

REPORT
**ON 2012 ACTIVITIES OF THE HUNGARIAN BANKING
ASSOCIATION**

Budapest, March 2012

CONTENTS

EXECUTIVE SUMMARY	4
1. ECONOMIC ENVIRONMENT – PERFORMANCE OF THE BANKING SECTOR IN 2012	7
2. MAJOR FACTORS AFFECTING BANKS' OPERATIONS	13
2.1 Retail banking - home and mortgage lending	13
Early Repayment Scheme	13
Exchange Rate Cap (Overflow Account Loan) Scheme 2	13
Helping debtors with loans delinquent for more than 90 days	14
National Asset Management Company (NAMC)	14
Interest subsidy	15
Transparent pricing.....	15
2.2 Corporate banking, corporate lending	15
Corporate and SME lending.....	15
Agricultural lending	16
Late payments to subcontractors	16
Municipal lending – consolidation of municipalities with less than 5000 inhabitants	16
2.3 Financial Transaction Levy, taxation issues	17
Financial Transaction Levy	17
Foreign Account Tax Compliance Act (FATCA) developments.....	17
Other taxation issues	18
2.4 Payments	19
Intraday settlements system (Intergiro 2 – IG2).....	19
Basic payment accounts	19
Bank cards.....	20
2.5 Bank security	21
3. REGULATORY CHANGES, GOVERNMENT AND AUTHORITY MEASURES	21
New Civil Code	21
Supreme Court working document on unilateral contract amendments	22
Measures related to the implementation of the Bankruptcy Act (Act XLIX of 1991)	22
Interpretation issues related to the legislation on branches of foreign financial institutions	22
Central Credit Bureau	23
Legislation on APR cap, amendment to the APR Decree	23
PSZÁF regulations, reporting	24
MNP proposal on SWAP portfolios	25
4. COMMUNICATIONS	25
Main directions and communications channels	25
Complaint handling, advice	26
Hitelintézeteti Szemle (Credit Institutions Review)	27

5. INTERNATIONAL REGULATION, INTERNATIONAL RELATIONS.....	27
5.1 Prudential regulation and supervision	27
Global regulation	27
Prudential regulation in the European Union.....	29
European Banking Authority.....	31
European Banking Federation (EBF) and IBFed	32
5.2 Other regulatory developments	33
EBF Payments Systems Committee	33
EBF Consumer Affairs Committee	34
5.3 Participation in operations of the European Banking Federation.....	34
5.4 Regional cooperation, contacts with the banking associations of the Visegrád group and Serbia, invitation by the Banking Academy of the National Bank of Ukraine	34
6. ASSOCIATION LIFE, EVENTS.....	35
Changes in the Board and membership.....	35
25th anniversary of the reinstatement of the two-tier banking sector in Hungary	35
Foreign Bankers Club	35
Awards.....	36
New working groups, new office holders	36

EXECUTIVE SUMMARY

The banking sector's operating environment remained adverse in 2012, with a weak international economy, negatively affecting the sector and the Hungarian economy as a whole. Growth in Hungary's major trading partners was slow, with a drawn-out euro-zone crisis. There were only two positive factors in the external environment (although neither of them long-term): the stimulus measures of the ECB and the FED, and the ensuing liquidity growth and relative calm in the financial markets.

The performance of the Hungarian economy was weaker than expected. Partly due to external market conditions and partly to internal economic policy measures reducing investment and consumption, the Hungarian economy slipped into recession in the last three quarters of the year. GDP fell by 1.7% in 2012. Aimed at keeping the general government deficit under 3% and having Hungary removed from the EU Excessive Deficit Procedure, the government imposed new austerity measures during the year. The measure of keeping of the bank tax fully in force (contrary to the envisaged 50% reduction in 2013) and the introduction of a financial transaction levy represent a more than HUF 400 billion burden on the banking sector in 2013. The effects of these measures were felt already in 2012. Under the December 2011 agreement with the government, the banking sector has assumed significant burdens in exchange for a predictable tax burden. The government's new austerity measures ignored this agreement. The Early Repayment Scheme, concluded at the end of February 2012, caused a gross loss of HUF 370 billion, of which the banking sector's share exceeded HUF 260 billion. Adding to this were the HUF 140 billion in bank tax and the tax on interest subsidies, introduced in 2007. In addition to these, the implementation costs of the various regulatory changes imposed an additional burden on banks. The sector's burdens have also increased due to the fact that the bank tax continues to be levied on the basis of the 2009 total assets, while banks' total assets are falling year by year.

All these effects are reflected in the sector's 2012 performance. After nearly breaking even in 2010, the sector made a loss of more than HUF 240 billion in 2011, followed by a loss of HUF 161 billion in 2012, the second worst result in ten years.

Credit institutions' total assets dropped by 9.8% year on year, the net stocks of corporate and retail loans fell by 13.3% and 16.3%, respectively. Banks' liabilities also dropped in 2012. Hungary continues to be rated in the non-investment grade. As a result, some banks were also downgraded. The losses sustained have put Hungarian banks at a competitive disadvantage in the CEE.

As a result of changes in banks' stock of loans and liabilities, the loans-to-deposits ratio fell to 111% in 2012 (from 140% in 2010 and 133% in 2011).

Real ROE was negative in the sector for the third consecutive year, being at -11.6% at the end of 2012.

In three years, banks lost nearly one-third (29.6%) of their 2009 year-end equity.

Banks' loan portfolios remained vulnerable. The ratio of 90+ day delinquent foreign currency-denominated loans was 14.8% (17.2% of all corporate loans and 16.2% of all retail loans). The ratio of 90+ day delinquent foreign currency-denominated loans was 19.3%. The quality of the retail loan portfolio was influenced by the weakening of the forint's exchange rate, the rising interest rates of loans, the early repayment scheme and unemployment.

Despite the adverse operating environment, the Hungarian banking sector is stable, with a capital adequacy ratio of 15.7% as of the end of 2012. As mentioned earlier, the deterioration in the Hungarian banking sector's competitiveness has caused a drop in direct foreign funding in the sector, with parent banks continuously withdrawing their funds, as a reflection of the shrinkage of lending activity due to the lack of demand. At the same time, a responsible attitude by parent banks is reflected in the significant capital contributions granted to subsidiaries during 2012 (equity in the sector rose by 8.4%).

In retail banking, issues related to lending continued to dominate in 2012. The effects of the Early Repayment Scheme were still strongly felt at the beginning of the year. This scheme has not only caused losses to banks, but also eliminated their performing and profitable customer base. The Exchange Rate Cap Scheme continued to be available, as did the scheme aimed at helping debtors with loans in arrears for more than 90 days and the National Asset Management Company's quota for the purchase of homes was raised. The system of government subsidies for foreign currency debtors in distress was amended in several steps. In April, a regulation on the transparent pricing of mortgage loans was introduced. Pursuant to this, mortgage loans can only be granted at fixed or benchmark-pegged interest rates.

As for deposits, household's saving capacity and propensity remained low in 2012, retail deposits fell by 1.2%. Due to the restrictions on foreign fundraising, domestic savings have become increasingly important for banks. To retain their customers, banks continued to pay real interests on deposits, while the state posed new competition for banks by issuing high-yield government bonds.

The stock of corporate loans has been declining for the third year in a row, falling by 13% in 2012. The quality of SME loans continued to deteriorate. The stock of SME loans dropped by 0.4%.

A major development in 2012 was the legislation on the consolidation of municipalities with less than 5,000 inhabitants. In addition to the economic environment, banks' operations were considerably influenced by the multitude of laws and regulations, often leaving no implementation time. A part of these laws affected retail lending, added to by mostly consumer protection-type recommendations from PSZÁF. The legislation on bankruptcy and liquidation proceedings was also changed in 2012 and the Supreme Court issued a working document summarising its position on the issue of unilateral contract amendments. The legislation on financial transaction levy was amended twice, tying up significant staff resources at the banks. The enforcement of interests of the banking community during the finalisation of the new Civil Code was also a major challenge.

A major development in payments was the launch of the intraday settlements system in July 2012. Credit transfers in the interbank space are now managed according to the SEPA standards, which are becoming increasingly common in European payments and will be mandatory in the euro-zone from 2014. In line with the European Commission's recommendations, basic payment accounts were introduced in 2012. The Association's Board issued a relevant recommendation, which was adopted by all major banks. As a result, basic payment accounts are now available nationwide.

Hungarian banks' operations are affected in the short and long-term by international standards. In our report we provide a detailed account of the main directions of global regulation, in particular, on operations of the Basel Committee on Banking Supervision and on prudential regulation in the European Union, including the creation of a European Banking Union and operations of the European Banking Authority. We also touch upon operations of the European Banking Fed-

eration. The Association is actively involved in the EBF's work and we received information, assistance, and support from the EBF in a number of specific issues in 2012, as well.

The Hungarian Banking Association conducted its advocacy work in an adverse environment in 2012. Our main endeavour was to make decisions based on consensus and to mitigate adverse impacts on banks. In our relations with the government, our permanent objective was to settle issues by negotiations and consultations. In the second half of the year, government measures ignoring our previous agreements were imposed. This made it necessary to change the focus in our relations with the government: alongside and instead of seeking comprehensive agreements, more emphasis is now given to focusing on specific issues or projects.

Association life was also eventful in 2012. Despite the difficult conditions, the Association's membership remained essentially unchanged in 2012. The working committees and working groups, coordinated by the Association and made up of key specialists from member banks were the backbone of our operations in 2012. New working groups were created to address new issues, including a High Level Working Group made up of CEOs from member banks to represent our interests in negotiations with the government.

To recognise those making an outstanding contribution to the Association's operations and advocacy work, we established the Golden Beehive Award and the Golden Beehive Certificate of Recognition.

On the 25th anniversary of the reinstatement of the two-tier banking System in Hungary, in addition to the presentation of the awards, the Association published a collection of essays and a banking glossary.

