HUNGARIAN BANKING ASSOCIATION

REPORT

ON 2009 ACTIVITIES OF THE HUNGARIAN BANKING ASSOCIATION

BUDAPEST, MAY 2010

CONTENTS

INTRODUCTION

The Association's activities in 2009 were primarily determined by tasks related to addressing the diverse and complex challenges posed by the financial crisis. Impacts of the global economic crisis: the narrowing of financing sources, the increase in financing costs, the change in risk sensitivity, and the impacts of the crisis on the real economy (declining production, sales difficulties) caused a deterioration in borrowers' ability to repay debts and, as a consequence, a deterioration of the loan portfolios, which further reduced banks' lending propensity. The weakening of the forint in early 2009 and the ensuing increase in the costs of foreign currency loans led to serious insolvency problems, especially in the retail sector. It became clear that the consumer lending practices of previous years, leading to excessive household borrowings couldn’t continue. Impacts of the crisis were added to by EU and national governments endeavours to change, through legislation and political pressure, the approach to some decades-long consumer protection issues, such as unilateral contract amendments, consumer information and prepayment fees. Another major area was the adoption and implementation of the new EU financial legislation in 2009.

Key activity areas in 2009 included the following (see details in the relevant sections of the report):

- the regulation of **unilateral contract amendments** (an amendment to Section 210 of the Credit Institutions Act, unworkable and highly burdensome for both customers and banks), the Code of Conduct to replace it and the related new amendment to the Credit Institutions Act;
- developing banking solutions, agreements and regulatory proposals to maintain customers' solvency;
- the Competition Office's investigation on inter-bank interchange fees;
- The Board reviewed and adopted **Recommendation 6/2009** on simplifying bank account switching. The vast majority of banks signed up to the Recommendation. By adopting this recommendation, the Association has implemented the common principles on bank account switching adopted by the European Banking Industry Committee. Banks signing up to the Recommendation have, effective from November 1, 2009, undertaken to ensure a one-stop system for transferring standing orders and direct debit mandates from the old to the new bank account.
- After in-depth professional reviews, the law transposing the EU Consumer Credit Directive and the Government Decree on responsible lending were enacted;
- Endorsing an MP amendment motion, submitted on the day of the vote, contradicting the Parliament's Standing Orders and the Finance Ministry's position, Parliament passed Draft Law No. T/10999, **capping interbank interchange and merchant fees**. The new regulation violates the freedom of contracting and the principles of a market economy.

  In view of the MP amendment motion in question, submitted right before the vote and passed by Parliament despite its baselessness, the Association turned to the President of the Republic, requesting him not to sign the draft law. The representatives of MasterCard és a VISA Europe in Hungary also turned to the President of the Republic, asking him to seek a constitutional test. Notwithstanding, the Act was promulgated under No. CL of 2009. Subsequently, as a result of a joint effort with the Ministry of Finance, a compromise solution was reached and an acceptable amendment to the Act was passed still before entry into force of the Act;

- Under its crisis management package, the government substantially reduced the **scope and size of government subsidies.** At members' request, the Association turned to the drafter of legislation for clarifications on certain provisions of the relevant Government Decree. A key issue was the ill-drafted provision on advance loans on home-building subsidies. The new regulation required banks to repay the undue government subsidy paid for fault of the customer, but failed to provide rules for the collection of the same sum from the customer. The Association wrote a letter to the drafter of legislation, objecting to this procedure and submitting a specific wording proposal to amend the provision in question;
- The Association has long urged for a regulation of **financial intermediaries** (agents). The Hungarian Financial Supervisory Authority in June held a consultation on key principles for the proposed regulation. The Association's Intermediaries Working Group was actively involved in the drafting of the regulation. The relevant provisions were incorporated in the amendments to the Credit Institutions Act under Act CL of 2009 amending certain financial Acts.

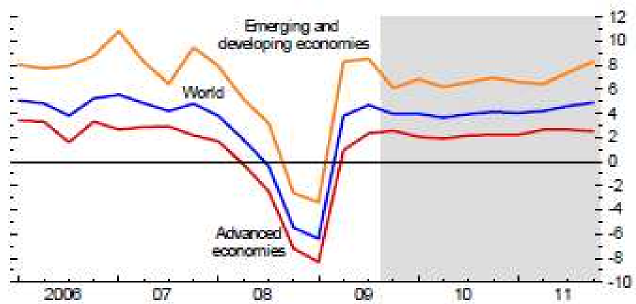
I. ECONOMIC AND FINANCIAL DEVELOPMENTS

1. The world economy at the beginning of 2010

The decline in the global real economy reached its nadir in the first quarter of 2009. The fragile growth, mainly triggered by government stimulus measures in the advanced economies, poses a political trap: the choice between reducing indebtedness and stimulating growth.

After the worst recession in 70 years, production and trade are once more on the rise. According to the IMF, the global economy is recovering. However, the picture is modulated by the fact that it is the emerging economies that drive the growth; the recovery in the advanced economies is slow. The G20's deficit-to-GDP ratio was around 9% in 2009, with their debt-to-GDP ratio rising to 100-120%. At the end of January, the IMF adjusted its World Economic Outlook forecasts upward, projecting a growth of 3.9% for 2010 and 4.3% for 2011. The IMF projects an around 2% growth in the developed countries (USA: 2.7%, Germany: 1.5%, France: 1.4%, U.K.: 1.3%, Euro area: 1%, Japan: 1,6%) and 6% in the emerging and developing economies (China: 10%, India: 7.7% Russia: 3,6%, Brazil: 4,7%, Central and Eastern Europe: 2%).

Global GDP growth

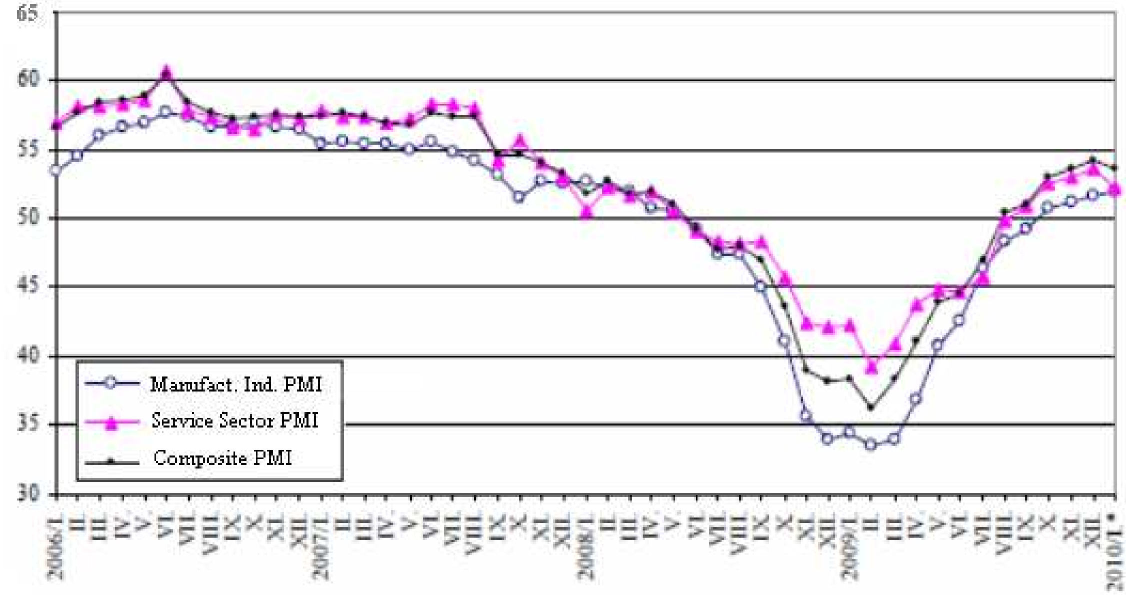


Source: IMF

As opposed to the decline of 12% in 2009, world trade volume is projected to grow by close to 6% in 2010 and over 6% in 2011. Energy prices are expected to increase (for example, oil, by 22%), consumer prices are projected to grow by 1% in the advanced economies and 6% in the emerging and developing countries.

According to the IMF, despite the rebound, *financial stability* in the advanced and the hardest-hit emerging economies is still fragile. As a result of improving economic outlooks, decreasing macroeconomic risks and improving monetary and fiscal conditions, credit and market risks are decreasing. However, there is still a need to continue repairing the financial sector: the impacts of the crisis are still felt and some new risks have also appeared (sovereign debt). A relatively rapid return to healthy growth in many emerging economies has exerted pressure toward an increase in asset prices and exchange rates. There has been a surge in equity and real estate investments, prompting concerns about price bubbles.

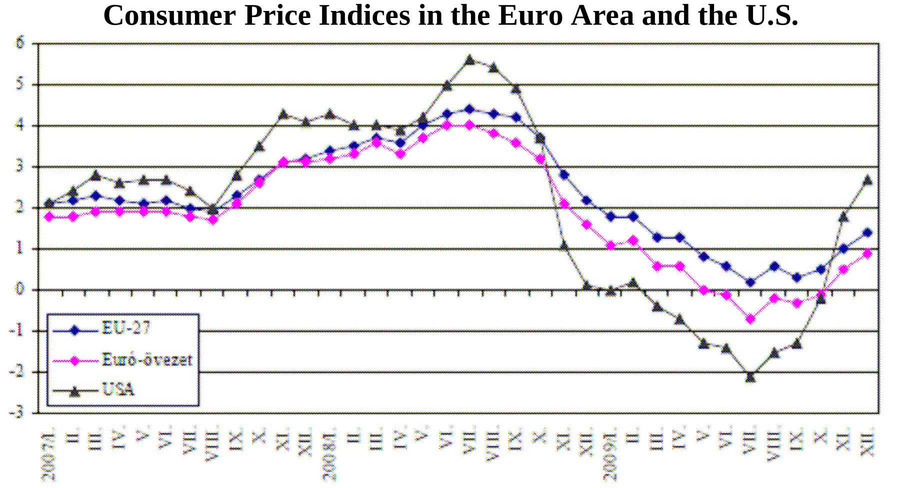
Purchasing Manager's Indices in the Euro Area



Source: Ecostat

The slowdown in inflation in the U.S. halted in the middle of 2009. Prices rose by five percentage points in the first half of the year in the U.S. and two percentage points in the EU. These rates are close to the optimal and historical inflation rates (3% in the U.S and 2% in the EU). Probably these are the rates where the relative price asymmetry is the smallest, which also explains why market players prefer this range of inflation rates.

Consumer Price Indices in the Euro Area and the U.S.



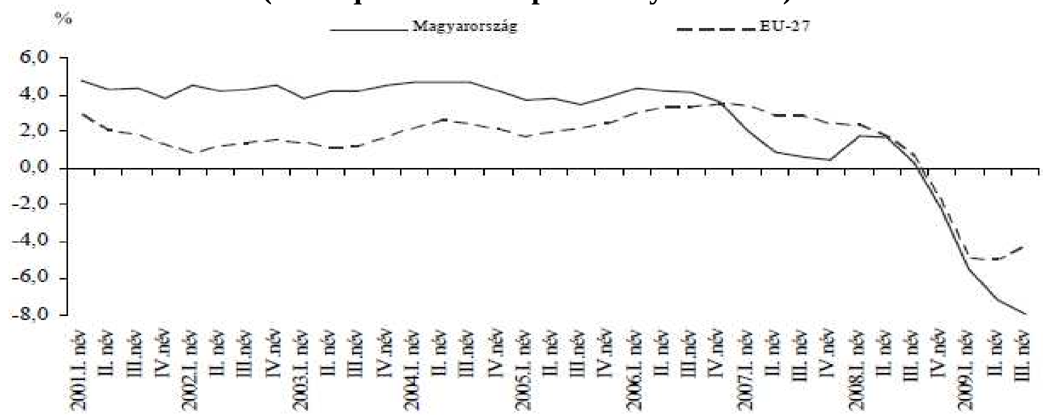
Sources: Eurostat, Bureau of Labour Statistics

2. The Hungarian economy in 2010 in the aftermath of the financial crisis

2.1 GDP

GDP fell by 6.3% in 2009 (5.3% in the last three months of the year). With a weak internal demand and a slowly improving external demand, the GDP is projected to grow between 0 and 1%, a pick-up is only expected in the second half of 2010. Impacts of the gradual, although slow, global economic growth seen in the second half of 2009 is now felt in Hungary, the pace of economic decline has slowed.

Hungary's and the EU-27's GDP growth rates
(same quarter of the previous year = 100)

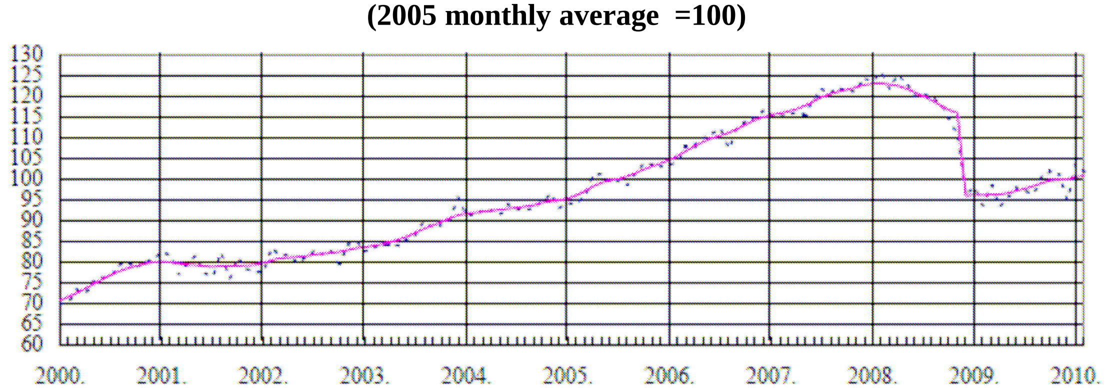


Source: Central Statistical Office (KSH)

2.2 Industry

Industrial production fell by 17.7% in 2009. Exports declined by 18.6%, domestic production fell by 12.6%. Industrial production rose by 5.9% in the first two months of 2010, growing by 8.4% in February year on year. Industrial production is projected to grow by 3% to 5% in 2010. Industrial exports rose by 14.5% in the first two months of 2010, growing by 15.5% in February year on year. Domestic sales declined in February by 8.7%. The growth in exports mainly came from motor vehicle production (+30.8%), and computer, electronic and optical product exports (+10.2%).

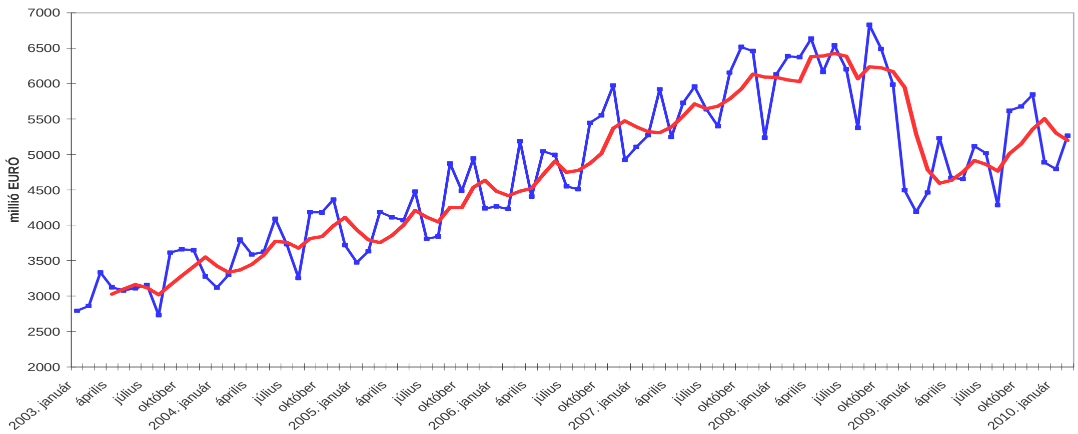
Industrial production volume indices and trend 2000 - February 2010
(2005 monthly average =100)



2.3 External trade

The balance of trade has been positive and improving each month since February 2009. The decline in external trade has slowed, exports in December showed a rise. Exports fell by 12%, imports by 17% in 2009. According the Central Statistical Office's estimates, the balance of trade showed a HUF 374 million growth in February, a EUR 78 billion increase over the previous year. Exports were up 18%, imports up 17.4% in euro terms in February year on year. In an improving global environment, European economies are rebounding. This has a positive impact on Hungary's external trade and its exporting industries: 80% of Hungary's exports and 70% of its imports are transacted with the EU member states. 68% of Hungary's imports 79% of its exports were transacted with the EU member states in February 2010.

