HUNGARIAN BANKING ASSOCIATION

REPORT

on 2014 Activities of the Hungarian Banking Association

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I. Executive summary

The global business environment in 2014 was shaped mainly by the falling raw material prices, the change of orientation in the Fed and ECB monetary policies and geopolitical events (primarily the conflicts in Eastern Ukraine and the Near East). According to the estimates of the International Monetary Fund, the total output of the global economy expanded by 3.3%. While the U.S. economy was improving, growth slowed down further in the European Union due to a sluggish external business environment, a euro which remained strong for most of the year, thus impeding exports, and a persistent decline in corporate lending.

The growth of the Hungarian economy continued last year despite the unfavourable external environment. The gross domestic product increased by 3.6% over the year. Even despite weaker performance on our external markets, export has remained one of the main driving forces of the growth. Internal demand was boosted by capital expenditure and an increase in consumption, stemming from the improving employment and wages from the second half of the year. Inflation decreased strongly, primarily due to a major decline in raw material prices; on average consumer prices dropped by 0.2% since the previous year, and core inflation was 2.2%. The CBH continued cutting the base rate to 2.1% and announced the end of the process in July. The balance indicators continued to be favourable and the deficit of the central sub-system of the budget turned out to be much lower than projected, representing 2.6% of the GDP. Nonetheless, the GDP proportionate national debt (77.3%) could not be reduced.

The situation of the banking sector in 2014 was determined primarily by the decisions on the settlement of retail FX loans, the related expectations and financial losses. Even despite the accrued losses, the overall capital position of the sector continued to be strong (17.3% capital adequacy ratio) with adequate overall liquidity within the system, although there are major differences between specific institutions. The banking system is able to satisfy the account and cash turnover demand. At the same time, the continuing low profitability, mainly due to government measures, the low creditworthy loan demand and the regulatory stress currently hinder banks in fulfilling their role of stimulating real economic growth. (In 2014, the phasing out of FX loans continued in all lending segments, corporate loans stagnated after the elimination of exchange rate effects and the retail loan portfolio declined immensely.) According to pro-forma, unaudited, profit figures, the total banking sector closed 2014 with HUF 369 billion loss, the highest ever in history. (Without the provisions recognised due to settlements, the sector would have booked approximately HUF 230 billion profit.)

The nominal increase in corporate lending is essentially the result of the Funding for Growth Credit Scheme of the CBH. The Monetary Council set the limit of phase II of the scheme, launched on 1 October 2013, at HUF 500 billion, then increased it to HUF 1,000 billion in September and decided to extend the scheme by one year at the end of October. Credit institutions entered into contracts for HUF 584.2 billion (of which almost 97% were new loans) in phase II of the FGS scheme by 31 December 2014.

The state assumed HUF 456 billion debt of 509 municipalities concluding the consolidation of local governments at the beginning of the year, with which it lifted in total more than HUF 1,300 billion debt from the indebted municipalities.

The situation of the banking sector was determined by the events relating to the retail FX loans last year. The most important developments in that context are summarised below:

(1.) The Constitutional Court ruling relating to the Government's submission on FX loan agreements stated that the Constitutional Court pronounced that it had no jurisdiction to directly examine the compliance of contracts or contractual provisions with the Fundamental Law and to, based on this, annul the contract or contractual provision in question. It further said that for the state to amend the contents of a contract, the same conditions must be present as those required for a judicial amendment of the contract. A legislative amendment to the contract must take into account the interests of all parties and seek to strike a balance by taking into account the equitable interests of both parties.

(2) Then Curia's uniformity ruling in June declared the application of different exchange rates and contractual provisions enabling the unilateral amendment unfair if they did not comply with the principles laid down in Opinion No. 2/2012 (XII. 10.) PK of the Curia (the principle of clear and intelligible drafting, the principle of taxonomic definition, the principle of objectivity, the principle of factuality and proportionality, the principle of transparency, the principle of terminability and the principle of symmetry).
The Hungarian Banking Association is of the view that the Curia has gone beyond the legislative intention of the legal uniformity ruling, as did not promote the establishment of unified legal practices through the interpretation of legal provisions, but instead created a new legal norm that, in a number of places, goes in the face of effective legislation. According to the opinion of the HBA, concerning the exchange rate margin, it represented an erroneous professional position that goes against previous decisions or market practices. The civil legal uniformity decision represents retrospective legislation, as it sets out obligations that ignore and go beyond the stipulations of the provisions of the Civil Code and the relevant, sectoral legislation, which must also be applied to previously concluded contracts.

(3) *The Uniformity Act (Act XXXVIII of 2014)*, passed at some unprecedented speed in the wake of the Curia's decision, declares the application of the exchange rate margin unfair retrospectively from May 2004. It also uses the presumption of unfairness in respect of all General Contracting Terms and Conditions that stipulate the option of unilateral contract amendment, in relation to which financial institutions had, in the case of FX loans, 30 days from the effective date to contest such presumption of unfairness in court, in legal actions conducted under civil law. Under the Act, any unfairly settled sums must be reimbursed to the clients based on a separate Settlement Act.
Prior to the promulgation of the Act, the Hungarian Banking Association wrote a letter to the President of Hungary, asking him to rely on his constitutional rights and initiate preliminary normative control. When the Act was passed, the Hungarian Banking Association issued a press statement, explaining that financial institutions had been providing their services in line with the effective legislation at all times, subject to the strict monitoring and approval of the legislator and the banking supervisory authority. The approved Act demands compliance with principles retrospectively for a decade, which have so far not been formulated and published by either the legislator, or the supervisory authorities or the courts. The Act rearranges the private law agreements between banks and their clients in a retrospective manner, and overrides the general, guiding rule of 'lapsing' (the Statute of Limitation), which may have unforeseeable consequences on society.
Most banks filed a lawsuit. However, all litigations were concluded, even at the appellate level, by late November, with banks losing the cases (apart from a few exceptions). Despite banks' requests, only a few proceeding judicial councils made submissions to the

Constitutional Court. Complementing the submission, the Banking Association sent an "amicus curiae" letter to the Constitutional Court, presenting the banking sector's arguments in detail, and compiled a background document to substantiate the constitutional complaints to be filed by banks. In its ruling No. 34/2014. (XI.14.), the Constitutional Court wholly rejected the judges' initiatives. A number of judicial submissions and constitutional law complaints are still waiting to be ruled by the Constitutional Court.

(4) *The Settlement Act (Act XL of 2014)* provides rules for the settlement of FX loans based on the Uniformity Act. It follows from the close interrelation between these two Acts that the Banking Association also considers the Settlement Act unconstitutional and deemed its preliminary constitutional review justified. To achieve this, we wrote a letter to the President of the Republic, requesting him no to sign the Act, with a view to ensuring legal certainty and predictable application of the law. The President of the Republic disregarded the request and the Act took effect on 15 October 2014. (The experts of the Banking Association also prepared a draft to be used for constitutional complaints against the Settlement Act.) The provision of the law according to which overpayments should be recognised as prepayments is a special burden for the sector. Based on the authorisation granted in the Settlement Act, the CBH issued a decree with detailed rules on the settlement to be made with consumers. Experts from banks and the Banking Association were involved in drafting the detailed rules. During the related constructive consultations, the participants sought to ensure that – under the given circumstances and within the given legal framework - the regulation can be implemented with the least difficulties and according to rules ensuring a fair settlement. However, in our view, the chosen settlement method made it impossible to come up with simple and understandable settlement with consumers.

(5) *Act LXXVII of 2014 on the settlement of issues related to the currency conversion of certain consumer loan contracts* (the HUF Conversion Act) defines new contractual terms and conditions for contracts involved in the FX loan settlement process. The Act facilitates the conversion of loans into HUF at the market exchange rates applicable on the dates fixed in the Act (thereby avoiding further losses for the banking sector). Furthermore, it regulates the conditions for the conversion of foreign-currency denominated and foreign currency mortgage loans, the relevant procedures and the conditions under which the consumer may ask for retaining the original currency of the contract. The Act also lays down rules regarding the payment of the new repayment amounts, the applicable interest rates and the rules for review.

(6) *Act LXXVIII of 2014 amending Act CLXII of 2009 on consumer loans and certain related Acts* (the Fair Banking Act) provides new rules regarding consumer information, amendments to the contract, the free-of-charge termination of the contract by the consumer and the shift to the new contractual terms and conditions, in respect of contracts concluded after the entry into force of the Act and, with some limitations, contracts concluded after 1 May 2004. The Fair Banking Act also sets out the rules for unilateral amendments to consumer loan contracts and provides for the rules for changing the interest rates, interest premiums for fixed rate and reference rate loans. The Fair Banking Act amends and complements the Settlement Act in several points and repeals the redundant provisions of the Credit Institutions Act.
The new legislation also called for the revision of the Code of Conduct, which will remain in effect until the end of 2015.

While drafting the Acts, the Ministry of Justice conducted intensive consultations with the Banking Association during the drafting of the latter two Acts. Experts involved in the

consultations submitted proposals to make the Acts clear, intelligible and implementable for both banks and consumers. The short available time and the rather particular evolution of the legislative process (the legislators tried correcting the problems detected during the review of the draft bill, next in the line by including provisions amending previously adopted Acts) were the main factors holding back the consultations. The constantly changing and shaping rules and the extremely short deadlines made the preparation of banks' operating and IT systems extremely difficult.

Apart from the four-component legislative package referred to above, the CBH Decree regulating the maximum payment to income (PTI) ratio and minimum loan to value (LTV) ratio also limits any future increase in retail loans from 1 January 2015.

Apart from the settlement package, the other rule of law of key importance to the sector was the approval of Act on the further development of the institutional system promoting the security of certain actors of the financial intermediary system (Act XXXVII of 2014), generally known as Resolution Act, which aimed at the adaptation of the EU Directive on Bank Recovery and Resolution (BRRD). Both the Directive and the Hungarian law have introduced the bail-in concept, which means the involvement of shareholders and creditors in the resolution, with strong limitation of ownership rights.

The preparation for the full application of the new Civil Code, entering into force on 15 March 2014, was an also important challenge for the sector. The clarification of the regulatory details of the monthly two free of charge cash withdrawals option, the creation of the operational conditions at banks, the drafting of the legislation on the customer statements register and the development of the system at BISZ Zrt. also kept our Association very busy. GIRO Zrt. and, indirectly BISZ Zrt., were acquired by the CBH in the first half of the year. The dissolution of the SEPA Association was postponed to 2015, while preparing the specific criteria of the "bad bank" project initiated by the CBH and the beginning of the transfer of the portfolios will be a task for this year.

The payout of the majority of the funds, previously accumulated in the National Deposit Insurance Fund in relation to the liquidation of savings co-operatives, excluded from integration, was an extremely negative development of the previous year for the banking sector. As the bankruptcies of banks and brokerage firms at the beginning of 2015 exhausted the resources of NDIF and IPF (Investor Protection Fund), these funds are likely to borrow large amounts during the year.

Last year the global regulatory authorities practically concluded their work dedicated to the elimination of the regulatory shortcomings that caused the financial crisis. The main elements of the regulatory reform include building resilience and adaptability of financial institutions, managing systemically significant institutions (resolving the too-big-to-fail problem), transforming the shadow banking system into a transparent system with flexible market-based financing and making derivatives markets safer (provisions of the OTC directives). In 2014, the Financial Stability Board published a consultation document on the total loss bearing capacity, while the Basle Committee on Banking Supervision published reviewed documents on the leverage ratio and liquidity regulation. The Committee regularly reviews the implementation of the Basle III regulation and analyses its impacts. The BCBS revised guidelines on corporate governance pertaining to banks and the simple operational risk measuring methods. It finalised the Net Stable Funding Ratio for long-term liquidity, updated the methodology for assessing and identifying global systemically important banks and,

following a global survey conducted in co-operation with IOSCO, developed criteria for identifying simple, transparent and comparable securitisations.

In the EU legislation was in full gear and a number of long-discussed directives and regulations were adopted prior to the parliamentary elections. To only mention the most important ones: agreements were reached on the Bank Recovery and Resolution Directive, the Single Resolution Mechanism, the Deposit Guarantee Scheme Directive, the Payment Accounts Directive and the Regulation on European Account Preservation Order. Practically the only step has remained for the new parliamentary cycle is the structural reform of the banking sector. The European Banking Federation does not support the European Commission's relevant proposal. The European Banking Authority continued to steam ahead on regulations related to the capital and liquidity framework (CRR/CRD4) and on the standards relating to the Bank Recovery and Resolution Directive. The new bodies of the European Union, established after the elections, defined the capital market union as the new priority in the financial sector.

The European Central Bank continued its intensive work preparing for the Single Supervisory Mechanism and putting in place its organisation, operating rules and staff. It developed rules on supervisory fee payment and sanctioning and published a list of significant credit institutions. A comprehensive review was conducted on the asset quality of the banks transferred under direct ECB supervision and the 2014 annual stress test was also conducted under the control of the European Banking Authority. As planned, the banking union started operation formally on 4 November; the European Central Bank assumed the supervisory tasks of the 120 banks (bank group) qualified earlier as significant in the monetary union. Another important development related to the banking union was the adoption of the direct bank recapitalisation instrument (fiscal backstop) and the development of detailed rules on contributions by banks to the national resolution funds and to the Single Resolution Fund.

