

LESSONS FROM 3 DECADES AND THE FUTURE VISION OF THE BANKING SECTOR



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The transformation of the banking sector into a two-tier banking system was a key pillar of building a market economy

Two-tier banking system: new commercial banks were undercapitalized with poor quality loan portfolio

- Budapest Bank – mines and infrastructure projects
- Magyar Hitelbank (MHB) – manufacturing
- Országos Kereskedelmi és Hitelbank – agriculture and manufacturing of food

OTP, MKB, Általános Értékforgalmi Bank

- Foundation of the Hungarian Banking Association
- CA-IB (Creditanstalt Investment Bank)
- Transition to market economy – price- and import-liberalisation



1987

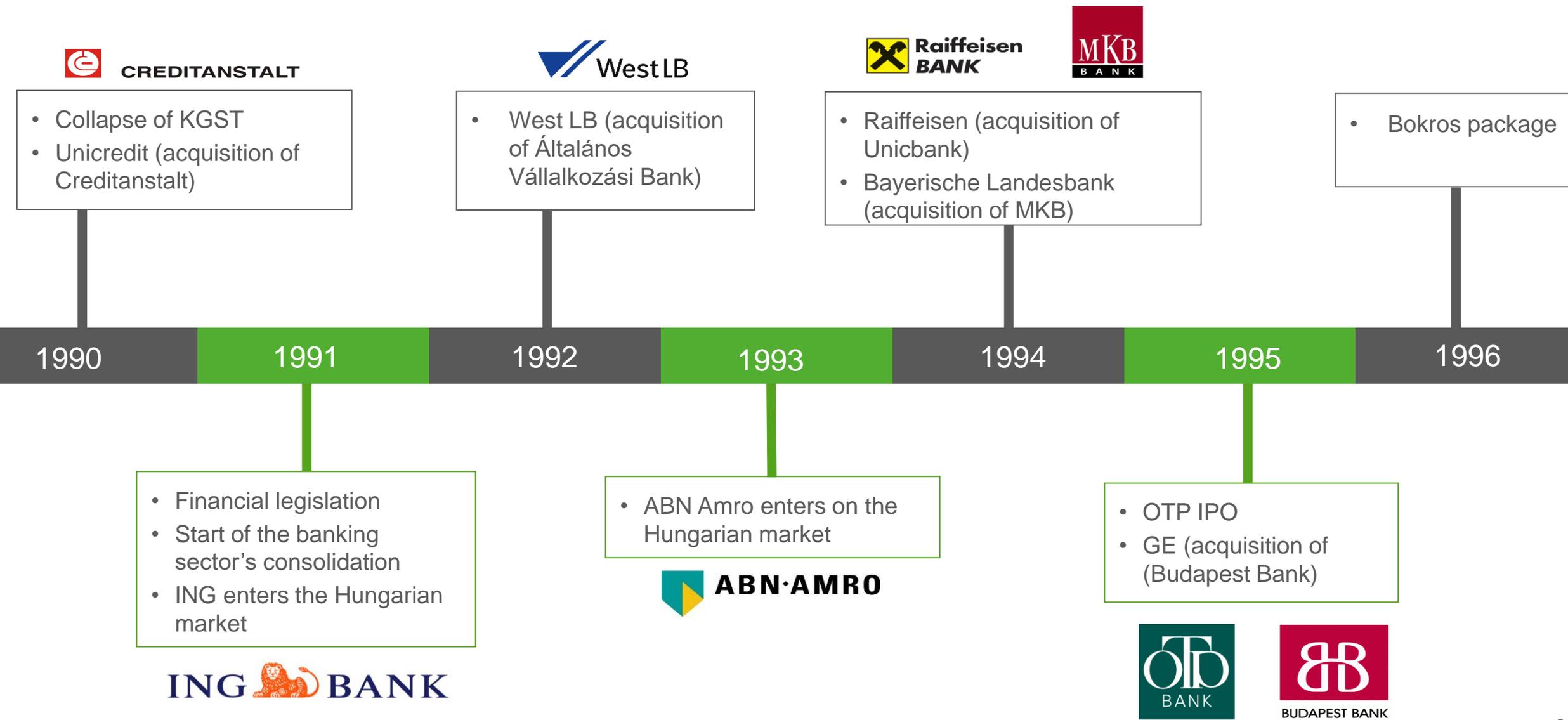
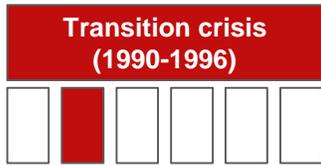
1988

1989

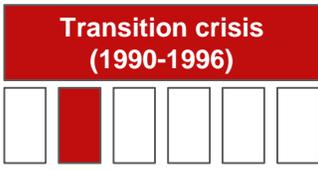


- Foundation of Postabank (retail banking)
- Foundation of GIRO (payment and clearing services)
- Tax reform – introduction of personal income tax and VAT

Privatisation and a complete revision of financial legislation helped the sector cope with the adverse macroeconomic environment and the poor quality of the inherited portfolio



High NPL ratios exposed by the new financial regulation forced the consolidation of the Hungarian banking system



NEW LEGISLATION IN 1991

Act on Accounting:

- Compulsory disclosure and elements of financial statements

Act on Credit Institutions

- Capital, reserves, liquidity and allowance requirements; deposit insurance

Act on Bankruptcy and Liquidation

- Common insolvencies, circular debts



CREDIT CONSOLIDATION

- Government bonds for bad loans
- 50% or 80% recovery on swapped assets

DEBTOR CONSOLIDATION

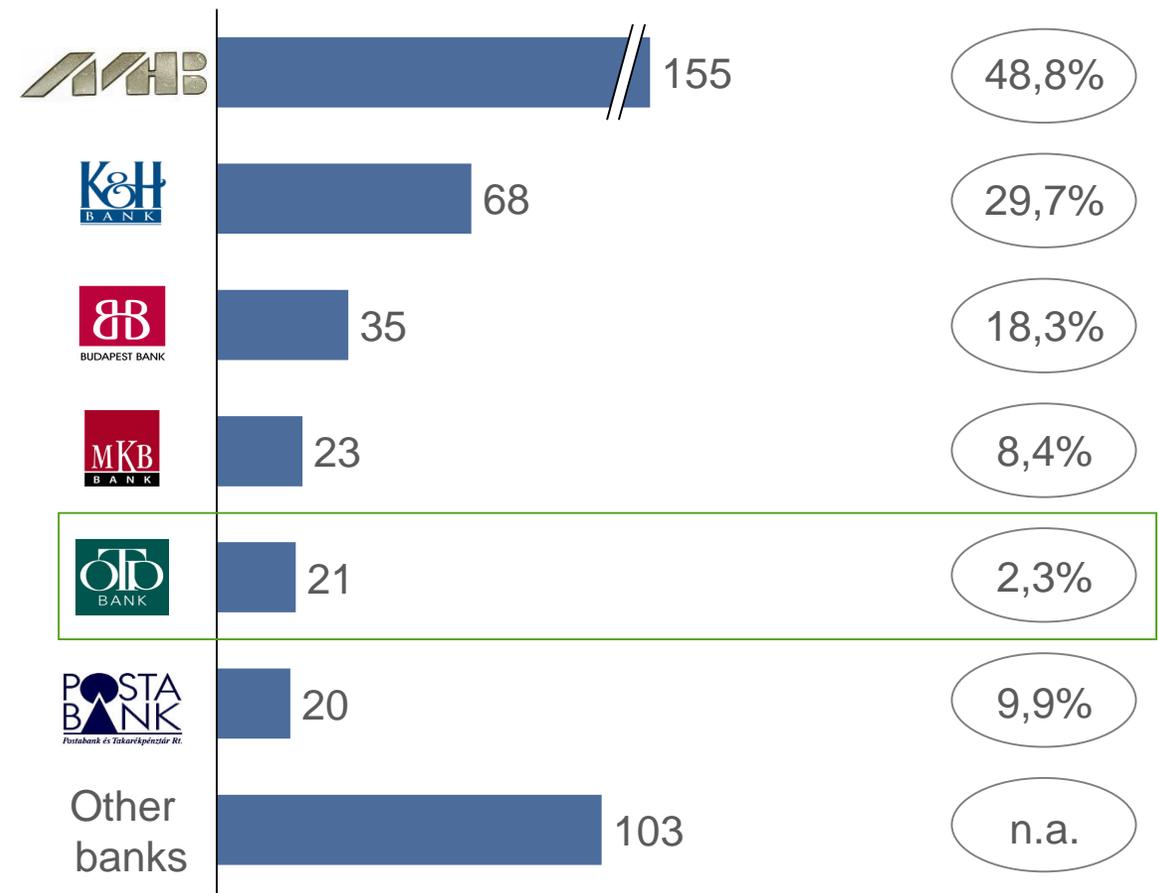
- The state bought the loans of 13 companies deemed as of national economic importance