Hungary's exports and export trends between 2003 and 2010, in euro



Source: Central Statistical Office (KSH)

External trade quarterly figures in 2009

(folyó áron – *at current prices)*

Időszak / *Period*	Érték, milliárd forintban / *Value, billion HUF*: behozatal / *imports*	kivitel / *exports*	egyenleg / *balance*	Értékindex / *Value index* (az előző év azonos időszaka = 100,0 / *same period of previous year = 100.0*): behozatal / *imports*	kivitel / *exports*	Volumenindex / *Volume index* (az előző év azonos időszaka = 100,0 / *same period of previous year = 100.0*): behozatal / *imports*	kivitel / *exports*
I. negyedév – *I. quarter*	3 890,0	4 077,1	187,1	80,8	83,5	75,2	78,1
II. negyedév – *II. quarter*	3 795,2	4 119,9	324,7	79,3	86,0	75,9	81,5
I–II. negyedév – *I–II. quarters*	7 685,2	8 197,0	511,8	80,0	84,7	75,5	79,8
III. negyedév – *III. quarter*	3 790,1	4 054,3	264,2	85,3	93,5	84,9	90,2
I–III. negyedév – *I–III. quarters*	11 475,3	12 251,3	776,0	81,7	87,5	78,4	83,0
IV. negyedév – *IV. quarter*	4 073,1	4 421,5	348,5	91,3	99,8	98,7	103,9
I–IV. negyedév – *I–IV. quarters*	15 548,4	16 672,8	1 124,5	84,0	90,4	83,0	87,8

2.4 Agriculture

After record yields in 2008, gross agricultural production dropped by 10%, with value added falling by 17.5% in 2009. The volume index of agricultural product sales was 99.7% in 2009, showing no major decline. Then, in the first two months of 2010 the index was 80.1%, which indicating a major decline in agricultural purchase.

Cereal production fell by nearly one-fifth. Yields fell, mainly due to adverse weather conditions, with 22% less wheat, 15% less corn and 21% less potatoes harvested in 2009 than in 2008. Producer prices fell by 9.5%. Crop and livestock prices declined by 12.7%, and 4.6%, respectively. Producer prices in January and February 2010 rose, by 1.6% year on year, with crop prices rising by 4.4% and livestock prices falling by 2.7%.

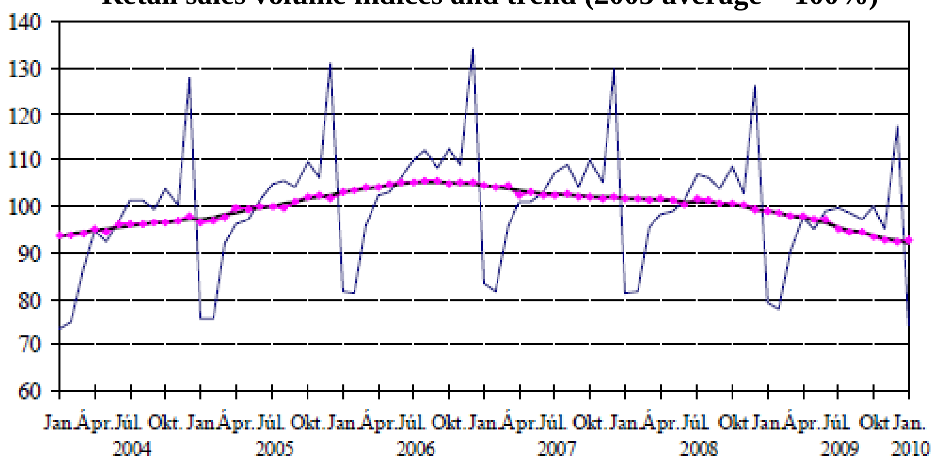
2.5 Household incomes, final consumption expenditure

Average gross nominal incomes rose by 0.5% in 2009. Real incomes in the public sector fell by 8.3%, those in the business sector grew by 0.2%, according to the Central Statistical Office. The sharp fall in final consumption expenditures played a major role in the decline in internal demand (falling by 5.3% in the first half of 2009 and 5.7% overall in 2009). Household expenditures fell by 6.7%.

Retail sales, measured at constant prices, declined substantially, by 7.4% year on year in December 2009 and 5.6% year on year in January 2010, indicating a slight improvement in 2010. Vehicle and vehicle parts continued to show the highest rate of decline (28.3%) in the first month of 2010. Miscellaneous industrial product sales and furniture, household product and building material sales also fell substantially, by 18.8% and 12.6%, respectively, compared to 2008.

ECOSTAT forecasts a 3.1% decline in household consumption, a 2.8% decline in final consumption expenditure and (after a 1% rise in 2009) a 0.8% decline in public consumption for 2010. Public consumption is expected to rise by 1.8% in 2011.

Retail sales volume indices and trend (2005 average = 100%)



2.6 Investments

Investments were down 8.6% from the previous year (investments in the EU fell by more than 11 %). Capital investments fell by 6.5%. Inventories, rising in 2008, dropped by HUF 480 billion in 2009. Two-thirds of the investments were carried out in the transport and real estate sectors. Public road construction projects and development programmes, launched under the New Hungary Development Plan, including school construction and refurbishment projects take up a major part in total investments.

The highest rates of decline in investments were recorded in the trade and health care sectors in 2009 (-18.6% and -7.6%, respectively). Investments in manufacturing were down 15.2% year on year. Investments rose in the agricultural sector (+7%), transportation and storage (+8.3%) and education (+13.3%), the latter mainly due to major university renovation and expansion projects. (ECOSTAT projects a 1.2% increase for 2010).

Investments in certain sectors

Description	Share in total investments 2009 %	Variance year on year		
		2007	2008	2009
Total investments	100.0	+0.3	-3.0	-8.6
of which:				
Agriculture	5.6	-10.9	24.4	7.0
Manufacturing	20.2	23.9	-3.6	-15.2
Trade	7.5	-3.9	7.3	-18.6
Transport	17.5	-2.0	-6.0	8.3
Real estate	21.8	-0.5	-1.5	-5.4
Administration, defence	3.5	-31.2	-28.1	-14.7
Education	2.0	-13.5	-13.8	13.3
Health care	1.3	-12.3	-2.1	-17.6

2.7 Employment

The annual average number of employed people in 2009 was 3,782,000, 2.5% less than in the previous year. The number of unemployed people rose by 27.8%, to 421,000. Employment figures of the last three years reveal a drop of 130,000 in employment and a 1.4% decline in the employment rate. Two years ago, only less than half of those in the 15-74 age group were employed, and this rate continued to shrink over the recent two years. With the number of unemployed growing by 150,000 over the recent two years, and by 100,000 in 2009, the unemployment rate rose to a double-digit figure in 2009.

Economic activity in the 15-74 age group between October 2007 and December 2009

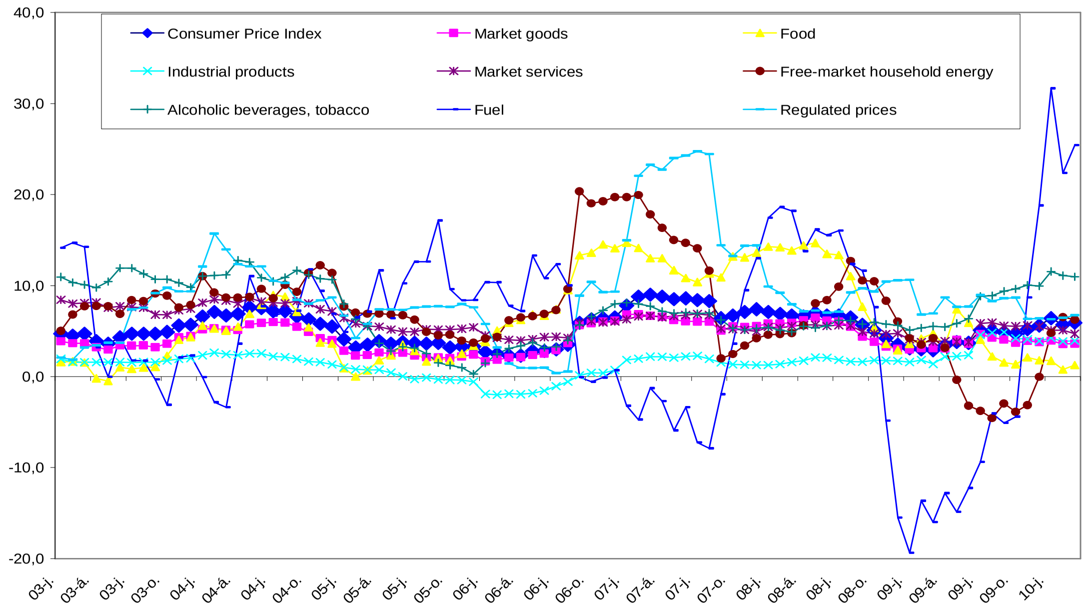
Időszak – *Period*	Foglalkoztatottak *Employed*	Munkanélküliek *Unemployed*	Gazdaságilag aktívak *Economically active*	Gazdaságilag nem aktívak *Economically inactive*	Munkanélküliségi ráta *Unemployment rate*	Foglalkoztatási arány *Employment rate*	Aktivitási arány *Participation rate*
	száma, ezer fő/*thousand persons*				%		
December 2007 - February 2008	**3854.7**	**337.0**	**4191.7**	**3525.6**	**8.0**	**49.9**	**54.3**
December 2008 - February 2009	**3789.9**	**377.7**	**4167.6**	**3533.1**	**9.1**	**49.2**	**54.1**
December 2009 - February 2010	**3725.9**	**478.7**	**4204.6**	**3480.5**	**11.4**	**48.5**	**54.7**

Source: Central Statistical Office (KSH)

2.8 Consumer price index

The consumer price index was 4.2% in 2009. Food prices rose by 3.3%, household energy prices by 2%, consumer durable prices by 4.3% over the previous year. Inflation rose from 2.9% in March 2009 to 5.9% in March 2010. The MNB baseline scenario forecast for Hungarian inflation is 4.4% for 2010, a 0.2% increase over 2009.

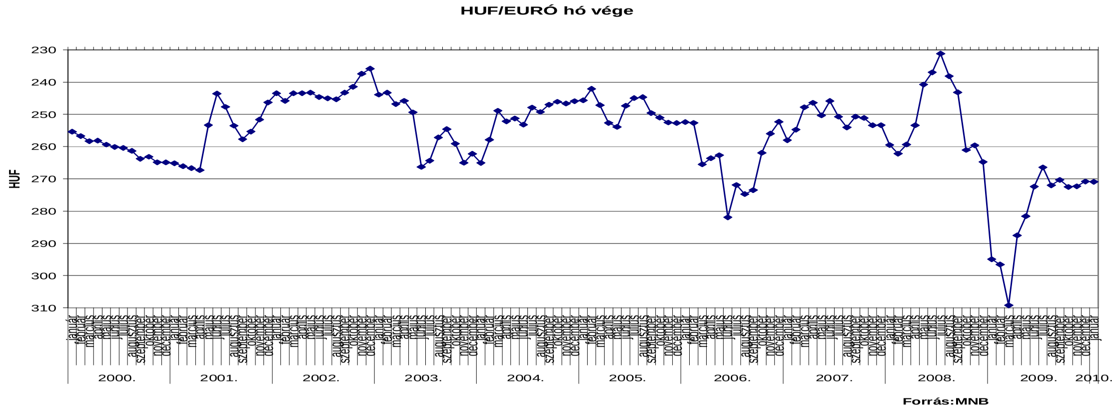
The Consumer Price Index and its components



2.9 HUF/EUR exchange rate

The HUF/EUR exchange rate, based on monthly averages, between January 2000 and September 2009 was 255.67. Following a rapid decline after October 2008, the exchange rate returned to around 270 HUF = 1 EUR, showing no significant weakening compared to the 10-year average. The average rate in the first quarter of 2010 was HUF 268.67, stronger than in any quarter in 2009.

End-of-month average HUF/EUR exchange rates



Source: MNB

3. Performance of the Hungarian banking sector in 2009[1]

3.1 Total assets

Banks' *total assets* declined by 0.5% in 2009 in forint terms (with the HUF/EUR exchange rate declining by 3.4%), as opposed to a 16% to 20% increase in the previous years.

Banks' assets structure

HUF billion

ASSETS	2003	2004	2005	2006	2007	2008	2009
Cash and settlement accounts	452.2	725.8	696.6	688.7	812.2	606.3	535.0
Securities for trading	674.3	645.3	628.7	930.3	1 648.6	1 903.8	3 528.6
Securities for investment	1 480.8	1 454.6	1 560.4	1 554.8	1 741.2	2 769.7	3 045.7
Total securities	2 155.0	2 099.9	2 189.0	2 485.1	3 389.8	4 673.6	6 574.3
Central bank and interbank deposits	1 286.8	1 613.9	2 179.4	2 379.3	1 634.4	1 435.3	1 649.4
Of which: central bank deposits	423.9	541.0	1 290.7	1 204.9	446.3	499.7	309.9
interbank deposits	863.0	1 072.9	888.8	1 174.4	1 188.1	935.6	1 339.5
Loans (net portfolio)	8 124.9	9 482.6	11 370.7	13 462.4	16 439.2	19 874.6	18 198.0
Of which: corporate loans	4 030.6	4 613.0	5 236.2	5 716.4	6 566.4	6 946.8	6 339.5
Retail loans	2 000.3	2 597.1	3 370.8	4 242.6	5 450.0	7 130.1	6 719.2
Participations	253.9	240.4	285.0	487.7	542.2	628.6	640.7
Accrued interest receivable	170.8	231.0	223.6	214.3	268.2	461.4	400.0
Prepayments and other assets	179.6	231.5	255.9	506.3	655.0	915.3	515.9
Own assets	237.3	286.8	359.1	539.6	634.7	582.8	521.9
Total assets	**12 860.7**	**14 911.9**	**17 559.4**	**20 763.5**	**24 375.7**	**29 177.9**	**29 035.1**

Source: Hungarian Financial Supervisory Authority

[1] *Sources of the tables presented below*:

- *Time series published by the Hungarian Financial Supervisory Authority (HFSA) without figures of the Hungarian Development Bank, Eximbank, Venture Financing Hungary, KELER and Garantiqua Creditgruarantee Ltd. Figures of the Hungarian Development Bank and Eximbank are included in the MNB Report on Financial Stability. Since the objective of the analyses is to assess the impacts of and responses to the changes in the external conditions, we have focused on the figures published by the Hungarian Financial Supervisory Authority.*
- *The MNB's and the HFSA's assessments show different results: according to the MNB's report, pre-tax profit in the banking sector rose from HUF 290 billion to HUF 306 billion, while according to the HFSA's analyses (excluding the Hungarian Development Bank and Eximbank), pre-tax profit decreased from HUF 281 billion to HUF 256 billion.*

3.2 Assets

Securities for trading rose by HUF 1,625 billion year on year (from HUF 1,904 billion to HUF 3,529 billion), ***loans decreased by nearly the same value***, ***HUF 1,677*** (from HUF 19,875 billion to HUF 18,198 billion), with **corporate loans declining by HUF 607 billion** and **retail loans falling by HUF 411 billion.**

- The rate of decline in the loans portfolio is illustrated by the 9% decline in corporate loans, as opposed to a 6% to 15% increase in the previous five years.
- Retail loans declined by 6% in 2009, as opposed to a 26% to 31% increase in the previous five years.
- Banks used their available funds (unchanged in size) to increase their portfolios of securities for trading and to reduce loans. (A significant shift was reflected in the more than HUF 400 billion rise in deposits and a decrease in accrued interest receivable).
- The decline in the loans portfolio affected *businesses* differently:
  - medium-sized businesses were hit the most, with a 14% decline in loans;
  - loans to large companies declined by 10%?
  - loans to micro-enterprises fell by 6%,
  - loans to small businesses declined by 1%.