II. Macroeconomic outlook, operating environment

In 2014, the global business environment was driven primarily by the falling raw material prices (mainly the major cuts in oil prices), the re-orientation of the monetary policy of the Fed and the ECB (and the consequential devaluation of the euro and the currencies of numerous emerging countries) as well as geopolitical events (primarily the conflicts in Eastern Ukraine and the Near East). According to the estimates of the International Monetary Fund, the output of the global economy in 2014 grew by 3.3%, similarly to the previous year. The GDP of OECD, a block dominated by developed countries, was on average 1.8% up in 2014 from the figure of the previous year. The growth differed significantly between the major economic centres. In the US, the unfavourable business trends of the first quarter were followed by improving performance in the rest of the year. The performance of the emerging countries improved during the year, and then declined and stagnated even despite the incentives of the Chinese government. On the contrary, in the European Union growth decelerated further as a result of the external environment and the euro which remained strong for most of the year, thus impeding exports and a durable decline in corporate lending, and the trend could not be offset even by the weakening of the euro against the dollar in the last quarter of the year. Since Q4 the EU has also faxed the risk of a deflation pressure and the threat of slowdown, also due to the slowdown of the German economy.

In 2013 the Hungarian economy began to grow and the same trend continued in 2014 as well. As for the economy, the external environment was not supportive, with a slow EU economy, uncertainties in the euro zone and geopolitical tensions caused by the Russia-Ukraine conflict. As the Hungarian export capacities expanded recently in segments somewhat less sensitive to economic trends, the weaker expansion of our external markets did not have any major impact on the dynamism of Hungarian exports, which continued to remain one of the main driving forces of economic growth. The internal demand was determined by capital expenditures throughout the year and, owing to improving employment and wages, internal consumption from the second half of the year, contributing to the outstandingly good performance figures of the European Union. The gross domestic product expanded by 3.6% over the year, owing to primarily an increase in the output of agriculture (13% on annual basis) and the motoring industry and related supply branches in industry (5.3% on annual basis). The growth of the construction industry was remarkable (+14%), yet its volume did not have any considerable effect on growth. In terms of consumption, ultimate consumption went up by 1.8%, capital expenditures increased by 14% and overall domestic consumption grew by 4.3%. Exports were up by 8.7%, and imports by 10%.

There was a robust decline in inflation throughout 2014, driven primarily by the major cuts in raw material prices, low food prices, weak external demand and unused capacities in the economy. Consequently, consumer prices fell on average by 0.2% since the previous year. In addition, the core inflation was also down significantly (to 2.2% by the end of the year). The economy still does not show any sign of any inflationary pressure. The low inflation and relative stability of the HUF exchange rate forced the CBH to start a series of interest rate cuts, as a result of which the base rate reached 2.1% in July, when the central bank announced the end of the process. In the wake of the decreasing base rate, the HUF interbank reference rates and banks' HUF deposit and lending rates decreased further.

Although the active state employment policy continued to be a significant factor of the employment market, the rising labour demand of the market sector proved to be the most important factor in the improving dynamism of the second half of the year. On average, the

unemployment rate fell by 2.5 percentage points to 7.7% in 2014. Real wages increased by 3.2% in 2014, contributing to the improvement in the internal consumption indicators.

Hungary's economic indicators continued to be favourable. The preliminary deficit of the central subsystem of general government is reported at HUF 825.7 billion for 2014 (2.6% of the GDP), HUF 325.8 billion lower than the HUF 1,151.5 billion projected. (In 2013 deficit was HUF 932.8 billion.) In addition to the positive impact of growth and higher employment on budget revenues, the lower than expected budget deficit was largely due to a major decrease in interest expenses. The debt-to-GDP could not be reduced in 2014. Within the 77.3% ratio, 2 percentage points related to the variation of the HUF exchange rate since the end of 2013. (The HUF exchange rate weakened significantly in comparison to the major currencies between the end of 2013 and 2014. The euro exchange rate boosted by 6.1% and reached HUF 314.89, the Swiss franc strengthened by 8.2% and reached HUF 261.85, while the exchange rate of the USD rocketed by 20.2% to reach HUF 259.13 by the end of the year owing to the reorientation steps in the Fed monetary policy.) The external equilibrium is clearly improving, as reflected in the Q1-Q3 data of the current account balance. Thus, similarly to 2013, the external financing capacity remained close to 8% of GDP in 2014 too.

The financial position of the banking sector in 2014 were determined by the financial losses incurred in relation to the settlement and the related expectations concerning the transformation of the asset-liabilities structure in relation to other regulatory issues. The overall capital position of the sector remained strong despite the accrued losses (with 17.3% capital adequacy ratio calculated according to the new capital requirement calculation method even after the 2.2 percentage point drop since the previous quarter). The liquidity of the overall banking sector is also sufficient, although there are major differences between the individual institutions. The banking system is able to satisfy the account and cash turnover demand. At the same time, the continuing low profitability, mainly due to government measures, the low creditworthy loan demand and the regulatory stress currently hinder banks in fulfilling their role of stimulating real economic growth.

In 2014, the credit institutions continued the balance sheet adjustment processes of their assets, but it no longer entailed any further contraction of the total assets. The total assets grew by 5.4% since the previous year, where approximately half of the increase was caused by the weakening of the HUF exchange rate against the major currencies. The balance sheet adjustments may be captured primarily in the shrinking of the gross loan portfolio (with 0.5% nominal decline, in which approximately 4.5% is attributable to the volume increasing effect of the weaker exchange rate.) Certain restructuring occurred in the liquid assets: the volume of short-term deposits kept in the central bank increased outstandingly due to the conversion of the two-week central bank bonds into deposits in August and a major increase in the central bank deposit portfolio (by almost HUF 5,000 billion).
While during the year the phasing out of the foreign currency loans continued in all loan segments, the corporate loans stagnated after the elimination of exchange rate effect; within the 3.4% increase, almost 3.2% was attributable to exchange rate. By taking into account that within the overall growth 2.1 percentage points were related to impairment reversed due to the improving asset quality, it is clear that the nominally positive data still reflected unfavourable tendencies. It is important to note that without impairment the volume of corporate HUF loans was up by HUF 105 billion, which figure was significantly lower than the total loans disbursed under the FGS 2 scheme in the same period (according to the available information, nearly HUF 500 billion HUF conversion took place from the beginning of the scheme to the yearend).

The retail loan portfolio declined steeply (nominally by 3.8%, although the data, net of exchange rate effects, indicated a further, approximately 5% decrease) in which recognition of further impairment was a major factor. The increase of HUF loans in certain retail loan segments (personal, home and other loans, including credit cards) during the year, offsetting the nominal shrinking of the respective FX loan portfolio in the latter credit category was a favourable sign.

In 2014, the default ratio was down in all loan segments compared to the end of 2013. The higher ratio of longer than 90 days of delinquency in retail loans was a negative development. It is clear from the data that deterioration occurred primarily among the FX loan debtors, presumably due to the increased moral risk triggered by the settlement process. In the retail segment, 31.1% of the portfolio is delinquent, within which 19.3% of the loans are delinquent for more than 90 days; the respective data are 39% and 23.5% for foreign currency loans. In the corporate sector, payment discipline improved significantly and therefore the ratio of delinquent loans fell from 24.4% at the end of 2013 to 18.6% by the end of 2014.

Since the previous year, the stock of deposits grew significantly, by 7.8%, yet there were some negative changes in the structure of deposits. The primary reason behind the increase was the rise in the short-term deposits of financial intermediaries other than credit institutions. In addition, the stock of corporate deposits was also up significantly, stemming almost exclusively from increasing demand and current account deposits. Presumably, the increase was driven mainly the funds transferred to the sector in the FGS scheme. In addition, the budget deposits and the deposits of non-profit organisations also expanded considerably. At the same time, retail deposits continued to erode (-1.3%), mainly due to the low interest rate environment, the crowding out effect of government debt financing, creating an unlevel playing field, and the competition generated by investment funds. While earlier the stock of corporate deposits equalled approximately 50-60% of the volume of retail deposits, as a result of the processes outlined above the ratio was close to 80% by the end of 2014. By the end of 2014 the net loan-to-deposit ratio of the sector fell by further 8 percentage points from the 107% at the end of 2013. Nonetheless, the indicator is slightly deceiving, because the stock of deposits was dominated by the volatile current account/short-term deposits.

There was a major increase in interbank funds in HUF in 2014. The major factor in this trend was the rise in HUF funds taken from central banks and the Hungarian banks and the volume increase caused by the revaluation of foreign currency stocks due to the weaker HUF exchange rates. The accrual as provisions of the net losses, expected to incur as a result of the settlement, is a major factor in the increase of funds (net HUF +597 billion increase, which explained 35% of the HUF 1,695 billion increment in the funds).

According to pro-forma, unaudited, profit figures, the total banking sector closed 2014 with the highest loss in history. Compared to the highest loss of HUF 243 billion before tax, reported before, the loss incurred in 2014 amounted to HUF 369 billion. Without the provisions recognised in relation to the settlement of retail loans, the sector would have booked approximately HUF 230 billion profit, which suggests that the actual performance of the sector is unlikely to be significantly different from the average return generated by the European banks even considering the outstandingly high tax rates prevailing in Hungary.

III. Corporate lending

Funding for Growth Scheme Phase II

The CBH launched the Funding for Growth Scheme in June 2013 and then decided to extend it. The Monetary Council set the limit of phase II of the scheme, launched on 1 October 2013, at HUF 500 billion to be potentially increased up to HUF 2,000 billion, if required.

Having regard to the favourable impacts of the scheme, the economic and financial processes and the continued buoyant loan demand of small and medium-sized enterprises, on 2 September 2014, the Monetary Council raised the limit for phase II by HUF 500 billion to HUF 1,000 billion. In addition, the Council also decided to extend the final draw-down date for financial leasing and financed EU grant receivables to 30 June 2015 and to keep the end of 2014 contracting deadline unchanged. Then on 29 October 2014, the Monetary Council decided to extend phase II of the Funding for Growth Scheme by one year. The deadline for concluding the loan agreements was shifted from the end of 2014 to the end of 2015 and, as in the current practice, for certain loan objectives there will be further six months for drawing down the loans.

According to CBH statistics, credit institutions entered into contracts for HUF 584.2 billion with almost 14,000 small and medium-sized enterprises in phase II of the FGS scheme by 31 December 2014. Almost 97% of the contracted amount relates to new loans.

Conclusion of the municipality consolidation process

The government had revised the laws regulating the day-to-day operation of municipalities and the provisions required for the performance of their tasks during its former four-year mandate. Apart from the restructuring of the tasks of the municipalities, the conditions of their operation and the mode of their financing have also changed. As a major step, the government sought to consolidate the debts of municipalities that were required to fund their operating and development expenses, previously not funded by the state.

To achieve the above goal, in 2011 the state provided a HUF 189 billion one-time non-refundable aid to county municipalities, funding the repayment of their debts towards financial institutions. In 2012 it was followed by the consolidation of municipalities of settlements with less than 5,000 inhabitants, affecting 1,720 municipalities and 10 micro-regional associations of municipalities, to a total value of HUF 85 billion. In mid-2013, the government partly assumed (40-70%) the debts of municipalities of settlements with more than 5,000 inhabitants, affecting 279 municipalities and HUF 614.4 billion.

To conclude the debt consolidation process, pursuant to the Act on the 2014 budget (Act CCXXX of 2013), the government assumed the debts of municipalities and their micro-regional associations to financial institutions, outstanding on 31 December 2013. The consolidation extended to the full debt (capital, delinquent capital) outstanding at the end of 2013 and the related charges (interest, default interest, commitment fee, management fee) until 28 February 2014. In the last phase the state assumed HUF 456 billion debt from 509 municipalities. The above data indicate that the Government lifted in total HUF 1,344.4 billion debt from the indebted municipalities.

During the consolidation process the Hungarian Banking Association was actively involved in the review of the draft legislation and sent proposals assisting implementation to the Ministry for National Economy. The banks made special efforts and duly met their fairly tight statutory data supply obligations in all phases of the debt consolidation process.

IV. Retail lending

Settlement of retail FX mortgage loans

The series of decisions of the Constitutional Court and the Curia concerning the foreign exchange loans and the consequential legislation were the major events affecting the banking sector in 2014. The implementation of the approve acts will determine the activities of the credit institutions in 2015 too. Below we provide a detailed overview of the respective events.

- *Decision of the Constitutional Court concerning foreign currency loans*

The government addressed two questions to the Constitutional Court at the end of 2013. First it asked the Constitutional Court to interpret Paragraph (2) of Article M) of the Fundamental Law as to "*whether or not it can be derived from it directly that a contractual provision applied en masse in a manner causing consumers a unilateral and material disadvantage,* in particular, by assigning the exchange rate risk solely to the customer and giving the creditor a relatively free and wide discretion to raise the interest rates, and the contractual provision on the application of a spread *and the relevant court decision confirming it, and the statutory provision serving as a ground for such provision and court decision are contrary to the Fundamental Law*".
In the second question the government asked the Constitutional Court to interpret "Article II and Paragraph (1) of Article B) of the Fundamental Law in terms of *under what constitutional conditions other than those provided by the Constitution may existing contracts be amended by law*."

The Banking Association's FX litigations working group discussed the government's motion and developed a common position based on previous Constitutional Court rulings.