BANK CONSOLIDATION

- Capital injection

■ State aid received until 1994 (bn HUF, at 1994 prices)

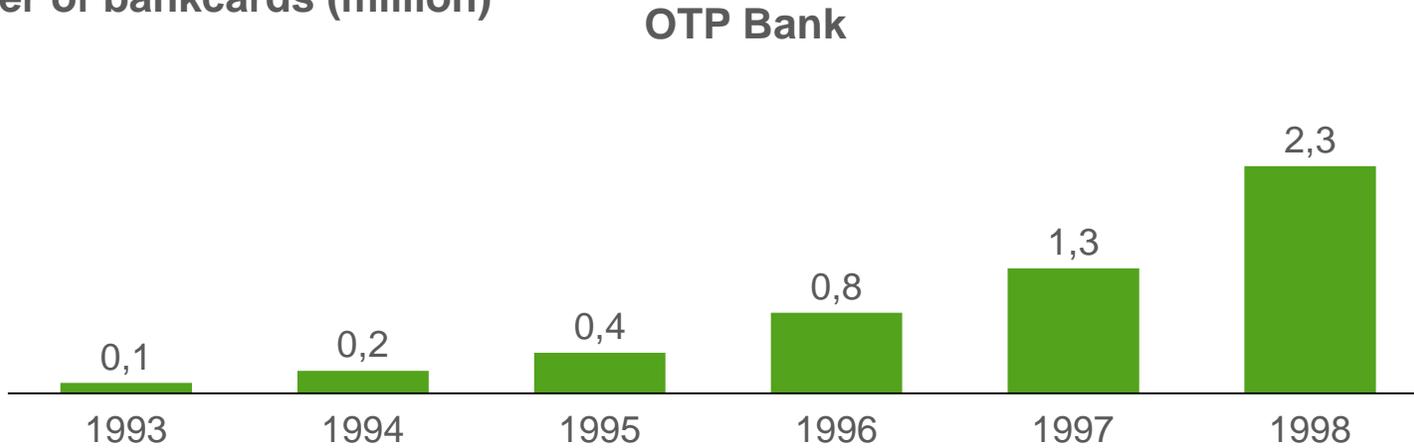
○ % in percent of total assets



The early 90's saw the foundation of modern banking infrastructure

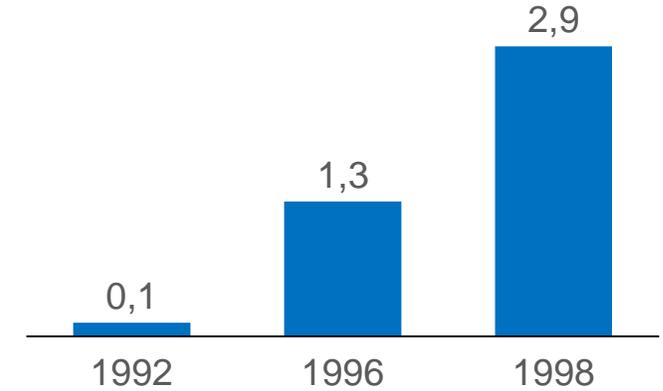


Number of bankcards (million)

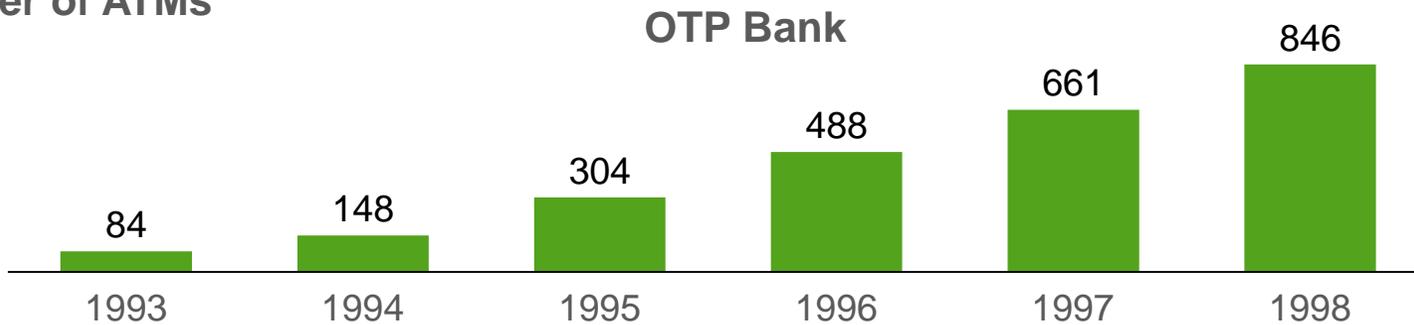


OTP Bank

Banking sector

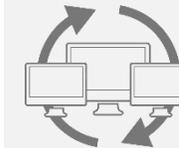


Number of ATMs



OTP Bank

OTP Bank developments



Full switch to Integrated Information System

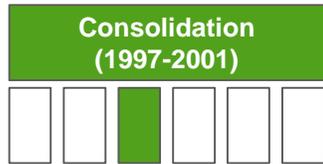


Development of back-office systems (GIRO, internal clearing system)



Euronet (non-bank owned ATM operator) founded in Hungary, starting with one ATM to grow into a worldwide player on the card acceptance market

The completion of privatisation and a stable macroeconomic environment ushered in an era of balanced growth for the banking sector



- First building societies: Otthon Lakáskassza, Fundamenta, OTP Building Society
- Postabank goes bankrupt
- Intesa (acquisition of KENB)
- KBC (acquisition of K&H)
- Erste (acquisition of Mezőbank)
- FHB (greenfield)



Investment services permitted for banks



• ABN Amro - K&H merger
• Roll-out of subsidized housing loan scheme



Capital Injection for Posta Bank



Citibank acquires ING Bank's retail and SME portfolio



The bailout and subsequent privatisation of Postabank was a milestone in the consolidation of the Hungarian banking sector



1988

- Foundation of the bank
- 22% of the shares held by the Hungarian State

1995

- Second largest retail bank in Hungary

1997

- Bank run – HUF 70 billion deposit withdrawal in a few days' time caused by rumours about bankruptcy

1998

- Due to accounting misconducts revealed, the Hungarian subsidiary of Arthur Andersen, the auditor of Postabank, collapsed
- State-ownership after a bailout of HUF 151 billion