Loans to non-financial businesses

HUF billion

	Loans to non-financial businesses by business size				
	Micro-enterprises	Small enterprises	Medium-sized enterprises	Large companies	Total corporate loans
Audited 2008	**1236.2**	**1158.9**	**1376.5**	3175.2	6946.8
Preliminary 2009	**1158.9**	**1143.2**	**1185.8**	2851.6	6339.5
	94%	99%	86%	90%	91%

Source: Hungarian Financial Supervisory Authority

- The decline in retail loans was clearly due to
  - the decrease in consumer loans, taking up HUF 240 billion of the HUF 290 billion total decrease;
  - home loans decreased by a bare 1%.

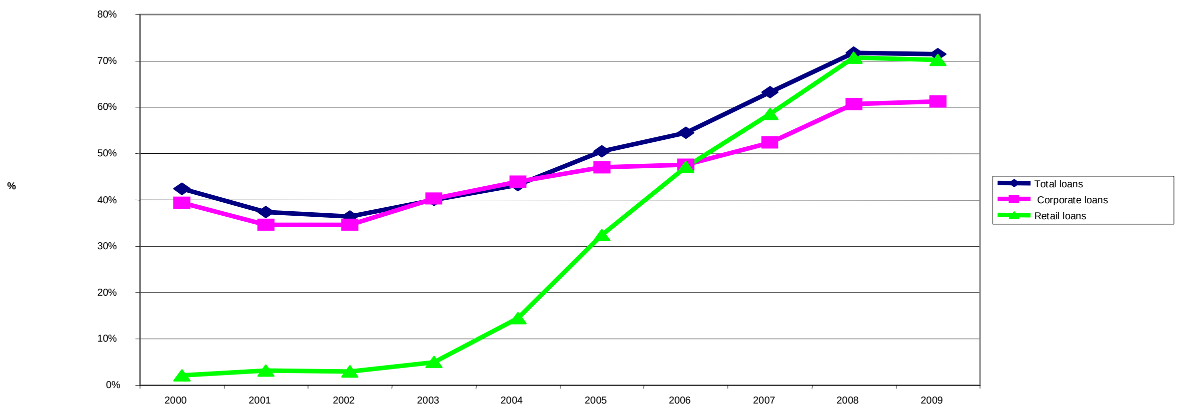
Structure of retail loans

	2008	**2009**	2009/2008
	HUF billion		%
Retail loans total (Households + sole proprietors)	**7 251.530**	**6 960.200**	**96**
Households	**7 158.756**	**6 877.114**	**96**
Overdraft	326.658	333.393	**102**
Consumer loans	2 903.943	2 663.753	**92**
Purpose credit	0.484	0.627	**130**
Mortgage loans	3 772.562	3 716.917	**99**
Other loans (with authentic repurchase agreements)	155.109	162.424	**105**
Sole proprietors	**92.774**	**83.086**	**90**

Source: Hungarian Financial Supervisory Authority

- The decades-long rise in the share of foreign currency loans in total loans halted, the share of foreign currency loans in retail loans fell slightly.

Share of FX loans in total loans



3.3 Liabilities

The liabilities side changed less significantly:

- Corporate deposits declined by HUF 200 billion,
- Retail deposits grew by HUF 200 billion,
- Interbank deposits rose by nearly HUF 400 billion,
- Accrued interest payable and other assets decreased by HUF 540 billion
- Own funds rose by HUF 280 billion or 13%.

Structure of liabilities

HUF billion

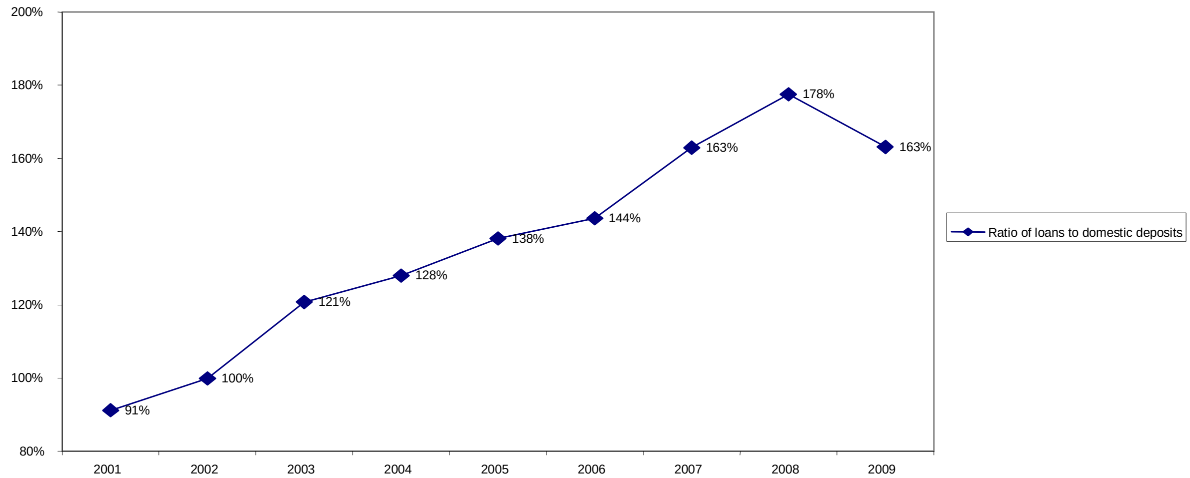
Liabilities	2003	2004	2005	2006	2007	2008	2009
Deposits	7 277.2	7 897.2	8 891.3	10 049.9	10 746.0	12 214.0	11 936.2
Of which: Corporate deposits	2 290.7	2 399.2	2 686.0	3 326.3	3 375.0	3 447.7	3 253.4
Retail deposits	3 867.8	4 279.3	4 666.6	4 863.9	5 173.3	6 022.6	6 252.0
Interbank deposits	1 240.8	1 457.2	2 113.2	2 684.8	4 024.8	4 826.2	5 197.5
Loans taken	1 387.2	1 788.9	2 134.0	2 416.7	3 135.9	4 216.7	4 238.2
Debt securities	1 097.7	1 482.6	1 765.2	2 030.1	2 441.5	3 024.3	3 118.0
Accrued interest payable	135.3	212.5	185.4	200.6	276.0	492.0	412.2
Other accruals, deferred income and other liabilities	337.9	499.0	627.7	944.2	945.7	1 345.5	798.2
Subordinated liabilities	175.5	181.5	270.6	541.3	601.3	640.4	657.0
Provisions	138.0	130.8	138.6	180.5	200.9	233.7	212.7
Own funds	1 071.1	1 262.3	1 433.4	1 715.4	2 003.7	2 185.2	2 465.1
Total liabilities	**12 860.7**	**14 911.9**	**17 559.4**	**20 763.5**	**24 375.7**	**29 177.9**	**29 035.1**

Source: Hungarian Financial Supervisory Authority

3.4 Loans-to-deposits ratio

According to literature, a loans-to-deposits ratio exceeding 10% is considered as risky and indicates what is termed aggressive lending. This has been the case in Hungary since 2002. The loans-to deposits ratio, rising steadily up to 2008, decreased slightly in 2009.

Ratio of loans to domestic deposits



Source: Hungarian Financial Supervisory Authority

3.5 Interest rates

In 2009 and in the first two months of 2010, deposit and lending rates (except for those for home loans in euro) declined. In the period between December 2008 and February 2010, the average interest rate of the ten instruments analysed fell by 1.7 percentage points. The gap in interest rates of the same instruments in forints and euro nearly doubled in 2008. This gap closed back by 2010.

3.6 Portfolio quality

The quality of balance sheet items deteriorated in 2009. The ratio of substandard + doubtful + bad items, hovering around 3% in the previous 5 years, doubled from 2.9% in 2008 to 5.7% in 2009. The ratio of substandard + doubtful + bad items doubled in all segments, including securities, loans and other assets. The ratio of substandard + doubtful + bad items was close to 10% (9.3%) in the corporate loans portfolio and 7.4% in the retail loans portfolio.

Share of substandard + doubtful + bad items in total items subject to classification

%

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Total balance sheet items subject to classification	3.6	3.7	3.0	2.9	2.7	2.4	2.4	2.9	5.7
Securities for trading	17.6	1.5	9.9	26.9	5.6	0.5	0.2	0.7	2.4
Securities for investment	9.2	3.7	1.0	0.6	0.1	0.1	0.0	0.4	0.8
Loans and other placements with financial institutions	0.1	0.3	0.2	0.1	0.8	0.3	0.0	0.1	0.3
Corporate loans	2.8	3.7	3.6	3.9	3.4	3.6	3.7	5.3	9.3
Retail loans	5.3	3.4	2.4	2.4	2.5	2.6	2.8	3.1	7.4
Loans to other sectors	0.4	0.2	0.1	0.1	0.1	0.1	0.1	0.4	0.3
Foreign placements	0.8	2.6	3.0	2.9	3.7	1.9	0.2	1.0	3.5
Other receivables and other assets	30.7	22.4	17.3	12.2	12.5	5.7	8.7	4.2	7.5
Of which: Participations	41.9	34.1	26.2	19.5	18.2	7.1	12.1	6.5	12.1

Sources: Hungarian Financial Supervisory Authority and specialist estimates

The deterioration of the portfolio quality had a significant impact on banks' results.

3.7 Profitability

Looking at the structure of ROA and ROE:

- The decades-long decline of net interest margin continued in 2009 (although at a slower pace), which is important: a major reason for the narrowing of the margin in the previous years was the increase in foreign currency loans, and while the increase in foreign currency loans halted in 2009, the net interest margin continued to decline.
- Banks continued to cut on operating expenses. In response to the financial crisis, a number of banks made major headcount reductions, thus reducing operating costs.
- The share of non-interest earnings increased in banks' 2009 profits.
- With the deterioration of the portfolio quality, the increase in impairments and provisions was the primary factor deteriorating banks' profits in 2009.
- ROA on aggregate remained positive, even with a decline from 1.4% in 2007, before the financial crisis, to 0.7% in 2009, a rate exceeding that of the EU, Japan or the U.S.
- ROE in the banking sector was around 9% in 2009, bringing the real ROE (ROE adjusted by inflation), amidst a financial crisis, to 4.4%.

Breakdown of ROA in the banking sector

%

Description	2001 Audited	2002 Audited	2003 Audited	2004 Audited	2005 Audited	2006 Audited	2007. Audited	2008 Audited	2009 Preliminary
Net interest income	**3.9**	**4.0**	**3.9**	**4.0**	**3.8**	**3.6**	**3.2**	**2.7**	**2.6**
Interest received	9.0	8.8	9.1	10.4	8.5	7.9	8.2	8.2	8.4
Interest paid	5.1	4.8	5.2	6.4	4.7	4.3	5.0	5.5	5.8
Non-interest income (net)	**1.0**	**1.4**	**1.6**	**1.7**	**1.6**	**1.6**	**1.6**	**1.3**	**1.9**
Earnings from commissions and fees	1.1	1.3	1.5	1.3	1.3	1.2	1.1	0.9	0.9
Dividends	0.1	0.1	0.2	0.1	0.1	0.1	0.2	0.6	0.2
Net profit on financial and investment services	1.9	0.4	0.4	0.6	0.8	0.6	0.8	0.5	1.0
Gains on forex trading and exchange rates	0.5	0.5	0.5	0.6	0.3	0.2	0.2	0.7	0.2
Other non-interest earnings	-2.1	-0.5	-0.5	-0.3	-0.6	-0.4	-0.5	-0.8	-0.3
Operating expenses	**3.4**	**3.6**	**3.4**	**3.0**	**2.9**	**2.7**	**2.6**	**2.4**	**2.0**
Change in impairment and provisions		**-0.3**	**-0.3**	**-0.4**	**-0.2**	**-0.4**	**-0.5**	**-0.5**	**-1.5**
Profit from ordinary business activities		1.6	1.8	2.3	2.3	2.1	1.7	1.0	1.0
Extraordinary profit	0.1	0.0	0.0	0.0	0.0	0.2	0.0	0.1	-0.1
Pre-tax profit	**1.5**	**1.6**	**1.8**	**2.3**	**2.3**	**2.2**	**1.7**	**1.1**	**0.9**
Tax liabilities	0.3	0.3	0.3	0.3	0.4	0.4	0.3	0.2	0.1
After-tax profit ROA	**1.2**	**1.3**	**1.5**	**2.0**	**1.9**	**1.9**	**1.4**	**0.9**	**0.7**

Sources: Hungarian Financial Supervisory Authority and specialist estimates

ROE between 2004 and 2009

	2004	**2005**	**2006**	**2007**	**2008**	**2009**
Average equity (HUF billion)	1166.7	1347.9	1574.4	1859.5	2094.5	2325.2
Average assets (HUF billion)	13886.3	16235.7	19161.5	22569.6	26776.8	29106.5
Assets-to-equity ratio (%)	11.9	12.0	12.2	12.1	12.8	12.5
ROA (%)	**2.00**	**1.90**	**1.90**	**1.40**	**0.90**	**0.70**
ROE (%)	**23.8**	**22.9**	**23.1**	**17.0**	**11.5**	**8.8**
Consumer Price Index (%)	**6.8**	**3.6**	**3.9**	**8.0**	**6.1**	**4.2**
Real ROE (%)	**15.9**	**18.6**	**18.5**	**8.3**	**5.1**	**4.4**

Source: Hungarian Financial Supervisory Authority and specialist estimates

II. INTERNATIONAL ISSUES: REGULATION, SUPERVISION

The various international institutions and bodies, including the Financial Stability Forum, the IMF, the G20 countries, the Basel Committee and the CEBS, in 2009 tried to translate the conclusions of the financial crisis into regulation. Regulatory resolve and anger, ever growing since the appearance of the first signs of the crisis in 2007 has affected all banks.

The Association's annual report is not the forum for presenting all the many regulatory initiatives and proposals in detail. (We sought to present them in detail in the annexes to our quarterly reports). In this report we will only focus on the most marked ones: those aimed at strengthening prudential regulation (capital, liquidity), redefining the scope and boundaries of international prudential supervision, improving corporate governance and risk management and enhancing the financial infrastructure and transparency. We will also review the main global and - the sometimes proactive, sometimes reactive - European developments.

1. Strengthening prudential supervision

Proposals aimed at ***strengthening prudential supervision***, including central banks' lender-of-last-resort role and other elements of the official safety net mechanism and the need for more international convergence were formulated on several international fora and in several documents. The need for more stringent capital requirements, including additional capital requirements for trading book items, securitisation and off-balance sheet positions[2], reducing procyclicality, and, as a means for this, introducing dynamic provisioning, was emphasised virtually in all proposals. Proposals also included the narrowing of the scope of commercial banking activities, the separation of commercial and investment banking activities and the extension of prudential regulation to quasi-banks, shadow banks and hedge funds, changing the originate-to-distribute banking model and imposing restrictions on securitisation.

The Basel Committee's package of consultative proposals, published in December, can be considered as a summary of all these proposals. The Basel Committee's proposals are aimed to strengthen global capital and liquidity regulations with the goal of promoting a more resilient banking sector that can withstand and absorb shocks arising from financial and economic stress. The proposals cover the following areas:

Raising the **quality**, consistency and transparency of the capital base. In addition to raising the quality of the Tier 1 capital base, the Committee is also harmonising the other elements of the capital structure. Tier 3 capital (in the Hungarian terminology: supplementary subordinated loan capital) will be abolished.

Strengthening the risk coverage of the capital framework. In addition to the trading book and securitisation reforms announced in July 2009, the Committee is proposing to strengthen the capital requirements for **counterparty credit risk exposures** arising from derivatives, repos and securities financing activities. The strengthened counterparty capital requirements will also increase incentives to move OTC derivative exposure to central counterparty.

---

[2] Proposals for strengthening the capital requirements framework were presented in the Basel Committee's Consultative Document on Proposed Revisions to the Basel II Market Risk Framework and Guidelines for Computing Capital for Incremental Risk in the Trading Book, and, in a broader sense, its Consultative Document on Principles for Sound Stress Testing and Supervision.

Introducing a **leverage ratio** as a supplementary measure to the Basel II risk-based framework with a view to migrating to a Pillar 1 treatment based on appropriate review and calibration. The leverage ratio will help contain the build-up of excessive leverage in the banking system. To ensure comparability, the details of the leverage ratio will be harmonised internationally, fully adjusting for any remaining differences in accounting.