Paragraph (2) of Article M) of the Fundamental Law provides for the obligation of the state to ensure fair competition and, with a view to consumer protection, to develop and maintain legislation that protects consumer interests, creates an institutional system to act against excessive market power and protects consumers' rights. Pursuant to the Constitutional Court Resolution 8/2014 (III.20.), *failure to meet the legislative, institution management and law applier's obligations provided by the Fundamental Law may ultimately serve as a ground for the Constitutional Court to establish the breach of the Fundamental Law on the ground of the state's failure to fulfil its obligations. However, Paragraph (2) of Article M) of the Fundamental Law does not provide for a constitutional ground to establish the illegality of court decisions.*
The Constitutional Court has no jurisdiction to directly examine the compliance of contracts or contractual provisions with the Fundamental Law and, based on this, to annul the contract or contractual provision in question. The Fundamental Law is not aware of that legal concept, it has no procedure for it, and there are no rules for defining the competent organisation or legal consequences either.

Concerning the amendment of the existing contracts by law, the Constitutional Court concluded that *legislation may, exceptionally,* based on the clausula rebus sic stantibus[1] principle, *amend the contents of a contract entered into before the effective date of such legislation.* For the state to amend the contents of a contract, *the same conditions must be present as those required for a judicial amendment of the contract. In amending the contract by law, the legitimate interests of both parties should be taken into account and a balance of interests under the changed circumstances should be sought.*

- *Civil Uniformity Decision of the Curia*

The Curia published in advance the questions to be assessed under its uniformity procedure. The banking sector developed an opinion on the principle question related to the transparency of conditions serving as a basis for unilateral contract amendments and we submitted a preliminary detailed working document to the Curia's Civil Department.

On 16 June 2014, the Curia published the operative part of its uniformity decision No. 2/2014, taking position on three main issues.

According to the decision, it is not unfair to expect borrowers to assume the risk of unfavourable exchange rate movements. This issue forms part of the main subject matter of the contract, therefore, as a main rule, its unfairness is exempt from assessment.

Contractual provisions enabling the unilateral amendment of a contract are unfair if they do not comply with the principles laid down in the Opinion of the Curia No. 2/2012 (XII. 10.) PK (the principle of clear and intelligible drafting, the principle of taxonomic definition, the principle of objectivity, the principle of factuality and proportionality, the principle of transparency, the principle of terminability and the principle of symmetry). Contractual clauses defining the criteria of unilateral contract amendment are fair if they clearly and intelligibly define how and to what extent changes in the circumstances of the listed causes affect the consumer's payment obligations and if they make it possible to verify the unilateral amendments' compliance with the principles of proportionality, factuality and symmetry.

As for the application of an exchange rate margin, the Curia ruled that it was unfair to apply exchange rates of different currencies as on the opposite side there was no service provided directly to the consumer. The buying and selling rates applied in foreign exchange loan contracts shall be replaced by the official foreign exchange rate of the CBH. (The full text of the uniformity decision was published in the 3 July 2014 edition of the Hungarian Gazette.)

The Association's Board and its Litigations Working Group discussed the uniformity decision in detail on several occasions. In our opinion in this decision that the Curia has gone beyond the legislative intention of the legal uniformity ruling, as did not promote the establishment of unified legal practices through the interpretation of legal provisions, but instead created a new legal norm that, in a number of places, goes in the face of effective legislation. This uniformity decision constitutes retrospective legislation as it ignored the relevant provisions of the Civil Code and sector laws and established obligations beyond their provisions, to also be applied to existing contracts.

- *Uniformity Act (Act XXXVIII of 2014) and related Constitutional Court proceedings*

[1] The principle used for managing fundamental changes in the circumstances

Parliament adopted Act XXXVIII of 2014 on the settlement of certain questions related to the Curia's uniformity ruling on financial institutions' consumer loan contracts based on the motion of the Government on 4 July 2014. During the extremely short period of discussions in Parliament (between 27 June and 4 July), the Association initiated with the Minister for National Economy that the Act should not extend to those who had participated in the Early Repayment Scheme, and expressed its disagreement to overriding the general limitation period rules. Before the promulgation of the Act, the Association turned in a letter to the President of the Republic and requested - unsuccessfully - a constitutional review of the Act. The Act was published in the Hungarian Gazette on 18 July. The scope of the Act extends to foreign currency-denominated loan and financial leasing contracts and similar contracts denominated in HUF. The Act sets a number of obligations for the banks. Banks filed civil lawsuits against the assumption of unfairness, within 30 days from entry into force of the legislation in the case of foreign currency-denominated loan contracts and within 90 to 120 days in the case forint-denominated loan contracts. Foreclosure proceedings are suspended from the date of entry into force of the Act. Apart from some negligible exceptions concerning contractual conditions, in most proceedings the courts rejected the banks' claims.

In the course of consultations with the Ministry of Justice, the Banking Association requested the consideration and offsetting of preferences previously granted to clients. The Litigation Working Group held several meetings dedicated to the interpretation of the law and implementation of the tasks, and also consulted with the implementing chamber and the competent leader of the Chamber of Notaries Public.

Involving renowned constitutional lawyers, the Litigations Working Group prepared an analysis on the constitutional aspects of Act XXXVIII of 2014 to help banks in the drafting of their petitions to overturn the assumption of unfairness of the loan agreements. In the litigations most banks proposed that judges apply for a constitutional review and in fact several constitutional reviews were conducted by the Constitutional Court upon the request of judges. Complementing the constitutional review motions filed by the judges, the Hungarian Banking Association sent an amicus curiae letter to the Constitutional Court, presenting the banking sector's arguments in detail. The letter, together with the professional opinion of the Minister of Justice, was disclosed on the website of the Constitutional Court.

We prepared a submission template for a constitutional complaint, which has been used by some of the banks in their complaints. Three major decisions have been adopted in relation to the complaints and there are hundreds of constitutional complaints in progress. (Hundreds of natural persons filed complaints due to the legislative suspension of lawsuits related to foreign currency loans.) The Constitutional Court rejected, with minority opinions of four judges, the motion of the judges of the Metropolitan Court [Constitutional Court Decision 34/2014. (XI.14.)] and the Metropolitan Court of Appeal [Constitutional Court Decision No. 2/2015. II.2)] and concluded that the Uniformity Act was not contrary to the Fundamental Law. No decisions were made yet on the submissions of the banks when this report was prepared.

- *Settlement Act (Act LX of 2014) (President of the Republic, Constitutional Law complaint)*

The Banking Association submitted several motions for amendment to the party presenting the proposal on the *"Draft bill on rules of settlement and other provisions related to Act XXXVIII of 2014 on the settlement of certain questions related to the Curia's uniformity*

ruling on financial institutions' consumer loan contracts", but unfortunately achieved no result. Following the adoption of the Act, we wrote a letter to the President of the Republic, asking him not to sign the Act but to send it for review by the Constitutional Court. As generally known, it did not happen.

The promulgated Act XL of 2014 complements, amends and corrects the Uniformity Act in numerous points. It extends the scope of the legislation to contracts performed in foreign currency (FX-FX contracts) and provides that contracts concluded after November 2010 should not be a priori presumed to be unfair. In these cases, the CBH may launch an action in the public interest for the declaration of unfairness. The Settlement Act also extended the scope of application of Act XXXVIII of 2014 to loan contracts terminated through early lump sum repayment and contracts terminated through purchase by the National Asset Management Company. In these cases the Act has a priori excluded banks from remedy.
Following the promulgation of the Act, the Banking Association joined the preparatory work on the implementation decrees and sent a letter to the Ministry of Justice concerning certain provisions of the Act that required interpretation or modification.

At its meeting held on 1 December 2014, the Board decided that, irrespective of the fact that the individual banks were preparing their own submissions, the Banking Association should prepare a preliminary submission draft on the constitutional problems of the Settlement Act and related legal regulations and to share the completed constitutional complaint draft with its member banks.
The completed constitutional complaint presents and objects to

- *the subsequent re-classification by the legislator of any consumer overpayment falling within the scope of the Act as prepayment for contracts concluded or even terminated prior to the entry into force of the Act,*
- *the amendment with a retrospective effect of the rules pertaining to the statutory limitation period,*
- *and to the provision of the Act disregarding the power of the substantive law without any due constitutional reason.* (The Act contained a provision with retrospective effect for legal disputes, previously assessed and effectively closed in a lawsuit.)

The submitted complaint objects to the fact that no legal remedy can be sought while litigation and that only out of court procedures are available in relation to settlement. The submission also disputes the consistency between the provisions of Act XXXVIII of 2014, amended by the Settlement Act and previously not assessed in Constitutional Court decisions and the Fundamental Law.

- *HUF Conversion Act and Fair Banking Act*

While drafting the Acts, the Ministry of Justice conducted intensive consultations with the Banking Association in the course of drafting of both Acts. Experts involved in the consultations submitted proposals to make the Acts clear, intelligible and implementable for both banks and consumers.

Act LXXVII of 2014 *on the settlement of issues related to the currency conversion of certain consumer loan contracts* (the HUF Conversion Act) defines new contractual terms and conditions for contracts involved in the FX loan settlement process. The scope of the Act does not apply to credit cards, loan contracts related to payment accounts, subsidised loans or, in relation to the effect of former contracts, loan contacts concluded before 1 May 2004. *The Act facilitates the conversion of loans into HUF covered by it at the market exchange rates*

applicable on fixed dates. It also regulates the conditions of the HUF conversion of foreign-currency denominated and foreign currency mortgage loans, the relevant procedures and the conditions under which the consumer may ask for retaining the original currency of the contract. The Act also lays down rules regarding the payment of new repayment amounts, the applicable interest rates and the rules for review.

Act LXXVIII of 2014 *amending Act CLXII of 2009 on consumer loans and certain related Acts* (the Fair Banking Act) provides new rules regarding consumer information, amendments to the contract, the free-of-charge termination of the contract by the consumer and the shift to the new contractual terms and conditions, in respect of contracts concluded after the entry into force of the Act and, with some limitations, contracts concluded after 1 May 2004. *The Fair Banking Act also sets out the rules for unilateral amendments to consumer loan contracts. Only the interest rate, the interest premium and the fees and charges can be changed unilaterally and detrimentally to consumer, subject to conditions set out in the contract.* The Fair Banking Act amends and complements the Settlement Act in several points and repeals the redundant provisions of the Credit Institutions Act, therefore the Credit Institutions Act now contains only a few remaining provisions applicable to unilateral contract amendments in respect of non-consumer loan contracts.

While the acts were being drafted, the professional working groups of the Banking Association had regular meetings and banking experts also actively joined the consultations held in the Ministry of Justice. The interpretation of certain provisions of the acts has not been completed and in fact Act II of 2015 already amended some acts pertaining to the settlement process.

- *CBH and MNE decrees related to the Settlement Act*

The CBH developed a rather particular structure of decrees to define the detailed rules of the Settlement Act. In the so-called main decree, it regulated the general cases of the settlement process and methodology in a main decree (CBH Decree No. 42/2014 (XI. 7.). Issues causing difficulties during the settlement process are regulated in two further decrees. One regulates the settlement of loans subject to the Exchange Rate Cap Scheme and loans where concessions have been granted to the debtor (CBH Decree No. 54/2014 (XII.10.), the other provides estimate methods for lack of data in the case of liquidation and winding up (CBH Decree No. 55/2014. (XII.10.). The rules for consumer information and stringent consumer protection provisions are included in a third decree (CBH Decree No. 58/2014. (XII.17.). The complexity of the issue is shown by the fact that the main decree had to be amended as early as on 10 December (CBH Decree No. 53/2014. (XII.10.). The Ministry for National Economy issued a separate decree regulating the extension of the term of buffer account loans due to settlement.

In the course of the drafting the settlement methodology and the codification of the consumer information decree, experts of the CBH and the Banking Association held a series of constructive consultations. The participants sought to ensure that, under the given circumstances and within the given legal framework, the new rules are suitable for fair settlement and may be implemented with the least difficulty. However, in our view, due to the chosen settlement method chosen it was not possible to develop a settlement, easily understandable for the customer.

Review of the Code of Conduct on Retail Lending

The various laws and regulations adopted since 2010 have repeatedly overridden a number of provisions of the Code of Conduct on Retail Lending – in particular, those of Chapter III on unilateral contract amendments. To conclude the process, the Fair Banking Act, enacted to protect consumers, regulates this issue on a completely new basis from February 2015, after which the conditions of loan agreements concluded with consumers may be modified unilaterally according to the interest variation and interest premium variation indicators instead of a list of reasons.
The new legislation called for the reconsideration of the future of the Code of Conduct: the revocation of the whole Code was an option but, following consultations with the Ministry for National Economy and the CBH, it was agreed that, in view of its other consumer protection provisions, the Code, updated by abolishing the provisions overridden by the legislation, should remain in force until the end of 2015.

Regulations on income-based repayments (PTI)

The CBH's unit responsible for macroprudential regulation presented to specialists from banks and the Banking Association its concept for the introduction of the Payment-to-Income (PTI) limit and the minimum Loan-to-Value (LTV) ratio in order to replace Government Decree 361/2009 on prudent housing loans.