2003

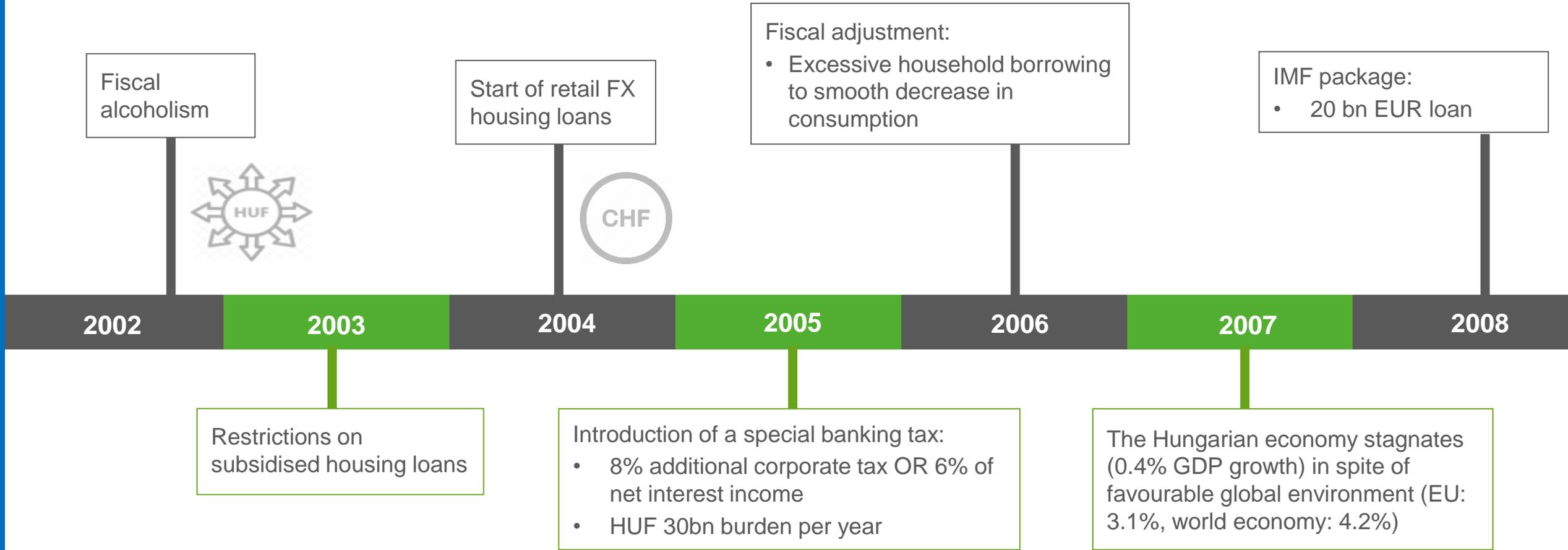
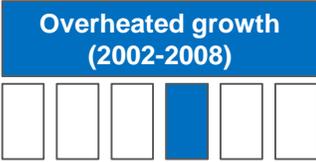
- Erste Bank Hungary wins the privatisation tender and acquires the bank

2004

- Finalisation of the merger between Erste Bank Hungary and Postabank



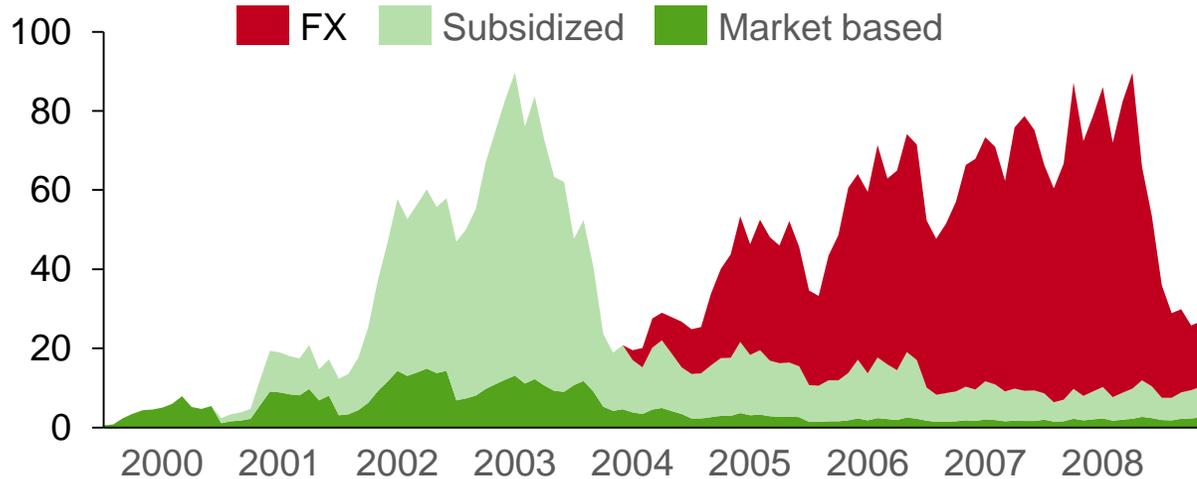
Reckless fiscal spending and sub-prime type FX lending boosted economic growth at a cost of excessive indebtedness and accumulation of toxic portfolios



Retail lending boom was fuelled by subsidized and FX housing lending

Overheated growth (2002-2008)

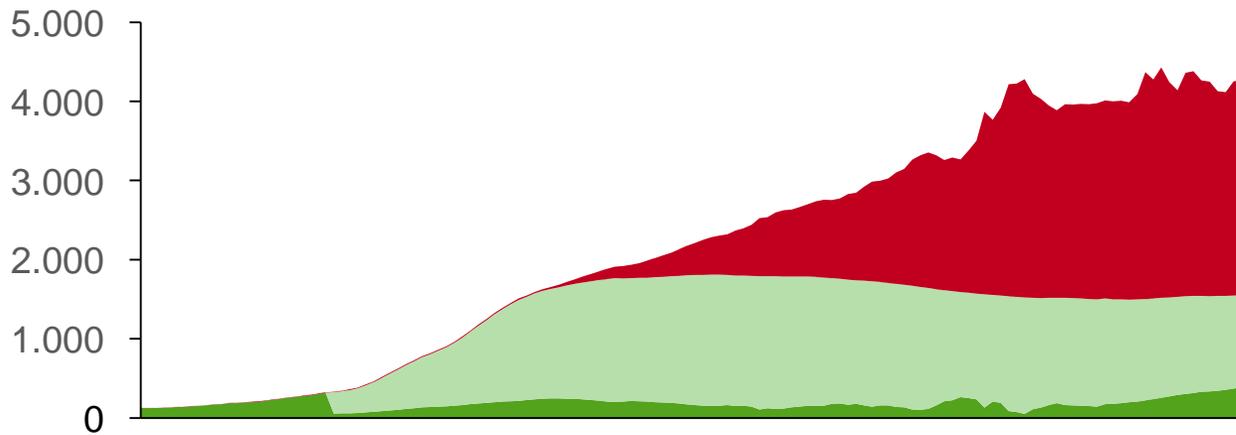
Housing loan monthly disbursement in currency breakdown (HUF bn)



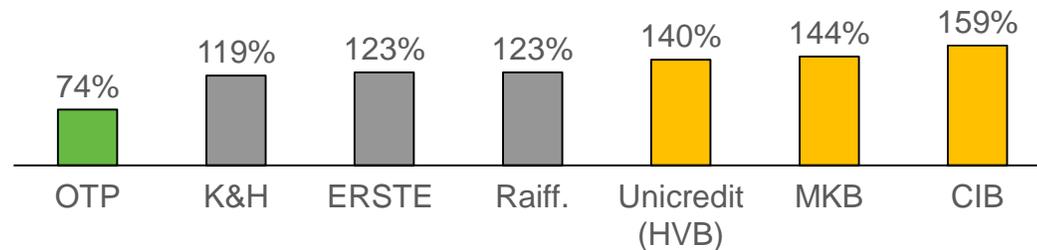
Housing loan interest rates (%)