Introducing a series of measures to promote the build-up of **capital buffers** in good times that can be drawn upon in periods of stress. In addition, the Basel Committee is promoting more **forward-looking provisioning based on expected losses.**

Introducing a global **minimum liquidity standard** for internationally active banks. The first is a **Liquidity Coverage Ratio,** defined as the stock of high quality liquid assets divided by net cash outflows over thirty days. The second ratio, or **Net Stable Funding Ratio**, is the ratio of the available amount of stable funding to the required amount of stable funding. The framework also includes a common set of monitoring metrics to assist supervisors in identifying and analysing liquidity risk trends at both the bank and system-wide level. (Liquidity risk - in view of the role it has played in the crisis - is addressed by the Basel Committee in a separate consultative document).

The Basel Committee is also reviewing the need for additional capital, liquidity or other supervisory measures to reduce the externalities created by **systemically important institutions.**

The Committee has initiated a comprehensive impact assessment of the capital and liquidity standards proposed in the consultative documents. The impact assessment will be carried out in the first half of 2010. On the basis of this, the Committee will review the regulatory minimum level of capital and the reforms proposed in the document to arrive at an appropriately calibrated total level and quality of capital. The new standards are proposed to be phased in as financial conditions improve and the economic recovery is assured, with the aim of implementation by end-2012. The Committee will put in place appropriate phase-in measures and grandfathering arrangements to ensure a smooth transition to the new standards.

The Basel Committee's decisions aimed at fine-tuning the Basel II Capital Accord were translated into provisions in the EU Capital Requirements Directive. The first amendment to the CRD was prepared in the course of 2008 and adopted by the European Parliament in April 2009. In addition to the originally targeted issues (**large exposures, hybrid capital instruments, supervisory arrangements and division of responsibilities between home and host supervisors, derogations for cooperative bank networks**), in the wake of the financial crisis the amendments also addressed **the treatment of and capital requirements for securitisation exposures and supervisory cooperation in crisis management**. (The provisions of CRD2 are required to be transposed into national legislation by October 31, 2010 and applied from December 31, 2010).

Consultations concerning the **second amendment to the Capital Requirements Directive (CRD3)** began in October 2008, and it is expected that the text, based on a compromise enjoying the agreement of every Member State, will be adopted in the first half of 2010. The amendments affect the capital requirements **for the trading book and re-securitisations (complex securitisations) and the disclosure requirements for securitisation exposures**. The European Commission supplemented the amendments, bringing the CRD in line with the decisions of the Basel Committee, with a proposal for the implementation of appropriate remuneration policies. The proposal requires institutions to assess, under the supervisory review process (Pillar 2), their remuneration policies and practices, including their consistency with effective risk management. Supervisors would have the ability to ensure compliance through sanctions, including the imposition of additional capital requirements. CRD3 also includes the Basel Committee's decision announced at the Committee's press conference of July 13, according to which the capital floor (80% of the Basel I calculation) will remain in force after 2009.

The European Commission published the **consultative document for CRD4** at the end of February 2010. The proposal differs in several points from the preliminary working paper published at the end of July[3] and basically corresponds to the Basel Committee's consultative documents published in December. The document provides regulatory proposals for **liquidity management, raising the quality of capital, the introduction of a leverage ratio, the treatment of counterparty risk, the clearing of OTC derivatives through central counterparties**, **improving the counter-cyclical nature of the regulatory framework (capital buffers, dynamic provisioning)**, **and the introduction of additional rules for systemically important institutions.** The proposals made by the Basel Committee are complemented with provisions for the introduction of a **single rule book.** The European Commission aims to further reduce the number of national discretions and options. This would turn the CRD from a minimum harmonisation directive into a maximum harmonisation one. A key element of the proposal is related to the **treatment of mortgage loans,** with a view to facilitating the consistent application of preferential risk weights. The CEBS[4] is conducting a quantitative impact study to assess the combined impacts of the proposed measures. The European Banking Federation, working together with the IIF[5], is also studying the impacts of the proposed measures on the real economy. The industry has concerns that that the combined impact of the changes might place disproportionate and impracticable burdens on banks.

2. Scope and boundaries of prudential supervision

Political decision-makers and regulators all agree about the failures of the supervisory system preceding the crisis. Accordingly, the second major group of regulatory proposals relates to the ***redefinition of the scope and boundaries of international prudential supervision***. An important step at the global level was the creation of the Financial Stability Board, with the task to promote the convergence of financial regulation and supervisory policies. The creation of **supervisory colleges** for all internationally active banks, strongly supported by the G20**,** is also aimed at promoting supervisory convergence**.** Another important objective is the reform of the regulatory and supervisory system to take account of **macroprudential risks**. To prevent similar crises, it is proposed that the IMF should be put in charge of developing and operating a financial stability early warning system. Also in this context, a **cross-border crisis management framework** should be developed. The proposals include extending the scope of regulation and oversight to **all systemically important institutions**, including **hedge funds** and **credit rating agencies**.

[3] The European Commission's working paper provided proposals regarding dynamic provisioning, the reduction of national options and discretions, the limitation of LTV, and simplification of the Bank Branch Accounts Directive. The paper also proposed to provide incremental capital requirements for residential mortgages denominated in foreign currency where loan-to-value exceeds 50%.

[4] Committee of European Banking Supervisors

[5] Institute of International Finance

In the wake of the crisis, the restructuring of the supervisory architecture in Europe will be accelerated and broadened in scale. The European Commission's consultation document was published in May, followed by a proposed regulatory package in September 2009.The European Council set out Member States' common position on the regulatory package on December 2. The rapporteurs' amendment proposals were published in the second half of February. The most debated issue was the powers of the new European supervisory authorities[6]. Despite the differences in opinions, the objective is to have the new regulations passed before the Parliamentary break and enacted effective January 1, 2001.

The **European Commission's** regulatory package was essentially based on the report presented by the de Larosiére expert group. The aim of the package is:

- to sustainably reinforce financial stability throughout the EU,
- to ensure that the same basic technical rules are applied and enforced consistently,
- to identify risks in the system at an early stage,
- to resolve cases of disagreement between national supervisors and to take efficient and coordinated measures in emergency situations

The legislative proposals envisage the creation of a **European Systemic Risk Board (ESRB)**, responsible for macro-prudential supervision and the **European System of Financial Supervisors (ESFS)**, in tandem with new **European supervisory authorities (ESAs) for the banking, securities and insurance and occupational pensions sectors: the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA).** The ESAs will take over the operations, responsibilities and duties of the 3L3 Committees and will be vested with additional responsibilities, specific legal mandates and broadened powers. The new authorities will have extra competences, including

- Developing proposals for technical standards, respecting better regulation principles;
- Resolving cases of disagreement between national supervisors, where legislation requires them to co-operate or to agree;
- Contributing to ensuring consistent application of technical Community rules (including through peer reviews);
- The European Securities and Markets Authority will exercise direct supervisory powers for Credit Rating Agencies[7];
- A coordination role in emergency situations.

The European Supervisory Authorities will be created by EU regulations (to be applied by member states on a mandatory basis). Binding decisions adopted by the ESAs may not have direct implications on members' states budgets. The new authorities will be bodies with legal entity and will belong to the European System of Financial Supervisors (ESFS). Members of the ESFS will include the Joint Committee of European Supervisory Authorities (the body responsible for the supervision of financial conglomerates), national supervisors and the European Commission. Day-to-day supervision would remain at the national level. The financial means for rescuing financial institutions would also remain at the member state

---

[6] In this report we only present the European Commission's initial proposal. For the positions and comments of the European Council, the EP rapporteurs and the European Banking Federation, see our fourth quarter report.

[7] A regulation on credit rating agencies was adopted at the beginning of 2009. The regulation puts in place a common regulatory regime for CRAs. Following the enactment of the regulation, CESR published a consultation document on establishing a CRA central repository.

level. The colleges of supervisors will supervise cross-border groups. The European Supervisory Authorities would participate in meetings of the supervisory colleges, as observers.

The powers of the new supervisory bodies are regulated by an omnibus directive. This amends the relevant sector regulations by providing common rules under an umbrella legislation to ensure efficiency of the EFSF. The amendments define the desirable scope of technical standards, incorporate mechanisms for the settlement of disagreements between national supervisory authorities into the relevant directives and ensure that the directives operate in the context of new authorities.

In addition to a new supervisory architecture, a key issue for the EU is the development of a **cross-border framework for bank resolution**. The crisis has shown that the EU needs a crisis management framework, which mirrors the cross-border nature of financial markets. A new framework should equip authorities with adequate tools to identify problems in banks at a sufficiently early stage and to handle cross-border banking failures in ways that minimise costs to taxpayers, and allow even the largest banks to fail without damaging financial stability. In this context, it was proposed that an **EU resolution fund** financed by banks should be established. Proposals are also under review for the further harmonisation of **deposit and investor guarantee schemes**.

3. Corporate governance, risk management, transparency, accounting policies

In addition to reforming the prudential regulatory and supervisory system, global regulatory priorities include the improvement of ***corporate governance, risk management*** and transparency, the convergence of accounting standards and practices and the improvement of the ***financial infrastructure***.

The Basel Committee is reviewing its guidance on enhancing corporate governance for banking organisations, issued in 1999 and revised in 2006[8]. The crisis has revealed that board members and senior managements at institutions have often failed to have a clear understanding of the risk profile of the institution. Accordingly, the Basel Committee sees a need to revise and complement its guidelines on corporate governance in the areas of board policies, risk management, transparency and clear understanding of the institution's organisational structure.

In the context of corporate governance, regulators, and especially, political decision-makers have given special emphasis to the issue of **directors' remuneration**. The Financial Stability Board and the CEBS have separately published guidelines for remuneration policies. The European Commission has issued two recommendations and proposed amendments to the CRD in relation to regarding companies' remuneration policies. The proposals are aimed at ensuring that **remuneration policies are in accordance with requirements on effective risk management,** encouraging risk awareness, limiting the variable part of the remuneration and ensuring that variable pay is aligned with the institution's long-term interests. It is also an objective to ensure that directors' pays reflect the institution's performance and can also be reduced.

[8] In the EU, the 3L3 Committees have called for cross-sectoral convergence of corporate governance principles.

Improving transparency is key to ensuring better understanding between financial institutions and investors. This can be achieved through appropriate **disclosure requirements.** The Basel Committee has developed proposed revisions to the existing Pillar 3 requirements, focusing on six areas: securitisation exposures in the trading book, sponsorship of off-balance sheet vehicles, resecuritisation exposures, the Internal Assessment Approach (IAA) for securitisations, valuation with regard to securitisation exposures, pipeline and warehousing risks with regard to securitisation exposures. The transparency of **derivative transactions** also needs to be improved. Better investor information and comparability of financial reports could be achieved by introducing a **global accounting standard**.

In line with the above objectives, the European Commission presented a proposal at the beginning of the year for the strengthening and direct financing of accounting and auditing standard setters. The CEBS also made a number of important steps aimed at improving transparency. It published a consultation paper on guidelines for supervisory disclosure taking account of the lessons learned from the financial crisis and extended the supervisory disclosure requirements beyond the CRD (mergers and acquisitions; securitisation, credit risk mitigation, Pillar 2, Pillar 3). Furthermore, revisions to COREP and FINREP are also aimed at promoting the convergence and comparability of financial reports within the EU.

4. Committee for European Banking Supervisors (CEBS)

The CEBS's activities in 2009 were focused on the priorities set for 2009, although its work plan was occasionally overridden by requests from the European Commission and other developments. The CEBS published a record number of consultation papers and guidelines in 2009.

In relation to risk management, the CEBS published consultation papers on **high-level principles on risk management** (CP24), **supplementary guidelines on implementation issues of operational risk** (CP21)**, draft guidelines on concentration risk** under the supervisory review process (CP31), **draft guidelines on the management of operational risk in market-related activities** (CP35) and guidelines on operational risk mitigation techniques for AMA institutions.

Following the publication of the relevant consultation papers (CP26 and CP27), the CEBS issued its **implementation guidelines on the revised large exposures regime** and its **implementation guidelines on hybrid capital instruments,** followed by a consultation paper on **implementation guidelines on capital instruments** (CP33). It also issued its revised guidelines on stress testing under Pillar 2 (CP32), updating the guidelines issued in 2006 based on experience obtained in recent years and taking account of the Basel Committee's revised principles for sound stress testing practices and supervision. In addition, the CEBS provided technical guidance to the European Commission on the **effectiveness of the minimum retention requirement for securitisations.** The CEBS's task force on procyclicality developed a proposal to address the potential **procyclicality effects** of Basel II and the CRD. The proposal, focused on IRB banks, provides for the introduction of a scaling factor in the supervisory review process under Pillar.

The CEBS's consultation paper on implementation guidelines on **liquidity buffers** (CP 28) sets out high level principles for liquidity management. The guidelines propose that, when building their buffers, credit institutions should consider three types of stress test scenarios: idiosyncratic, market specific, and a combination of the two. The CEBS has also published a liquidity identity card aimed at providing supervisors of European cross-border banking groups with a single prudential language to enable meaningful exchanges of information between supervisors.

After its **good practices paper on the functioning of colleges of supervisors** for cross-border banking groups, in accordance with the relevant provisions of CRD2 the CEBS published its **draft guidelines for the operation of supervisory colleges** (CP34). The draft guidelines aim to complement the CRD provisions where additional guidance appears necessary in order to avoid inconsistencies and regulatory arbitrage.

The CEBS guidelines on **passport notifications** address co-operation and information exchange between the competent supervisory authorities, including the harmonisation of documents exchanged.

The CEBS's tasks include the provision, at least twice a year, of **assessments** of **micro-prudential** trends, potential risks and vulnerabilities in the banking sector**.** The assessments are currently produced based on surveys conducted at 17 banks involved in the operational networking project. In May 2009, the ECOFIN mandated the CEBS to carry out an EU-wide forward-looking **stress test of the banking system**. The exercise was conducted on a sample of major European cross-border institutions representing 60% of the total assets of the EU banking sector, for a baseline and an adverse scenario. The results showed satisfactory Tier1 compliance under both scenarios.[9]

In addition to the above, the CEBS is carrying out diverse activities. In cooperation with the ECB, it has drafted a relational database, aimed at streamlining statistical and supervisory reports. It held an open seminar on the **internal capital adequacy assessment process** (ICAAP) and organised a public roundtable **on Pillar 3**.

The development of a new European supervisory architecture will be a major challenge for the CEBS in 2010. The reform will involve important regulatory consequences: the CEBS will be transformed into an authority, consequently, all its standards and guidelines issued earlier will have to be updated, as currently these are non-binding and based on the comply-or-explain principle.

5. EBF Banking Supervision Committee

The ***European Banking Federation*** was actively involved - mainly through the IBFed - in the global standard setting process. The EBF carried out active lobbying in all related issues to enforce the industry's interests. It is not an objective of the Association's annual report to present the positions taken by the EBF on the various issues. However, the EBF's **general position** is well summarised in the letter written by the EBF's president, Alessandro Profumo to the British prime minister, Gordon Brown ahead of the G20 summit in September.

In his letter, the EBF's president confirms the European banking community's support of the reforms launched, emphasising the need for a coordinated global approach and outlining the

[9] Under the baseline scenario, reflecting current macro-economic projections, the banks' aggregate Tier 1 capital ratios will be well above 9%. Under the adverse scenario, the potential credit and trading losses over the years 2009-2010 could be close to € 400 bn. However, the aggregate Tier 1 ratio for the banks in the sample would remain above 8% and no bank would see its Tier 1 ratio falling under 6% under the adverse scenario.

aspects that should be taken into account with a view to ensuring economic and financial stability:

- Global coordination of regulation, enhanced cooperation between regulators, avoidance of regulatory arbitrage.
- Development of a single high-quality reporting standard. Cooperation between the IASB and the Basel Committee to strike balance between regulatory and accounting requirements.
- European banks support the proposal that regulatory capital requirements be set higher than before the crisis. However, the cumulative impact of the individual measures (dynamic provisioning, the potential introduction of a leverage ratio, a more stringent definition of own funds, additional liquidity reserves) should be assessed and taken into account.
- The introduction of a leverage ratio raises a number of problems and can only be considered as a supplementary measure to the risk-based framework. A leverage ratio may encourage investment in risky assets. It would also undermine competition: divergent accounting standards would result in divergent ratios. The introduction of a leverage ratio can only be perceived within the Basel II framework, by taking account of the concerns raised.
- European banks agree with the need to enhance corporate governance and implement remuneration policies that take account of risk taking, and support the G20 proposal for such remuneration practices.