At the repeated expert and senior-level consultations with the CBH, as well as in letters to the central bank, the banking sector in general supported the regulatory concept yet provided a number of objections to the proposed detailed rules. Most of our objections were related to the negative impacts on lending of the PTI limits (50% for net incomes under HUF 400,000 and 60% for net incomes of and over HUF 400,000) envisaged by the CBH and the cumbersome rules for income certificates, different from banks' current practice. We emphasised that the introduction of this regulation will not achieve its goal without making queries to the Central Credit Information System mandatory. To mitigate the impacts, the Banking Association proposed phased introduction for the PTI limits by product group and the extension of the unnecessarily short implementation deadlines. Except for the relaxation of the rules for income certificates and the making of the queries to the Central Credit Information System mandatory, the CBH did not support the Banking Association's proposals. Even in relation to the Central Credit Information System it explained that although it supported the proposal, it did not have the competence to make the queries mandatory and proposed further consultations with the involvement of the Ministry for National Economy and the Ministry of Justice.

The CBH submitted its draft to the ECB for review, without any substantive changes in the major issues, at the end of May. In its opinion sent in late June, the ECB welcomed the regulatory concept and made no objections to the detailed rules of implementation, either. During the subsequent consultations, the CBH was receptive to our proposals concerning the practical implementation of the regulation, while kept invariably rejecting our theoretical objections to the introduction of the PTI limit.

The CBH Decree was promulgated in September and entered into force on 1 January 2015. As the Government Decree previously regulating the same topic contained parts not only for the correlation between the market value of the real property and vehicle collateral and the

disbursed loan but also further provisions, it stayed in effect even after the relevant parts have been deleted.

Development of a standard lienee statement for property insurance related to home loans (Cooperation with the Association of Hungarian Insurance Companies (MABISZ))

The new Civil Code that became effective on 15 March 2014 prohibits the transfer of ownership, other right, or claim for the purpose of security for a pecuniary claim. This prohibition put a stop to the well-established practice of banks whereby they required the debtor/lienee to take out adequate property insurance on the real estate provided as collateral and to assign the potential insurance compensation to the bank, thereby ensuring that any compensation is spent on the reconstruction of the damaged real estate. This enabled the bank to make sure that any insurance compensation received for claims can be used for the restoration of the damaged real estate. This is an important goal for both creditors and debtors and we needed to find a different tool to achieve it. Since the new Civil Code considers the lien as ultimate universal collateral, the solution was found in the laws regulating the lien. Since pursuant to both the old and the new Civil Code, the pledge also extends to the value replacing the destroyed pledged asset, the lien on the insurance claim is the collateral in this case. Of course, the insurance company should also be informed of any lien established on the insurance claim. For such purposes, we and MABISZ (Association of Hungarian Insurance Companies) jointly developed forms to be used after the entry into force of the new Civil Code. In the forms, the insured party notifies the insurance company of the fact that a particular (creditor) bank has a lien on the insurance claim.
The developed form and the relevant procedure turned out to be effective in practice too.

Housing loan repayment support provided by the employer in the cafeteria system

Many applied for the housing loan repayment support of employers, which is free to the employee and is taxed preferentially for the employer (cafeteria). The employers had to supply data certified by the bank to NAV about it. It was suggested that a special purpose title code should be created to be used by employers transferring money for home loan repayments under the cafeteria system, providing also useful assistance to account managing banks in maintaining their regulatory data supply obligations relating to the cafeteria schemes. In order to introduce the code, the banking community turned to the International Organisation for Standardisation (ISO). ISO added the requested title code to the existing code list, referring to future home related subsidies provided in the framework of the cafeteria system. GIRO Zrt. informed the banks of the introduction of the new title code, which can be used for transfers from January 2015. Based on the title code the payer's bank can collect the total amount of housing contribution granted by the employer in the particular year under the cafeteria system, on which it is required to provide an annual certificate to their account holder employer customer to be able to prove the payments to NAV.

V. Other important regulatory developments affecting the banking sector

Entry into force of the new Civil Code

The new Civil Code (Civil Code) is the fundamental code of the law of obligations, more specifically, the law of contracts, which defines in general the contents of the contracts used by the banks as background regulation. The special rules are laid down in various sectoral

acts, including especially the Act on Credit Institutions, the Act on Consumer Loans and the Act on the Supply of Payment Services. In terms of chronology, the acts containing general provisions are adopted first and are followed by the special, non-general regulations pertaining to a specific area. The entry into force of the new Civil Code turned that order upside down, as the revised background regulations had to be (re)interpreted in view of the existing special regulations. During the codification of the Civil Code, the demand for including new contract types not covered by the old Civil Code yet in the new code occurred very often but, practically justifiably, was prevented by the requirement of making the Civil Code a permanent code with general provisions.

As the primarily dispositive (permitting differences) provisions of the book of the Civil Code dedicated to the law of obligations only offers models for the contents of certain legal relationships, the entry into force of the new code brought important changes in areas which, quite exceptionally in the law of obligations, contain prohibiting rules and which introduced changes to the rights in rem. An example for the first one is the ***prohibition of fiduciary collaterals***, which rendered any collateral null and void that was established for the transfer of ownership, or other right or claim for the purpose of security of a pecuniary claim or on the right to purchase. An important example for the other change, i.e., a change in the right of rem, is the ***new foundation used for a pledge***, whereby the collateral deposit became a type of pledge. As originally no pledge could be established on savings deposits and the rules pertaining to savings deposits have to be applied to payment accounts, the new Civil Code made it impossible to establish a collateral deposit on a payment account as a type of pledge. That called for ***modifications in the Act on the Savings Deposits***, which took place in Act XXV of 2014.

As fiduciary collaterals were prohibited, new mechanisms had to be found to replace the practice for assigning to the creditor the insurance compensation received for any damage in the real property serving as collateral. (For more details on this topic, see the previous point of the report.)

Another important change within the concept of pledge is the ***establishment of the Collateral Register*** (HBNY), which contains declarations on establishing a pledge in a broader sense on assets that cannot be registered (property items, rights etc.). (The encumbrances established on registered assets - real property, ships, aircraft, etc. - are still included in their own respective registers.) The Collateral Register kept by the Chamber of Notaries Public must be a public but not authentic electronic, yet personalised register, in which queries can only be made for lienor and not for pledged assets. The practical experiences of operation definitely call for the modification of the collateral register.

To the extent it was possible, any confrontation between the new Civil Code and the other acts had to be resolved by modifying the latter, because the legislator did not intend to amend the new code shortly after its entry into force; however, according to our information, problems that may be remedied only with the amendment of the Civil Code can also be resolved in 2015.

Bank Resolution Act

At its extraordinary summer session Parliament adopted Act XXXVII of 2014 on the further development of the institutional system promoting the security of certain actors of the financial intermediary system, aiming at the partial transposition of the EU Directive on Bank

Recovery and Resolution (hereinafter: BRRD[2]). The government was unusually fast in transposing the BRRD as only the draft of the BRRD was available at the start of implementation of the Act. The enactment of the Act came even faster than expected by the EU; the BRRD, which was adopted in the meantime, sets 1 January 2015 and 1 January 2016 as the deadlines for transposition of the Directive into national law, whereas the provisions of the Hungarian legislation took effect three and sixty days after the promulgation of the Act.

The Act is a key element of the regulatory response to the financial crisis. It aims to provide a framework for the rescue of troubled financial institutions by restructuring and retaining its operable units and avoiding liquidation with the help of private funding, sparing the state from having to bail-out systematically significant institutions with public funds. The BRRD is aimed to converge and harmonise laws, therefore, it was unclear why the Hungarian legislator had to pre-empt the EU regulation. The cross-border operation of individual credit institutions and groups would have called for the introduction of a global, at least EU-level framework in a coordinated manner.
The BRRD and likewise, the Hungarian law, introduce the bail-in concept, which means the involvement of shareholders and creditors in the resolution, with a strong limitation of ownership right. In other words, the shareholders and creditors of the troubled institution are forced to bear the losses incurred from the write-off of their shares and the conversion of their claims into capital. The resolution should be carried out rapidly, under the rule of law, with judicial control and appropriate legal remedy opportunities. On the state's side, the process is launched and supervised by the resolution authority. In Hungary, the function of resolution authority has been vested in the CBH, further expanding its competences. However, the legislation fails to clearly define the relationship between the various competences of the CBH or the relationship between its various potential measures (ordinary and special supervisory measures, resolution authority measures). In addition, the Act formulates the possibility of imposing a resolution in a broad and uncertain manner.

During the unreasonably short consultation period compared to the importance of this Act, we provided a number of objections regarding the content, the insufficient degree of elaboration and the inconsistencies between the Act and the BRRD. We drew attention to the absence of adequate judicial control and the conflicts of certain CBH powers, but unfortunately our efforts failed.

The Act was tested soon in practice too, when in December the CBH allocated five resolution commissioners to MKB, recently acquired from its Bavarian owner. As MKB is exclusively owned by the Hungarian State, it is unlikely that any shareholder interest infringements will be concluded in relation to the resolution.

Other regulatory changes affecting the money and capital markets

- *Transposition of the amended Deposit Guarantee Scheme Directive (DGSD)*

One of the most important features of the Act amending the Credit Institutions Act, implementing DGSD, is that deposits of certain municipalities operating with low budgets of less than EUR 500,000 will also be covered by the insurance. Contrary to the insurance logic, the new Act also states that such municipality deposits will not be included in the fee payment base. The termination on 3 July 2015, of NDIF protection over bonds and deposit certificates

[2] Bank Recovery and Resolution Directive

issued by banks subsequently is another major change. The Community deposit category, eligible for multiple NDIF protection, will also be abolished: according to the effective regulations, the limit amount of compensation (HUF amount equivalent to EUR 100,000) for deposits placed in community deposit accounts shall be taken into account in the case of condominiums and housing cooperatives separately for each residential unit, and in the case of building societies and school savings associations it shall be taken into account separately for each depositor. The abolishing of this rule brings some simplification and should hence be welcomed, but depositors must be informed of the respective changes, which generate a single administrative burden to the banks. In certain equitable cases, where the deposit originates from the sale of a home, severance pay or insurance, etc., depositors are temporarily (for three months) eligible for higher protection up to EUR 150,000, but the NDIF membership fee is still payable only on the basis of EUR 100,000.

The savings co-operative bankruptcies in 2014 practically depleted the resources of NDIF. In the current interest environment, which is further depressed by the low rate of inflation, it will be even more difficult to offer any attractive deposit interest rate due to the unlikely reduction of NDIF fees even in the long term and expected additional contributions.

In the course of reviewing the legal amendments we proposed that the joint and several liability assumed by the members of the savings co-operative integration for each other as a prerequisite of the group status leading to more favourable capital requirements for them should also be extended to the deposit repayment obligation, whereby in relation to savings co-operative deposits the compensation obligation of NDIF should be preceded by the guarantee obligations of the co-operative institution protection system. Unfortunately, our efforts in this field failed, yet the issue will be kept on the agenda and will be presented in relation to each amendment to the Credit Institutions Act.

- *Amendment to the Capital Market Act*

This amendment package, whose purpose is to improve the regulation of capital markets, is primarily aimed to ensure compliance with the EU regulations on central securities settlements and depositories. Our comments on the package were primarily focused on making the provisions on lien on securities unambiguous and making electronic contracting easier. We also submitted proposals for some minor yet important changes to make the Stability Savings Accounts and the Preliminary Pension Savings Accounts (NYESZ) more attractive. For creditor protection reasons we expressed our objection to the extension of the designation of death beneficiaries to securities accounts and the related customer accounts.

VI. Developments related to the supervisory authority

Other CBH fines for the unilateral amendment of fees and charges by banks

At the beginning of the year the CBH conducted consumer protection investigations to check whether the unilateral changes made by market players to their fees, commissions and charges were in line with the relevant laws. After the almost HUF 1.2 billion consumer protection fines imposed in March on 35 financial institutions for unlawful changes, in April the CBH imposed a further HUF 71.75 million fine on additional ten financial institutions for the same reasons. Institutions found in breach were required to also refund the illegally collected fees. One of the typical reasons for these fines was that previously free, 0 forint transactions were

made payable which, according to the CBH, meant the introduction of a new fee, which is prohibited. This position of the CBH is contrary to an earlier position statement of HFSA, but because the CBH is not the legal successor of HFSA, it does not consider HFSA position statement binding. The lack of legal continuity between the HFSA and the CBH has already been observed in other matters.

Establishing reference rates

To implement the reform of reference rates (BUBOR, BIRS, HUFONIA) set under the sponsorship of the Hungarian Forex Association (MFT), proposed by the HFSA and the CBH in 2013 H1, negotiations on a cooperation agreement were launched between MFT, the Hungarian Banking Association and the authorities involved. The parties (CBH, the Hungarian Banking Association and the Hungarian Forex Association) signed the agreement in the first week of June. In accordance with the agreement, the Hungarian Forex Association set up a Rate-Setting Committee, into which the CBH and the Association delegated members. The Committee had its first meeting in July. Since its establishment, it has developed its rules of procedure, elected its chairman, modified the BUBOR regulation and began developing a code of conduct for rate setting. Relying on the statistical analysis of CBH experts, the Committee analysed the rates set in 2014 in terms of potential manipulation and did not find any indication of manipulation.

Consultations on the "bad bank"

The idea of setting up a "bad bank" collecting bad loans was mentioned for the first time by the CBH in its Financial Stability Report for May 2014, as part of its measures to help banks clean up their corporate loan portfolios. The central bank intends to establish the new asset management company to help banks reduce their non-performing (steadily) commercial real estate loan portfolios and the banking system get rid of its bad loans. In late summer, the CBH's competent Deputy Governor initiated consultations with the Banking Association on details of the respective bad loans portfolio and the operation of the asset management agency. At its extraordinary meeting in September the Banking Association's Board agreed to set up a high-level working group for the consultations on the issue.