1. ECONOMIC ENVIRONMENT – PERFORMANCE OF THE BANKING SECTOR IN 2012

1. INTERNATIONAL OUTLOOK. The IMF forecasts global GDP to grow by 3.3% in 2012 and 3.6% in 2013. These growth rates basically correspond to the average growth rate of the past 30 years. The estimated 1.3-1.5% growth for the advanced economies is 1% lower, the 5.3%-5.6% growth rate forecast for the developing economies is more than 0.5% higher than the thirty-year average growth. Out of the countries highlighted in the IMF's analysis, only Italy and Spain will remain in recession, while the UK., the euro-zone, the EU and Japan are expected to grow by around 1% in 2013. The U.S. GDP (partly due to the growth in population) is expected to grow faster than the advanced economies' average, by 2.1%. As for the developing economies, the Asian, Sub-Saharan, Latin American and Central and Eastern European economies are forecast to grow by 7.2%, 5.7%, 3.9% and 2.6%, respectively. In the period between 1990 and 2012, the over-consuming advanced economies with twin deficits have been financed by the developing economies with twin surpluses, while the ratio of per capita GDP in the advanced economies to that in the developing economies has halved.
2. In the Hungarian economy in 2012 the GDP growth was -1.7%. Since further detailed statistics were not available from the Central Statistical Office at the time of closing this report, we will use the figures of the first three quarters of the year. Compared to 2007, investment in Hungary fell by 10% in the private sector, 23.1% in the public sector and 18.6% overall in the economy. The rate of employment rose by 1.1 percentage point to 51.4%, while the rate of unemployment decreased by 0.3 percentage points to 10.4% year on year in Q3 2012. The number of those employed rose by 113,000 to 3,935,000. Family tax benefit adjusted real earnings fell by 3.6% in Q1-Q3 2012 year on year. Consumption in Q3 fell by 3.9% year on year, a rate not lower than that in the PIIGS countries. Per capita real earning dropped by 3.5%. Exports in euro terms rose by an annual 2.3% in 2011 and 2012, exactly the same rate as the rise in consumer and industrial producer price indices in the euro area as of October 2012. Hungarian exports in real terms have been stagnant for the second consecutive year, the increase in revenues mainly comes from price increases. Hungarian exports in real terms have been stagnant for the second consecutive year, the increase in revenues mainly comes from price increases. Industrial production in October 2012 was at the level of October 2010. Seasonally and calendar adjusted industrial production in October 2012 dropped by 3.8% year on year. Total sales fell by 2.6% (domestic sales by 5.7%, export sales by 0.7%). Construction production fell by 3.8% year on year between January and October 2012, although the second half of the year saw some increase. Seasonally and calendar adjusted construction production was up 7% in July, down 4.3% in August and up 5.3% in September.
3. The Hungarian credit institutions sector saw one of its worst in years in terms of both total assets and profits, with banks' profit after tax at -HUF 161 billion that of cooperatives at +HUF 9 billion.

4. CREDIT INSTITUTIONS' TOTAL ASSETS dropped by 9.8% year on year. The net stocks of corporate and retail loans fell by 13.3% and 16.3%, respectively, a decline barely offset by the 11.6% increase in the stock of securities. In 2012, the state took over the debts of municipalities with less than 5000 in habitants.

Table 1 - Credit institutions' assets structure, 2000-2012 (in HUF billion)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Cash and settlement accounts	689	644	491	505	782	759	765	917	673	626	694	734	887
Securities for trading	580	487	458	912	890	933	1283	2113	2570	4340	3328	3408	4026
Securities for investment	740	1004	1059	1534	1508	1627	1631	1831	2922	3 189	3793	4084	4389
Total securities	1320	1491	1517	2446	2398	2560	2914	3944	5491	7529	7121	7492	8415
Central bank and interbank deposits	1528	1476	1445	1391	1745	2391	2681	1940	2175	2382	2275	2594	1872
Of which: central bank deposits		492	643	425	543	1307	1219	468	827	472	452	889	630
interbank deposits		984	802	966	1203	1084	1462	1472	1347	1910	1823	1705	1241
Loans (net portfolio)	4323	4905	6097	8523	9977	11935	14223	17319	20979	19791	19911	19423	16226
of which: corporate loans	3076	3176	3284	4154	4772	5433	5994	6923	7456	6958	6745	6596	5777
retail loans	429	677	1204	2265	2914	3712	4613	5847	7536	7519	8093	7647	6497
Participations	192	156	197	257	248	292	500	555	638	651	686	730	737
Accrued interest receivable	117	109	114	184	249	241	234	299	505	460	427	462	464
Prepayments and other assets	71	90	144	186	241	268	521	671	959	661	509	939	739
Own assets	187	169	192	268	326	404	589	688	642	591	600	627	590
Total assets	8427	9040	10196	13759	15965	18850	22428	26334	32063	32691	32223	33002	29929

Source: Expert's estimate based on PSZAF figures

5. STRUCTURE OF THE CREDIT INSTITUTIONS SECTOR. The structure of the credit institutions sector has changed somewhat over the past four years. The share of banks in terms of total assets fell from 91% to 88%, that of branches of foreign banks rose from 4% to 6%, the share of cooperatives grew from 5% to 6%. Institutions' market shares in lending have changed accordingly, with the share of banks' dropping, that of branches of foreign banks rising more and that of cooperatives growing slightly.
6. FACTORS AND IMPACTS OF THE DROP IN TOTAL ASSETS. Looking at financial depth as the ratio of total assets to GDP, we can find that between 2000 and 2009, it rose from 64% to 128%, then declined rapidly, from 128% in 2009 to 106% in 2012. Measuring financial depth as the ratio of customer loans to GDP, we can see the same picture, with a substantial decline in 2012. (A 12% decline year on year when measured with total assets and an 8% drop when measured with customer loans). The retail loans-to-GDP ratio rose from 3% in 2000 to 30% in 2010, falling to 23% by 2012. The rise after 2008 was mainly attributable to the repricing of existing foreign currency loans rather than to new loans. The corporate loans-to-GDP ratio rose from 23% in 2000 to 28% in 2008, dropping to 20% between 2008 and 2012 (falling by 4% in 2012). The decline in corporate loans means that capital is diminishing in the economy.

Table 2 - Financial depth, 2000-2012

	Total assets/GDP	Customer loans/GDP	Corporate loans/GDP	Retail loans/GDP
2000	64%	27%	23%	3%
2001	60%	26%	21%	4%
2002	60%	26%	19%	7%
2003	73%	34%	22%	12%
2004	77%	37%	23%	14%
2005	86%	42%	25%	17%
2006	95%	45%	25%	19%
2007	105%	51%	28%	23%
2008	121%	56%	28%	28%
2009	128%	56%	27%	29%
2010	121%	56%	25%	30%
2011	118%	51%	24%	27%
2012	106%	43%	20%	23%

Source: Expert's estimate based on Central Statistical Office and PSZÁF figures

According to the current stance of orthodox economics, a declining stock of capital entails a declining GDP. Looking at the 2-year moving average of changes in loans and GDP in real terms, we can find that Hungary's GDP grows by an average 1.5% + 0.226 times the change in corporate loans annually. Illustrated by figures, at a zero growth in corporate loans, GDP grows by 1%. If corporate loans grow by 4% in real terms, GDP grows by around 2.5%. If corporate loans fall by 12%, GDP falls by around 1.5%.

7. LIABILITIES AND THE LOANS-TO-DEPOSITS RATIO. Total liabilities fell by 9.8% in 2012 year on year. The changes in terms of the various components was rather uneven. Equity rose by 8.4%. Deposits barely changed (0.3%), with corporate deposits falling by 0.4%, retail deposits by 1.2%. The HUF 3,073 billion total drop in liabilities was attributable to two major items: a 28% or HUF 1.448 billion drop in interbank deposits and a 26.5% or HUF 1,058 billion decline in loans taken.

Table 3 - Credit institutions' liabilities, 2001-2012 (in HUF billion)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Deposits	6056	6660	8086	8837	10029	11403	12217	13823	13942	13749	14586	14625
of which: corpo- rate deposits	1716	2046	2369	2483	2790	3568	3622	3787	3785	4104	4387	4371
retail depos- its	3173	3389	4575	5105	5665	5930	6321	7191	7579	7365	7782	7689
Interbank deposits	752	726	1245	1462	2133	2815	4244	5641	5876	6106	5933	4485
Loans taken	697	796	1390	1795	2152	2462	3230	4409	4705	4466	4540	3482
Debt securities	158	459	1098	1483	1765	2030	2441	3024	3118	3288	3099	2810
Accrued interest payable	55	68	142	220	192	214	299	523	450	385	412	449
Other accruals, deferred income and other liabilities	340	360	348	511	641	962	976	1406	1043	1445	1659	1113
Subordinated liabil- ities	126	131	179	190	279	550	612	650	670	0	0	0
Provisions	90	108	141	134	143	185	206	242	233	189	236	205
Equity	767	888	1130	1334	1516	1806	2109	2343	2653	2594	2538	2761
Total liabilities	9040	10196	13759	15965	18850	22428	26334	32063	32691	32223	33002	29929

Source: Expert's estimate based on PSZÁF figures

Looking at credit institutions' loans-to-deposits ratio between 2001 and 2012: between 2001 and 2004, loans were adequately funded from domestic deposits and equity, with the loans-to-deposits ratio being at 81%-113%. Between 2001 and 2004, with the expansion of lending, the loans-to-deposits ratio jumped from 119% to 152%. Then, with the eruption of the crisis, it fell gradually to 111%.

Table 4 - Loans-to-deposits ratio

HUF billion	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Deposits	6056	6660	8086	8837	10029	11403	12217	13823	13942	13749	14586	14625
Loans	4905	6097	8523	9977	11935	14223	17319	20979	19791	19911	19423	16226
Loans/Deposits	81%	92%	105%	113%	119%	125%	142%	152%	142%	145%	133%	111%

Source: Expert's estimate based on PSZÁF figures

8. Profitability. Real ROE was negative in the sector for the third consecutive year in 2012. In three years, banks lost nearly one-third (29.6%) of their 2009 year-end equity.

