question is on ESG. From what you said, it looks like you can do things in Hungary. You have KPIs for management. You have carbon-neutral deadline, but not in other countries. Why not? Is there an issue here with a lack of legislation in some countries? Maybe differences in attitudes. I'm just curious, maybe there's a big gap when it comes to ESG between your EU-based subsidiaries and those outside of the EU.

Gergely Pókos– Green Program Director

Thank you very much. I think it's a fair question. And you hit some of the elements. There is obviously a difference in legislation for EU and new member states. Our subsidiaries in Croatia, Slovenia, Bulgaria, and Romania have the same legislation framework. However, the local legislations is somewhat different than those outside of the EU. It's even more complicated. However, setting the targets on a group level is not just down to legislations. It's more of an operative delay. We have just concluded the group level strategy and by translating and localizing that to the local economy. As you saw in our strategy statement, we are aiming for something that is applicable to the local environment, to the local government, which is very much in line of what the UN charter for the PRB asks and demands of the banks. So that translation to the local environment is happening as we speak.

According to the group strategy, we hope to have a group-level KPI set by end of 2Q next year. So it's really just a time-related issue. We are strongly committed to realize the ESG program for the whole group. And as you could see in the KPIs, not all the initiatives can be translated to a group level. So we just need to add the different global initiatives. I hope I answered your question.

Operator

The next question is from Gábor Kemény, Autonomous Research.

Gábor Kemény – Autonomous Research

Hi, few questions from me. First one is on the growth outlook. I mean it looks like we are in a bit of a goldilocks scenario right now. Interest rates are going up and you upgraded the loan growth guidance yet again. So I would be interested to hear your thoughts on the loan growth outlook for 2022. At what stage do you think higher interest rates could create a headwind for new lending?

The second question is a little bit technical. Shall we model any recurring impact from the APR adjustment on credit cards?

And the third one is on ESG. Fascinating slides. Thank you for sharing. On the disclosures, are you sharing or are you planning to share the Scope 1 and Scope 2 CO_2 emissions? And is there any color you can provide on ESG stress testing?

Gergely Pókos – Green Program Director

So maybe I just quickly answer the ESG-related questions. The current Scope 1 and Scope 2 emissions of the bank we share each year in our sustainability report, for each subsidiary individual and also for the group. And we will have an external audit on achieving our carbon neutrality target and we'll disclose around that as well how Scope 1 and Scope 2 will be reduced to 0 in Hungary by end of next year.
Regarding the stress testing, around ESG risk, it's a very complex and new topic for us, not only for us, but we believe for the whole banking industry. We are developing methodology and are in consultation with the Central Bank on its implications also. I cannot go into details just for a simple reason that it's being developed. We hope to run the first test in the coming months and maybe by this time next year, we will have much more clarity around how that works.

László Bencsik – Chief Financial and Strategic Officer

Regarding your two other questions, that's a very, very good question, what we should expect for next year in terms of volume dynamics given the various factors, including the higher rate environment, especially in Hungary.

Now, our guidance does not refer to '22, right? So this remark that we made was just related to this year. It's mostly due to the fact what we have seen so far. In 9 months, we had 11% growth. It's quite likely that volume growth will continue despite the rate increases in the fourth quarter. Therefore, we think that the volume growth for this year can be closer to 15% than 10%. That does not imply much for next year. We are in the process of developing next year's budget. So we are in this very detailed bottom-up planning and top-down planning process, and we have not concluded that yet.

It's too early for us to make sensible comments for next year. The situation is complicated, I think. It's not just the rate increases. It's also the energy prices and utility prices going up, the supply chain problems and so on and so on. And whether, depending on your view, whether you believe that this is just a very short, temporary situation or it might be longer and core problem in economies and in certain sectors or for specific players. It is actually a difficult call to make.

We have not made any guidance for next year, and I'm not going to do that today. We are in the process of making next year budget. In the due course, we will inform you about our expectations regarding 2022. So this kind of volume communication what we have and the expectations update what we made, that's purely relevant for 2021.

The APR in credit card and overdraft, this adjustment which we had to make is only related to those volumes which participated in the moratorium and only for the duration they participated in the moratorium. If someone with a negative credit card balance entered the moratorium, as long as the moratorium lasts the accrued interest rate and that balance will be calculated using a lower rate than a usual credit card rate. But once this client exits the moratorium, the rate goes back to normal. So this adjustment and the lower rate to credit card and overdraft applies only for those volumes that actually participated in any given period in the moratorium. When they don't, then it doesn't apply. So it should not have above-moratorium ramifications, so to say.