The CBH founded the envisaged company i.e., MARK Magyar Reorganizációs és Követeléskezelő Zrt. with some delay, in early November, then consultations began among the HLWG of the Banking Association, the competent experts of the CBH and MARK's leaders and specialists.

As a result of several months of preparatory project work, in December the CBH and MARK Zrt. presented to the representatives of the Banking Association the following proposals for the tasks and operation of MARK Zrt.:

- The claims/assets will be purchased on market basis, with solutions based on business decisions between equal partners.
- The bank receivables and assets to be transferred by way of assignment or acquisition of assets will be defined specifically. (It is likely that only Hungarian real estate or loans secured by Hungarian real estate will be purchased by MARK.)
- The take-over may take place in two ways (an accelerated process or under a normal schedule), but the details of these procedures are yet to be developed.
- According to the initial concept if the real estate loan is part of a bigger service package offered by a bank group, the claim assignment will not affect the other

products (e.g., guarantees) and services (e.g., account management) included the package. The relevant details are yet to be clarified.
- In developing the programme, the requirements set out by EU institutions should also be taken into account.

The representatives of CBH, MARK and the Banking Association established a joint expert group which began its work in the second week of January 2015.

CBH decrees, recommendations, communications

In 2014, the CBH used various instruments (decree, recommendation, communications) to regulate the operation of the banking sector. Some of those, including the new CBH decree on complaint handling and the recommendation on the internal lines of defence intended to update former HFSA regulations. The rest were transitional or detailed rules promoting the application of the capital requirement regulations (CRR/CRD4) including a decree on the rules promoting the phased application of CRR, the decree on the rules relating to the discounted value of performance remuneration, the recommendation on the liquidity outflow relating to retail deposits, and the communication on the national options and discretions included in the CRR.

CBH Consumer Protection Booklets (Financial Navigator Booklets)

The CBH Financial Consumer Protection Centre produces thematic booklets on 40 topics related to finance, investments and self-provision to be published gradually in 2014 and in 2015. We have the opportunity to review and comment on the contents of the booklets before publication. The first booklets were dedicated to the risk of indebtedness, the question of what to do in case of payment difficulties, and issues related to complaint handling and were followed on booklets with information on card payments.

Extension of the CBH data supply: changes in regular data supplies and extraordinary reports

The fundamentally changed capital requirements regulations and relating significantly revised data supply obligations was a major challenge to the European banking community, including also Hungarian credit institutions, in 2014. Preparations were greatly impeded by the delay of the European Commission in the issue of the technical regulations assisting implementation. Thus the CBH was also in delay with making the decisions required at national level (the merger of HFSA-CBH in October 2013 and the organisational restructuring within the institution were further factors contributing to the delay). Credit institutions had very little time to study the new regulations and make complex modifications involving IT developments. Consequently, the Banking Association formed an expert group, involving also members of staff of the CBH to cover the methodology issues of the new regulations and to facilitate standard implementation of the new COREP and FINREP data supply obligations.
Our Association also turned to the central bank and submitted proposals and remarks on numerous other issues concerning other data supplies (e.g., new data supply plans for 2015) and requested guidelines from the central bank on several occasions (including the new statutory provisions on disclosure) as well as urged for the adoption of the national decisions. Upon the initiative of our member banks, we also acted in relation to extraordinary data supplies order in special resolutions (CAX, P55, report relating to the Resolution Act, DMM)

and intervened successfully in order to have sufficient time for preparations for the new reports and to extend the originally set deadlines.

VII. Payments

Acquisition of the GIRO and establishment of its Consultation Board

Having acquired the holdings of the former majority owner commercial banks, the CBH gradually became the single owner of GIRO Rt. by H1 2014. The acquisition of the central bank was motivated by three goals:

- to promote the reduction the fees payable by clients,
- to improve the efficiency of payment turnover developments, and
- to nationalise that fundamental infrastructure.

When acquiring the shares of GIRO Zrt., the CBH undertook to consult all strategic issues relating to GIRO with the commercial banks. The Consultation Board within GIRO was intended to be a discussion forum of strategic issues for representatives of the CBH, GIRO, and senior payments specialists of commercial banks and the Hungarian State Treasury (MÁK).
At its meetings, the Consultation Board discussed and approved the new short and long-term strategy of GIRO Zrt. with a major modification of omitting the transfer of collection items (direct debit, regulatory transfer) from the IG1 system to the IG2 system among the short-term plans. The Board of the Banking Association sent a letter to the responsible Deputy Governor of the CBH in order to make that change. The letter recognised the importance of the development referred to by GIRO and stressed that in 2015 the banks will concentrate primarily on the successful implementation of the Acts of Settlement and on HUF Conversion, which will require so much resources that may pose a risk to the implementation of any other development. The CBH accepted the arguments of the Banking Association and agreed to put back the transition project on the agenda only at a later time.

The CLS project

At the request of the CBH, the Banking Association is actively involved in the *CLS*[3] *programme*, originally planned to be concluded in April 2015. The programme is aimed to connect the *forint* as a foreign exchange currency to the Continuous Linked Settlement System operated by CLS Bank in order to eliminate the settlement risks of foreign exchange deals of Hungarian banks. The CLS system manages FX transactions in 17 currencies, based on the *payment-versus-payment* (PvP) principle. The system settles the transactions through multilateral netting finally and irrevocably.

The Banking Association actively took part in the joining process and in all phases of the programme (commitment, due diligence, implementation); it was also actively involved in the implementation of events, consultations, workshops and questionnaire-based surveys. However, following the uniformity decision of the Curia on FX loans and in order to successfully complete the programme, the Banking Association requested the CBH to extend the deadline of completion to the beginning of 2016. To justify the request, it explained that the compensation of foreign currency debtors for the exchange rate margin and interest rate

[3]Continuous Linked Settlement

increase as well as the HUF conversion of the loan portfolio had a major impact on the foreign exchange position and transaction turnover of a large number of its member banks, overriding their business plans. The individual projects were due to start and the implementation phase also had to be launched in the CLS programme during the same period. Having considered the arguments of the Banking Association and bearing in mind the importance of the successful completion of the CLS programme, the CBH Financial Stability Board postponed the target date of connecting the forint to the CLS system as 30 November 2015.

KELER WARP project

WARP (*Wide Application Order Routing Platform*) is KELER's innovation in the Hungarian capital market in 2014. It is an order processing and transaction management system supporting the distribution and settlement of investment units. It has been implemented in order to provide an effective tool for actors involved in the distribution of investment units by making their work processes simpler and more secure. The system's services extend from the registration of the distributors' orders to the posting of the settlement to KELER's account management system, also including the preparation of the distribution and settlement reports, balance inquiries, and automatic fee calculation for fund managers. The professional consultations required for the successful implementation of the project took place with the participation of the affected member banks under the co-ordination of the Banking Association.

Third Party Providers (TPP) in the payment chain

Some of our members noticed that while performing an on-line banking service, a third party (Third Party Service Provider; TPP) cut into the payment chain in the course of their customers' web store payments by submitting payment orders. (E.g., SOFORT.) Services provided by Third Party Service Providers are not considered payment services under the currently effective payment regulations. At the same time, the statutory requirement of *non-sharing of the customer's security identifiers with any third party* in the relationship between the account managing payment service provider and the customer is compromised, and *the liability issues* related to risks that may arise during performance *are currently not addressed, either*. The regulators have already addressed the issue of appearance of TPPs, which are likely to be resolved in the currently amended Payments Services Directive. As the amended Directive has not yet entered into force, the Banking Association sent a letter to the CBH requesting some guidance for the good banking payment practice relating to TPPs.

In response, the CBH issued a communication in cooperation with the National Consumer Protection Authority (NFH), drawing attention to the risks in TPP services, with a view of raising consumer awareness and protecting consumer rights in online payments. The communication states that the new service entails significant security risks for the consumer in terms of abuse of customer data, the unauthorised acquisition of which may cause significant losses to the consumer. By sharing online banking security codes with a third party, customers may violate banks' security requirement of not sharing secret information. The communication also stresses that currently the activities of Third Party Service Providers are not considered payment services and therefore are not subject to supervision by the CBH in terms of consumer protection. The issuers of the communication are looking forward to the revision of the Payment Services Directive with the introduction of appropriate and clear

security requirements and consumer protection rules to eliminate the risks related to TPP services.

Latest news on Bank cards

- *Regulated IC fees*

With an amendment to the Payment Services Act (Act LXXXV of 2009), the regulation of interchange fees (IC fees) for domestic bank card transactions took effect on 1 January 2014. This caps the interbank interchange fees for debit and credit cards at 0.2 and 0.3 percent, respectively. This regulation is unprecedented in Europe in terms of both extent and introduction date, since the European Parliament had not yet adopted the relevant Directive envisaging similar rates by the end of 2014 and proposes an implementation period of at least one year.
The subjects of the Hungarian regulation (the Payment Services Act) are payment service providers, but it is the card associations, doing the settlements that can technically apply the IC fees. Accordingly, in January 2014 the Hungarian Banking Association officially approached both major card companies. The replies ascertained the application and adequate implementation of the provisions of the legislation.

- *Reduction of the Financial Transaction Levy on bank card payments*

The banking community advocated for the reduction of the Financial Transaction Levy on bank card payments on a continuous basis in 2014, since it adversely affects the broad and intensive use of this advanced payment method. In January 2015 the amended regulation entered into force according to which, instead of the amounts concerned, the levy should be based on the total payments made with the same bank card in the particular year, as a result of which the levy is likely to decrease. Pursuant to the new regulation, the FTL on bank card transactions of the cards in circulation will be an annual lump sum of HUF 800, or HUF 500 for contactless cards.

After the draft bill was published on Parliament's website, the experts of the Banking Association requested numerous clarifications (e.g., interpretation of "the same card", management of unused card, etc.) and the bank card working group, in co-operation with the tax and payments working group, proposed several modifications, some of which were actually recognised. In addition, the competent MNE promised to issue position statements to clarify those questions which are not adequately clear in the legislation.

- *Central customer statements register related to the monthly two free of charge cash withdrawals option*

Pursuant to an amendment to the Act on Payments, by providing a statement consumers may apply for the monthly two free of charge cash withdrawals option up to HUF 150,000. Although the option of monthly two free cash withdrawals has been available to customers since February 2014, the statutory deadline for establishing the related customer statements register (aimed to prevent ineligible withdrawals) was December. The Banking Association organised numerous, broadly attended consultations for BISZ Zrt., responsible for the establishment and management of the system, and for its member banks. At the consultations, BISZ presented in detail the timetable for the development of the system, the status of authority permits, the developments required in its own company and at the banks, the

contents of the contracts to be concluded and the relevant process of implementation. Following successful initial population and testing in the autumn of 2014, the system went live on 1 December 2014. The system was also able to provide a consolidated report by then, clearly showing the payment account lawfully used by the customer for the free of charge cash withdrawals and any account usage that was subsequently deemed ineligible.
The Banking Association assisted the adequate operation of the registration system with numerous legal initiatives, successfully achieving the following:

- extension of the deadline of reporting the declarations into the system,
- no need for registering account changes within the bank which would increase the probability of errors, as reporting the account number was also omitted, and
- elaboration of the requirements for the content and format of the declaration with which a customer may replace in the new bank the declaration designating a bank account, made in the old bank.

According to the experiences so far, the registration system operates without any relevant complaint.

- *Conclusion and evaluation of the POS deployment project in Fejér County*

In 2013, the Central Bank of Hungary initiated a subsidised scheme for the deployment of POS terminals in order to promote bank card payments. The programme was financed by MasterCard and implemented with the involvement of VISA Europe, the Hungarian Banking Association and six institutions providing card acquiring services (BB, Erste, K&H, OTP, Six Payment Services and Takarékbank). The project was actively supported by the Fejér Country Chamber of Commerce and Industry. Merchants and service providers in Fejér County were able to receive the POS terminals for accepting cards and can use them under preferential terms.

Payment service providers involved in the project approached thousands of merchants with favourable offers. The card acquiring providers deployed 114 POS terminals at merchants in Fejér County. Nearly half of the POS terminals are used by merchants with less than HUF 10 million revenues. According to estimates, the growth rate in POS terminals in Fejér County during the deployment period was double the national average. The project generated moderate results and thus the institutions participating in the project agree that the above experiences should be used to further explore the motives of the various players and public policy measures that may contribute to promoting the card acceptance among retailers.

- *Launch of a contest for the Hungarian term to be used for "contactless bank cards"*

According to the data published by the CBH, the contactless bank cards continued to spread intensively in Hungary in 2014 both in terms of the number of plastics and the number of POS terminals, suitable for contactless payments. A large number of market players in Hungary offer contactless payment solutions. Both card companies have introduced the technology in their day-to-day practice (MasterCard PayPass, Visa PayWave). Hungary has a podium place in this innovative payment technology in Europe. However, there is no Hungarian technical or popular term for the contactless technology yet.