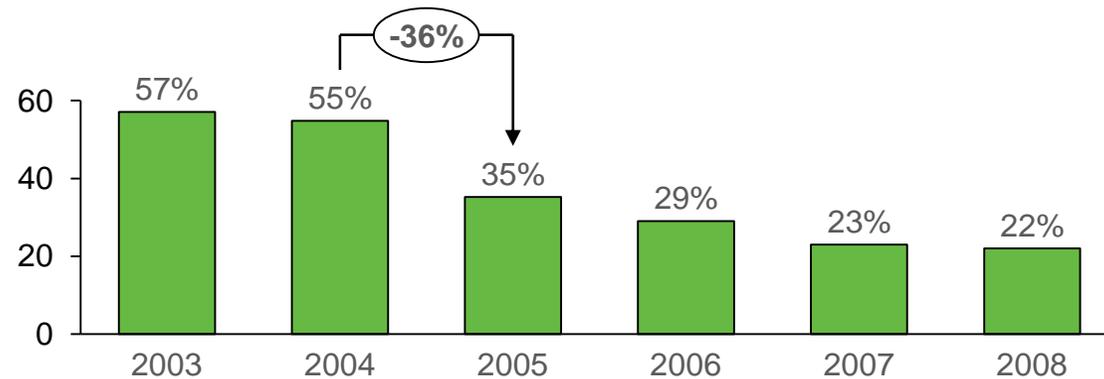
Housing loan portfolio currency breakdown (HUF bn)



Net loan to deposit ratios (2003, %)



Housing loan market share of OTP (%)



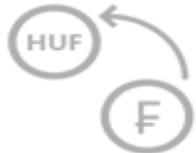
Recovery was supported by several adept measures of the National Bank of Hungary.
 On the other hand, the sector was hit by special levies on top of soaring risk cost

Deepening of FX lending crisis

Early repayment scheme
 (loss of HUF 267 bn)

NHP programme

Conversion of retail FX loan portfolio



Special banking tax:

- 0,15 and 0,5% rate on adj. total assets
- A burden of HUF 182 bn from 2010 on

Transaction tax:

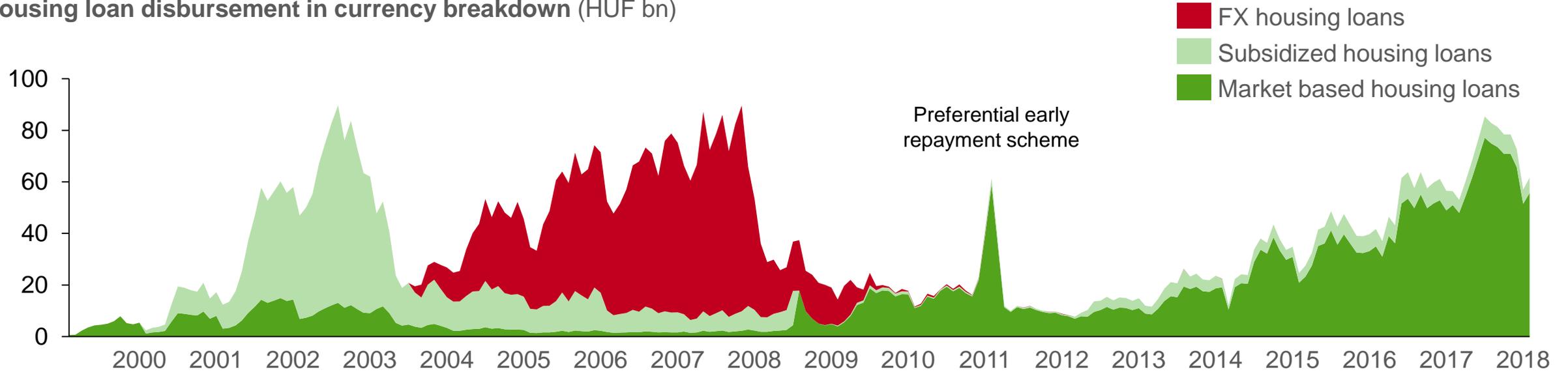
- 0,3% and 0,6%
- 800 or 500 HUF/year on cards
- Beginning of a cycle of cutting the base rate

- MNB self-financing programme
- Free of charge cash withdrawal

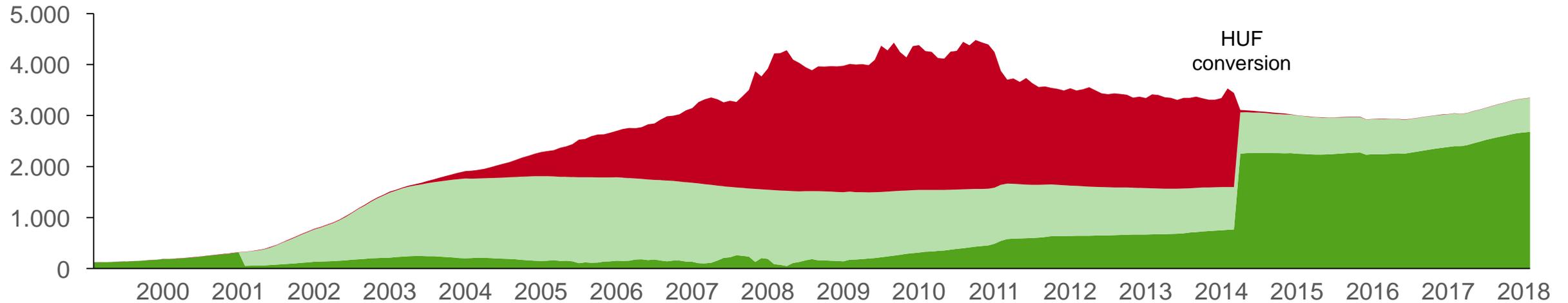
Conversion of FX household loans to HUF at the end of 2014 was a key and perfectly timed step in cleaning banks' balance sheets

Crisis and recovery (2009-2015)

Housing loan disbursement in currency breakdown (HUF bn)



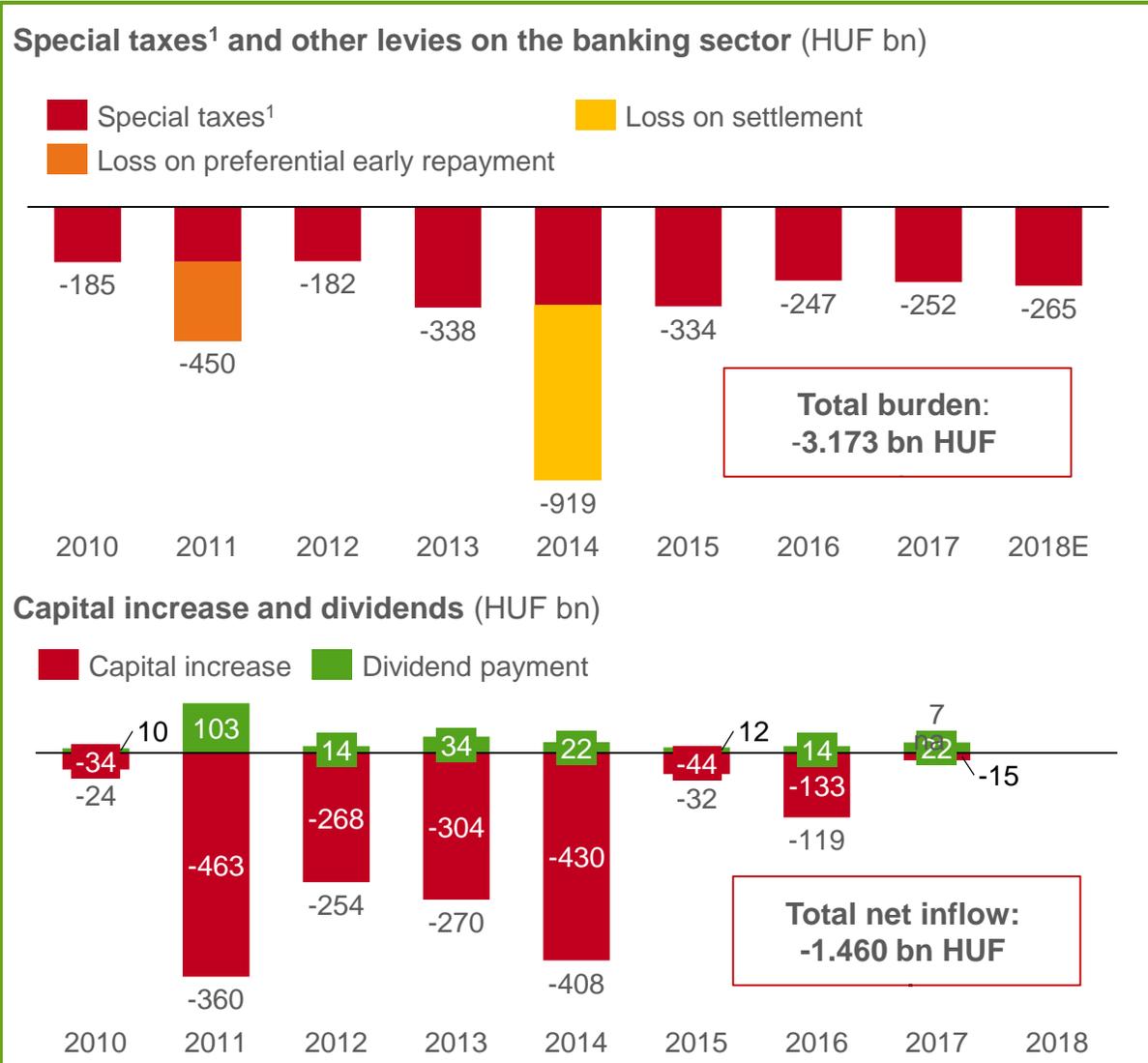
Housing loan portfolio currency breakdown (HUF bn)