Table 6 - Breakdown of ROA in the banking sector, 2001-2012

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Net interest income	3.9%	4.0%	3.9%	4.0%	3.8%	3.6%	3.2%	2.7%	2.6%	3.0%	3.0%	2.8%
Interest received	9.0%	8.8%	9.1%	10.4%	8.5%	7.9%	8.2%	8.2%	8.5%	7.2%	7.1%	7.6%
Interest paid	5.1%	4.8%	5.2%	6.4%	4.7%	4.3%	5.0%	5.5%	5.9%	4.1%	4.1%	4.8%
Non-interest income (net)	1.0%	1.4%	1.6%	1.7%	1.6%	1.6%	1.6%	1.3%	1.9%	0.6%	0.9%	-0.4%
Earnings from commissions and fees	1.1%	1.3%	1.5%	1.3%	1.3%	1.2%	1.1%	0.9%	0.9%	0.9%	0.8%	0.8%
Dividends	0.1%	0.1%	0.2%	0.1%	0.1%	0.1%	0.2%	0.6%	0.2%	0.2%	0.3%	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%	0.7%	0.9%	0.3%
Other non-interest earnings	-2.1%	-0.5%	-0.5%	-0.3%	-0.6%	-0.4%	-0.5%	-0.8%	-0.3%	-1.2%	-1.2%	-1.7%
Operating expenses	3.4%	3.6%	3.4%	3.0%	2.9%	2.7%	2.6%	2.4%	2.0%	2.1%	2.0%	2.0%
Change in impairments and provisions		-0.3%	-0.3%	-0.4%	-0.2%	-0.4%	-0.5%	-0.5%	-1.5%	-1.3%	-2.4%	-0.5%
Profit from ordinary business activities		1.6%	1.8%	2.3%	2.3%	2.1%	1.7%	1.0%	0.9%	0.2%	-0.5%	-0.2%
Extraordinary profit	0.1%	0.0%	0.0%	0.0%	0.0%	0.2%	0.0%	0.1%	-0.1%	-0.1%	-0.2%	-0.2%
Pre-tax profit	1.5%	1.6%	1.8%	2.3%	2.3%	2.2%	1.7%	1.1%	0.8%	0.1%	-0.7%	-0.4%
After-tax profit ROA	1.2%	1.3%	1.5%	2.0%	1.9%	1.9%	1.4%	0.9%	0.7%	0.0%	-0.9%	-0.6%
After-tax profit ROE		15.5%	17.8%	23.6%	23.3%	22.7%	17.5%	11.3%	9.1%	0.5%	10.5%	-6.6%
REAL ROE	109.2	105.3	104.7	106.8	103.6	103.9	108	106.1	104.2	104.9	103.9	105.7
Net interest income		9.6%	12.5%	15.7%	19.0%	18.1%	8.8%	4.9%	4.7%	-4.2%	13.8%	11.6%

Source: Expert's estimate based on PSZAF and MNB figures

As for the structure of ROA in 2012:

- 1) Net interest income was 2.8%, one of the lowest in the 2001-2012 period. (Average net interest income in the 2011-2012 period was 3.4%). Net interest income in 2011 was 3.0%. In 2012, banks had 0.5% more in interest received and 0.7% more in interest paid.
- 2) Non-interest income is made up of two elements. One is earnings from commissions and fees and net profit on financial and investment services, the other is other non-interest income, including the bank tax. Earnings from commissions and fees were the same as in 2011 (0.8%). Dividends (0.2%) fell by 0.1%, net profit from financial and investment services (0.3%) dropped significantly (by 0.6%) over 2011. Average total earnings from commissions + dividend + net profit from financial and investment services 1.3% in 2012, as opposed to the 2.1% average in the period between 2001

and 2012 and the 2% of 2011. Other non-interest income was greatly negative in 2012 (-1.7%) against the -1.2% of 2011 and the average -0.8% between 2001 and 2012.

- 3) Operating expenses were as low as 2.0%, the same as in 2011, an all time low. Average operating expenses were at 2.7% between 2001 and 2012.
- 4) The change in impairments and provisions was surprisingly low, -0.5%, a rate similar to the figures before the crisis and significantly different from the -2.4% of 2011. The average change in impairments and provisions in the period between 2001 and 2012 was -0.8%.
- 5) Profit from extraordinary business activities was -0.2%, the same as in 2011. The 12-year average profit from extraordinary business activities was 0%.
- 6) Pretax profit was -0.4%, better than the -0.7% of 2011. Average pre-tax profit in the period between 2001 and 2012 was +1.2%.
- 7) ROA in 2012 was -0.6%, better than the -0.9% of 2011, however, significantly worse than the +1.0% average ROA between 2001 and 2012.
- 8) ROE was -6.6%, better than the -10.5% of 2011, however, substantially falling behind the 2001-2012 average of +11.3%.
- 9) Consumer inflation was 5.7% in 2012, significantly higher than the 3.9% of 2011 and exceeding the 12 year average of 5.5% as well. Accordingly, real ROE was 11.6% in 2012, the second lowest after the -13.8% of 2011. Average real ROE in the period between 2001 and 2012 was 5.8%, not very high, either.

2. MAJOR FACTORS AFFECTING BANKS' OPERATIONS

2.1 Retail banking - home and mortgage lending

Following the announcement of the Early Repayment Scheme in 2011, a measure causing banks severe losses, the government and the Association signed an agreement in December 2011 to address the problems arisen in connection with foreign currency denominated loans granted in previous years. This agreement fundamentally determined the conditions for home and mortgage lending in 2012 by relaxing the conditions of the Exchange Rate Cap Scheme, offering a solution for debtors with loans delinquent for more than 90 days, stipulating appropriate amendments to the Act on the National Asset Management Company and providing for government subsidies for HUF loans for specific purposes.

Early Repayment Scheme

The Early Repayment Scheme, adopted unilaterally without any prior consultations, allowing debtors to make repayments at a significantly lower exchange rate than the market rate, was concluded in February 2012, causing banks a huge loss (HUF 370 billion gross). Loans of more than 170,000, mostly performing, customers were early repaid, depriving the banking system from the expected future revenues of a magnitude similar to the loss sustained.

The Association, while taking legal action against the Early Repayment Scheme, assisted banks in the various technical details (e.g., the drafting of a sample promissory note, the accounting treatment of the deduction from the bank tax of the losses) required for implementation of the legislation.

In October 2011, the Association turned to the Constitutional Court, requesting the Court to annul the legislation on early repayment (Act CXXI of 2011 on amendments to certain laws related to home protection). After the change in the law on the Constitutional Court, banks affected by the Early Repayment Scheme filed a constitutional complaint with the Court. In line with the Board's decision, the Association provided members professional and organisational assistance in filing the complaints. The motion requesting the Constitutional Court to declare the unconstitutionality of Act CXXI of 2011 and to annul the Act was rejected by the Constitutional Court under its Resolution of February 11, 2013.

Exchange Rate Cap (Overflow Account Loan) Scheme 2

Pursuant to the agreement between the Association and the government, the conditions of the Exchange Rate Cap Scheme introduced on August 1, 2011 have become even more favourable:

- The preferential repayment period has been extended from three to five years,
- The state has assumed the exchange rate risk above a certain exchange rate,
- Banks and the state each have assumed fifty percent of the interest on the repayment amount on the overflow account,
- Additional preferences over and above those mentioned above have been provided for public employees.

Both the government and banks have expected that the vast majority of the several hundred thousand debtors affected would avail themselves of the scheme. Despite several publicity campaigns conducted by banks and the Association and calls by the state for debtors to participate,

only a quarter of the affected debtors (110,000 in number) joined the Exchange Rate Cap Scheme as of the end of 2012. Therefore, Parliament has extended the application deadline for the scheme to March, 2013.

The Association organised several consultations for members' specialists concerning regulatory amendment proposals aimed to help implementation of the Scheme. The Association was also actively involved in the drafting of the relevant decrees (government guarantee on the overflow account loan, subsidies for public employees, reporting requirements).

Helping debtors with loans delinquent for more than 90 days

Pursuant to the agreement with the government, banks had to offer debtors with loans delinquent for more than 90 days the option to make their loans repayable by converting the loan into HUF and forgiving 25% of the debt. An additional assistance was the interest rate subsidy provided by the government. The incentive for banks was that 30% of the forgiven debt could be deducted from their 2012 bank tax.

Implementation of these provisions of the legislation was a complex task for both banks and debtors. Debtors had to decide on their participation without knowing the exchange rate at which their loans would be converted into HUF (and thus, the future repayment amount), while banks had to face the fact that even the 25% forgiveness would not help the majority of these debtors. The delay in issuing the decree on the interest subsidy also made the operation of the facility more difficult.

The Association organised several consultations for members, addressing the issues related to customer information, the costs related to the converted loans (e.g., notary fees), the issue of accounting for the bank tax refund, and taxation issues related to debts forgiven in excess of 25% (personal income tax, duties, corporation tax).

National Asset Management Company (NAMC)

In accordance with the agreement made between the government and the Association on December 15, 2012, the Act on the National Asset Management Company (Act CLXX of 2011) was amended as of June 20, 2012. Under this amendment (taking also account of the Association's proposals) the number of properties that can be purchased by the NAMC until 2014 has been raised from 5,000 to 25,000. Pursuant to the December agreement, the NAMC may purchase the property irrespective of whether or not it has been included in the quota on forced sale. The eligibility criteria for offering the property for purchase by the NAMC were also relaxed and the government's regulatory flexibility increased by referring the definition of social need to a lower-level legislation (government decree). Pursuant to the relevant government decree, families with one child may also offer their home for purchase by the NAMC. As a result of these improvements, the number of homes offered for purchase had risen and exceeded 1,100 by October. However, the 2012 quota of 8,000 was not exhausted in 2012. Also, the regulatory amendment to ensure that the transaction is free of the liquidator's fee was not enacted in 2012.

Banks have difficulties in getting hold of the customers: a criterion for eligibility is that the default is 180 days or more and these debtors in many cases have severed contact with their banks for months.

Interest subsidy

The government decree on helping foreign currency debtors in distress was amended in several stages. An interest subsidy was made available for loans that

- have helped the customer move into a smaller flat,
- have helped customers purchasing the homes of debtors in distress,
- have affected those customers converting their FX loans into HUF (with 25% of their debt forgiven).

The Association submitted a number of proposals to make the implementation of the decree easier for both banks and customers. As a result, the rate of the interest subsidy was increased, and to facilitate lending, the interest rate limit was raised in view of banks' high funding costs. At the end of the year, the government introduced additional preferences for the purchase of new and used flats with a view to stimulating a frozen housing market.

Transparent pricing

A major change in mortgage lending was caused by the regulation taking effect on April 1, 2012, providing that mortgage loans can only be granted at a fixed interest rate or an interest rate pegged to a benchmark rate and no interest-type fee or cost may be charged over and above the interest on the loan. (Any non-regular fee or charge payable in addition to interest may only be increased to the extent of the Central Statistical Office's consumer price index).