European banks encourage governments, central banks and supervisors to analyse the scope and size of competition-limiting impacts of government bailout measures, to ensure that exit strategies developed at national, regional and international levels ensure a level playing field.

In relation to systemically important banks, the EBF supports the European leaders' call for consensus on strengthening the supervision of these institutions by measures such as stress tests and continuity plans. Adequate implementation of such measures would make the building up of more capital requirements unnecessary. European banks also support the development of internationally consistent intervention and recovery schemes that would strengthen the legal certainty of cross-border operations. At the same time they point out that reducing bank group's operations to national level (individual units) is not a solution.

In relation to the Basel Committee's proposals published in December 2009 and the European Commission proposals of February 2010, the EBF strongly supports the proposal to conduct a complex impact assessment on the aggregate impact of the proposed changes. The timeline, including sufficient time for preparations, is also considered by the EBF as a key issue. The new measures should only be imposed after Basel II is implemented in the U.S. Most of the envisaged rules should only be introduced after economic recovery begins, or else the regulation itself will be an impediment to overcoming the crisis.

III. PROFESSIONAL ISSUES, LEGISLATION

1. Legislation and regulatory measures affecting the banking sector

1.1 Measures to help debtors in distress

Banks, on their own and also in conjunction with the government made significant efforts to help debtors in distress.

As a first step, under an agreement with the Ministry of Finance, coordinated by the Association, banks undertook to introduce measures aimed at helping debtors with foreign currency loans (by reducing the repayment amounts or temporarily suspending the repayments). However, it turned out fairly soon that this project, started at the end of 2008 - early 2009, would not suffice and more comprehensive measures were needed.

Seeking to avoid a large-scale failure on loans, the government, in conjunction with banks, developed measures to be applied in the repayment phase and before the foreclosure phase. After complex discussions, the proposal for a real estate fund to be set up by the government and banks to purchase bad loans while allowing the former owners to stay in their homes against a moderate monthly rent was dropped. Instead, efforts were focused on finding a solution to rescue borrowers in the repayment phase in order to avoid the risk of eviction. The solution, developed jointly with the Association, provided that the borrower should assume a minimal monthly repayment for 2 years (10,000 to 20,000 forints), with the bank providing him/her a government-backed "bridging" loan for the balance of the repayment amount. (Assuming that after the 2-year preferential repayment period, as the crisis eases, most borrowers would be able to cope with the burden of repayment of the bridging loan).

In view of the government involvement, the relevant legislation required approval from the EU. This caused a significant loss of time for borrowers. Act IV of 2009 on government guarantees for home loans came into force in the summer of 2009. Despite a continuous relaxation (at the Association's initiatives) of the eligibility criteria for the bridging loan, only a few hundred borrowers availed themselves of the facility. At the same time, the debtor rescue schemes developed by banks on their own eased the situation of more than 60,000 customers. The reason for this was that banks, seeking to retain as many customers as possible, made special efforts to find the most efficient and most flexible solutions, which a more rigid legal regulation could not compete with.

1.2 Amendment to Government Decree No. 12/2003 (I 30) on rules for the extrajudicial sale of charged property

Act XLVIII of 2009 on certain law amendments necessary for the protection of home-loan borrowers provides municipalities with preemption right during the forced sale of mortgaged real estates. The preemption right can be exercised in protection of the borrower living in the flat under sale, under loans to be made available for the purpose. The subject government decree had to be amended to allow the involvement of municipalities in the sale process. The Association was actively involved in the drafting of the relevant Government Decree [Government Decree No. 209/2009. (IX 29.)]: we held several consultations with the Ministry of Justice and made a number of complementary and adjustment proposals to the draft decree. We also pointed out that a broader amendment of the decree was needed in view of the abuses experienced during the sale of properties of debtors in distress. Apart from procedural provisions related to municipalities' preemption rights, a provision was added to the decree to provide that the forced sale should be considered unsuccessful if the highest bid price is lower than 70% of the market price as stated by the appraiser.

1.3 Unilateral contract amendments

The government submitted to Parliament draft legislation, containing, inter alia, restrictions regarding the right to unilaterally amend contracts. The Association submitted its oral and written objections to the proposed legislation to all competent forums: the Ministries involved (the Ministry of Finance, the Ministry of Justice), the competent Parliamentary Committees and at discussions invited by Members of Parliament. However, only some of our objections were accepted.

The general uncertainty caused by an ill-considered regulation could have been significantly reduced if the Hungarian Financial Supervisory Authority had declared that the right of unilateral contract amendment was a risk management tool, which a prudent bank should be able to resort to from time to. Regrettably, the Supervisory Authority did not represent this view and the Act (considered by us as unconstitutional) was promulgated. In the meantime, the Ministry of Finance also realised that in its current form the Act was not workable, and initiated the drafting of a self-regulation (Code of Conduct) to replace the relevant provisions of the Act.

1.4 Code of Conduct on principles of fair conduct by financial organisations engaged in retail lending

The Code of Conduct on principles of fair conduct by financial organisations engaged in retail lending was adopted in September. Around 150 financial institutions have signed the Code. The Code covers all aspects of retail lending. It provides general standards for responsible lending, general principles for creditors' pre-contractual conduct, rules for the unilateral modification of the terms and conditions of the contract, procedures for the treatment of customers' payment difficulties and principles for responsible conduct by creditors prior to and during foreclosure procedures. Following the adoption of the Code, Section 210 of the Credit Institutions Act, regulating unilateral contract amendments, was amended to reflect the provisions of the Code.

1.5 Act on Consumer Credit (Act CLXII of 2009)

The EU adopted a Directive on consumer credit to provide for the approximation of laws, regulations and administrative provisions in member states and to promote competition in banking services in the single market. The draft-law implementing the Directive in Hungary contained a number of questionable points: the drafters proposed to enact the new law effective January 2010 without allowing any time for preparations; the draft-law provided for unreasonably low prepayment fees for mortgage credits; advertisement would have been required to contain an unreasonable amount of information. In view of the importance of the issue and the short time allowed for review of the proposal, the Association' Board set up a working group to address the issue. The working group managed to achieve a number of compromise solutions aimed at promoting implementation. At the same time, the group failed to prevent the new law from being extended to mortgage credits. The fees for prepayments were set at a higher level than originally proposed, but still lower than expected by market players.

1.6 Decree on responsible retail lending

After more than six months of preparations and discussions, a government decree, fundamentally affecting banks' retail lending policies was adopted. Due to the large number of defaults experienced in the wake of the financial crisis, the MNB proposed a self-regulation, which would have substantially reduced the lending limit for both forint and foreign currency loans. The Association's counter-proposal for self-regulation, drafted with the involvement of specialists from member banks, adopted the approach suggested by the MNB, but contained more manageable rates regarding the actual lending limits. We expressed our opinion that by applying the limits proposed, the ensuing dramatic decrease in lending would just further deepen the crisis and would put foreign lenders at an undue advantage.

The competent government bodies joined the consultations. The resultant decree relies in many points on the Association's self-regulation proposal. However, it contains some problematic points, as well. Problematic elements in the regulation: the restrictions on foreign currency lending - although more moderate than those proposed by the MNB - still seem to be too stringent, combined lending has become much more difficult.

The decree contains a provision - accepted by all parties - that collateral-based lending will be stopped.

1.7 Credit Institutions Act – Regulation of intermediaries

The Association's competent specialist working group was actively involved in the drafting of regulation on financial intermediaries. The relevant provisions were incorporated in the provisions amending the Credit Institutions Act under Act CL of 2009 amending certain financial acts.

The Act contains provisions for the personal and material requirements for independent intermediaries and the details of supervisory licensing. The Hungarian Financial Supervisory Authority keeps a registry of intermediaries and intermediary subcontractors. The registry is published on the Supervisory Authority's website. The Act also provides regulations regarding the liability of independent intermediaries: the intermediary is liable for any damages arising from its activities; however, the principal is responsible for making available the information required for the intermediary to carry out its tasks and provide the customers with appropriate information. Independent intermediaries may accept a fee for their services; however, the fee should be paid on a pro-rata basis based on the term and delivery of the service.

The Act includes provisions on the method and contents of customer information and professional qualification requirements for persons employed or assigned by the intermediary.

The new provisions came into force on January 1, with transitional provisions for certain rules taking effect later. During application of the new rules, a number of interpretation problems have arisen; the Association is working out clarifying these with the Hungarian Financial Supervisory Authority and the Ministry of Finance. **In relation to implementation of the legislation**, the government has issued decrees to regulate

- the content requirements for professional liability contracts for independent intermediaries, and
- the method for determining and paying intermediary fees, including the schedule of payments.

Furthermore, the Minister of Finance should issue a decree on intermediary education, the criteria for obtaining, on completion of the education, a certificate from the Hungarian Financial Supervisory Authority authorising the pursuit of financial intermediary services, and derailed rules for the rate, payment and reimbursement of the relevant examination fees.

We submitted to the Ministry of Finance detailed concepts and specific text proposals for all three Decrees and conducted consultations with the competent department of the Ministry.

2. Other regulatory changes

2.1 Legislation on strengthening the supervision of the financial intermediary system (Act CXLVIII of 2009)

This Act, designed as an omnibus law, inter alia, contained amendments to industry-specific regulations related to complaint handling. In relation to call centre recordings, we managed to ensure that it will suffice to provide the customer with a copy of the minutes drawn up on the recording and allow him to listen to the recording, rather than providing the recording on sound media as recommended by the Data Protection Ombudsman's relevant ruling.

We provided detailed comments on the proposed special authorisation of the MNB to prohibit, limit, or make subject to conditions certain activities/services for a period up to 120 days. We expressed our opinion that this authorisation was excessive, improperly defined, and would vest the MNB with rulemaking powers, which, according to previous rulings of the Constitutional Court, is unacceptable. The rulemaking powers proposed are alien to the MNB's tasks.

The organisational structure of the Supervisory Authority has changed: the Supervisory Authority is managed the President in conjunction with the two Vice-Presidents. A growing emphasis on the Supervisory Authority's consumer protection role is reflected in the provision mandating the Prime Minister to appoint one of the Vice-Presidents to be responsible for consumer protection-related issues.

The composition of the Financial Stability Council has also changed: members of the council include the Minister of Finance, the President of the Hungarian Financial Supervisory Authority and the Governor of the MNB. The Minister of Finance, followed by the Governor of the MNB and the President of the Hungarian Financial Supervisory Authority on a semi-annual rotation basis, chairs the Council. Associations of persons and entities supervised by the Hungarian Financial Supervisory Authority, consumer organisations and prominent economists of international renown attend the Financial Stability Council's meetings as observes with the right of consultation.

To ensure the stability of the financial intermediary system, the Supervisory Authority has been given the power to adopt **special measures**: the Supervisor Authority may, for a definite period not to exceed 90 days, ban, limit or make subject to certain conditions the carrying out of certain activities and the provision of services, the conclusion of deals and the sale of products within the scope of such activities by any person or entity subject to its supervision.

The Supervisory Authority may adopt such measures if the activity in question involves significant risks to the overall functioning and stability of the financial intermediary system and if such risks cannot be prevented by other means.

We provided comments regarding the proposed amendments to the organisation and powers of the Hungarian Financial Supervisory Authority and the separation of the powers of the Hungarian Financial Supervisory Authority and the Competition Office. We proposed that the Hungarian Financial Supervisory Authority be given the power to act in all consumer protection matters related to financial institutions. This proposal of ours was not accepted.

2.2 Amendments to the Bankruptcy Act (Act LI of 2009 amending Act XLIX of 1991 on Bankruptcy and Liquidation Proceedings)

The objective of this amendment was to regulate bankruptcy proceedings with a view to improving the process of debt settlements, the protection of bankruptcy assets and job retention in light of the economic crisis. Also, the draft law included proposals regarding the rationalization of liquidation procedures and the sanctioning of wrongdoing by senior officers and majority shareholders.

A number of our proposals were accepted during the drafting process and in the subsequent amendment motions, including the proposal for a more specific regulation of the powers of creditors' committees, contents of the application for reorganisation, the regulation of issues related to payments, the indisputability of claims incorporated in a notary document, the rules for the calculation of creditor votes in bankruptcy proceedings, the assignment of liquidators to be done electronically (by computer) in a regulated manner, with any deviation from this procedure to be stated publicly, including the reasons therefor. The creditors' committee should have the right to initiate the dismissal of the liquidator without stating the reason. The mortgagee should have the right to receive the pledge if the auction or the bidding process has been twice unsuccessful. The settlement of claims arising from bank and insurance guarantees unused during the liquidation procedure was incorporated in the draft law upon our proposal. The liquidator should create reserves to cover these pending claims. Claims filed by the mortgagee before the liquidation balance sheet date will be met from these reserves, claims becoming due subsequently will be met from the legal deposit in accordance with the relevant rules for assets settlement.

Despite our objections, a number of provisions detrimental to creditor interests were included in the draft law.

We were actively involved in the drafting of implementation decrees to the Act. Among these, especially important is Government Decree 237/2009 (X 20) amending Government Decree 225/2000 (XII 19) on rules for the public sale of assets under liquidation and on accounting tasks related to liquidation. This defines the procedures under which the liquidator may sell the assets of the company under liquidation. Unfortunately, only a few of our comments were incorporated in the Decree. According to our specialists, a much more detailed regulation would be needed. The Decree, being of a loose framework nature, grants an unwarrantedly wide room for manoeuvre for liquidators to the detriment of creditors.

2.3 Amendment to the Companies Act (Act IV of 2006)

This law amendment facilitates the establishment of simplified limited liability companies (limited liability companies with no minimum capital requirements). The amendment, transposing EU Directive 2007/36 on the exercise of certain rights of shareholders in listed companies, allows the exercise of shareholder rights through proxies and the participation in general meetings by electronic means. In respect of public limited companies, the amendment makes the right to propose items to be put on the agenda of the general meeting and table draft resolutions subject to holding a minimum of 1% of the voting rights. This provision is a limitation of shareholder rights. The amendment also provides for the disclosure of remunerations of board of directors and supervisory board members of public limited companies.

In our comments we objected to the extension of certain provisions of the new legislation to private limited companies (Zrts). We provided adjustment proposals regarding the provisions related to the convening of general meeting and the procedures for exercising shareholder rights. The new provisions were enacted by Act CXXI of 2009.

2.4 Netting agreements

Pursuant to Act LI of 2009 amending the Bankruptcy Act, no netting is allowed during the period of deferral of payment granted to the debtor, the collection of claims and the **satisfaction of claims from collaterals is suspended.** Furthermore, collaterals provided prior to the starting date of the bankruptcy proceeding cannot be enforced (an exception from this is the enforcement of claims from security deposits provided under contract). This provision made derivative and other leverage-type deals extremely difficult. The Association objected to this provision during the drafting of the legislation, but without success.

The ISDA, the Association and fellow professional associations approached the Ministry of Finance and the Ministry of Justice in the matter.

We requested that netting agreements and collateral agreements concluded with banks and investment firms be exempted from the prohibition of enforcement of collaterals.

After personal meetings and extensive correspondence with the two Ministries, the Act was amended: claims covered by netting agreements can now be enforced even during the payment moratorium.

Also upon our proposal, the provision of Act LI of 2009 amending the Bankruptcy Act, saying that a netting agreement between non-institutional investors can only be taken into account if the agreement was concluded more than 180 days before initiation of the bankruptcy proceeding, was cancelled.

2.5 Private debt settlement procedure

The Ministry of Justice submitted for public review the draft concept for private debt settlement procedures in March 2009. The objective of the concept was to establish a procedure for the settlement of private debts, for a limited circle of debtors, namely for those with assets worth less than their debt but sufficient to cover at least 25 % of the debt. There would be two different procedures: a debt settlement procedure based on agreement between the debtor and the creditor and a debt settlement procedure initiated by the debtor without agreement with the creditor. We provided a number of comments on the proposed concept: according to the banking community, the proposal may undermine repayment discipline and may create false illusions regarding the possibility to escape from the debt spiral. We emphasized that even currently there are a number of arrangements available between creditors and debtors to help debtors in distress. In our comments, we maintained our previous position and drew attention to risks in the concept regarding mortgage loans and financing through mortgage bonds.