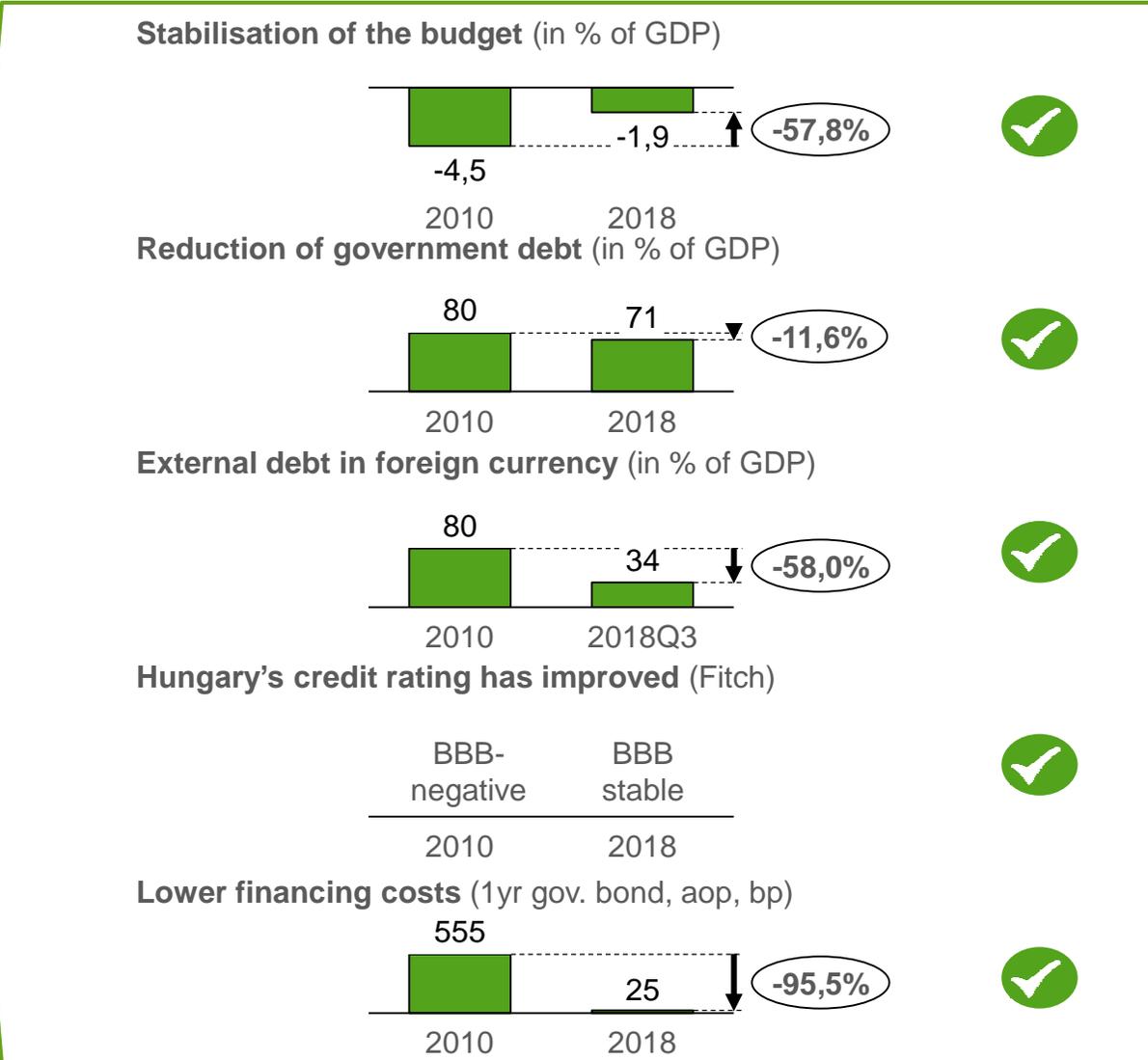
Source: MNB

Huge special levies exacerbated the woes of the banking sector in the crisis.
 On the other hand, special levies helped stabilise the economy

Huge special levies on the vulnerable banking sector

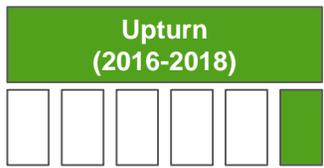


Stabilisation of the Hungarian economy

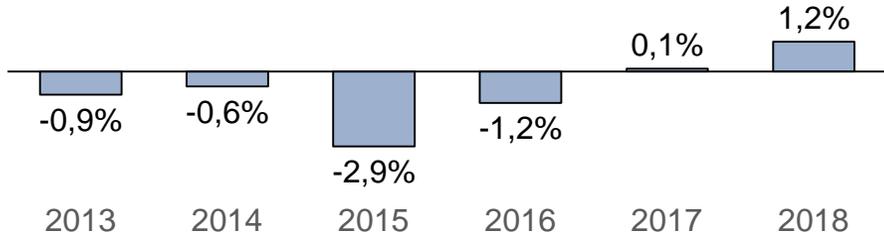


(1) Fees of fin.inst., banking tax, transaction tax, one-off transaction tax. Banking and transaction tax in the budget plan, actual banking tax may differ

Since 2016 both the Hungarian economy and the banking sector are characterised by robust and balanced growth



Growth of retail loan portfolio (yoy)