In the case of fixed interest rates, the interest rate is fixed for a period of three, five or ten years and the new interest rate must be published at least ninety days prior to the end of the interest period. In the case of benchmark-pegged rates, the benchmark rate is the BUBOR or the yield on government bonds for HUF loans and the international benchmark rates (LIBOR, EURIBOR) for FX loans.

Customers had the option to request the conversion of their loans into one of the transparent pricing models until August 31.

2.2 Corporate banking, corporate lending

Corporate and SME lending

The volume index of investments continued to decline in 2012. In the first three quarters of 2012, the volume of investments was down 5.2% from the base period. Overdraft facilities continue to play an increasingly important role in corporate lending: companies mainly borrow to finance their working capital needs and daily expenses, borrowing for investment projects is less significant. The investment-to-GDP ratio dropped from 22.5% in 2008 to 16% in 2012.

The deterioration of the quality of the SME loan portfolio continued in 2012. According to PSZÁF's statistics, only 60% of the loans are repaid on time and the NPL rate is more than 22% (in June 2011 it was "only" 17%). Small businesses are in the worst situation: their NPL rate is close to 29%.

Agricultural lending

An important development in 2012 was the submission for public debate of the new Land Act. The Association expressed its view that the new law would make the financing of agricultural producers more difficult and increase credit risks.

Another important development in 2012 was the review of the proposed amendments to the Act on Public Warehousing. Although this Act is far from being comprehensive, the proposed introduction of warehousing collateral, the definition of high-risk warehousing, the annual output cap on onsite warehousing and the preference of electronic protection, the better definition of warehouse liability and the involvement of the Public Warehousing Authority in possession protection procedures are forward-looking improvements.

Late payments to subcontractors

Since the beginning of the crisis, construction fell by 16 percent in the EU and by 42 percent in Hungary. Home construction dropped by 70 percent: the number of new homes built was only a quarter of the desirable 40,000 in 2012. Renovations show a similar proportion, with 100,000 renovated homes against the optimum 400,000. The number of those employed in construction declined from 280,000 at the beginning of the crisis to 110,000 in 2012. Late payments to subcontractors rose to an unprecedented level of HUF 400 billion.

After a nearly two-year long drafting process, the draft law on reducing late payments to subcontractors may now be presented to Parliament. The Association supported the Economic Ministry's work by regularly reviewing and commenting on the proposals, in particular, in respect of the issue of bank guarantees and the role of the proposed Performance Certification Authority.

Municipal lending – consolidation of municipalities with less than 5000 inhabitants

In 2012, the government recast the laws regulating the day-to-day operations of municipalities and the provisions ensuring the performance of their functions and the framework for their financing was also changed. As a first step, the government sought to consolidate municipal debts related to day-to-day operations and development projects previously not funded by the state.

To achieve this, based on Act CLXXXVII of 2012, the state provided a one-time non-refundable aid to municipalities with less than 5000 inhabitants and the multi-purpose micro-regional associations of these municipalities, as a repayment support for their debts to financial institutions outstanding as of December 12, 2012. The consolidation extended to the full stock of debts (capital, delinquent capital, delinquent interest) and the related interest charges, calculated as of December 28, 2012.

The scope of costs subject to consolidation was defined based on the relevant consultations between the government and the Hungarian Banking Association. Calculated at December 27, 2012 exchange rates, the state assumed debts of 1,710 municipalities to a total value of HUF 74 billion, arising from 3,848 contracts.

2.3 Financial Transaction Levy, taxation issues

Financial Transaction Levy

A major government measure affecting banks in 2012 was the drafting of legislation on a financial transaction levy, to be imposed from 2013. The government announced its plan to impose this new tax in early April. As opposed to the EU concept, where the tax is mainly aimed at investment products, the proposed financial transaction levy was designed to be imposed on payments, at a rate of 0.1%, with no cap. The initial concept was later changed as a result of the relevant consultations and certain macroeconomic developments. The government's revenue expectations from the levy were also changed. Finally, the revenue estimate in the 2013 Budget Act was set at HUF 301 million, of which, taking into account the effect of subsequent amendments, HUF 260 billion is expected to be collected from the banking sector,

The negotiations with the financial government on the proposed tax started in May with a meeting between the responsible State Secretary of the Ministry for National Economy and the Association's Board, followed by a meeting between the State Secretary and the Association's four-member negotiating team, also attended by PSZÁF and the MNB. As a result of the negotiations, a tax cap of HUF 6,000 was achieved and the scope of the tax was amended to exclude payment transactions related to lending and investment services, interbank transactions, and partially, cash-pools.

The Act on Financial Transaction Levy was passed by Parliament on July 9, 2012. Due to ambiguities in the legal text, a working group set up from payment and legal specialists from member banks drafted specific text proposals to be included in the legislation. Several of our proposals were accepted and the legislation (taking effect on January 1, 2013) was amended twice at the end of 2012.

The real change under these amendments was not the technical adjustments needed from banking points of view, but the revocation (as a result of international pressure) of the levy on certain central bank transactions and the ensuing doubling of the levy rates to make up for the missing budget revenue (including an outstandingly high levy rate on cash transactions, aimed at curbing cash payments). As a result, the general levy rate was raised from 0.1% to 0.2% and that for cash transactions from 0.2% to 0.3%¹. It was also announced that the exemption of securities and investment transactions will cease once the EU Directive on a Financial Transaction Tax is adopted, after which the EU legislation will apply.

An achievement at the beginning of 2013 was the reduction of the data contents of the monthly tax returns on the financial transaction levy. At the same time, the Tax Authority has indicated that for inspection and tax revenue planning purposes, they will need more information than that contained in the monthly tax returns, hence, banks should expect a gradual increase in the data to be reported.

Foreign Account Tax Compliance Act (FATCA) developments

¹ The HUF 6000 cap remained.

The Foreign Account Tax Compliance Act, adopted in the USA in 2011, requires foreign banks to check if the customer is a U.S. national, and report, once a year, details of their American customers to the IRS for tax purposes, or deduct a 30% withholding tax from customers refusing to consent to such reporting. Should a foreign bank fail to comply, the tax will be deducted from the U.S. source funds paid to them.

Since sovereign states cannot allow entities within their jurisdiction to report to or withhold tax for a foreign tax authority, major EU member states have approached the U.S. administration to enter into bilateral agreements, under which they undertake to adopt the U.S. requirements in national legislation, requiring banks to report the details required by the FATCA not to the U.S., but to their own national tax authorities. In this way, banks will be relieved from the withholding obligation, while customer identification and reporting will be done according to the usual anti-money laundering and other relevant procedures.

Compliance with the U.S. Foreign Account Tax Compliance Act is a challenge for Hungarian banks as well, as a number of the FATCA's provisions conflict with Hungarian laws. At the same time, it is important for Hungarian banks to be able to comply with the FATCA, with the minimum possible burdens. To achieve this, we proposed to the Ministry for National Economy that the responsible Hungarian government agencies initiate a bilateral agreement with the U.S. Treasury and the IRS for Hungary to become an FATCA Partner, as other EU member states have done.

We conducted several consultations with specialists from member banks and worked closely with the Ministry for National Economy on the issue. Also, we put together a proposal for the aspects to be taken into account in the inter-governmental agreement and had a meeting with the responsible staff at the U.S. Embassy. We will continue to inform members on FATCA-related developments on an ongoing basis.

Other taxation issues

Most of the questions raised were related to the FX debtor rescue schemes and the relevant regulatory changes, including the deduction from the bank tax of losses arising from early repayments initiated in 2011 but carried out in fiscal year 2012, the bank tax refund for debt cancellations related to 90+ days delinquent foreign currency loans, and the rules related to the tax refund due in 2012 under the Growth Pact set out in the agreement concluded with the government in December 2011.

During the implementation of the new regulations, it became clear that the legislation on bank tax had to be corrected. Accordingly, we submitted to the Ministry of Economy a set of amendment proposals, most of which were incorporated in the law.

Issue addressed by the Association's Taxation Working Group in 2012 included the regulations regarding establishing the customer's VAT category, the year-end tax certificates for private individuals, the treatment of nationality certificates, tax reporting requirements, the taxation rules related to 3-5 year savings contracts with regard to partial redemptions at the end of the third year, the handling of preliminary pension savings accounts, and the VAT on bank cards.

In relation to international treaties on the avoidance of double taxation, we submitted to the Ministry for National Economy a proposal for aspects to be taken account in these treaties: we proposed that local trade tax, an important items for businesses, should be included in these

treaties. Also, in relation to the taxation of interest income, we proposed, for practical reasons, that interest income should not be subject to withholding tax in the source country.

2.4 Payments

Intraday settlements system (Intergiro 2 – IG2)

The intraday settlements system went live on July 2, 2012. As opposed to the T+1-day execution time in the previous system, electronic payment instructions in the new system are executed on the same day. Thus, the customer receives the money one day earlier. While this is major improvement for the customers, it means increased tasks for banks in liquidity management.

The new system has a long-term significance. In the inter-bank space, credit transfers are executed according to the SEPA standards. The SEPA payment schemes are becoming increasingly common in the EU and will be mandatory in the eurozone from 2014. The SEPA payment schemes are based on the new ISO 2022 UNIFI global message standards, with special rules for use in SEPA). From the banks' point of view, this means that when the euro is introduced in Hungary, only the currency type will have to be changed.

The adoption of the SEPA standards is a significant change also for corporate customers: by connecting their internal systems to the banks' systems according to the Hungarian Credit Transfer scheme's standards, developed for domestic payments based on the SEPA standards, companies can make payments automatically, without any manual intervention. Here, again, transition to the euro will only require minor adjustments to the systems. The SEPA standards also allow for more data to be included in the messages.

The intraday settlements system was implemented after several years of preparations, under a national project. Participants in the project included the MNB, GIRO and the banks. The project involved the implementation of major development projects at GIRO and at the banks.

The Association's staff members actively supported the implementation of the project in the project steering committee and working groups.