Based on the concept, the Ministry of Justice drafted a text proposal and submitted it for review. We provided comments and attended the subsequent rounds of consultation on the proposed legislation. Also, we provided data for an impact assessment on the proposal. The drafting work continues at the Ministry.

2.6 Promoting long-term savings

The Government seeks to promote long-term private savings through tax allowances. From 2010, long-term private savings will be taxed at preferential interest tax rates: instead of the current 20% general interest tax rate, the interest tax rate will be 10% for 3-year fixed term savings and 0% for 5-year fixed term savings. The preliminary pension savings account facility (NYESZ-R), introduced as the fourth pillar of the pension system and aimed at promoting long-term investments and self provision will be retained (as opposed to the original proposal, which envisaged the gradual phasing out of this facility by 2013). The Association, in consultation with banks, provided proposals to make the provisions of the legislation more specific and easier to implement. These proposals were incorporated in the final text of the law.

2.7 Proposal for the regulation of claim work-out

The Association's Board reviewed a proposal regarding the need to regulate claim work-out and decided to initiate with the Ministry of Finance the setting up of a working group to draft the relevant legislation.

We met with the Finance Ministry's State Secretary and competent Head of Department. The Ministry shared our views in all essential points regarding the concept of the proposed regulation. The banking community is interested in a regulation that takes account of the specifics of the institutional system.

2.8 Proposed legislation on group litigation

Members of Parliament Judit Csiha and Bálint Magyar submitted a **proposal for provisions on group litigation** under Act III of 1952. The draft law was submitted to Parliament under No. **T/11332**

Given that the proposal directly affects the financial community in relation to legal disputes related to banking, competition law and consumer protection issues, the Association's Secretary-General wrote a letter to the Speaker of Parliament.

In this letter, we drew attention to the shortcomings in the proposal and requested that the proposal be recast before being put to the vote. The Ministry of Justice, working on a similar draft regulation for quite some time, also voiced serious concerns regarding the proposal.

If passed, the proposal would lead to serious problems: the professional shortcomings and absence of basic guarantees in the proposal might be used by some economic players as a tool to put their competitors in an awkward situation or make illegal economic threats or cause damage to reputation. Even now we can see some aggressive NGOs with obscure backgrounds: such a tool in their hands **could cause incalculable damages**.

The draft-law was rushed through the competent parliamentary committees and its general debate was concluded by Parliament. However, taking account of the Association's objections, the Speaker of the House returned the draft-law to the Constitutional Committee for review. Although the law was passed by Parliament in February 2010, the President of the Republic returned it to Parliament for re-consideration prior to signing.

2.9 New Civil Code

The Ministry of Justice, in conjunction with the competent Ministries and professional associations organised several conferences Code during the drafting of the new Civil code. The Association also attended these conferences.

The Ministry presented an unofficial draft text, including those amendments supported by the Ministry. This version was updated from time to time to keep track of the changes. The Ministry of Justice also drafted a separate text to ensure consistency and accuracy of the language of the Code. Except for the provisions on factoring contracts, the chapters affecting banking operations are unchanged.

Act CXX of 2009 on the new Civil code was promulgated in Magyar Közlöny (Hungarian Gazette) on November 20, 2009. However, the President of the Republic returned the separate Act enacting the new Civil Code to Parliament for re-consideration. Parliament passed the Act unchanged (Act XV of 2010).

Pursuant to the Act enacting the Civil Code, out of 1,200 articles of the Civil Code, 100 go into effect in May 2010; the rest will enter into force on January 1, 2011. Those taking effect in May 2010 include the provisions on guardianship, foundations, privacy rights and other provisions related to economic players. In addition to provisions related to the coming into force of the Civil Code, the Act includes a number of provisions aimed at ensuring consistency with other laws. Many of these provisions directly affect banks (such as those related to the Act on Judicial Distraint, the Bankruptcy Act and the Act on Building Societies). The Association's Civil Code Working Group was actively involved in the drafting of the Act.

Amendments to certain financial laws, ensuing from the new Civil Code, were enacted under a separate Act (Act XII of 2010.) The Association's Legal Working Committee was involved in the drafting and review of this legislation.

3. Payments

3.1 Regulations on payments

The Association was working together with the Hungarian SEPA Association's PSD Implementation Group on reviewing the proposed legislation on the transposition of the PSD into Hungarian law. Banks disagreed in a number of points with the proposal of the National Derogation announced by the Ministry of Finance. Inter alia, they objected to the Ministry's proposal to apply the same rules for consumers and micro-enterprises.

Payment regulations had to be adjusted by November 1, 2009 to meet the provisions of the PSD Directive (Directive 2007/64/EC). This was a complex legal and technical task for all EU member states and a major challenge for us, as well. The Ministry of Finance revised the draft law several times. We provided detailed comments on each revision, highlighting those key issues where banks disagreed with the proposal. The Government and MNB Decrees on payments were replaced by an Act on Payment Services, effective from November 1, 2009. Thus, Hungary has met the EU requirement by the set date and payments in Hungary are now regulated by the new EU legislation.

3.2 Regulation of interchange fees and merchant fees

Endorsing an MP amendment motion contradicting the Parliament's Standing Orders and the proposer Finance Ministry's position, Parliament passed Act CL of 2009 amending certain financial acts. The new law caps interbank interchange fees and merchant fees. The new regulation violates the freedom of contracting and the principles of a market economy.

In view of the MP amendment motion in question, submitted right before the vote and passed by Parliament despite its unfoundedness, the Association turned to the President of the Republic, requesting him not to sign the draft law. The representatives of MasterCard és a VISA Europe in Hungary also turned to the President of the Republic, asking him to seek a constitutional test. Notwithstanding, the Act was promulgated under No. CL of 2009. The contested provision was to take effect on March 1, 2010. According to professionals, the practicability of the law is questionable both "technically" and professionally.

In the Association's opinion, the new provisions of the law are unconstitutional. Since the Ministry of Finance was of a similar view, we conducted intensive talks with the Ministry's competent staff and the Parliamentary groups to achieve that the most worrying provisions are abolished or their entry into force is postponed. As a result, an amendment to the provisions in question was incorporated in Act XII of 2010 on amendments to certain financial laws, in relation to the new Civil Code. According to this, the former provision on interchange fees will not be enacted, and the rate of commissions, fees and other costs (merchant fees) directly related to a payment made by a cashless payment instrument, charged by the financial service provider to the beneficiary may not exceed 2% of the payment amount. This new provision will become effective on May 1, 2010. The new provision puts banks in a much better position; therefore, no further action is needed at present.

3.3 Electronic Payments System (EFER)

The Electronic Payments System, to be implemented under the Electronic Administration Operational Programme is aimed at simplifying administration by allowing payments to state administrative bodies to be made by bankcard or by other electronic means. In addition to the Tax Office and the Hungarian Customs and Finance Guard, these modern payment methods would be introduced after due preparations at Document Offices and other government institutions. Banks' professional experience is counted on in this project. Following a meeting held with the Finance Ministry's Information Technology Centre, the Association set up a working group to support the project. As a first step, the working group had to define the requirements for POS terminals to be purchased by the government to facilitate bankcard acceptance.

4. Conclusion of the Competition Office investigation on interchange fees

In conclusion of its investigation on the interbank agreement on interchange fees, launched in 2008, the Competition Office's Competition Council promulgated its decision on September 24, 2009. The Competition Council found the agreement as limiting competition and an infringement of law was established in the case of all banks involved. The interbank agreement concluded in 1996 violated Section 11 of the Fair Competition Act enacted on January 1, 1997 and, since May 1, 2004 until termination of the interbank agreement on July 30, 2008, Article of 81 of the Treaty establishing the European Community.

The Competition Council imposed fines totalling HUF 2 million. However, only those two international card association and seven banks concluding the agreement on interchange fees in 1996 were imposed a fine, banks joining the agreement subsequently were exempted from the penalty.

The fines were calculated based on the interbank transaction volumes managed by the affected banks between 2004 and 2007 and current market shares. The Council considered it an extenuating circumstance that the banks affected recognised that they should have changed the fees.

5. Proposed law on Central Credit Information System

In view of the fact that the draft-law submitted by the Government to Parliament substantially differed from the drafts reviewed, we conducted talks in the first half of 2009 with the Ministry of Justice to provide a sound legal framework for the proposed comprehensive (positive-list) credit information system (a positive-list credit information system would be an important asset in making founded credit decisions).

During the consultations, conducted with the involvement of specialists from member banks and external consultants, we managed to ensure that deals concluded after entry into force of the legislation is required to be registered in the system on a mandatory basis. At the same time, in respect of existing loans (initial upload of the system), the drafters adopted a difficult process, based on customer consent.

We solicited banks' opinions on this issue. Based on the comments received, the Association's Board decided to insist on making the registration of loans mandatory by law and not to support the government's compromise proposal.

Due to this debate, Parliament failed to decide on the issue during its spring session. Then, it took the issue off the agenda of the autumn session, citing the financial crisis as a reason.

6. Reporting

6.1 Changes in deposit insurance, deposit reporting requirements

Deposit insurance-related provisions of the Credit Institutions Act were amended effective from July 1, 2009 in line with the relevant EU legislation. Accordingly, the deposit guarantee limit has been increased from HUF 13 million to EUR 50,000. The conversion rate for determining the HUF equivalent of the deposit will be the MNB's exchange rate on the day before the date of commencement of the compensation. Under the new legislation, the payout delay has been reduced from 90 days to 20 days (which, in exceptionally warranted cases, may be extended once, by 10 days). The availability of information on deposits covered by the deposit guarantee scheme, including the availability of the National Deposit Insurance Fund's system and the Hungarian Financial Supervisory Authority will inspect the aggregation of deposits held by one depositor on site.

The Association held several consultations with the Hungarian Financial Supervisory Authority and the National Deposit Insurance Fund to make the provisions of the law more practicable. Also, we submitted proposals for some wording adjustments to the Ministry of Finance. The new text specifies that in the case of a proxy, the rules applicable as of the date of compensation shall be applied, that is: the dates of the powers of attorney will not have to be watched. Thus, the creation of joint deposits due to powers of attorney dated before 1997 will be avoided. Also, in the case of condominium and housing co-operative deposits, the compensation limit will be determined based on the number of flats, rather than the number of owners. While the number of owners is impossible to follow due to the various ownership changes, the number of flats is indicated in the documents to be presented on opening the account. Also, the amended provision related to inheritance makes it clear that the heir's deposit will not have to be merged with the decedent's deposit.

According to a decision of the National Deposit Insurance Funds' Board, banks shall provide their clients with annual statements on their insured deposits. Statements shall be first issued on the status as of December 31, 2010, by January 31, 2010.

6.2 Supervisory information requirements for consumer protection purposes

Pursuant to a Finance Ministry Decree, effective from July 2010, financial institutions will be required to provide information on their loan and leasing products to the Hungarian Financial Supervisory Authority. The new information requirements will be imposed by the Supervisory Authority under to its relevant legal obligation and will serve consumer protection purposes. Information provided by banks will be published and regularly updated on the Authority's website. Based on this information, consumers may choose the product they would like to get more information on from the relevant service provider and make comparisons between real estate leasing products, mortgage loans for any purpose, consumer loans, overdrafts, loans against deposits and credit cards.

The Association indicated to the drafters of the legislation and to the Hungarian Financial Supervisory Authority that the relevant law itself does not require the creation of such an extensive database. We requested that the information requirements be designed in a manner that involves the minimum possible costs and is as easy to meet as possible.

IV. ASSOCIATION WORKING COMMITTEES, WORKING GROUPS, ASSOCIATION RELATIONS, EVENTS

1. Association working committees, working groups

1.1 Bank Security Committee

1.1.1 IT Security Working Group

The most important subjects of the working group were the following in 2009.

The Association's IT Security Working Group heard a briefing from the Hungarian member of the EPC Information Security Support Group (ISSG) on the conclusions of the ISSG's last meeting and on the role of the ISSG, its structure and working procedures. He reviewed the topics addressed by the working group and how these topics can be used by the IT security working group and the banking community.

The Working Group reviewed the security aspects of migration to the InterGiro system. It was proposed that an ad hoc working group should be set up to address issues related to the electronic network and electronic signatures.

The Working Group endorsed a proposal put forward by the head of the Working Group for cooperation between the IT Security Working Group and the Fraud Meeting.

The Working Group drafted proposals for amendments to the Hungarian Financial Supervisory Authority's recommendation on online banking. The Association's Board decided that the Association should initiate a revision of the Supervisory Recommendation based on this proposal.

The Working Group reviewed the programme for developing an electronic messaging system between bailiff offices and banks and appointed persons to represent the Association in the relevant technical committee. The technical committee reviewed the various system description versions prepared by IND Information Technology Ltd. (commissioned by the Chamber of Bailiffs) and, in cooperation with them, drafted a procedures manual to specify the cooperation framework. Banks would decide on joining the system on an individual basis.

The Association held a discussion with GIRO Ltd. on the possibilities to extend the proposed system so that it can be used for communications with other authorities.

1.1.2 Physical Security Working Group

The Bank Security Working Committee's Physical Security Working Group addressed at several of its meetings the issue of increasing bank robberies and assaults on ATMs.

Regarding assaults on ATMs, specialists from the National Investigation Office were also invited to the meetings. The parties agreed to regularly exchange information and experience on the issue. Banks handed over a list of the most exposed ATMs and the National Investigation Office provided banks with the latest statistics. In assault prevention, also based on analysis of EU examples, ink staining seems the most efficient solution. The Association's

President wrote a circular to member banks, drawing their attention to the importance of such protection.

Recognising the human factor as a security risk, the Working Group reviewed and adopted a proposal to give more focus to human security issues in the future. Accordingly, the Working Group's name was changed to Human and Physical Security Working Group.

The Working Group welcomed the launch of the Direct Action system after several years of testing. The system is designed to provide prompt information to police units in action during bank robberies on the exact parameters of the scene (bank branches).

1.2 Compliance Committee established

The Association's Compliance Working Group, previously tasked with addressing money-laundering issues under the Bank Security Committee, was transformed into a separate committee. Two new working groups were set up: the Working Group on Anti-Money Laundering and Terrorist Financing the General Compliance Working Group.

The Compliance Committee agreed to organise a thematic presentation series on compliance issues. The completion of the presentation series would be an additional qualification requirement, recognised by the profession, for persons employed in the area of compliance.

1.3 Work-Out Committee

At the proposal of banks' work-out officers, the Association set up a work-out working committee from economists and work-out specialists from member banks. The objective is to establish regular cooperation and information exchange between banks and to develop common stances on regulatory proposals directly or indirectly affecting the area and on practical issues to be addressed.

At the first meeting of the Committee, experiences regarding the proposed amendments to the Bankruptcy Act and the concept for the Act on personal bankruptcy were reviewed. Objectives of the working committee include professional interest-representation, representing banks' aspects in the media and liaising with other professional organisations (bailiffs, liquidators).

1.4 Working Group on electronic communications between bailiffs and banks

The Hungarian Chamber of Bailiffs in 2008 launched a project to develop an electronic interface system between bailiffs and banks. Through this, bailiffs would be able to send their inquiries to banks in the form of electronically signed deeds through the Chamber's server. The Association set up a working group to participate in the discussions and coordinate the related developments at banks. Members of the working group include IT specialists, payment specialists and legal counsels.

The working group was involved in developing the data schemes for inquiries and the technical specification for the system. We held several meetings with the Chamber of Bailiffs and GIRO Ltd. (GIRO Ltd. is responsible for the IT development of the system). During the launch of the system, a number of practical problems have arisen, mainly on the part of the bailiffs. Discussions to solve these problems are underway. The experiences with this reporting system could be used in communications and reporting to other authorities and organisations.