Operator

The next question is from Nida Iqbal, Morgan Stanley.

Nida Iqbal – Morgan Stanley, Research Division - Equity Analyst

My first question is on inflation, which you just touched upon briefly. With inflation running quite high across the CEE region, are you worried about the impact on your cost base into 2022? Any color around that would be very helpful. And then in terms of cost of risk, it seems that this quarter was higher due to conservative provisioning but also lower recoveries at OTP factoring. So is this a trend that we should expect to continue into the fourth quarter? And how should we think about 2022 as well?

László Bencsik – Chief Financial and Strategic Officer

Yes. I am worried about the inflation and the implications on the cost base. I mean there are some cost increases you can avoid. Utility, I mean, although we are not energy dependent industry, but it does matter to some extent. And then wage inflation, obviously, this is a big question. We expect strong real wage inflation to continue next year. And that will be very hard not to follow. We are in a talent heavy industry and talent is scarce and expensive and we cannot afford not to have the best people who can contribute to our success.

Cost pressure will be there next year. I think this is something we have to account for. This is obviously part of the intense discussions we are having at the moment internally in Hungary and across the countries in the group with our counterparties in the organization to set targets, which are reasonable but stretched. But this is certainly a factor we have to take into consideration next year.

The risk costs, what I said was that this 23 basis points credit risk cost rate what we had the first 9 months, I think this is a better proxy of what happened during the year than the somewhat lower second and higher third quarter levels. And the portfolio quality is stable. We have somewhat lower revenues from Factoring or payments from Factoring, but this is also related to the fact that the deterioration has been quite low during the last 2 years. Therefore, they don't have much new delinquent loans to work on.

The portfolio quality seems to be stable. I don't see much irregularities other than some noise in one quarter or the other either positive or negative. As long as this stronger GDP growth environment continues, and somewhat increasing inflation and especially the wages and real wages grow. That typically helps credit quality. I don't see major problems coming.

There might be somewhat higher or lower risk costs in the last quarter. Typically, if you look back to previous years, year-end we always look at every accepted opportunity by tax authorities and auditors and regulators to be as conservative as possible within this framework. We will attempt to do that this year as well, but I have no idea what exactly the risk cost will be end of the quarter.

I'm not sure whether this is the answer you were looking for. Certainly, for 2022, again, we are not yet prepared to express any expectations regarding next year and any guidance. We will reveal our guidance when we report the full year results in early March.

Operator

The next question is from an attendee joined via phone.

Robert Brzoza – PKO BP Securities

This is Robert Brzoza from PKO BP Securities. I have a question regarding your strategic options in Russia, in the light of, first of all, the regulatory changes, the recent measures from the Central Bank regarding the point of sale loans. How does it affect your business? That's my first question.

Going further, obviously, you're having great time there, given the strong increase in lending volumes. However, on the NII, it's not that visible. I mean, it doesn't really translate into results because of the competitive pressures?

And my next question is, what are you going to do about this? What's generally the strategic idea? How do you want to have your business shape in Russia going forward?

László Bencsik – Chief Financial and Strategic Officer

These questions are the ones that we are thinking about as well. Certainly, the latest regulation, I mean almost every quarter, we have a new and more and more strict regulation regarding high APR lending in Russia; the new one gives the right to the supervisor to individually restrict or define high APR quotas for individual institutions. Honestly, we don't know yet how it's going to be implemented and what is going to be the practice.

It is clear that the regulator wants less high APR lending and slower volumes development, and this is not helping our business. So far, it has manifested in higher and higher capital requirements, which given our capital levels, group and local levels, we are able to provide. But if there's a direct regulation or direct limit of volumes to be generated, then obviously, it's going to be a hard wall for us and that is going to limit our activity.

Having said that, we don't have any indication whether this is going to be applied and how it's going to be applied and whether it's going to be applied to our operations in Russia or not. Indeed, your observation is right that due to declining net interest margin, the volume increase has not translated into NII growth. The NIM compression has been happening there for years now, for 5 or 6 years, we started somewhere 18% or 19% net interest margin. Those years are obviously gone now. We're at much more lower level now.