Before the July 2 go-live of the intraday settlements system, the MNB sent us for review a draft amendment to its decree on payments. Since the proposal affected the system of intraday settlements to be launched within weeks, at the request of members, the Association expressed its disapproval of the timing of the proposed amendments and asked that those amendments not directly related to the system be postponed. During the consultations, we managed to ensure that only those amendments absolutely necessary and not jeopardising the go-live of IG2 and those helping the execution of payment instructions for the benefit of customers are introduced with immediate effect and the implementation date for changes not related to IG2 is extended by six months.

Basic payment accounts

In implementing the relevant EU recommendation, the Association received a request from the Ministry for National Economy to introduce a basic payment account facility within the framework of a self-regulation. Accordingly, our working group drafted a recommendation and the Association's Board issued Recommendation No. 1/2012 on basic retail payment accounts.

Rather than creating a new bank account facility, the Recommendation is aimed at identifying those bank account products that meet the criteria of a basic payment account. The list of basic payment account products offered by those banks and savings cooperatives that have adopted the Recommendation is displayed on our website. With all major banks signing up, basic accounts are now available nationwide.

It should be noted that there have been several bank account facilities cheaper than the basic payment account, including those with a zero fee, but these have been subject to regular income transfer to the account. Since, according to the EU recommendation, such a condition cannot be set for a basic payment account, the basic payment account is "only" cheap, but not free. (With the introduction of the financial transaction levy, zero-fee accounts have diminished).

In relation to the recommendation, we reiterated to the government our view that an effective measure to promote the use of bank accounts and thus, "whiten" the economy would be the mandatory transfer of salaries and social benefits to bank accounts.

A total of 21,250 basic bank accounts have been opened since the issue of the Recommendation.

Bank cards

2012 saw several developments in the bank card market. In the wake of Malév suspending operations on February 3, 2013, it was the first time for a chargeback process to take place en masse. Under this process, customers purchasing their tickets by bank card could reclaim the full ticket price. According to estimates, about one-third of the 750,000 affected passengers purchased their tickets by bank card. The Association, together with specialists from member banks, promptly developed a uniform process to allow fast and coordinated administration. PSZÁF expressed its appreciation to the Association and its members for their consumer protection attitude. At the same time, there is a still ongoing settlement dispute between travel agencies and accepting banks over who is responsible for the refund: in accordance with their relevant contracts with the travel agencies, banks have passed on the refund to the travel agencies, who are disputing the legality of this move, but have not launched any legal action.

In technology, chip migration has been essentially completed. Those banks not commencing migration in the past months have also agreed on the timetable. In the case of most banks, the only constraint to full migration is the expiry/renewal dates of the cards. (The migration of ATMs and POS-terminals was completed long ago).

New technologies are gaining ground in the market. An increasing number of banks are introducing contactless cards, one Hungarian bank has fully migrated its plastic cards to the contactless technology. On the issuer side, VISA joined the contactless cards business in the second half of the year.

In relation to bank card frauds, the Association is regularly drawing attention to the fact that the fraud rate in Hungary is very low by European and global comparison, not least thanks to the sms control service, which can be regarded as a Hungarian invention. The Association deems it important to act against advices for the customer to cancel the sms control service to mitigate the increase in banking costs. According to statistics, most frauds are concentrated on the "card not present" (on line) transactions. Hence, at the joint initiative of several working groups of the Association, we issued a communication before Christmas, drawing attention to the dangers and providing practical advice on how to make online purchases safer.

A press report in December revealed that VISA had approached the Ministry for National Economy, threatening to pull out of the Hungary because of lower interchange fees. Experts are of the view that it was its own commitment that pushed VISA into a disadvantageous position in the Hungarian market. At the Ministry's request, the MNB made a proposal for the regulation of interchange fees, based on its previous study undertaken jointly with the Competition Authority and its regulatory package updated in the spring, without consultations with banks. Currently, it appears that the IC fee regulation and the MNB regulatory package are inconsistent in a number of elements, which, according to the Cards Working Group, is a major concern. We made steps to get our professional arguments to the drafters of the legislation.

2.5 Bank security

The Association wrote a letter to the Minister of Interior to correct the provisions on remote alarm services regarding false alarm under the Act on personal and property security (Act CXXXIII of 2005). In June, the Ministry initiated a consultation on the issue. As a result of this consultation, the legislation was appropriately amended.

The Hungarian branches of two international crime organisations specialising in ATM looting were eliminated in 2012.

3. REGULATORY CHANGES, GOVERNMENT AND AUTHORITY MEASURES

In addition to the above mentioned regulatory measures aimed at helping debtors with foreign currency loans, several other regulations, authority measures and court working documents, fundamentally affecting the operations of banks were issued in 2012.

New Civil Code

Parliament passed the new Civil Code on February 11, 2013. The new Code is the product of 15 years of consultations and drafting. The Association and its members have been actively involved in the process (reviewing the proposals, participating in the various working committees, attending consultations, presentations and forums, etc.). In the previous Parliamentary cycle, Parliament passed Act CXX of 2009 on the Civil Code. As a result of a resolution adopted by the new Parliament in the spring of 2010, this Act did not enter into force. Then, the Codification Committee revised the draft law, which was subsequently amended in several points.

The new Civil Code covers the full range of civil law relations and will determine the development of business law for a long time. The Code contains regulation in eight books on nearly four-hundred pages. Family law and company law are also part of the Code.

We managed to have our proposals accepted in many issues during the drafting process. However, there is a number of issues where the solutions adopted are contrary to what we have proposed. These include, for example, the regulation of fiduciary collaterals or the new uniform lien regulations. In contract law, concerns remain regarding the contract types affecting banks. However, since contract law leaves wide scope for deviations, we trust that the application of the new Civil Code will not be detrimental to market players.

The new Civil Code will take effect after a one-year implementation period on March 15, 2014. During this implementation period, the required amendments to related laws and a separate act to provide for transitional provisions shall be adopted.

Supreme Court working document on unilateral contract amendments

In accordance with the relevant provisions of the new act on the organisation of courts, the Chair of the Supreme Court set up an analysis group to examine the case law of courts in judging whether the provisions on the unilateral amendment of contracts, as stipulated in financial institutions' general terms and conditions for consumer loans, are unfair. After several months of work and processing dozens of court decisions, the analysis group issued a working document for review by a wide range of professional organisations. The working document pointed out that a financial institution can stipulate the right to unilaterally amend the contract and such a stipulation in itself is not null and void. The working document analysed in eight points the aspects to be taken into account by courts in judging whether or not a consumer contract is unfair. According to the working document, it is not sufficient for a bank to observe the relevant sector laws, it should also comply with the requirements of fairness and good faith.

We reviewed the Supreme Court's working document with an expert group, and, jointly with fellow organisations (the National Association of Savings Cooperatives, the National Interest Representation Organisation of Savings Cooperatives, the National Association of Financial Firms and the Association of Hungarian Mortgage Banks), provided detailed comments in several rounds. We also attended the discussion day held at the Supreme Court. The working document was adopted with minor modifications at the Supreme Court's Civil College meeting of December 10, 2010.²

Measures related to the implementation of the Bankruptcy Act (Act XLIX of 1991)

In relation to the revised Act taking effect at the beginning of 2012, the Ministry of Justice drafted the relevant implementation decrees. We were actively involved in the review of the proposed decrees, which contain important regulations regarding the management of liquidation proceedings and the enforcement of creditor claims. The decrees in question include the decree on the electronic appointment of liquidators and bankruptcy trustees, the decree on the public sale of debtor assets, the decree on register of liquidators, the decree on electronic sale of debtor assets under liquidation and the decree on decisions to be published in liquidation proceedings.

Interpretation issues related to the legislation on branches of foreign financial institutions

In the wake of the Supreme Court's Legal Unity Decision No. 1/2012, the regulations on financial branches of foreign companies registered in the EEA had to be amended. The legal unity decision

² Civil College Opinion No. 2/2012. (XII. 10.) in the matter of unfairness of the provisions on the unilateral amendment of contracts stipulated in financial institutions' general terms and conditions for consumer loans.

provides that a financial branch of a foreign company registered in the EEA cannot sue nor can be sued in Hungary. This legal unity decision was required because the legal framework and the case law of courts was not consistent on the question whether or not a branch as specified in subsection (3) of Section 24 of the Act on Branches of Foreign-Registered Companies (Act CXXXII of 1997) has legal capacity. Different courts have adopted different decisions on the issue. Pursuant to the Supreme Court's resolution, a branch acts on behalf of its founder, has no legal capacity and may only represent its founder in a lawsuit. This problem adversely affects not only branches of banks, but also branches of insurance companies, payment service providers and investment firms.

Together with the Association of Hungarian Insurance Companies and the National Association of Securities Dealers, we initiated with the Ministry for National Economy an amendment to the legislation. Act CLI of 2012 has amended the legal status of branches of foreign companies by providing that a foreign branch may act in its own name as well as on behalf of its founder. In our view this is questionable both from consumer protection and legal certainty points of view. In a letter to the Ministry for National Economy, we again drew attention to the contradictions between the new provisions. At a meeting with the responsible Deputy State Secretary, we received a promise that the Ministry would once again approach the Ministry of Justice on the issue.

Central Credit Bureau

The Association's Central Credit Bureau project was successfully concluded in the middle of 2012. As a result, in addition to the former negative information, the full credit history of retail customers is now available in the system. This is a major improvement in assessing the customer's creditworthiness.

After achieving the necessary amendments to a hastily adopted Central Credit Bureau legislation, our activities were focused on implementation. The working groups of the project addressed the related business and legal issues, developing recommendations and best practice for users of the system in about 70 issues. Most of the issues were related to obtaining the customer's consent for data inquiries and the adjustment of the data structure to best meet inquiry needs. The next step was the initial upload of the system. The number of loan contracts registered in the system rose from 1.7 million to 8.5 million and the number of customers in the system rose from 0.9 million to 4.8 million. (The corporate database did not change in this respect, since it has been a "full-list" database from the outset).

Both banks and the management of BISZ, the operator of the Central Credit Bureau, found it important to have regular consultations between the service providers and users of the system. Accordingly, the Association set up a Working Group on Central Credit Bureau. At the first meeting of the Working Group, decisions were made regarding an implementation date and method that is acceptable for all parties. The working group also addressed the issue of improving data accuracy and widening the scope of use of credit information obtained from the Central Credit Bureau.