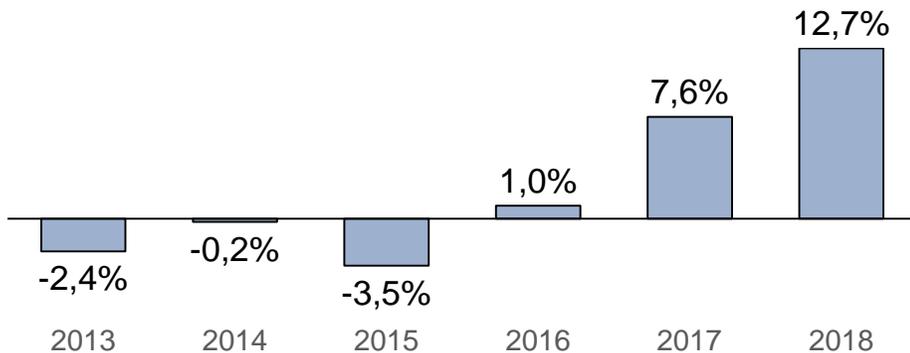


- Retail loan portfolio starts to grow
- 0% effective interest rates



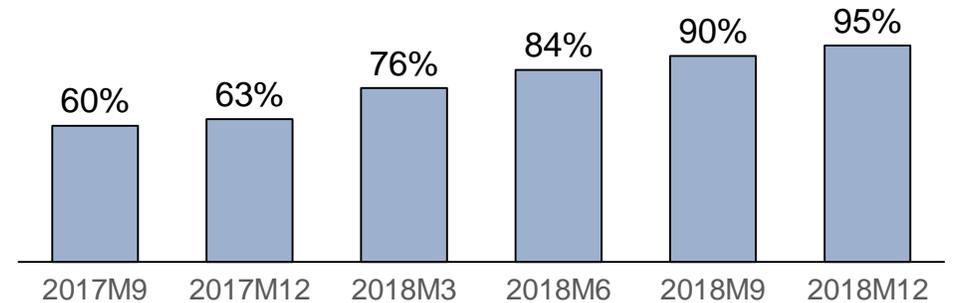
Corporate loan portfolio starts to grow

Growth of corporate loan portfolio (yoy %)



In 2018Q4 95% of new housing loans had fixed interest rates

Share of fixed rate loans among new housing loans



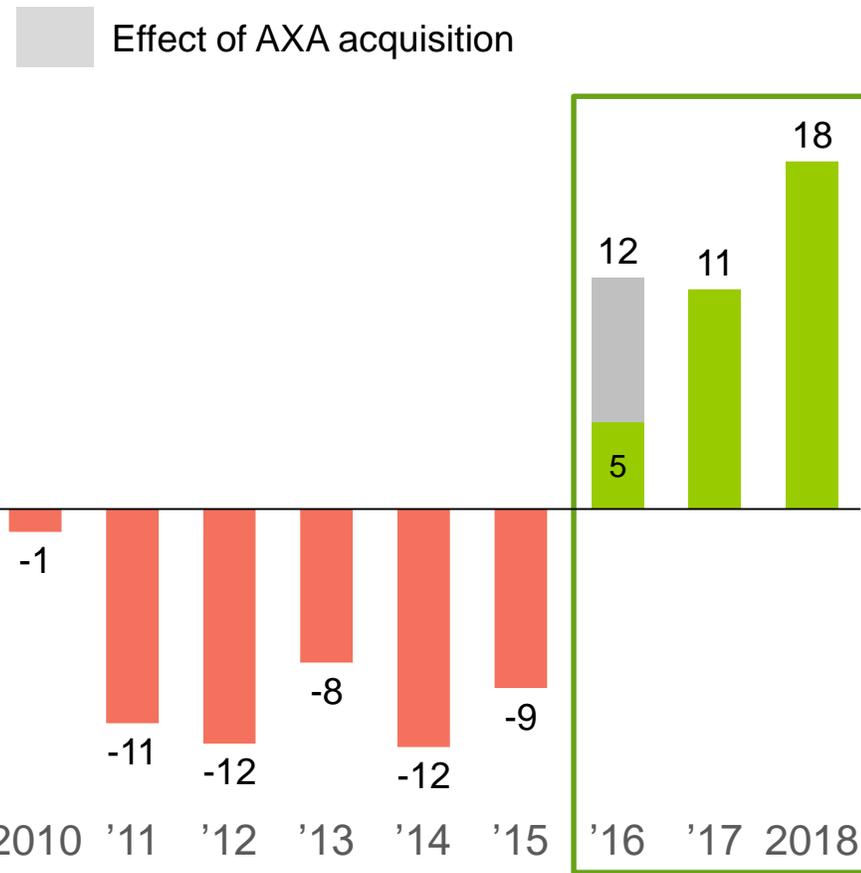
Excellent performance of OTP is reflected in the all-time high share price



OTP stock price (HUF)

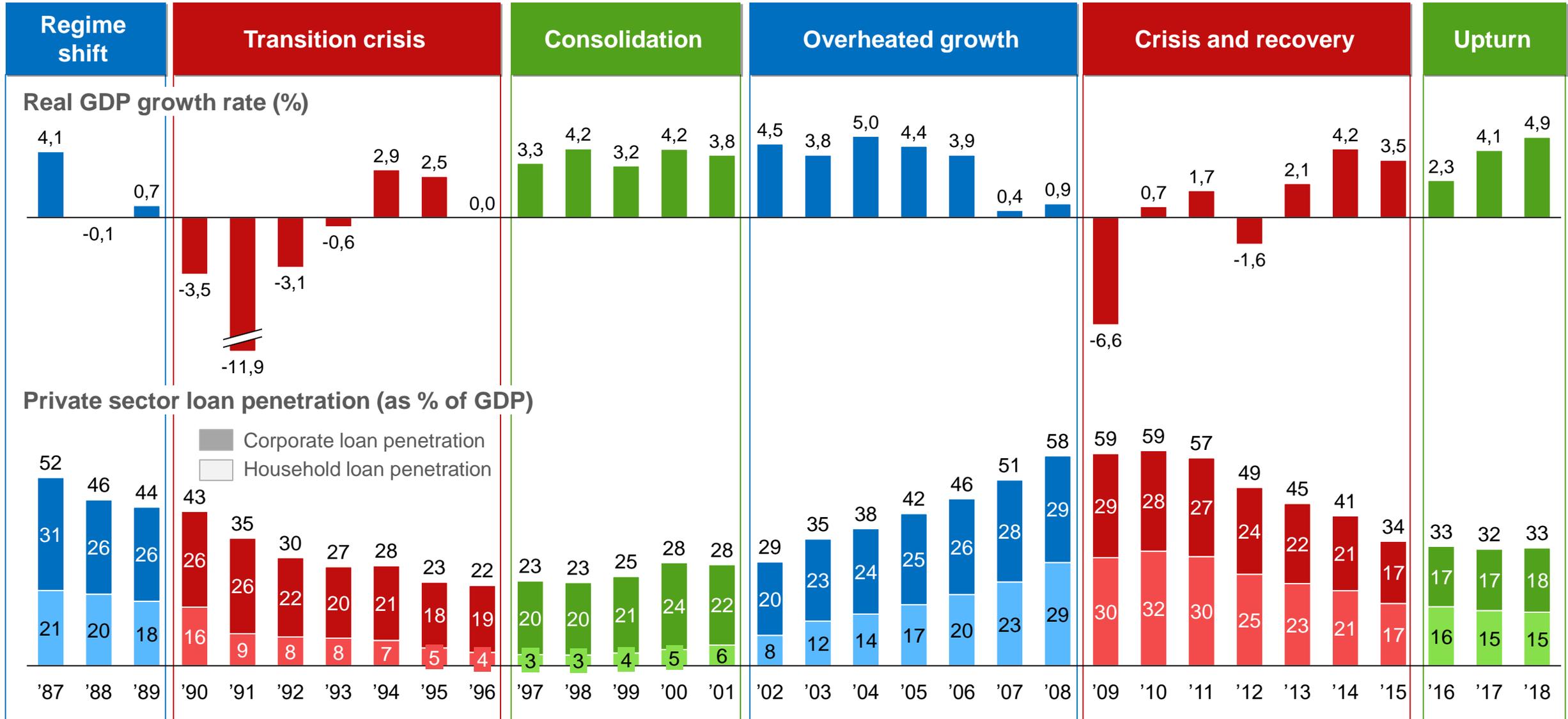


OTP Core performing loan volume changes (yoy, FX adj., %)