The Hungarian Banking Association launched a contest to find simple, intelligible and technically proper terms in two categories: one for the *bank cards* and one for the *payment method*. The general public was very responsive, with 3,000 proposals submitted in 1,270

entries. The award ceremony, combined with a press conference, was held on 4 November 2014. The jury included representatives from the Central Bank of Hungary, the two large card companies (MasterCard, Visa) and the Hungarian Banking Association. Observance of the linguistic aspects and rules and the aspects of colloquial and professional use were ensured by a linguistic expert from the Hungarian Academy of Sciences and an economic journalist. The Jury ruled that the winner for the term for the card was "érintőkártya" (**touch card**), while the winner for the method was the term "érintés" (**touch**).

Revision of the self-regulation on basic payment accounts, BPA and bank switching statistics

The Board issued its Recommendation for the self-regulation on basic payment accounts in 2012, in line with the relevant EU Recommendation. Due to regulatory changes, the Recommendation had to be revised, in particular with regard to the capped fee. It was also time to review the services related to BPAs, since the monthly two free of charge cash withdrawals, including from ATMs owned by other banks, rendered pointless the monthly one free of charge cash withdrawal from the bank's own ATM or a branch stated as one of the services associated with the BPA. Accordingly, instead of the previous 1%, we set the maximum fee for a BPA at 1.1% of the gross annualised minimum wage at all times. This only appears to be a fee increase though, since with fee discounts subject to certain conditions of account usage that can be easily met, the actual payable fee is in fact much lower.

Based on data from member banks, 46,700 basic payment accounts were opened by clients in 2014, including 1,400 accounts opened by non-Hungarian EU citizens. This figure is lower than the respective figure of 2013. (60,400 BPAs were opened, of which 1.600 by non-Hungarian EU citizens.)
Under the simplified bank account switching procedure also introduced under the Banking Association's self-regulation 3,400 customers initiated switching in 2014, of which 1,800 cases were successfully completed. These figures are also lower than those of the former year.

Consultations on a new banknote series, introduction of the new HUF 10,000 banknote

The CBH announced its plan to introduce a new banknote series, starting with the issued new HUF 10,000 note. Although the rate of counterfeit banknotes in circulation was low, the CBH says that this quiet period should be used to issue a banknote series with much stronger security features. The issue of the new banknotes will require significant development, organisation, education and communication efforts from all players involved, including the banks, therefore the CBH held several consultations to prepare and coordinate the tasks. The new HUF 10,000 banknote was successfully introduced on 1 December 2014, and consultations are still in progress with the involvement of the Banking Association on the distribution of further elements of the banknote series.

Recommendation concerning the security of online payments

At the CBH's request, the Banking Association informed its members involved in payments on the future expectations regarding the security of online payments. The SecuRe Pay Forum, established by the European System of Central Banks (ESCB) and the European Banking Authority (EBA) in 2011 developed 14 recommendations for online payments, including criteria for evaluating compliance with them. The payment service providers of the member

states must comply with the recommendations from 1 February 2015. The EBA published its final guidance based on these recommendations in October 2014.
The CBH will inspect compliance of the Hungarian payment service providers with the recommendation in February 2015 with a self-control questionnaire and during the on-site payment inspections.

SEPA[4] developments

2014 was a year of changes for SEPA both in Hungary and in a pan-European sense. It was the first year when interbank co-operation with SEPA was managed by the Hungarian Banking Association following a decision on the wind off (dissolution) of the Hungarian SEPA Association (MSE). The agreement between the dissolved MSE and HBA clearly defined the tasks and activities that were transferred to the HBA for continuity. Consequently, a SEPA Working Committee and its managing body, the Steering Committee as well as the three functional working groups, dedicated to the *SEPA Payment Schemes (Methods)* (SPS), the development of a standard *XML account statement* and the professional and co-ordination tasks of joining various SEPA payment models of the National Adherence Support Organisation (NASO)[5] were established within the Hungarian Banking Association. The SPSM working group regularly monitored the activities of the similar working group of the European Payments Council (EPC[6]) and contributed with its remarks to the development of version 8.0 of the transfer model and the re-call message for the prevention of transfer fraud. The solution for the special treatment of home loan repayment support available within the *Cafeteria* system was an important practical achievement of the working group. The working group dedicated to the account statement standard completed its discussions and consultations by the end of the year and began to put in place the conditions required for publishing the standard with the involvement of the HBA and GIRO Zrt. On the one hand, NASO supported the EPC registration activity and, on the other hand, it was involved in the process of joining of new Hungarian participants (CBH, HST). The SEPA Working Committee secretariat also provided continuous support for the dissolution of MSE.

The SEPA Working Committee managed international relations and was represented at the EPC plenary sessions and at the regional SEPA meeting. In relation to the former, it needs to be stressed that 2014 was the year of renewal and the decisions required for it to EPC as well, as the SEPA End-Date Regulation (260/2012/EC) created a new situation for the payment service providers operating in the Euro zone countries by making SEPA (ISO 20022) standards obligatory in transfers and collections from 1 February 2014. In the course of 2014, the EPC designed and implemented changes in content organisation and financing, which also affects directly each Hungarian payment service provider who is a member of any SEPA payment model from 2015. Through our EPC representative our association was guaranteed to have access to any information that was required for the respective Hungarian institutions to be represented adequately in the bodies of the new EPC organisation. Our regional co-operation with Austria, the Czech Republic and Slovakia also contributed to the attainment of the same goal.

Transformation of the European Payments Council (new EPC)

[4] Single Euro Payments Area Single Euro Payments Area
[5] National Adherence Support Group
[6] European Payments Council

Fundamental changes have occurred in the payment services since the start of the new millennium. The EPC fulfilled its basic mission by developing transfer and collection payment models and the challenges relating to SEPA marked a new phase in development. All these called for the restructuring of the EPC organisation, which took effect in January 2015. Pursuant to the Charter, the ***New EPC*** governance and work structure is modular and is financed accordingly. The role of the plenary meeting will be taken over by the **General Assembly** (GA), EPC plenary members – including the Hungarian Banking Association - will automatically become members of the General Assembly. The General Assembly will elect the Board for both modules. The NEW EPC membership entailed 10,000 €/year membership fee.
The payment schemes under Module1 (SCT, SDD, SDD-B2B schemes) form an independent unit with their managing body, the Scheme Management Board (SMB). Each payment service provider taking part in the various models at the time of the decision will automatically become Module1 members. In future, membership in each scheme will entail 230 €/year membership fee.
Module2 will be managed by the Board. It was agreed that the former working groups (e.g. the *Cash Expert Working Group* and the *Payment Security Support Group*) would be (partially) revived. In addition, new working groups will be established to mirror the working groups operating in the Euro Retail Payments Board-ban (ERPB[7]). Two working groups were created: a working group dedicated to mobile payments between natural persons and another working group dedicated to mobile and card-based contactless payments.

The Charter allows each country to acquire seats in coalitions in the two independent management bodies. The Hungarian Banking Association acquired a seat in the **SMB** in coalition with *Italy, San Marino and Croatia* and a seat on the **Board** in coalition with the *Czech Republic and Slovakia*. The coalitions will appoint their representatives on a rotational basis, in accordance with coalition rules to be drawn up in accordance with the relevant provisions of the Charter.

The Hungarian SEPA community received information about the transformation plans of the European Payments Council directly from ***Etienne Goosse***, when the EPC secretary general gave a lecture at the Hungarian Banking Association.

Bitcoin

Bitcoin is a new, unconventional instrument that can serve as a payment instrument, investment instrument, cash and account money. Its appearance has been made possible by the spread of information technology and the Internet and the widespread use of devices with Internet access. The Internet is not just a potential banking communication and distribution channel but can also enable access to certain financial and payment services by bypassing banks. Bitcoin makes not only banks but conventional money circumventable, moreover, dispensable: it allows an extremely cheap value transfer, which can eradicate financial exclusion and replace expensive money transfer services used for example by homeless people, refugees and migrant workers to send money home. However, as an investment instrument, it may be very risky, and therefore both the ECB and the CBH issued

[7] Euro Retail Payments Board: a body established by the European Central Bank to promote SEPA dialogue between stakeholders on the demand and supply sides relating to the SEPA process and to identify and address strategic issues and manage their implementation. It is made up of representatives of the stakeholders from the demand side (consumers, SMEs, large companies) and the supply side (banks, payment service providers and e-money issuers). Furthermore, representatives of the central banks from the Euro zone and non-euro area also attend the ERPB meetings on a rotational basis as well as of the European Commission as observers.

communications with an alert about the risks associated with bitcoin. Bitcoin could also be suitable for financing prohibited transactions, although experts believe that such transactions can be monitored and prevented with adequate methods.

VIII. Taxation, accounting

Major taxation issues in 2014

During the year, several consultations were held in the taxation working group of the Banking Association on current taxation issues, partly to assist our members in the application of the law. The following main topics were discussed:

- At the beginning of the year, we were looking for a standard procedure as a solution for the transfer of Long-Term Investment Accounts (TBSZ). Specialists from the Association of Investment Service Providers were also involved in the consultations.
- With the involvement of experts of business areas, our Association also joined the preparations for a decree assisting preferential employer subsidised loan repayments in the form of a cafeteria service, launched in 2014, with several consultations and draft legislative texts, submitted to the competent ministry.
- In the first part of the year we requested a position statement from the Ministry regarding the record keeping and documentation requirements in establishing the arm's length price in the context of the Funding for Growth Scheme. (This issue is relevant in relation to transactions between a credit institution and its affiliated enterprises engaged in financial leasing.)
- After the parliamentary elections in the spring we assumed that a package of amendments to tax laws was being drafted and therefore we submitted our respective proposals to the Ministry for National Economy. We also requested extending the rule on tax exemption for debt forgiveness to claims arising from financial leasing contracts, and that the preferential employer subsidised loan repayments could also be applied to loans taken from financial enterprises. We also highlighted practical issues related to provision incorporated in the 2014 VAT legislation in relation to services provided on an ongoing basis. The promulgated amended legislation contained several of our proposals.
- On 12 May Parliament passed the Act promulgating the FATCA inter-governmental agreement concluded with the USA and containing the regulatory amendments required for the implementation of the agreement. The Act took effect on 16 July. Our Association held consultations with the competent experts of the MNE and the Tax Authority on the issues concerning certain provisions of the Act and the underlying inter-governmental as well as the NAV (Tax Authority) forms to be used by banks for the purpose of FATCA reporting.
- The Association also proposed abolishing the financial transaction levy on cash withdrawals under the monthly two free of charge cash withdrawals option, as tax imposed on a free of charge service was unacceptable to us. In addition, we also requested the amendment of the rules on the financial transaction levy on securities and derivative deals as, according to European declarations, it became increasingly obvious that a European FTL would soon be applied to the same products. In relation to the measures combating the shadow economy, we pointed out that preference should be given to cashless payment methods and proposed abolishing the financial transaction levy charged on bank card payments.

- The implementation of the Uniformity Act (Act XXXVIII of 2014) also brought up numerous taxation and accounting issues, hence we prepared proposals for the Draft Bill submitted to Parliament. Our Association expressed its opinion whereby it would not be a fair solution that the law does not permit the respective tax settlement for all relevant tax types for the retrospective adjustment period of ten years, but allows for offsetting against the corporation tax retrospectively only for five years. This provision is not competition neutral either, as it limits the amount of refundable tax and in the case of loss-making institutions it may protract actual financial settlements even for decades. In order to ensure compliance with the increased capital requirements, we requested impairment on capital increases recognised by financial institutions in subsidiaries subject to consolidated supervision to be recognised as an expense incurred in business. We also made a proposal for solutions that reduce administration (cancellation of the condition of local adjustment of local taxes). The Association applied to the Ministry for National Economy for position statement due to the uncertainties and the issues representing a tax risk in relation to the promulgated tax laws.
- According to its first version, the Act on Advertisement Tax (Act XXII of 2014) was targeted at companies whose revenues stem from advertising services, but the amendment made in the summer already covered advertising for own benefits, extending the tax liability to a much broader group of taxable persons. As the tasks of performing the tax to liabilities in relation to advertising for own benefit impose substantial administrative burdens even on those businesses which otherwise have no tax liability, we proposed amending the provisions pertaining to advertising for own benefit. Several issues reflecting uncertainties were submitted to the Ministry for National Economy requesting position statements from them in order to facilitate the appropriate interpretation of the law.
- The 2015 tax law package passed by Parliament introduced a new special tax on investment funds and investment fund distributors. However, the legislation fails to provide clear guidance on a number of issues. In consultation with the Association of Hungarian Investment Fund and Asset Management Companies (BAMOSZ), we requested a position statement from the Ministry for National Economy and submitted proposals to make the wording of the legislation more specific, particularly in respect of the definition of the tax base and the tax status of investment funds. The new tax, applicable from 1 January 2015, affects the calculation of the net asset values of investment funds.

Developments concerning the IFRS transfer government programme

The professional programme dedicated to accounting regulations under the control of the Ministry for National Economy in order to make sure that certain companies should also prepare their individual financial statements only according to the International Financial Reporting Standards (IFRS) was continued in 2014. The agenda of the programme included the identification of the companies to be designated, the potential timing and schedule of the change, the management of the required law approximation issues, the translation of the (English) technical literature, not yet fully available in Hungarian, education and training, as well as issues of methodology changes affecting statistical and supervisory aspects.
With regard to the programme launched in 2013, the Banking Association originally requested an optional change for 2015, but the CBH could not accept it. The central bank experts involved in the programme believe that only a mandatory and uniform switch of all credit institutions would be manageable and feasible, in their opinion, from 2017.