Legislation on APR cap, amendment to the APR Decree

The legislation setting a cap on APR took effect in April 2012. Although there have been laws in place prohibiting usury, the proposed new legislation would have imposed an extremely low,

uniform APR cap of around 30% for all types of loans. The Association explained at all decision-making forums (including the Ministry for National Economy and Parliamentary Committees) that a 30% cap would make most consumer loans impossible, since short-term loans with frequent repayments are by definition assigned a high APR in the relevant EU legislation, consequently, overdrafts, credit cards and consumer loans, which otherwise promote domestic consumption, could be practically eliminated. The legislators took note of our arguments and raised the APR cap for these loan types.

With the revision of the EU APR regulation, the relevant Government Decree also had to be amended. Our comments regarding credit cards and overdrafts were duly taken into account in the amendments.

At a request from member banks', the Association requested the Ministry for National Economy to confirm the interpretation of the relevant provision of the Banking Act that the APR cap must be complied with at the point in time when the loan contract is concluded. The Ministry confirmed that the primary role of the APR was to serve as an information helping the customer to decide, but it was also an objective of the legislation to limit the interests and fees charged by banks, therefore, the cap should be observed during any change in the interest rates or fees during the loan period.

PSZÁF regulations, reporting

PSZÁF orientates banks' operations in a number of areas. In its recommendation on large exposures, it provided prudential requirements for the management of operational risks related to trading activities and on the treatment of underlying risks under the large exposure rules. It conducted consultations on its proposed methodology guide for recovery plans and developed a joint concept with the Ministry for National Economy and the MNB for the treatment of general risk provisions consistent with Basel III. Under an amendment to Government Decree 366/2011 (XII 30) on liquidity coverage requirements for credit institutions and on the maturity mismatch of foreign currency positions of credit institutions, the minimum balance sheet coverage ratio for mortgage banks was reduced from 0.1 to 0.05. In this context, PSZÁF introduced a new reporting requirement from January 1, 2012.

PSZÁF issued several recommendations during the year, including recommendations on general consumer protection principles, complaint handling and debt collection. Here, it is important to note that the Authority also expects consumers to be reasonably informed, attentive and circumspect in making decisions. The Authority issued recommendations on the treatment of consumers with disabilities and on pledge loans, and a guide on online banking security.

Based on the relevant recommendation of the European Banking Authority, PSZÁF issued a decree on reporting requirements on the remuneration of banks' management and staff members.

In addition to the website service aimed to help retail customers in choosing between the various loan and savings products offered by banks, a similar service for bank account products is now available on PSZÁF's website, supported by a new regular report provided by banks.

The Association and specialists from member banks were actively involved in the consultations on the various proposals and reporting requirements of PSZÁF and generally managed to influence the contents of the final regulations.

During the review of the proposed decrees on the various reporting requirements of PSZÁF (and those of the MNB), we pointed out that the reporting requirements imposed an increasingly

heavy burden on the sector. We stressed that a three month implementation period should be allowed for any new reporting requirement. At our request, PSZÁF drafted and provided us with the correlation rules for data tables aimed at improving troubleshooting and transparency of the reports.

MNP proposal on SWAP portfolios

Due to the increase in banks' FX swap portfolios as of end-2011, since the first quarter of 2012 the MNB has been following closely the exchange rate effects and risks resulting from a high swap exposure. In its Financial Stability Report of April 2012, the MNB indicated that a regulation may be needed to mitigate the financial stability risks.

The central bank briefed the Association on its proposal for regulation at the Association's extended Extraordinary Board Meeting at the end of July. Although the issue could be solved by regulation, the MNB would prefer banks to reduce their FX swap portfolios on a voluntary basis by self-regulation. Citing econometric models, the MNB proposes to cap banks' open FX positions at 15% of total assets.

The Association held several meetings with the MNB with the involvement of treasury officers from member banks. During these meetings we challenged the MNB's assessments regarding the mechanisms and the measurement of the underlying processes and the level of the proposed limit. The MNB insisted on its position. To achieve a sector-level self-regulation, the MNB drafted a sample declaration to be voluntarily signed by each bank. Of the proposals made by banks, the draft declaration only contained the 2-year implementation period, the rest of the proposals were not taken into account.

4. COMMUNICATIONS

Main directions and communications channels

The Association continued to conduct active communications in 2012, with regular appearances in the media. In 2012, we had 2,250 media appearances on issues affecting the banking community. The most frequent were our appearances in the online media, in 1,200 instances, followed by the print media, in 670 instances, and the electronic media, in 400 instances. Altogether, we had more than 4,500 appearances and mentions in the media in 2012.

Public and media attention was focused on the following issues:

- A major issue in the first quarter was the management and results of the Early Repayment Scheme.
- The extended and prolonged Exchange Rate Cap Scheme was a key issue throughout the year.
- We received a lot of questions on the problem of debtors with loans delinquent for more than 90 days, the related socio-political measures, the fate of homes designated for forced sale and the launch of the National Asset Management Company and details of the relevant framework.

Additional issues included:

- the regulatory changes regarding the home Protection Programme and subsidised home loans;
- the new regulations on the transparent pricing of loans and on APR;
- in the second quarter, the launch of the intraday settlement system (IG2) and the publication of results of Exchange Rate Cap Scheme II were the focal points in our communications;
- the Financial Transaction Levy and its expected impact on the banking system generated ongoing interest from banks' corporate and retail customers. The Association instantly issued two statements at the end of June and regularly communicated its position and comments on the imposition of this levy. In relation to the financial transaction levy, banks were required to publish the relevant changes in their terms and conditions 60 days in advance. In its communications, the Association made it clear that these actions were necessary due to the regulatory changes. Banks are incorporating the levy in their prices to various extents and with different timetables according to their business policies and in compliance with the relevant laws. Banks' position was reinforced by the communications of PSZÁF pointing out that banks had the right to pass on the levy subject to the relevant conditions.

Based on the decision of the Board, the Association conducted two communications campaigns to promote the Exchange Rate Cap Scheme. A campaign launched in the middle of the summer with press appearances continued with advertisements between November 16 and December 2, followed by targeted articles in the online media. According to the analysis on the campaign, advertisements and articles appeared in more than one million instances, reaching 430,000 individual users. The number of applications for the scheme rose during the campaign: the number of participants in the scheme exceeded 120,000 as of the end of December 2012.

An additional task in communications was to convey the position of banks on the extension of the scheme.

The Association continued its Press Club events during the year, providing the media with regular information on current issues, including the management of the problem of debtors with foreign currency loans, results of the intraday payments system and the publication of our collection of essays on the 25th anniversary of reinstatement of the two-tier banking system in Hungary.

Experience shows that the media now regards the Association and its representatives as real opinion-makers. This new communications relationship helps in getting our messages to the public and reducing the approaches made to members' communications departments.

The Association's website was renewed in terms of both form and contents in 2012, with a new structure helping customers to obtain fast and straightforward information on current issues affecting the Association. The new website was implemented under a comprehensive new corporate identity project, with a new appearance and new features.

Complaint handling, advice

As was the case in the previous the years, we continued to receive a lot of approaches from customers in 2012. A part of these were complaints, mostly from retail customers, seeking solutions to problems such as repayment difficulties or the according to them extremely high and unbearable

able repayment amounts and charges, or a lack of responsiveness or communications from their banks.

Another part of the approaches from customers was requests for assistance in interpreting banking documents or answers, or advice on solving specific problems. Some customers asked for an opportunity to talk to us in person, we did meet some of these requests. A number of customers contacted us with complaints about a lack of response or lack of substantive response from PSZÁF to their complaints. We responded to all complaints received.

Hitelintézeti Szemle (Credit Institutions Review)

The Association's periodical, *Hitelintézeti Szemle*, continued to be published in 2012, renewed in both appearance and contents. Also, we published a special edition of the periodical with essays by doctoral students in banking.

Another important elements in our liaison with members are our quarterly analyses on the world economy, the Hungarian economy and the banking sector, regularly furnished to member banks.

In our external relations, the technical day on banking, held at the Judicial Academy with a highly positive feedback and the cooperation with office of the Ombudsman of Fundamental Rights deserve special mention.

5. INTERNATIONAL REGULATION, INTERNATIONAL RELATIONS

5.1 Prudential regulation and supervision

In 2012, global and European regulators continued to work on tackling the deficiencies that have surfaced during the crisis and on new prudential regulations aimed at implementing the decisions made at the various forums. Below we provide a brief summary of the most important regulatory developments in 2012, addressing separately the global and European landscapes and reviewing the activities of the European Banking Authority and the reactions of the European Banking Federation.³

Global regulation

The two main forums of global financial regulation are the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (BCBS).

The *Financial Stability Boards'* activities in 2012 were focused on implementing the decisions adopted by the G20 summits. In October, the FSB presented a report to the G20 finance ministers and central bank governors on the progress of financial regulatory reforms. The report addressed the following issues: strengthening the oversight and regulation of shadow banking activities, building resilient financial institutions, ending "too big to fail", completing OTC derivatives market reforms, development of a Global Legal Identifier System, addressing data gaps revealed by the financial crisis, enhancing the risk disclosure of major banking institutions, re-

³ Details on the various regulatory developments are provided in the annexes to our quarterly reports.

ducing reliance on credit rating agencies and monitoring the effects of reforms on emerging markets and developing economies.

A major focal point in the **Basel Committee's** operations was the refining and developing the details of capital and liquidity regulations. Although Basel 2.5 significantly raised the capital requirements for trading book items and securitisation, it failed to fully address the shortcomings of the framework.

Therefore, in 2012 the Basel Committee launched a consultation on a **fundamental review of the trading book** regime. The consultation paper sets a new market risk framework, including specific measures to strengthen the capital requirements for trading book exposures. The disappointing performance of securitisations and the central role they played during the financial crisis were a key motivation for the Basel Committee to perform a broader **review of the securitisation framework for regulatory capital requirements**. The Committee's objectives are to make capital requirements more prudent and risk-sensitive, mitigate mechanistic reliance on external credit ratings and reduce current cliff effects in capital requirements.

Although liquidity regulations are a new key element in Basel III, the development of a number of details of the framework was postponed. A major regulatory development in 2012 was the Basel Committee's revised guidance on Liquidity Coverage Ratio (LCR) and liquidity risk monitoring tools (endorsed by the Basel Committee's governing body in January 2013). The revisions to the LCR incorporate amendments to the definition of high-quality liquid assets (HQLA) and net cash outflows. According to the revised timetable, The LCR will be introduced as planned on January 1, 2015, but the minimum requirement will begin at 60%, rising in equal annual steps of 10 percentage points to reach 100% on January 1, 2019.