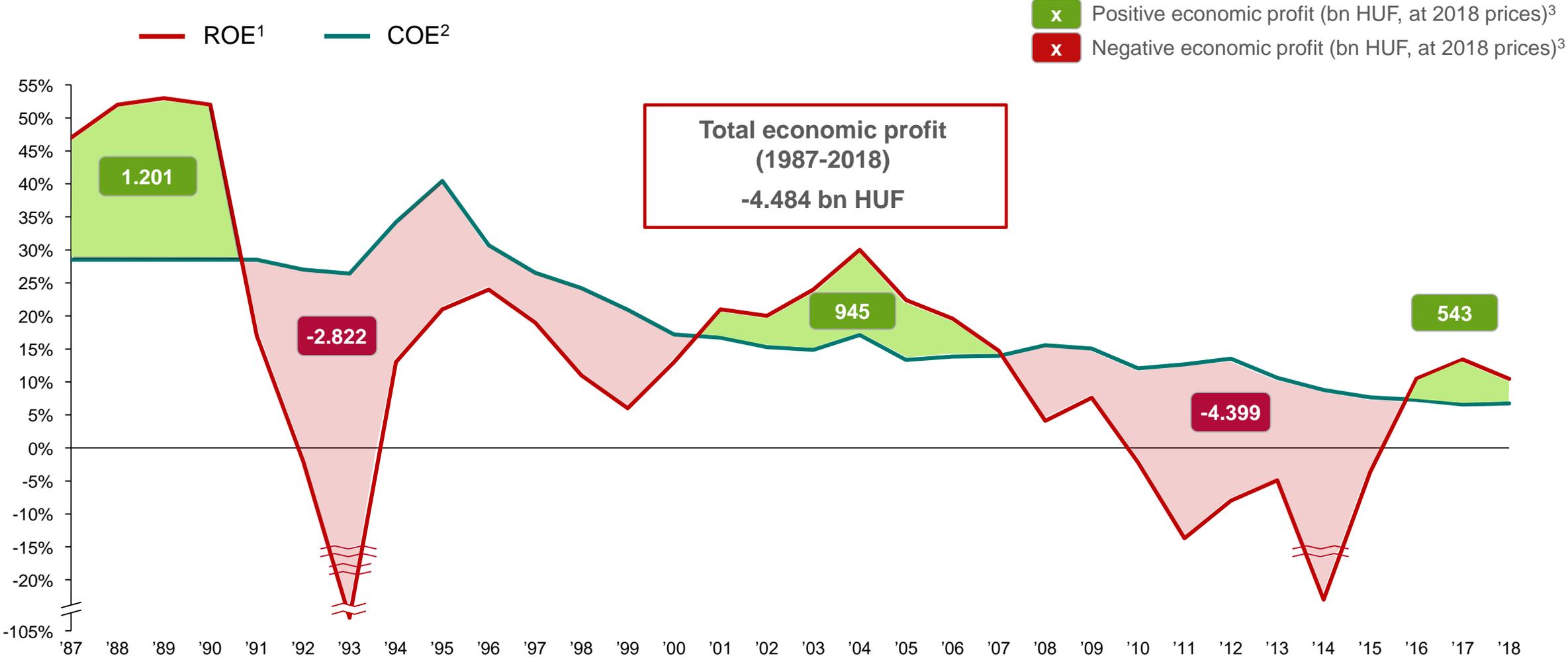
There is a strong correlation between economic growth and banks' lending activity

GDP growth and banking loan penetration in Hungary



Banking is a long term business. Profit in good years should cover losses in bad ones, especially in highly volatile emerging economies

ROE (Return on equity) and COE (Cost of equity) of the Hungarian banking sector (%)



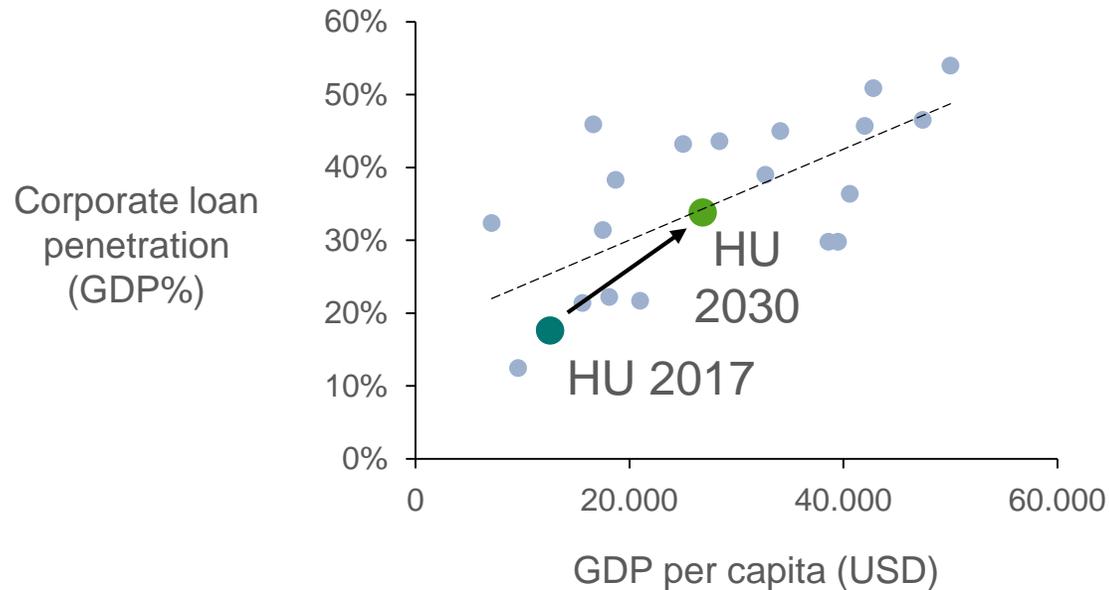
(1) ROE of the Hungarian banking system calculated from profit after tax, excluding dividend income (Source: Hungarian National Bank) and MKB's extraordinary profit due to release of claims (HUF 119,8 Bn in 2013 and HUF 84,5 Bn in 2014, Source: Annual reports) (2) Calculation of COE is based on CAPM method: 1 year gov. bond yield + 1,3 sector beta * 5% risk premium (3) Economic profit is at 2018 prices (nominal value adjusted by annual CPIs)

Growth may continue in the years ahead – loan portfolio could increase to five times of current levels by 2030



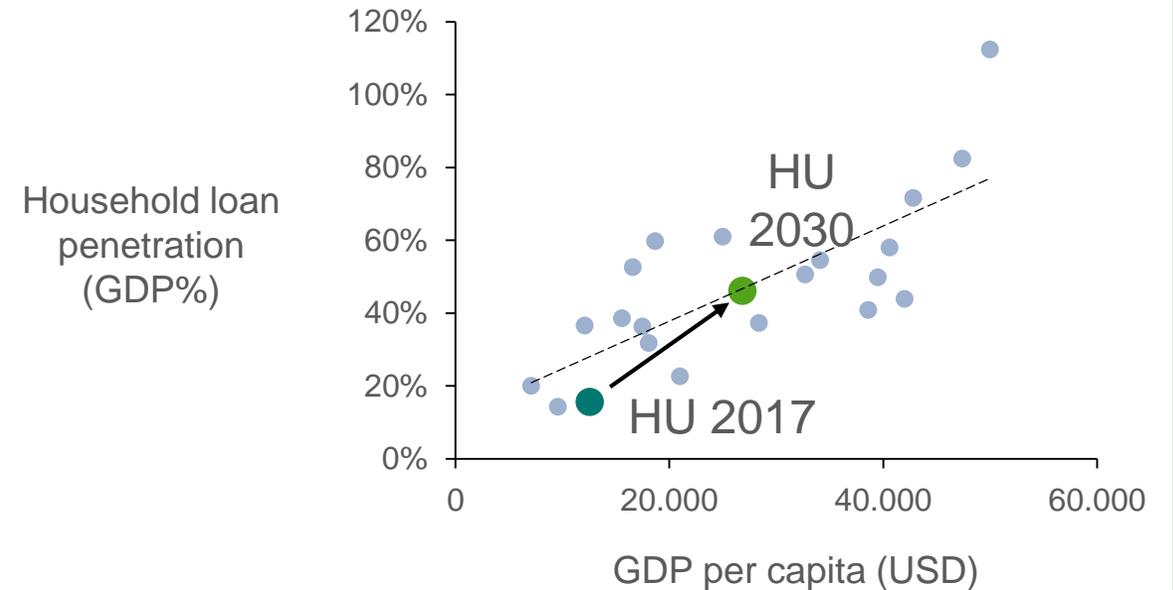
Providing that the Hungarian nominal GDP increases 6% annually on average and our penetration converges to levels corresponding to our development, loan penetration may reach 80% of GDP by 2030