At the end of 2014, a government resolution was published on the switch to IFRS programme, defining also the need for several studies and analyses in the first half of 2015 in continuation of the preparations before the final decision can be made. The experts of the Banking Association joined the financial institutional and taxation work groups. The work on defining the regulatory conditions is still in progress.

FX loan settlement and accounting issues of new European standard supervisory views

Our Association had several consultations with external accounting experts/auditors on the IFRS and HAS issues pertaining to the FX Loan Settlement Act. In relation to the accounting of the provisions recognised in 2014, we professionally disputed the application of general rules and therefore made a proposal for modifying the text of the legislation in order to facilitate a uniform treatment, which in the end the competent authority accepted.

For accounting reasons, we also requested an amendment to the CBH Decree on the regulation on any maturity mismatch stemming from FX positions (FX Funding Adequacy Ratio Decree). The CBH FX Funding Adequacy Ratio Decree did not cover the special provisions relating to the settlement of FX loans and therefore they had an adverse impact on the FX Funding Adequacy Ratio. We requested that at least a portion of the amount denominated in foreign exchange arising from the statutory settlement obligation but, according to the accounting regulations, recognised as provisions instead of impairment could be taken into account as an item reducing the FX loans in the same way as impairment during the calculation of the indicator. Instead the CBH offered a solution (central bank swaps) which could not be used by all banks. The central bank did not amend the Decree because the problem occurred only periodically but proposed the application of the general rules, i.e., the completion of a recovery plan as a solution.

The standardisation of the data supply framework of credit institutions reporting within the EU, which focuses on the predominantly important credit institutions of the system, prompted the CBH to introduce new reporting requirements *on non-performing and restructured loans* for all Hungarian credit institutions, with the same level of detail as that provided by the EU methodology. The imposition of the new reporting requirements would also have required the amendment of the relevant Hungarian government decree (Government Decree No. 250/2000 on book-keeping rules of credit institutions), which could not be carried out due to the complexity of the legal framework and the time required for the IT developments. In Q4 2014, we had several discussions on the topic with the experts of the CBH and the Ministry for National Economy. In the end the CBH accepted the arguments of the banking sector and the Decree on the bookkeeping obligations was left unchanged. Instead, the relevant reporting requirements taking effect on 1 January 2015, were revised.

IX. Other Banking Association developments

2014 General Meeting – Awards

The Association held its annual general meeting on 25 April. The meeting was also a festive event marking the 25th Anniversary of the foundation of the Hungarian Banking Association. The meeting was attended by the Minister for National Economy, Mihály Varga, and the CBH's Deputy Governors, Ádám Balog and Ferenc Gerhardt. Marking the Jubilee, the book on the history of banking advocacies in Hungary was presented, while its contents were also displayed on our website and published in a special edition of Credit Institutions' Review.

The general meeting discussed the usual agenda items i.e., approval of the reports on operation and economic activities as well as plans and elected new people for all executive positions. As a result, Mihály Patai, Chairman & CEO of UniCredit Bank was re-elected as President, and András Becsei, CEO of OTP Mortgage Bank, was elected as Vice-President. Members of the Board: Hegedűs Éva (Gránitbank), Jelasity Radovan (Erstebank), Nátrán Roland (Eximbank), Hendrick Scherlinck (K&H Bank) és Zolnai György (Budapest Bank). Henrik Auth was elected as the Chairman of the Ethics Committee.

In 2014 the Golden Beehive award was presented to the following banker colleagues and external partners at the General Meeting:

- Dr Iván Ferencz, Fundamenta-Lakáskassza Zrt.
- Gábor Kiss, Unicredit Bank
- Tamás Kovalovszki, K&H Bank
- Pál Kovács, OTP Bank
- Dr Iván Berár , Police Department District V
- Dr Győző Mészáros, Hungarian Leasing Association

Activities of the working committees and working groups of the Banking Association, not covered in the previous parts of the report

- *Data Protection Working Group*

The Data Protection Working Group continued to have regular meetings in 2014 too, discussing data protection issues of debt management, new types of damage management specified by law (e.g., issues relating to FATCA and the records of two free of charge cash withdrawals a month), internet security problems and matters concerning group level data management.

- *Electronic Channels Working Group*

Electronic payment solutions, such as online banking, contactless payments and mobile payments represent an increasingly popular, expanding and innovative product range in the international, European and Hungarian markets. Netbanking is practically available in all commercial banks. In Hungary the Mobile Wallet system (MobilTárca) was tested until the end of June 2014, and several of our member banks launched their own mobile payment solutions. Mobile wallets and QR code reading make online payments simpler, safer, and thus, presumably, more attractive to customers. The Hungarian Banking Association organised a kick-off workshop on the issue for interested members in July, in cooperation with Mobiltárca Egyesület (Mobile Wallet Association). The workshop was aimed to provide a professional overview, a review of the current market developments and to give an update on the results of the ongoing mobile payments pilot. The workshop also hosted the first meeting of the new Electronic Channels Working Group, re-established in response to interest from our member banks with the approval of the Board. The Working Group's objective is to monitor international trends, evaluate the various technologies and processes, keep track of developments in the Hungarian market and promote sound development of the market.

- *EXIM Sub-Working Group*

In March 2014, the EXIM sub-working group was established with representatives from 20 credit institutions within the framework of the SME working group. The number of

participants increased to 22 by the end of the year. The main purpose of the working group is to create a forum for banking consultations on the products and responsibilities of EXIM Bank, review of market/credit institution needs and the integration into EXIM product development, providing opportunities for all potential partners in a competition neutral manner. As a result of the consultations on the refinancing products, the refinancing agreements were amended reflecting the remarks of credit institutions. The most important changes include the replenishment option for the more than 2-year product and the revolving option for the less than 2-year product.
The EXIM Bank also presented to the sub-working group its product concept for the International Competitiveness Improvement Credit Scheme to be introduced in 2015. During the meetings the EXIM representatives regularly reported on the developments in refinancing of the latest period and give presentations on post-financing, credit guarantees and insurance, focusing especially on the opening of the agent network and the future plans.

- *Human Policy Committee: standardisation of banking trainings*

The Banking Association's Education and Training Working Group was set up in 2013. A key task for the working group is to formulate and set up standard training requirements that can serve as a framework for the basic training of branch employees and new recruits in the banking sector. To achieve this and to assess current practices and expectations for standardisation, the working group conducted a questionnaire based survey, which was evaluated with assistance from the Budapest Bankers' Training Institute. The Working Group decided to develop a proposal for a standard training syllabus for two subjects in a pilot project (for the training of new branch recruits and for training on investment services). The Chairman of the Working Group presented the proposed syllabi at the December Board meeting. The members of the Board had different opinions on the relevance of the continuation of the project hence, in view of the current tasks of the banking sector related to the implementation of the settlement, HUF Conversion and Fair Banking Acts, the Board requested the Secretary-General to submit a proposal for the continuation of the work at a later time.

- *Human and Physical Safety Working Group*

At the beginning of January 2014, an explosion took place in front of a bank branch in Budapest District 13 that *caused severe damage* and also affected two other branches nearby. The Human and Physical Safety Working Group and representatives from the investigation authorities met on the day of the incident to review the circumstances and the protective measures to be taken. On the next day, the secretary general and the chairman of the working group held a press conference. Upon a member bank initiative, we made an offer to the Ministry of Interior to double the HUF 10 million award announced for the provider of lead information on behalf of the banking community but it did not take place. The perpetrator has not been identified despite the fact that the National Investigation Bureau investigated the case intensively.

The *series of demonstrations* launched in the summer of 2013 protesting against the situation of foreign currency loan debtors continued in 2014 too. The objectives and methods of these demonstrations have changed significantly and are now expressly aimed at disrupting the banks' continuous operations and intimidating branch employees. The demonstrators have become more aggressive. The organisers of the demonstrations are using new and increasingly sophisticated methods, abusing the freedom of association. The increasingly

violent tone of the demonstrations is well illustrated by the protest organised on 20 June on the site of the January branch explosion, which ended without any major atrocities due to the exemplary co-operation between the police and the security staff of the branch.

The Banking Association's Human and Physical Safety Working Group *is working together* with the Police on an ongoing basis *to keep the demonstrations under control.* However, we have concluded that the Police has limited options in handling such events. Hence, we wrote a letter to the Minister of Interior, requesting him to initiate legislative measures ensuring that the personal, civil and constitutional rights of bank employees and customers enjoy the same degree of protection as those of the demonstrators but so far no such measures have been implemented. Presumably as a result of the new legislation adopted in relation to retail FX loans, in the second half of the year, the number of demonstrators dropped significantly but they did not fully disappear.

As a result of consultations with the National Police Headquarters, the Banking Association intends to supply *water and shock-resistant mobile phones* to the Police's operation control centres for maintaining contact *in an emergency*. The parties agreed on the rules of the supply and use of these phones and on the text of the related co-operation agreement, but negotiations are still in progress on whether or not the voice traffic of the mobile phones can be recorded.

- *Anti-Money Laundering and Terrorist Financing Working Group*

Both in 2014 and 2015 the main task of the Working Group is to coordinate preparations for the implementation of the Fourth Anti-Money Laundering Directive and for the next Moneyval assessment. Compliance with the continuously changing sanction requirements is also a permanent challenge for banks. The working group elected new executives last year: Ildikó Józsa, MKB Bank's Compliance and AML Director was elected head of the working group for a term of three years, replacing Zsombor Brommer in the post, who continues his career abroad.

- *Workout Committee*

The Workout Committee invited the President of the National Association of Liquidators (FOE), Ferenc Somogyi to give a presentation on the latest amendments to the Bankruptcy Act and the list of liquidators as well as the changes affecting liquidators.
The members of the Workout Committee dealing with retail debt management were involved in the discussions on the implementation regulations of the settlement acts as well as in the discussions held with the representatives of the Chamber of Bailiffs, the Chamber of Notaries Public and the Association of Hungarian Debt Collectors (MAKISZ).
We relied on the findings of the committee in submitting a proposal to the Ministry of Justice on the interpretation of the amendment to the Bankruptcy Act and reduction of the judicial foreclosure fees.

Preparations for attending the European Money Week programme series

The European Money Week is a new programme launched by the European Banking Federation (EBF) to promote financial literacy at national and European level. The objective is to raise awareness of the importance of financial awareness and basic financial knowledge. The programme intends to achieve its aim by consistently drawing on the available experience

sharing it internationally. The participants in the programme will concentrate their actions on financial education during the European Money Week, with a view to boosting public awareness and interest among the general public and stakeholders. The European Money Week will be held annually, in the second week of March. In Hungary The first EMW will be held between 9 and 15 March 2015. The Hungarian Banking Association organised a consultation and workshop on the EMW, attended by banks and major institutional experts, active and experienced in financial education. The Board supported the participation of the HBA in the programme. Éva Hegedűs, member of the Board, undertook to manage the programme. The development, finalisation and coordination of the Hungarian Money Week programme was the responsibility of the task force set up for the purpose. (The Pénz7 (Money Week) event series had been successfully completed by the time this report was prepared.)

Co-operation with the V6 countries

The semi-annual meeting of the banking associations of extended group of Visegrád countries (also including Croatia and Slovenia) was held in Bratislava. The key themes of the meeting included the increasing importance of consumer protection in the EU and its impacts on the banking sectors of the region, new developments related to special bank taxes, competition law changes, changes in the application of competition laws, and the regional impacts of the European Commission's bank structural reform proposals. At the Prague meeting organised in the second half of the year the attending countries held consultations on the typical cross-border activities associated with cybercrime and the available instruments of prevention. In addition, they discussed the extended consumer protection requirements and their impacts on the banking sector, the structural reform proposed by the European Commission and the special bank taxes applied in the region.

Communication

The Hungarian Banking Association had virtually continuous media appearances throughout 2014. The most frequent were our appearances in the online media, in 2,100 instances, followed by the print media, in 1,040 instances, and the electronic media in 770 instances. In total, we had more than 3,900 appearances and mentions in the Hungarian media in 2014. In 2014, the Banking Association informed the representatives of the media regularly in several press club events and other press events as well as in nine official press releases.

Public and media attention was focused on the following:

- The issues of settlement and HUF conversion in relation to consumer loans and their estimated impact on the banking sector;
- Tasks related to the monthly two free of charge cash withdrawals option, which generated a great deal of operation and communication work;
- Fraudulent payment attempts were often covered in the communication;
- The Financial Transaction Levy and its impacts on banking costs also generated regular attention and inquiries.

In terms of the settlement of consumer loans, our Association communicated the views and remarks of the banking sector in four press releases and in a note by the Secretary General, published since the end of July. In our communications, we first drew attention to the dangers and risks in the process. On adoption of the Uniformity Act we emphasised that the Act was unfair to the sector, since credit institutions had always provided their services fully in line with the prevailing legislation at all times and their services have been strictly supervised and

continuously approved by the legislators and by the supervisory authority. Our professional arguments highlighting the contradictions of the process referred to as the "calling to account of banks" were summarised and published in a note by the Secretary-General under the title "Law and Responsibility" on 18 September. On 23 September we spoke out against the government's advertising campaign against banks. On the adoption of the act providing for the detailed rules for settlements, on 29 September we published our position and requested the President of the Republic to submit the legislation to the Constitutional Court for preliminary constitutional review. We communicated banks' coordinated views, comments and position to the Hungarian and international media and the public mainly through press releases, and also via statements of the competent experts.