Another important element in Basel III is the treatment of systemically important financial institutions. After publishing the regulatory framework for G-SIBs in November 2011, the Basel Committee completed the **policy framework for domestic systemically important banks (D-SIBs)**. This allows for appropriate national discretion to accommodate structural characteristics of the domestic financial system. Also within the framework of Basel III, the BCBS published interim rules for the capitalisation of bank exposures to central counterparties (CCPs). These took effect on January 1, 2013.

In addition, the Basel Committee conducted consultations on the following issues:

- Monitoring indicators for intraday liquidity management;
- Supervisory guidance for managing risks associated with the settlement of foreign exchange transactions;
- Principles for effective risk data aggregation and risk reporting; and
- Margin requirements for non-centrally-cleared derivatives.

In addition to standard-setting, the Basel Committee's objective is to ensure **consistent Basel III implementation**. To help implementation, the Basel Committee has agreed to establish a program to assess implementation by its members of Basel III. The assessment programme includes three levels of review: Level 1: ensuring the timely adoption of Basel III, Level 2: ensuring regulatory consistency with Basel III and Level 3: ensuring consistency of risk-weighted asset outcomes. Currently, Level 2 reviews are in progress. The conclusions on the assessment of each jurisdiction will be published on a semi-annual basis (in April and October). The assessments include the scope of application, the definition of capital, minimum capital requirements, the

supervisory review process, disclosure requirements, liquidity standards, leverage ratio, and the application of the rules for D-SIBs.

In October, the Basel Committee published its preliminary assessments on Europe, the USA and Japan. The European Commission questioned a number of the findings of the assessment.

An important step forward in the ***implementation of the Basel III accord in the USA*** was the entry into force of Basel 2.5 effective January 1, 2013 (the adoption of these rules was previously hindered by the domestic legal framework in the USA [the Dodd-Frank Act]). Meanwhile, in a joint press release on November 9, the U.S. regulatory agencies announced the postponement - without a specific date - of the implementation of Basel III, originally also planned to be applied from January 1, 2013. Notwithstanding, the U.S. regulatory agencies emphasized their commitment to the implementation of the Basel accord.

Prudential regulation in the European Union

Capital requirements and liquidity standards: CRR/CRD4

EU prudential regulation in 2012 was focused on CRR/CRD4, implementing the Basel III capital requirements and liquidity standards. Following the publication of the European Commission's proposal in June 2011 and the EP rapporteur's preliminary report of December 2011, in the first half of 2012, the Danish presidency presented a compromise proposal allowing for more national discretions. The CRR/CRD4 failed to be adopted within the originally set timeframe in the first half of the year and no agreement was reached during the Danish presidency, either. Thus, the issue remains a key priority to be addressed by the Irish Presidency in the first half of 2013. The European Committee and Parliament continue to advocate for a Single Rule Book, while the European Council (Single Rule Book) would prefer a more flexible solution leaving more room for member states. As opposed to the Single Rule Book, the Danish presidency's Flexibility Package would have provided member states with more powers to determine the implementation dates, systemic risk buffers and macro-prudential measures.

The rotating Irish presidency in office in the first half of 2013 addresses the trilogue⁴ on the capital requirements framework as a key priority and seeks to conclude the discussion in the first quarter of 2013. The consolidated text proposal now contains the compromises reached during the Cypriot presidency. Agreements favourable for banks were reached regarding the treatment of minority interest and SME lending. The proposals regarding trade finance are also favourable, although they could be further improved, while the proposal on deferred tax instruments definitely needs correction. As regards the EBF's key priority issues, the proposals for the deduction of software from capital and the LGD floor are detrimental to banks. There is no agreement regarding the flexibility package, the Credit Valuation Adjustment (CVA), the prudential filters, the Basel I floor, liquidity reporting and the treatment of exposures to central governments or central banks. The liquidity standards are also pending and will be reviewed based on the BCBS' relevant document.

⁴ Members of the trilogue are: the European Commission, the European Council and the European Parliament.

European Commission proposal for a Directive establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD)

Establishing a crisis management framework for financial institutions, and in particular, banks, has been on the agenda at the global and European levels for several years now. Following the basic document issued by FSB, the European Commission published its proposal for a Directive establishing a framework for the recovery and resolution of credit institutions and investment firms on June 6, 2012. Consistent with the scope of application of the CRD, the proposed Directive would be applied to all credit institutions and investment firms, regardless of size and scope of activities.

The proposed framework aims to provide authorities with an effective common framework for crisis resolution without taxpayer money being used. The ultimate objective is to allow an insolvent credit institution to exit the market without jeopardising financial stability, while minimising the risk of contagion. As opposed to normal insolvency proceedings, a special bank resolution framework would allow authorities to use a set of tools and techniques that take into account the specifics of the bank, thus ensuring the protection of investors and the continuity of the business. Key elements of the proposed resolution framework include Recovery and Resolution Plans (RRPs), early intervention arrangements, resolution authorities, resolution funds. Here, the debt write down tool (bail-in) deserves special mention. The European Commission conducted a technical consultation on this prior to the publication of its proposal for the Directive.

The purpose of debt write-down is to stabilise the financial institution without the need for public bail out.

The European Parliament submitted to ECON more than 1,600 amendment proposals to the proposed Directive. The Irish Presidency published a compromise text proposal in January 2013. The three parties aim to agree on the BRRD before June 2013. Once the BRRD is adopted, a key task will be to develop a Single Resolution Mechanism as a central element of the banking union.

European Banking Union

Concurrently with its proposal for a bank resolution framework, the European Commission issued a memo on the creation of a European banking union. The proposed banking union would rest on four pillars: a single EU supervisor (Single Supervisory Mechanism - SSM), a single European deposit guarantee scheme, a common resolution authority and a common resolution fund and a Single European Rule Book. The first step in establishing the European banking union would be the creation of a single European supervisor. In September, the European Commission published a comprehensive proposal package for the creation of a banking union. The package includes a roadmap for the banking union, a regulation conferring powers to the European Central Bank concerning the prudential supervision of credit institutions and an amendment to the current regulation on the European Banking Authority (EBA). According to the proposal, the European Central Bank will become responsible for the prudential supervision of credit institutions established in the euro zone member states (participating member states). Member states outside the euro zone can also choose to join the Single Supervisory Mechanism (SSM). During the debate, the proposal was changed such that the ECB will be the ultimate supervisory authority for all euro-zone banks, however, practical supervision of less significant banks will be exer-

cised by the national authorities. Assigning the decision regarding macro-prudential resilience (originally an SSM competence), to national authorities is against the Single European Rule Book.

The implementation of the SSM was also postponed. The trilogue on the relevant rules commenced before Christmas. Member states would like to agree on the final text in the first quarter of 2013.

Other regulatory developments

Certain regulatory efforts are aimed to prevent the recurrence of large bank failures and the need for governments to bail out large banks by imposing limitations regarding institution size and activities. After steps made in this direction in the U.K. and the U.S. in 2011, the EU put the issue on its agenda. A High-Level Expert Group (HLEG) chaired by Erkki Liikanen, Governor of the Bank of Finland, was formed to look into possible **reforms to the structure of the EU** banking sector. The Liikanen report, published in September, recommends regulatory initiatives in 5 areas:

1. Mandatory separation of proprietary trading activities over a certain threshold,
2. Additional separation of activities conditional on the recovery and resolution plan,
3. Designated bail-in instruments,
4. A review of capital requirements on trading assets and real estate related loans,
5. Strengthening the governance and control of banks.

In addition to the main directions of prudential regulation, the European Commission addressed the regulation of shadow banking (in line with the FSB initiative), the proposed revision of the Financial Conglomerates Directive (FICOD) and proposed amendments to the EU regulation on Credit Rating Agencies (Regulation 1060/2009/EC).

European Banking Authority

In its second full year of operation, the EBA's activities continued to be focused on the priorities set out in its work programme. Pursuant to the relevant EU regulation, the EBA should play a leading role in regulation and in the creation of a Single European Rule Book. In 2012, this mainly meant the development of Binding Technical Standards (BTS⁵) under the new CRD4/CRR framework. (Due to the delay in the adoption of CRR/CRD4, the finalisation of the EBA standards will also be delayed). The EBA conducted **consultations** on proposed **Regulatory Technical Standards** on own funds, Central Counterparty (CCP) risks, Credit Value Adjustment risks, the calculation of Credit Risk Adjustments (CRA⁶) and prudential ratings, and **Implementation**

⁵ Binding Technical Standards (BTS) are important implementation instruments for the proposed Single European Rule Book. They include two types of standards: Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS).

⁶ Credit Risk Adjustments

Technical Standards on large exposures reporting and on data point models related to ITS on supervisory reporting, disclosure for own funds, supervisory reporting requirements for liquidity coverage and stable funding and supervisory reporting requirements for leverage ratio. In addition, the EBA conducted consultations on technical standards on own funds requirements for cooperatives, the assessment of the suitability of members of the management body and key function holders and the application of the capital calculation methods for financial conglomerates. Also, the EBA issued consultation papers on technical standards related to the European Market Infrastructures Regulation (EMIR) and on templates for RRP. It also held a workshop on regulatory reporting standards. The EBA issued guidelines on remuneration benchmarking, the measurement of operational risk under the AMA approach, stressed VaR, IRC⁷ and the assessment of the suitability of members of the management body and key function holders.

At the European Commission's request, the EBA assessed the proposals for the treatment of SMEs in CRR4/CRR and provided comments on the Liikanen High Level Expert Group's proposals on reforming the structure of the European banking sector.

Under its oversight activities, the EBA monitors the risks of European banks and the EU banking system. Accordingly, in 2012, the EBA provided assessments on the recapitalisation of European banks and two reports on the Basel III monitoring exercise. An important task of the EBA is to strengthen and coordinate home/host cooperation within colleges of supervisors.

European Banking Federation (EBF) and IBFed⁸

By definition, the European Banking Federation's lobbying activities are closely related to the global and European legislative processes. The EBF expresses its views in all important consultations and developments affecting the banking sector. The EBF normally participates in the EU consultations directly, but in certain cases it also represents joint opinions with other industry associations within the framework of the European Banking Industry Committee (EBIC). At the global level, the EBF represents the interests of European banks mainly through the IBFed.