The relation between corporate loan penetration and GDP per capita in the EU countries



Until 2030 corporate loans' annual growth rate could be 12% that would multiple the overall amount of loans by four times

The relation between household loan penetration and GDP per capita in the EU countries



The increase in household credit could average 15% till 2030 that would multiple the overall amount of household credit by six times

Hungarian microprudential regulation provides a fitting framework for balanced longterm growth. Higher profitability in upswing years is indispensable for the stability and continuous development of the banking sector



Avoiding the formation of toxic portfolios



Subprime mortgages

LTV and PTI limits



Hungarian FX retail loans

Stricter LTV and PTI limits for foreign exchange loans



Real estate project financing denominated in foreign currency

Office rent in EUR but likely to be renegotiated in crisis

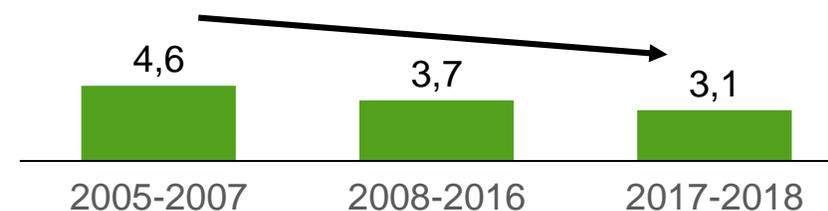


The microprudential measures by MNB successfully addressed risks

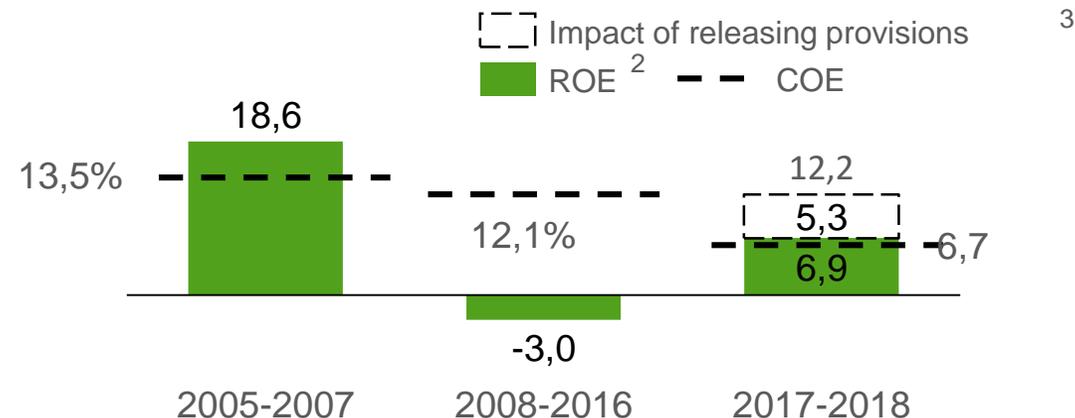


Profitability over business cycles

Net interest and fee margin¹ (%)



Return on Equity (ROE)² and Cost of Equity (COE) (%)



Net interest and fee margins are decreasing. Return on equity barely covers the cost of equity in upturn period



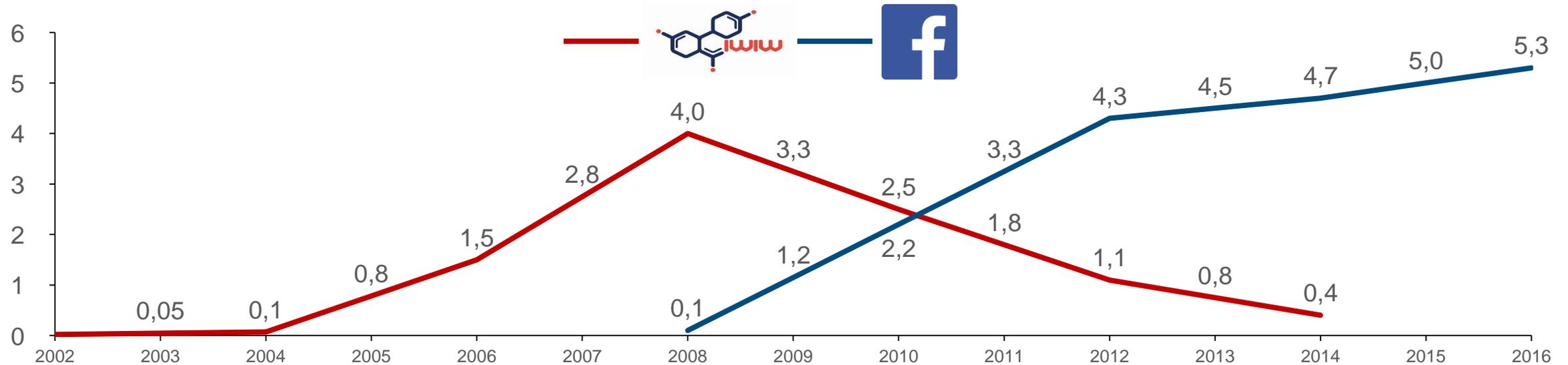
¹ Transaction costs are excluded from the commission margins

² Without dividend income

³ The difference between the actual risk costs (reversal of +182 bn HUF in 2017, and +47 bn HUF in 2018) and the -0,5% over the cycle risk cost (provisioning of -96 bn HUF on average)

In 2008, iWiW, a Hungarian social media platform, had 4 million active users with close to 100% market share. In less than six years iWiW lost 90% of its users resulting in a complete shut down of the service in 2014

Average number of active users in Hungary (logged in at least once per month, million)



Foundation of iWiW (Who is Who)

Magyar Telekom acquires iWiW for HUF 1 billion

Facebook mobile app

Shut down of iWiW

New business model – redesign and advertisements

Facebook available in Hungarian

iWiW mobile app

We expect banks to succeed in maintaining their leading role in financial intermediation

Possible scenarios



BANKS REMAIN THE KEY PLAYERS IN FINANCIAL INTERMEDIATION

CONSOLIDATION – BIG PLAYERS BECOME EVEN BIGGER



DIGITAL GIANTS DOMINATE CUSTOMER RELATIONS AND TAKE OVER AS MAIN PLATFORMS OF FINANCIAL INTERMEDIATION



EXPANSION OF DIGITAL BANKS AND FINTECH COMPANIES

The key role of big banks will likely be preserved



Strict regulatory environment



Need of physical interaction by the customers



Huge amount of customer data



Traditional banks are more resistant to crises



Modernisation, assimilation of fintech companies



Significant experience in cyber security



Effective actions against tax evasion & money laundering

Digital transformation is underway, OTP is a frontrunner in innovative solutions in Hungary

Revenue increase

1 Radical improvement of customer satisfaction



Tailor-made products and services



Customer journey digitalisation



Omnichannel customer experience



E2E online account opening and credit application



OTP
Holobank

2 Building a non-banking integrated ecosystem



Integrated non-banking product offers



Partnerships



Partner discount program

Cost reduction

3 New generation organisational model



Agile organisation and processes



Data based decision making



4 Digital transformation of internal processes



Modern IT and data infrastructure



Automatization and robotics



Q&A

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