1.5. Intermediaries Working Committee

The Association established an Intermediaries Working Committee to be involved in the drafting of legislation on intermediaries. The Working Committee participated in the discussions conducted with the Finance Ministry's State Secretary and staff during the drafting of the text of the proposed law. It was also involved in the drafting of amendment motions in the Parliamentary stage. Following the enactment of the Act, the Committee was involved in the drafting of the relevant implementation decrees and in clarifying certain interpretation issues. In respect of unclear issues related to the entry into force of the Act, we held discussions the Hungarian Financial Supervisory Authority and the Ministry of Justice and requested rulings on the relevant issues.

1.6 Specialist Group on Bank Reporting established

The Hungarian Financial Supervisory Authority and the MNB proposed to implement changes in the reporting requirements for individual banks due to changes in the MNB's balance sheet structure. A specialist-working group was set up to develop the new reporting templates. The group includes specialists from the Hungarian Financial Supervisory Authority, the MNB and representatives from banks operating as joint stock companies, Hungarian branches of foreign banks and co-operative banks. The supervisory authorities expect long-term cooperation from the specialist group, also in the context of the work conducted in the CEBS and the ECB, aimed at the convergence of bank reporting at the EU level.

A key element of the specialist group's working method is allowing the reporting entities to review the proposals developed by the Hungarian Financial Supervisory Authority and MNB at an early stage.

1.7 Communications Working Group

The Communications Working Group's activities in 2009 were governed by communications tasks set out in the Association's medium-term strategy and tasks related to coordinating banks' communications in the wake of the financial crisis.

The banking sector came under heavy pressure during the last year, with a lot of one-sided and baseless attacks, undermining confidence between customers and banks. This posed a major challenge for the Committee, requiring prompt response in a number of cases. In this situation, the Association's communications were often - and necessarily - explanatory and reactive.

We worked on strengthening media relations through regular press interviews and meetings. At the beginning of the year we organised a dinner, providing an opportunity for an informal exchange between banks' communications managers and prominent financial and business journalists. Also, background conversations were organised with journalists on specific developments and measures affecting the banking sector.

In summary: with the active participation of banks' communications managers, we managed to ensure that the most important issues affecting the banking sector were reported on objectively by most of the media.

The Association 2009 General Meeting decided that the opportunities for developing and implementing a programme aimed at improving social acceptance of the banking sector should be investigated. Accordingly, we solicited banks' CEOs opinions regarding the developing of such a programme. Most CEOs responded positively and an ad hoc working committee was set up. Banks provided proposals for the main topics and programmes to be implemented with a view to strengthening confidence between customers and banks. There was agreement that a programme of at least three years should be developed. It should be a <receiving the summary report on the proposals made, the Board in September decided that the preparation of the programme should be postponed to 2010. Accordingly, work aimed at developing the concept continues in the first half of 2010.

1.8 Working Group on Public Warehousing established

The Working Group on Public Warehousing drafted a proposal to improve the terms and conditions for warehouse receipt loans. The proposal was reviewed with the competent authorities and bodies.

1.9 SME Working Group

A meeting on potential new facilities to help micro, small and medium enterprises in the financial crisis was held by the competent State Secretary at the Ministry of Finance.

In consultation with member banks, the Association put forward its opinion that the most important task was to kick-start the long-in-the-pipeline Micro-Credit and Portfolio Guarantee Programmes. The reason most banks have not joined these programmes yet is that no agreement has been reached yet on the relevant contracts.

At the meeting, we submitted to the State Secretary a summary of the main obstacles. This gave a new impetus to the drafting work.

The development of a portfolio guarantee facility is underway at the Hungarian Enterprise Development Company and Garantiqa Creditguarantee Ltd. Banks are also involved in the consultations. The delay in the development of this facility causes delays in the use funds from the JEREMIE programme.

At the initiative of the Minister for National Development and Economy, the banks involved undertook to continue to complete the survey questionnaires on the monetary situation.

1.10 Agricultural working group

At an initiative from banks, the Association compiled a comprehensive study on the issue of assignments related to the prefinancing of EU supports. After several reviews, the Ministry of Finance undertook to take the issue forward.

At the initiative of the president of the Hungarian Chamber of Agriculture, we invited a meeting with banks involved in agricultural lending. The Chamber's president briefed the participants on the Chamber's operations and on current issues addressed by the Chamber.

1.11 Hungarian Banking Association - Hungarian SEPA Association Joint Working Group

Changes in the regulations on payments: the new Act on Payment Services, the new MNB decree, changes in related regulations and a second amendment to the Payment Services Act prompted the need to reinstate the Joint Working Group of the Hungarian Banking Association and the Hungarian SEPA Association. The Joint Working Group holds meetings on a monthly basis.

At the Working Group's first meeting, in the context of the new Payment Services Act taking effect on November, participants, including legal counsels responsible for the area of payment services, reviewed practical issues related to the new regulatory changes and agreed on the interpretation of certain terms (bank card, durable medium, letter of mandate, etc.).

At its second meeting, the Working Group reviewed other issues that needed clarification, such as the interpretation of Section 210 of the Credit Institutions Act and the conditions for unilateral contract amendments in the Payment Services Act, issues related to conversions, the acceptance of administrative payment orders and warrants, the scope of Government Decree No. 227/2006, and the refund of annual card fees.

Although some member bank had contacted the legislators in some of these issues earlier, it seem the problems have remained and some interpretation problems continue to be hindering compliance. Some of the issues can be solved during the working group's meetings. However, there are certain questions that, in our opinion, can only be solved by amending the relevant regulations.

1.12 Payment System Council resolutions affecting the Association

The Payment System Council requested the Hungarian Banking Association, the Hungarian SEPA Association, the MNB and GIRO Ltd. to prepare a project and a proposal for a timetable for the introduction of intraday settlements in tandem with the implementation of SEPA standards in Hungary. A Project Preparation Committee, including members from the MNB, the Hungarian Banking Association, the Hungarian SEPA Association and GIRO Ltd. was set up. Once a decision on the launch date for intraday settlements is made, the Committee's work will be taken over by a Project Management Committee.

1.13 Taxation Working Group

2009 was a busy year for the Taxation Working Group. The working group drafted and submitted a number of proposals to the Ministry of Finance in relation to the new tax packages presented by the government. In January, the working group developed 28 specific proposals ahead of the government's proposed amendments to 2009 tax laws. The proposals were submitted to the Ministry of Finance. In our proposals we pointed out those rules that should be changed to ease the burden on economic players and borrowers struggling with the impacts of the global financial crisis. We proposed, inter alia, the relaxation of the rules for forgiven debts. Also, we requested that the rules for loss accrual, applied to other economic players be extended to credit institutions. The rules were changed favourably in both issues. Additional tax law changes were imposed after the change of Prime Minister in April: from July, VAT was increased from 20 to 25 per cent, the rules for income tax and social security benefits were tightened, and tax incentives were introduced to promote long-term savings. The Working Group provided comments on provisions causing problems in banks' daily operations and tax administration. These comments were reviewed with the Ministry of Finance and as a result, the proposed measures were adjusted in several points and made more practicable.

The Working Group held six meetings in 2009. Members of the working group actively contributed to the Tax Forum organised at the end of the year.

2. Conferences, round table discussions

2.1 Consultation on the introduction of e-money in Hungary

The Association organised a forum on opportunities to introduce e-money in Hungary, based on a presentation by a consortium providing e-money services.

In his opening presentation, the Director for Financial Institutions of the European Commission's DG Internal Market drew attention to the opportunities in e-money services and the increasing competition posed by mobile service providers in this area. Representatives from the consortium explained the operation of the e-money system, the potential benefits of e-money services, including low costs, and the risks in missing out on a global trend.

2.2 Direct marketing

The Direct Marketing Association organised a one-day conference on direct marketing issues affecting banks. The conference addressed legislation and implementation issues related to direct marketing. Examples of successful direct marketing campaigns in Hungary and abroad were presented.

2.3 Reconciliation bodies

The Hungarian Financial Supervisory Authority and the National Association for Consumer Protection in Hungary organised a conference on the role of reconciliation bodies in dispute settlement related to financial services. The chairs of county reconciliation bodies attended the conference. Participants pointed out that although all reconciliation bodies are made up of qualified lawyers and, if necessary, also involve outside experts, banks do not regard them as competent: they fail to attend the hearings and only provide formal statements, whereas, in many cases, the complainants do no expect redress and just want to be heard. Experience varies though: one of the leading banks, for example, does attend every hearing in some counties, a fact appreciated by both reconciliation bodies and complainants.

2.4 International conference on the EU self-regulation on bank account switching

At the request of the European Banking Federation, the Association organised a consultation for national banking associations in preparation for the implementation of the EU self-regulation on bank account switching. At an initiative from the EU authorities, the organisation of European banking associations, the European Banking Industry Committee

(EBIC) developed a self-regulation framework, which has been applied by all EU member states since November 1, 2009. The banking associations in each member state are responsible for organising implementation of the self-regulation on a national basis. Accordingly, coordinated by the Association, a Hungarian self-regulation has been drafted and adopted. Most major banks affected have joined.

2.5 Conference on impacts of the financial crisis on banks' financial reports

In February 2009, the Association organised a conference for banks' accounting and risk management officers on impacts of the financial crisis on banks' financial reports. Presenters of the conference included specialists from PricewaterhouseCoopers, the Ministry of Finance, the Hungarian Financial Supervisory Authority and specialists from member banks. The presenters highlighted the reasons and substance of changes in European and Hungarian accounting standards introduced in response to the financial crisis, including the changes in international accounting standards (IAS39, IFRS7), the Hungarian Accounting Act and related Government Decrees. A presentation was delivered on supervisory and central bank measures adopted in view of the liquidity and confidence crisis, including stronger monitoring.

Another presentation reviewed practical issues arisen in connection with the new regulations, differences arising from divergence between international (IFRS) and Hungarian accounting standards, the impacts of these differences on banks' results and the problems ensuing from these differences. The presenter also spoke about the problems hindering the use of the new special repo facility, introduced to stimulate the government securities market. Opportunities offered by the new special repo facility and a bank specialist working in the area of securities also reviewed the role of this product in liquidity management. Participants were given an overview of the aspects of securities traders and other market players (issuers, primary dealers, custodians, private and institutional investors) and a review of the development of the Hungarian securities market.

2.6 Conference on 2010 tax law changes affecting banks

As in the previous years, the Association organised a one-day conference (Tax Forum) for banks' taxation officers. The presenters included representatives from the Ministry of Finance involved in the drafting of the new tax laws and consultants from PricewaterhouseCoopers. An audience of 80 heard presentations on main tax changes taking effect in 2010 (personal income tax, company tax, VAT, tax procedures, tax administration). Participants were particularly interested in the new tax rules affecting private savings: in addition to tax specialists, some banks also delegated product development specialists to the conference.

2.7. Conference on the new payment services legislation and on transfer of funds by court order

In October, the Association organised a half-day conference on the application of certain provisions of the new payment services legislation and the new rules for claim enforcement. Presentations were given by the competent officer of the Ministry of Justice and the president and vice-president of the Hungarian Chamber of Bailiffs.

2.8 Presentation on auditor's reports

At the beginning of December, the Association organised a presentation for banks' lending and risk management officers. In his presentation, Dr János Lukács, President of the Hungarian Chamber of Auditors, reviewed the formal and content requirements of auditor's reports, issues related to auditor's liability, contents of the various items of the balance sheet and the various categories of auditor's opinion (unqualified, qualified, adverse). It is essential for credit institutions engaged in financing to hold high-quality loan portfolios and keep their risks as low as possible.

The presenter highlighted the importance of audit and auditor's reports as a risk-mitigating trademark of trust. He presented a number of examples of potential risks that may not be included in the balance sheet. In assessing a financial report, the auditee's operations as well as its structure of assets and liabilities should be taken into account.

2.9 Consultation on the financing of higher education institutions

At the proposal of Bálint Magyar, Member of Parliament, the Association organised a consultation on proposed amendments to the Higher Education Act. The consultation was attended by the R&D Minister without Portfolio, Károly Molnár and a senior officer from the Ministry of Education. The government's representatives explained that as a result of consistent measures, higher education institutions have become increasingly independent in managing their finances. Institutions are increasingly free to manage their own assets and are therefore seeking appropriate opportunities in the market and are counting on cooperation opportunities with banks.

Banks expressed their reservations: state education institutions are difficult to handle from lending points of view: the registration of mortgage in their case is difficult, and even if successful, the possibilities for utilising, in case of default, the real estate provided as collateral are rather limited. The parties' views also differed on assessing the success of PPP projects. Banks pointed out that amidst the current economic crisis and difficulties in lending there is little focus banks can give to this issue. At the same time, it was raised that the area could be made more attractive through introducing government support schemes and refinancing facilities to be granted by the Hungarian Development Bank.

3. Foreign Bankers' Club

At our invitation, the Finance Minister, János Veres and the Finance Ministry's State Secretary, Álmos Kovács attended the Association's Foreign Bankers' Club's meeting of April 15. At the meeting, impacts of the economic and financial crisis, the government's crisis management measures and possibilities for strengthening the financial intermediary system were reviewed.

At the Club's November meeting, foreign CEOs met with the Association' new President, Tamás Erdei and the Hungarian Financial Supervisory Authority's President, Ádám Farkas.

At the meeting, main issues affecting the banking sector were reviewed, including proposed new regulations, the Code of Conduct on principles of fair conduct by financial organisations engaged in retail lending, the Code of Conduct on bank account switching and the MNB's initiative on responsible and circumspect retail lending.

4. Pre-Christmas Dinner for CEOs

The Association held its traditional pre-Chirstmas dinner for CEOS on December 7. The Minister of Finance, the Governor of the MNB and the President of the Hungarian Financial Supervisory Authority attended the dinner.

5. Relations with civil society
5.1 Cooperation with the Association of Bank Loan Victims

The Association has had meetings with Association of Bank Loan Victims for some years now. In contrast to its name, this organisation is a moderate, forward-looking and responsible civil organisation. The discussions with them revealed that the people they represent are actually victims of *non-bank lenders* and the controversial cases exposed by the media are related to non-bank lenders. While they are realistic about the attitude of borrowers who are in distress through fault of their own, they also shared their experience of banks often being unduly inflexible and uncooperative. They provided us with a summary of typical complaints, which could be worthwhile for banks to review and analyse.

5.2 Relations with the Hungarian Loan Association

The presidents of the Association of Bank Loan Victims and the Hungarian Loan Association at the end of August contacted the Association with a proposal for cooperation. They expressed their willingness to cooperate with the Association in communications vis-á-vis the financial authorities and the general public on all those issues where their interests and views coincide with those of the Association. They once again distanced themselves from some professional interest-representation organisations that have appeared recently and attacked the banking industry in a militant tone. They emphasised the importance of distinguishing between the activities of financial firms and those of banks. They also requested the Association's opinion and assistance in finalising their Codes of Ethics.

5.3 Meeting with the Data Protection Ombudsman's staff

The Data Protection Ombudsman issued a ruling regarding the disclosure of call centre recordings. This provides that the customer, if he so requests, should be allowed to listen to the recording and be provided with a copy of the recording. The latter should be provided once a year free of charge. It is recommended that the recording be provided with appropriate protection, certificate or electronic signatures. Call centre menus should be designed in such a way that the customer is informed in advance on those issues that are recorded and those that are not.

Based on banks' experiences and comments, we submitted a counter-proposal to the Ombudsman and asked for a meeting to discuss the issue. Banks' current practices are in accordance with the spirit of the ruling issued by the previous Ombudsman, that is, the customer is given the chance to listen to the recording and provided with a certified written transcript of the recording. In our opinion, the new Ombudsman's ruling is based on a rigid interpretation of the Consumer Protection Act. At the meeting held with professionals of the Ombudsman's Office in October (the Ombudsman was abroad on the date provided for the meeting), information was exchanged, but the ruling was not revised. Subsequently, the issue was solved through adjustments to the relevant sector laws, making the relevant provisions more specific.

V. INTERNATIONAL RELATIONS

1. European Banking Federation - Committee meetings

1.1 Consumer Affairs Committee

The Consumer Affairs Committee reviewed the recommendations for the banking sector formulated by the EU consumers' organisation, the BEUC, in the wake of the financial crisis. The BEUC's recommendations are primarily aimed at responsible lending and restoring consumer confidence. The Consumer Affairs Committee was of the view that the proposals made by the BEUC were wrong in both contents and timing: lending has dropped substantially due to the financial crisis, banks are currently being criticised for not lending enough and for tightening their terms and conditions. Responsible lending will be a matter to be regulated within the framework of transposition into national law of the Consumer Credit Directive.