There's this NIM compression and further regulation obviously intends to even compress NIMs further lower. That creates a strategic challenge for us, and we have been trying to answer these challenges in different ways. Again, this is not something new, this has been happening for years now. One clear strategic opportunity is to increase digital activities and digital sales, and because it's a much more cost-effective way of distributing products, the APRs can be somewhat lower proportionately and still make good business sense. What we have today is a quite expensive distribution channel: this physically distributed POS, obviously, due to commissions and the nature of the business, it's a countrywide quite robust operation what we have to operate in order to sell these loans and the digital alternative can be much more cost effective to manage. So that's the direction we have been trying to go, and this is a direction where we are going to strengthen in the future.

The other thing what we have started is diversifying into different products. I just mentioned that, for instance, the chunk of our growth this year was coming from car loans, and corporate activity also was strong during the year.

So, we are moving more towards digital and maybe diversifying more into other banking products and then just the unsecured retail lending. These are the most important current initiatives that we have. But indeed, this is a challenging environment.

In all other countries, I would say we clearly see the opportunity and what we need to do there in order to be quite successful. In Russia, it's not that obvious. We have been trying various scenarios: you might remember that 8 years ago we launched this pure online bank, which we closed down some years afterwards. So we have been trying different solutions in Russia, and we continue to try. So it's not that I have a very clear answer to that, but we believe that there are certain initiatives, namely digital and also diversification into different products and services, which seem to work. But how much they're going to provide us in terms of opportunities in the future, that we don't know yet.

Robert Brzoza – PKO BP Securities

That's surely a difficult question. And maybe just one follow up, could you possibly share what percentage of the unsecured lending in Russia goes, let's call it, via direct contracting with end customers? And what percentage goes, in a way, indirectly to retailers and then to customers?

As I understood the intention of the Central Bank, they want to eliminate indirect lending without a direct point of contact with the credit provider. So I'm simply interested if you provide such financing without the customer, with the retailer acting as a sort of invisible credit provider and without the customer's signing to the actual loan contract with you?

László Bencsik – Chief Financial and Strategic Officer

Okay. That's a more complicated question than what I can answer right now because we have our own agents, and we have like third-party agents. We have to check that. Honestly, I don't have the answer for that.

Operator

The next question is from an attendee joined via phone.

Olga Veselova – BofA Securities

This is Olga Veselova from Bank of America. My question is about your initiatives in Asia. At the last conference call, you mentioned you were considering maybe a joint venture, joint initiative in China. So could you please update us on that? Have you progressed in any way? What exactly do you consider now? Or do you possibly give up with this intention?

László Bencsik – Chief Financial and Strategic Officer

There is progress, yes. We haven't given up.

Olga Veselova – BofA Securities

Maybe you could give us the size of potential investments? I'm not asking precise number, but is it small? Is it large?

László Bencsik – Chief Financial and Strategic Officer

Small. Small with a large potential gain.

Olga Veselova – BofA Securities, Research Division

What do you mean exactly?

László Bencsik – Chief Financial and Strategic Officer

I hope it will be a high return investment, but it's rather small compared to the group and the typical acquisitions we do.

Olga Veselova – BofA Securities, Research Division

Okay. Are you in a position to disclose the areas, any segment or that's too early?

László Bencsik – Chief Financial and Strategic Officer

Obviously, we consider consumer lending, unsecured retail lending.

Operator

There is a question from Nida Iqbal, Morgan Stanley.

Nida Iqbal – Morgan Stanley

I just have a follow up on Russia. We recently saw some press articles talking about a potential acquisition in Russia. Can you just comment on that whether inorganic growth is part of the plans for Russia?

László Bencsik – Chief Financial and Strategic Officer

During the last 15 years, we looked into at least a dozen different opportunities in Russia, and whenever we see a potential acquisition opportunity, we typically look into those, and we have looked into many, and we will continue to look into opportunities. But we don't comment any specific opportunity until it becomes concrete.

Operator

As there are no further questions, I hand back to the speakers.

László Bencsik – Chief Financial and Strategic Officer

Thank you very much for attending this confcall, and thank you for your very good questions. Next time when we will have this session is when we talk about the annual results, as usual, in early March, I think it's the 4th of March, and I hope you will join us then as well. In the meantime, I hope to have an opportunity to talk to many of you. I wish you all the best, a very good weekend and a very good health and stay healthy as this is the most important in these times, and thank you again for your interest to participate. Bye-bye.

Operator

Thank you for your participation. The third quarter 2021 conference call is closed now.

Note: unabridged transcript with minor English stylistic corrections.