In prudential regulation, the EBF's activities in 2012 were focused on the drafting of CRD4/CRR. The EBF set its top ten priorities back at the end of 2011, which it represented consistently in all consultations with the various European institutions. The EBF seized every opportunity to advocate for a Single European Rule Book. It drew attention to the adverse global economic impacts of the inadequate treatment of trade finance and assets held for trading and available for sale. The EBF raised the issue of postponing the regulation. In a press release, the EBF welcomed the decisions regarding a liquidity coverage ratio. To promote CRR/CRD4 implementation, the EBF Banking Supervision Committee set up a Risk Assessment Working Group to review the meth-

⁷ IRC (Incremental risk capital charge): incremental default and migration risk charge

⁸ IBFed: International Banking Federation (Founding members of the IBFed include the American Bankers Association, the Australian Bankers Association, the Canadian Bankers Association, the European Banking Federation and the Japanese Bankers Association. Associate members of the IBFed include the China Banking Association, the Indian Bankers Association, the Korea Federation of Banks, the Association of Russian Banks and the Banking Association of South Africa)

odologies of credit risk measurement and develop proposals to promote the accuracy of risk weighting. The Working Group started off by reviewing the risk weighting of residential mortgage exposures and presented a report on its findings.

The EBF welcomed the creation of a banking union, emphasising that the development of a Single Rule book is a prerequisite for an efficient single supervisory mechanism. In relation to the Bank Recovery and Resolution Directive, the EBF advocates for the highest possible degree of harmonisation. The EBF set up a Task Force to follow the activities of the Liikanen High Level Expert Group and to make proactive efforts to prevent the mandatory separation of trading activities, which would make the universal banking model impossible. The EBF's position on the regulation of shadow banking activities is being developed by a Task Force made up of members from the EBF's Banking Supervision and Financial Markets Committee. In view of the latest regulatory developments, the EBF's SIFI Task force was transformed into a Macro-Prudential Supervision Task Force.

The EBF was actively involved in the Basel Committee's Trading Book Review and its consultations on a D-SIBS framework and provided comments on all consultations of the EU and EBA.

The *IBFed* wrote letter to the Financial Stability Board on the regulatory reform programme coordinated by the FSB, ahead of the G20 summit in Los Cabos. In its letter, the IBFed urged for the creation of effective resolution regimes, expressing its concern that there was a growing tendency for regulation to be produced in silos, which reduces consistency and gives rise to potential harmful interactions. The IBFed also drew attention to the risks in extraterritorial legislation. Furthermore, the IBFed was involved in the BCBS consultations on capital disclosure requirements, principles for the supervision of financial conglomerates, internal audit, and monitoring indicators for intraday liquidity management. The IBFed also gave comments on the FSB consultation on securities lending and repo markets.

5.2 Other regulatory developments

EBF Payments Systems Committee

The EBF Payments Systems Committee addressed several times the EU Regulation setting a SEPA end date. This defines February 1, 2014 as the deadline in the euro area for compliance with the SEPA Credit Transfer and Direct Debit Schemes. In non euro countries, the deadline is November 1, 2016. Hungary is not directly affected, since according to the Regulation, the application of the SEPA schemes is only mandatory if already applied to domestic euro payments. Indirectly, however, this is an important change, given that the most important trading partners of Hungarian businesses will apply the new payment schemes from 2014, consequently, banks in Hungary will have to prepare themselves to manage these new customer needs. The Hungarian SEPA Association, whose members include those Hungarian banks with the largest payment volumes, is addressing the issue as a priority.

Another important issue addressed by the EBF Payment Systems Committee is the revision of the Payments Systems Directive (PSD). The EBF's related work, conducted jointly with the EU authorities is focused on analysing the new operations and trends in the payments emerging since the adoption of the PSD five years ago, and identifying those that should be incorporated in the Directive, mindful of ensuring a level playing and in a way that does not hamper technology development. The Association's Payments Working Group gave its comments on the proposals

to the EBF Payments Systems Committee, pointing out the need to differentiate between the liability rules for bank cards and other electronic payment instruments.

EBF Consumer Affairs Committee

A priority of the EBF Consumer Affairs Committees was the EU review of the proposed mortgage lending Directive. Despite the drawn-out drafting process, the top level trilogue between the lending Directive. Despite the fact that the drafting process has been in process for quite some time, the trilogue at the top EU level between the European Parliament, Committee and Council were still addressing some basic issues (for example, residential vs. home equity loans, existing residential property vs. new home to be built from the loan), the regulations for loan intermediaries, and the extent to which the strong consumer protection provisions may limit responsible lending.

The EBF advocated for the following

- minimising the deviation of the proposed Directive from the well-proven structure and problem handling of the Consumer Credit Directive (CCD),
- bank should not be required to give the reason for rejecting a loan application (because this could open the way for lawsuits and unveil a bank's credit appraisal methods to competitors), and
- banks should not be required to judge which product would be the best for the customer (the responsibility for decision-making should not be taken over from the debtor).

The Directive was not adopted in 2013.

Another key issue on the Committee's agenda is are EU regulations on bank accounts. Although, at the initiative of the EU authorities, European banks have adopted two successful self-regulations (the one on bank account switching and the other one on basic payment accounts), the European Commission is not satisfied with banks' activities in this area. Therefore, it is expected that the EU will adopt a legislation (Directive and/or Regulation) on bank accounts. Since the Hungarian banking community has adopted a successful self-regulation on bank accounts, we should strive to ensure the least possible deviation of the proposed EU regulations from the principles of the already existing self-regulations.

5.3 Participation in operations of the European Banking Federation

The Association was actively involved in the operations of the European Banking Federation, including meetings of the Executive Committee and the various expert committees and working groups. Through this, the banking community received with up-to-date information on proposed decisions affecting the EU banking sector and the EBF's positions on these proposals. The EBF recognised our active involvement and in each case supported our initiatives (e.g., the EU boycott of Iranian banks, or the review of existing and proposed bank taxes in the member states).

5.4 Regional cooperation, contacts with the banking associations of the Visegrád group and Serbia, invitation by the Banking Academy of the National Bank of Ukraine

The Association seeks to establish cooperation in the European Banking Federation with the banking associations of the Czech Republic, Poland and Slovakia. The financial intermediation systems, the structure of the banking sectors and banks' ownership structures are in many respects similar in these countries, hence, it is expedient and useful for these countries to exchange experience and develop common positions, strategies and advocacy positions at the EU level. The proposed Visegrád-type cooperation is aimed to achieve these objectives. We took up the matter with the three countries' banking associations and two full-day meetings took place in Bratislava and Prague.

The development of cooperation under the auspices of the EBF with the Serbian Banking Association, an associate member of the EBF, is also forward-looking. The first meeting took place on March 8 and 9 in Belgrade.

At the invitation of the Banking Academy of the National Bank of Ukraine, we held two presentations at the Academy's conference titled "International Competition in the Banking Sector: Theory and Practice" of the Academy of the Ukrainian National Bank.

6. ASSOCIATION LIFE, EVENTS

Changes in the Board and membership

In April, the 2012 General Meeting elected Radován Jelasić (Chairman & CEO, ERSTE Bank) and Heinz Wiedner (CEO, Raiffeisen Bank) as Board Members.

In November 2012, Mihály Patai resigned from his office as president of the Association. His duties were taken over as Acting President by Dániel Gyuris, Vice President. During the year, Tamás Erdei and Dr László Balázs resigned from the Board due to the cessation of their positions as CEOs.

The Chair of the Ethics Committee, Miklós Pulai retired, Dr Ferenc Gerhardt, member of the MNB Monetary Council was elected as new Chair.

25th anniversary of the reinstatement of the two-tier banking sector in Hungary

On the 25th anniversary of the reinstatement of the two-tier banking system in Hungary, the Association published a collection of essays, titled "A Quarter Century of the Hungarian Banking System - Past, Present and Future"). This publication contains 15 essays by bank analysts, economists and associates of the Association. The essays provide a thorough view of the operating environment and key issues of the Hungarian banking sector. We hope that these essays speak not just for the present but also for the future.

On the occasion of this Anniversary, the Association's Golden Beehive Award for Lifetime Achievement was presented at the Association's pre-Christmas dinner to Tamás Erdei, who was president of the Association for the longest-time and former bank leaders who were CEOs of the banks formed on January 1, 1987: Antal Beszédes, Sándor Demján, Oszkár Hegedűs and Dr Pál Kiss.

Foreign Bankers Club

In addition to their involvement in the Association's information flow and participation in the decision-making processes, members of the Foreign Bankers Club gave positive feedback also on the events organised by the Club. Guest presenters at the Club's meetings included the President of PSZÁF, the Economic Ministry's State Secretary and the Deputy Governor of the MNB.

Awards

The Association's new Golden Beehive Award was presented to recipients for the first time at the Association's 2012 General Meeting. The Award was established to recognise those making outstanding contribution to the Association's professional and advocacy work. The recipients in 2012 were:

- István Prágay (GIRO Zrt.)
- Dr Ildikó Szabó (MKB)
- Zoltán Török (Raiffeisen)
- Zoltán Tuboly (OTP)

Following his resignation from the Board, the Golden Beehive Medal was presented to Dr László Balázs for his professional work on the Board.

On the occasion of the 25th anniversary of the two tier banking system several colleagues were awarded who are enlisted above.

New working groups, new office holders

In July 2012, a Data Protection Sub-Working Group was established under the Association's Legal Working Group. The Sub-Working Group is charged with following Hungarian and EU data protection regulations, drafting proposals and developing best practices mindful of the relevant provisions of the Competition Act. The Sub-Working Group is a consultation forum for banks' data protection officers, legal counsels interested in data protection, compliance officers and IT officers. Dr József Baki (FHB) was elected as head of the Sub-Group. At its meetings, the Sub-Working Group addressed issues related to the data protection of agent registers, the need for amendments to the Info Act and the possibilities for developing common data protection procedures for the sector.

New working group heads

1. Bank Security Working Committee: Péter Jakab (re-elected)
2. Human and Physical Security Working Group: György Fialka (re-elected)
3. IT Security Working Group: György Pávlicz (newly elected).