The competent EU authorities are continuing to examine the need for a collective redress mechanism. A key question is which national organisations this function should be allocated to. Banks are of the opinion that linking the current efficient alternative (out-of-court) dispute resolution mechanisms under FIN-NET could be a satisfactory solution for a collective consumer redress mechanism in the EU.

The European Commission's report on the national application of basic bank accounts in EU member states was received negatively. Although basic accounts are extensively used in some member states, authorities and parliaments still raise objections, citing various shortcomings, which, according to banks, are completely unjustified.

The Consumer Affairs Committee welcomed the European Commission's study on mortgage credit markets. It agreed with the conclusion that the licensing criteria for non-credit institutions (as competitors to banks) were not stringent enough, leading to consumer complaints that are detrimental to the entire financial community.

Committee members sharply criticised the EU Commissioner's report on bank account management fees. According to the EU authority, account management fees are often extremely high and opaque. In the Committee's opinion, the report, widely distributed in the EU, could seriously damaged the prestige of the industry as a whole, whereas the methodological mistakes made during the survey may fundamentally question the conclusions drawn and published.

1.2 Payment Systems Committee

The Payment Systems Committee gave special attention to issues related to the implementation of the SEPA Direct Debit Scheme. The key issue was that while the EU has supported the SEPA payment schemes, developed within the framework of self-regulation, it rejected the multilateral interchange fees provided by the scheme as incompatible with EU antitrust laws. Given that in many countries, interchange fees have been a key profitability factor in this payment method, the issue grew into a problem influencing the entire future of SEPA. According to the compromise reached, the EU will promote the implementation of self-regulatory schemes through regulatory measures and provide an interim period during which these interchange fees can be retained (during this transitional period the EU will not impose any regulation on national direct debit schemes that do not meet the EU's requirements).

Under the new Regulation on cross-border payments in the Community, Multilateral Balancing Payments (MBP) or Multilateral Interchange Fees (MIF) may continue to be applied for cross-border direct debits for a transitional period of three years, until October 31, 2012.

During the review of the EBF's activities related to legislation, it was mentioned that central banks would set up within the ECB a working group on Balance of Payment Reporting. In relation to the e-Money Directive it was mentioned that the second review of the Directive was underway.

SEPA should also drive the modernisation of retail payment markets, harmonising the use of internet and mobile phone from payment initiation to reconciliation in a secure environment.

Standardisation should allow for full end-to-end, straight-through processing, both in the customer-to-bank and bank-to-customer domains.

SEPA is a combination of self-regulation by the financial services industry and supporting legislative measures. There is a need for SEPA governance at both national and EU levels. Governance at the EU level should foster integration of the euro retail payments market in a way that meets the needs of end users.

To achieve these objectives, the European Commission, in cooperation with the European Central Bank, will establish an EU-level SEPA governance structure. Progress reports on the implementation of the SEPA framework will be published on a biannual basis.

1.3 Anti-Money Laundering and Anti-Fraud Committee

At the EBF's Anti-Money Laundering and Anti-Fraud Committee's meeting it was revealed that the Third Anti-Money Laundering Directive had not been implemented yet in most member states. In light of the fact that the lack of transparency has been identified as one of the key causes that have led to the financial crisis, customer and beneficial owner identification and cross-border information exchange might become key areas in combating money laundering. Tax amnesties to encourage the repatriation of assets held in foreign jurisdictions would in fact help legalise dirty money. Increasing the deposit guarantee limits would also result in more of these funds flowing into banks.

Due to the financial crisis, the volume of cash withdrawals has increased: customers are turning away from banks, as indicated in the increase in gold trade and in alternative lenders' activities.

1.4 Physical Security Working Group

At members' request, the Physical Security Working Group provided a clarification of its functions and working method. The Working Group is tasked to address, through international information exchange, the following key issues: trends in national and international crime related to physical security, new developments and methods of crime and law enforcement/protection, and introduction of key EU and member state law enforcement organisations.

Reports from member states revealed that when crime decreases in one area (for example, bank robberies), it increases in others (for example, assaults on cash transporters). Criminals try to find the weak links in cash handling, and often succeed, given the complexity of the process. A special concern is the increase in tiger kidnapping incidents (for example, in Ireland). However, there is also some good news: in Italy, the number of bank robberies has decreased substantially. A better assessment will be available once the report on 2009 statistics is finalised.

1.5 Accounts Committee

The financial crisis was not caused by accounting standards, although no doubt, the crisis has revealed shortcomings of the standard, which have added to losses in collapsing markets. The IASB has committed to revising the IAS 39 and publishing the revised standard by 2010.

The proposal addressing classification and measurement was submitted to public consultation. The Exposure Draft on fair value measurement, which also takes account of the related FASB[10] guidance on fair value of financial instruments in markets that are no longer active, was also published. According to the Exposure Draft, the extension of fair value measurement is not at issue, but the disclosure requirements regarding the methods used to develop fair value measurements will be strengthened. The IASB also decided to uphold the mixed measurement method for financial instruments (fair value or amortised cost). Reclassification between the two categories will be prohibited.

The IAS 39 rules for impairment, based on the Incurred Loss Model, are strongly disputed by the profession; the IASB is currently working on an Expected Loss-based approach. According to professional opinions, the proposed Expected Cash Flow Model is costly and complex: costly, because there are no historical data available and retrieving them would require substantial financial resources; and complex, because it is based on individual assessment, therefore, assessment on a portfolio basis would not suffice: currently, this approach can only be used for individually significant exposures. According to the EBF's experts, the current Incurred Loss Model should be revised to allow for more provisioning for exposures not held for trading and for off-balance sheet items. The EBF has commissioned working groups to address the issues of enhancements to IAS 39 and the further increasing of provisions and to review the related European-level proposals, drafted in the wake of the financial crisis, including the Spanish proposal for dynamic provisioning.

1.6 Legal Committee

The Legal Committee formulated a position on the European Commission Competition DG White Paper on damages actions for breach of the EC antitrust rules. The Committee drew attention that certain issues, such as the binding effect of decisions by national competition authorities (NACs) and interaction between leniency programmes and actions for damages were still under debate. Members of the committee pointed out the importance of leniency programmes.

[10] FASB: Financial Accounting Standard Board

The EBF position on intragroup asset transfers needs some fine-tuning based on prudential aspects. Members agreed that the scope of the Winding-Up Directive should not be extended to subsidiaries. A bank group is by definition different from an individual company with independent legal entity and limited legal liability. There are significant legal obstacles hindering progress on the issue. The proposed extension of Article 69 of the CRD (exception from the own funds requirements) also provoked debate, as did the issues of consolidated supervision and decision-making mechanism.

The EBF shares the Council's position that the European contract law – Common Frame of Reference (CFR) should not be regarded as a European Civil Code or a 28th Regime: rather, it should be seen as a non-binding tool which national legislators can use as a sample and source of ideas. Full harmonisation is still a debated issue; the Commission does not consider the full harmonisation of contract laws as an objective.

Some national banking associations and banks have included competition law in their compliance programmes. The EBF will assess the relevant experience and make initiatives in this area.

The Secretariat briefed members on discussions regarding the EBIC's proposed common principles for bank account switching. The Commission was disappointed at the initial proposal made by the industry, saying it was not ambitious enough. Members were of the view that self-regulation on this issue would be better than regulation.

After adoption of the Green Paper on the transparency of debtors' assets, a consultation began on potential measures to make it possible to obtain accurate information on debtors' assets and to improve creditors' access to information during cross-border lending.

The Secretariat briefed members on the latest developments, including the industry initiative for improving the transparency of securities markets and information provision, broadening the reporting framework, amending valuation rules and improving the efficiency of oversight.

The Committee reviewed issues related to self-regulation, the role of the Lamfalussy process and limiting overregulation in the EU.

1.7 Social Affairs Committee (BCESA)

The EBF Banking Committee for European Social Affiars (BCESA) discussed the letter written by the EBF Secretary General and the Secretary of the BCESA to the European Commission to clarify issues related to cooperation with UNI-Europa Finance, the European finance trade union federation. The Committee reviewed the social impacts of the financial crisis. UNI-Europa Finance would like to address social affairs in the broadest context and expects the BCESA's support accordingly. However, the BCESA considers that its mandate only extends to issues falling within the scope of social affairs.

In agreement with UNI-Europa Finance, the Committee conducted a questionnaire survey on the impacts of the financial crisis on employment. However, due to the divergent levels of detail of the information available in the various member states, the suitability of the results of the survey for drawing general conclusions is limited.

The chairman of the Committee requested representatives of member states to provide the BCESA Secretariat with regular information on the impacts of the financial crisis in their countries.

The Enlargement Project, organised in cooperation with the European Union was successfully concluded. In this project, old and new member states presented their social dialogue frameworks and the advantages of participating in social dialogue. The EU's representatives presented plans to promote the involvement of new member states in the EU social dialogue.

1.8 Communications Committee

The EBF Communications Committee reviewed the methods of tackling the financial crisis and the public perception of the banking industry in member states, and proposed measures aimed at restoring confidence in the banking sector. The Committee also adopted the EBF's communications strategy for 2009.

The Committee adopted a proposal submitted by the Hungarian Banking Association to set up a forum to share members' positions and views on legislation and key regulatory issues affecting the industry at the European and national levels. This forum, together with the EBF Executive Committee's positions and national associations' views could promote the development of common arguments to be represented vis-á-vis policy-makers, the media and the general public.

Accordingly, the Communications Committee set up the proposed forum under the name Vademecum of Common Arguments on Key Issues. At its first meeting, the forum addressed the following issues: capital requirements, government support and exit strategies, new regulatory and supervisory frameworks, retail banking charges, banks' bonus schemes, and financial reporting. The document drafted based on specialists' opinions was adopted and approved by the EBF Executive Committee.

ANNEXES

Annex 1

Board Meetings

January 19, 2009

Agenda:

1. Proposal regarding the draft law amending certain laws related to the supervision of the financial intermediary system.
2. Briefing concerning the appointment of a legal consultant in connection with the Competition Office's interchange fee investigation
3. Proposal for organising a conference on accounting impacts of the financial crisis
4. Report on the financial management of the Hungarian Banking Association in 2008 based on preliminary figures
5. Miscellaneous

March 2, 2009

Agenda:

1. Briefing on the status of the Competition Office's investigation No. Vj-18/2008 on multilateral interchange fees
2. Proposal for consultations on Draft Law No. T/8381 (unilateral contract amendments)
3. Proposal regarding the draft law on a comprehensive credit information system
4. Briefing on consultations regarding the proposed government guarantee scheme for debtors that have lost their jobs after September 30, 2008.
5. Report on proposed amendments to the Bankruptcy Act (Act XLIX of 1991)
6. Proposal for the 2009 budget of the Hungarian Banking Association
7. Proposal for amendments to the Association's membership fee rules
8. Miscellaneous

April 7, 2009

Agenda:

1/a. Proposal for the medium-term strategy of the Hungarian Banking Association (document for the General Meeting)
1/b. Report on 2008 activities of the Hungarian Banking Association (document for the general meeting)
2/a. Report on the financial management of the Hungarian Banking Association in 2008 (document for the General Meeting)
2/b. Proposal for the 2009 budget of the Hungarian Banking Association (document for the General Meeting)
3.a) Briefing on the EU consumer organisation's recommendations for the banking sector and the EBF's proposed response
3.b) Briefing on EU consultations on basic bank accounts
4. Proposal for an electronic communications system between bailiffs and banks
5. Miscellaneous

May 4, 2009

Agenda:

1. Proposal for amending the Code on Loan Trade-Offs
2. Proposal for charging a fee for negative answers to customer account inquiries from authorities
3. Proposal for participation in the development of the proposed tenement programme
4. Proposal for drawing up statistics on failed home loans
5. Proposal for the adoption of the reports on 2008 activities and finances and 2009 budget of the Permanent Court of Arbitration of Financial and Capital Markets
6. Miscellaneous

General Meeting
May 8, 2009

Agenda:

1/a. Report on 2008 activities of the Hungarian Banking Association
1/b. Proposal for the medium-term strategic plan of the Hungarian Banking Association
2/a. Report on the financial management of the Hungarian Banking Association in 2008
2/b. Proposal for the 2009 budget of the Hungarian Banking Association
2/c. Proposal for amendments to the Association's Rules regarding membership fees
3. Election of a Board Member and a Vice-President

June 8, 2009

Agenda:

1. Background documents for the press meeting of June 18, 2009
   a) Major economic and banking developments in the first quarter of 2009
   b) Situation in 2009 based on figures of the Central Credit Information System
   c) Report on banking measures aimed at helping borrowers in distress due to the financial crisis
2. Self-regulation for the limitation of foreign currency lending
3. Government measures to help home loan debtors in distress
4. Briefing on the launch of the CSR programme in the banking sector
5. Proposal for the Association's 2009 Asset Management Rules
6. Report on the Association's financial management in Q1 2009
7. Briefing on the status of implementation of the EU Payment Services Directive
8. Briefing on the proposed self-regulation on bank account switching
9. Miscellaneous

September 7, 2009

Agenda:

1. Proposal for a Code on Bank Account Switching
2. Report on the referendum initiative on unilateral contract amendments
3. Briefing on the study on the need for a regulation on claim work-out
4. Report on the Association's financial management in the first half of 2009
5. Report on developments regarding the Association's office rental contract
6. Miscellaneous

October 7, 2009

Agenda:

1. Presentation on the new trading platform of the Budapest Stock Exchange (Presenter: Dr György Mohai, Managing Director, Budapest Stock Exchange. Verbal presentation)
2. Briefing on the drafting of the government proposal and draft laws on strengthening the supervision of the financial intermediary system.
3. Proposal for a Code on Bank Switching
4. Briefing on proposed amendments to the Capital Requirements Directive
5. Admission request of the South-Transdanubian Regional Bank (Dél-Dunántúli Regionális Bank)
6. Miscellaneous

November 2, 2009

Agenda:

1. Report on the extended Board Meeting of October 20, 1990 and update on follow-up measures
2. Documents for the November 2 press meeting
   a. Main economic and banking developments 2008 - first half of 2009
   b. Briefing on the Code on Bank Account Switching
3. Proposal for the regulation of claim work-out
4. Proposed amendments to the legislation on bailout for home-loan debtors in distress
5. Banking tasks related to the new deposit guarantee rules taking effect on January 1, 2010
6. Report on the Association's financial management in Q1 - Q3 2009
7. Briefing on preparations for establishing the Compliance Committee
8. Miscellaneous

December 7, 2009

Agenda:

1. Presentation on a self-regulation model for dealing with companies in financial distress (the London rules)

   Presenters: Dr Iván Gara
   Dr Erika Papp

Miklós Fekete

2. Concept for bailing out debtors facing eviction

Presenter: Dániel Gyuris

3. Initiating a revision to the Hungarian Financial Supervisory Authority's recommendations regarding online security risks

4. Report on activities of the Association's Working Group on Public Warehousing

5. Letter of the President of the Hungarian SEPA Association

6. Report on work aimed at improving the compensation system of the National Deposit Insurance Fund

7. Briefing on amendments to financial legislation

8. Miscellaneous

Annex 2

Working Committees and Working Groups of the Hungarian Banking Association

Working Groups

Taxation Working Group
Agricultural Working Group
Basic Accounts Working Group
Loan Trade-Offs Working Group
BankAdat Working Group
Competition Office Interchange Fee Investigation Working Group
Human Resources Working Group
Specialist Group on Bank Reporting
Human Resources Working Group
Legal Working Group
SME Working Group
Communications Working Group
Public Warehousing Working Group
Home Loans Working Group
Macroeconomics Working Group
Civil Code Working Group

Working Committees

Bank Security Working Committee

- Compliance Working Group
- Physical Security Working Group
- Ant-Fraud Working Group

Working Committee on electronic communications between bailiffs and banks
Ethics Committee
Intermediaries Working Committee
Accounts Committee
Work-Out Working Committee

E-bailiffs
JEREMI Committee
HUNOR Operational Risk Database Decision-Making Body