Owing to the dialogue with economic journalists, the Banking Association was able to communicate its messages to the public broadly, fast and effectively. The high number of media inquiries shows that the Banking Association and its representatives continue to be regarded as key financial opinion-makers.

We continued to receive a lot of approaches from customers seeking assistance or advice in 2014, too. Most requests were related to the HUF conversion and settlement of consumer loans, while many indicated repayment issues and problems. All customer inquiries were answered. Individual cases were forwarded to the banks in question.

ANNEX

INTERNATIONAL DEVELOPMENTS: REGULATION, SUPERVISION

Below is an overview of the most important developments of the previous year in prudential regulation, discussing global and European initiatives separately. Detailed reports on regulatory developments are provided in the annexes to our quarterly reports.

Global regulation

In politics, the global regulation aims are set out at the meetings of the heads of state and governments of the G20 countries. The professional content and details are shaped by the international bodies responsible for global regulations, i.e., the Financial Stability Board (FSB[8]) and the Basel Committee on Banking Supervision (BCBS[9]).

Financial Stability Board

Having reviewed the results achieved in the implementation of the international financial reform programme, the chairman of the Financial Stability Board concluded the following:

1. The job of agreeing on measures to fix the regulatory fault lines that had caused the financial crisis was substantially completed. The international standards were improved and they now contribute to building more resilient financial institutions and more sound markets.
2. The endorsement of the regulatory proposals to handle the Too Big To Fail (TBTF) institutions in the banking sector will be a watershed. The TBTF agreements will play an important role in enabling global systemically important banks (G-SIBs[10]) to be resolved without using public funds or disrupting the broader financial system.
3. In the next phase of financial reform, the FSB will focus on addressing new and constantly evolving risks and vulnerabilities. Many of these risks arise from outside the core of the financial system. The FSB asks for the ongoing support of the G20 in addressing the new risks and, where appropriate, in developing common solutions to promote global financial stability.
4. The support of G20 leaders is also needed to promote an open global financial system based on mutual trust and co-operation**.** Trust stems from consistent implementation of mutually accepted standards with the recognition that each jurisdiction will need to take account of its own circumstances while implementing them.

In its report on the strengthening of supervision, last year the FSB elaborated the tools and methods that are required in order to intensify supervision especially when the capital and liquidity positions of an institution are inadequate. It issued a guideline on the *framework of assessing the risk culture*, highlighting interaction between the supervisory authorities and financial institutions. The FSB set the requirement of *total loss-absorbing capacity* (TLAC[11]) for global systemically important banks; it specifies in detail the liabilities (e.g., instruments and maturities) for meeting the minimum requirement and the external liabilities that are excluded from the TLAC. Similarly, the status report *on the progress in reforming resolution*

[8] Financial Stability Board
[9] Basel Committee on Banking Supervision
[10] Global Systemically Important Banks
[11] Total Loss Absorbing Capacity

regimes and resolution plans for G-SIFIs[12] was prepared in relation to the TBTF problem. The FSB publishes semi-annual reports also *on the reform of the OTC derivative markets.* A working group was established from regulatory experts of the countries with the largest derivatives markets for the cross-border implementation of rules pertaining to OTC derivatives. It also reviewed the jurisdictions' ability to apply and to comply with each other's OTC derivatives market regulatory regimes, addressing the regulations applicable to trade repositories (TRs), central counterparties (CCPs) and exchanges/electronic trading platforms (i.e., infrastructure providers) as well as market operators.

Without aiming at a complete list, the activities of the FSB in 2014 also included the following:

- Publication of a consultative document on methodologies for identifying non-bank non-insurer global systemically important financial institutions,
- Publication of a feasibility study on approaches to aggregate OTC derivatives data,
- Commencement of the review of foreign exchange benchmarks,
- Consultation on foreign exchange benchmarks,
- Consultation on major interest rate benchmarks,
- Comparison of supervisory frameworks and approaches to SIFIs (questionnaire for national supervisory authorities),
- Data Gaps Initiative: Common Data Template for Global Systemically Important Banks,
- Review of reducing excessive dependence on credit rating agencies,
- Remuneration monitoring,
- Global legal entity registration system.

Basel Committee on Banking Supervision

In conclusion of the Basel III regulatory package, the Committee last year:

Revised the document on the calculation of the *leverage ratio.* The Basel Committee monitors banks' data in order to assess whether the 3% is appropriate over a full credit cycle and for different types of business models. Implementation of the leverage ratio requirements has begun with bank-level reporting to national supervisors on the leverage ratio components and proceeded with public disclosure starting in January 2015. The Basel Committee will finalise the requirements in 2017 which will become part of pillar 1 in 2018.

To conclude the work on the *liquidity coverage ratio (LCR*[13]*)*, in January 2014 it published the *"Requirements for LCR-related disclosures" and "Guidance for supervisors on market-based indicators of liquidity"* and introduced the concept of *Restricted Committed Liquidity Facilities (RCLF*[14]*)*, to provide greater use of facilities provided by central banks.

Following the consultations at the beginning of the year, it finalised the *net stable funding ratio (NSFR*[15]*)*, which limits over-reliance on short-term wholesale funding, encourages better allocation of funding risk across all on and off-balance sheet items. It requires banks to maintain a stable funding profile in relation to their activities, thus reducing the likelihood that

[12] Global Systemically Important Financial Institutions: global financial institutions, important to the system
[13] Liquidity Coverage Ratio
[14] Restricted-use committed liquidity facilities
[15] Net Stable Funding Ratio

disruptions to a bank's regular sources of funding will erode its liquidity position in a way that could increase the risk of its failure and potentially lead to broader systemic stress. The NSFR will have to be applied from 1 January 2018.
In December the Basel Committee also launched a consultation on disclosure requirements for the NSFR.

It specifically addressed banks' risk weighting practices and their convergence, the standardised approaches, modelling parameters and assumptions of the internal models.

It reviewed the *disclosure requirements under Pillar 3* to enable market participants to compare the capital adequacy ratios disclosed by the banks and their denominators (risk weighted assets) and to come up with a response to the issues raised in relation to the non-transparency of the internal models.

In co-operation with IOSCO[16], it conducted a survey *on securitisation* and then defined the criteria for "*simple, transparent and comparable (STC [17])" securitisations.* The purpose of the consultative document distributed in December is to assist the financial industry in developing STC securitisation structures and help players involved in the transactions to evaluate the securitisation transactions. (Parallel with the BCBS consultation, the European Banking Authority also conducted consultations on simple, standardised and transparent securitisations.)

The BCBS-IOSCO Joint Forum also published a report on supervisory colleges for financial conglomerates.

It revised the *principles of operation of effective supervisory colleges* in order to take into account the best practices and strengthen their activities, with a view of new developments, such as the activities of crisis management groups (CMG[18]) or the priority of macroprudential requirements.

It published a consultative document on *the review of the standardised approach for measuring operational risk.* Once finalised, the new approach will replace the current non-model-based approaches (the Basic Indicator Approach, the Standardised Approach and the Alternative Standardised Approach), also addressing the weaknesses identified in them. The proposal replaces the gross income by a superior measure, the Business Indicator (BI). It disregards the business line, since it did not prove to be a significant risk indicator, yet a size-based supervisory coefficient was added to the new approach. Concurrently with this proposal, it published another consultative document, reviewing banks' implementation of the 2011 principles for the management of operational risk.

It revised the guideline including principles of corporate governance for banks. Focused on risk awareness in corporate governance, the guideline include thirteen principles: the board's overall responsibility, board qualifications and composition, the board's own structure and practices, senior management, group governance structure, risk management, risk identification, monitoring and controlling, risk communication, compliance, internal audit, compensation, disclosure and transparency, and the role of supervisors.

[16] International Organization of Securities Commissions: the global organisation for securities market supervisors
[17] simple, transparent and comparable
[18] Crisis Management Groups

It also updated the list of global systemically important banks (G-SIBs[19]) based on end-2013 data. G-SIBs will be required to hold additional Common Equity Tier 1 (CET1) capital of between 1% and 2.5% from 2016.

The Committee regularly monitors the progress of implementing Basel II, Basel 2.5 and Basel III in the Committee's member jurisdictions. The seventh status report published in October 2014 is based on information provided by individual member countries, and analyses primarily the consistency of implementation and compliance with the mutually established rules. The report reviews the status of adoption of the risk-based capital standards, the standards for systemically important banks, the leverage ratio and the liquidity coverage ratio.

The Committee also analyses the impacts on the market of the Basel III Accord every six months. On the basis of the data of 2013 year end, in September it published a report for the sixth time presenting how the immediate complex implementation of the rules would shape the capital adequacy and liquidity ratios of the banking system.

In addition to the above, the BCBS published documents on the following topics:

- Adequate management of risks related to money laundering and terrorist financing,
- Revised good practice principles for supervisory colleges,
- A sound capital planning process: fundamental elements,
- Standardised approach for measuring counterparty credit risk exposures,
- Guidance on external audits of banks.
- Capital requirement for bank exposures to central counterparties,
- Standard for measuring and controlling large exposures,
- Supervisory guidelines for identifying and dealing with weak banks.

European regulation

In 2014, European parliamentary elections were held in the EU, as a result of which a new Parliament and Commission entered into office. The elections determined the events of the year; legislation work accelerated before the elections, and then it stopped. Nonetheless, the practical implementation of the banking union and preparations for the single supervisory mechanism progressed steadily and the transition took place as planned.

Banking Union - Developments related to the Single Supervisory Mechanism (SSM[20])

The Regulation on the Single Supervisory Mechanism requires the ECB to report on a quarterly basis to the European Parliament, the Council and the Commission on the progress in implementing the SSM. The reports covered in detail the establishment of the ECB organisations performing supervisory functions and control over it (the Supervisory Board - SB[21], the Steering Committee - SC[22] and the Administrative Board of Review - ABR[23]), the selection and recruitment of employees, the establishment of joint supervisory teams (JST)[24], appointment of co-ordinators and the new regulations and rules of procedure.

[19] global systemically important banks
[20] Single Supervisory Mechanism
[21] Supervisory Board
[22] Steering Committee
[23] Administrative Board of Review
[24] Joint Supervisory Teams

To ensure the separation between monetary policy and supervisory tasks, the ECB set up a Mediation Panel. The rules of procedure pertaining to the operation of the Supervisory Board, the co-operation between the ECB and national authorities and co-operation with the authorities of the non-euro zone banking union member states were laid down in the SSM framework regulation. Within SSM the operational supervision of institutions is carried out by Joint Supervisory Teams (JSTs) based on the processes and procedures of supervision, detailed in the Supervisory Manual. Issues covered in the Supervisory Manual include the risk assessment system, the supervisory review and evaluation process, on-site inspections, supervisory processes and procedures and language policy. The manual is regularly reviewed on the basis of technical experience. The "Guide to Banking Supervision" is the public version of the Supervisory Manual and was published in all 16 official languages of the euro zone. The Supervisory Reporting Manual contains the data supply framework required for supervision, while the regulation on the supervisory fee lays down the method of calculating the total supervisory fee, the supervisory fee payable by individual banks and groups and the annual supervisory fee collection method. The ECB was also authorised to impose sanctions on the supervised institutions.

The ECB and the competent supervisory authorities jointly agreed on the list of significant credit institutions to be directly supervised by the ECB. The final list was published on 4 September 2014. (The institutions involved were officially notified of the categorisation by the same date.) The decision was made based on banks' year-end 2013 figures. In total of 120 institutions/groups were classified as significant (97 institutions were classified as significant based on their size [total assets exceeding EUR 30 billion], 13 based on their economic significance [total assets exceeding 20% of the home country's GDP, but at least EUR 5 billion], 3 based on their cross-border activity and 7 by virtue of being one of the three largest credit institutions in the member state). The list is reviewed annually.

Prior to the shift to SSM, an asset quality review (AQR[25]) and the stress test were conducted in order to select banks with bad asset quality and inadequate capital adequacy. (The asset quality review affected EUR 3.72[26] trillion risk weighted assets, 58% of total credit related RWA and 135,000 loan agreements.) The ECB and the European Banking Authority conducted the AQR in a co-ordinated manner.
The AQR implementation phase included data validation, sampling, on-site inspection of loan contracts, collateral valuation and the recalculation of provisions and RWA. After completion of the AQR, banks needed to hold a minimum of 8% in (Common Equity Tier 1 (CET1) share capital. For the purpose of the stress test, the minimum CET1 requirement is 8% for the baseline and 5.5% for the adverse scenario. Capital shortfalls are expected to be covered within six months for those identified in the AQR or the baseline stress test scenario, and within nine months for those identified in the adverse stress test scenario. According to the results published on 26 October capital shortfalls were only found at 13 banks during the AQR (including four Italian and two Greek-based banks), but no institution had to be closed down. The assessment found a total capital shortfall of EUR 25 billion, around the minimum expected. The review also found that banks' non-performing exposures increased by EUR 136 billion and concluded that EUR 48 billion other assets were excessively valued. Banks with capital shortfalls had to submit capital plans within two weeks from the public disclosure of the results to be assessed by the Joint Supervisory Teams.

[25] Asset Quality Review
[26] 10 over twelve, trillion in English

By the scheduled start date, the SSM control was fully operative, as by the beginning of November, 900 staff were recruited for the SSM five fields out of the total of 1,000 positions budgeted for. In accordance with the preliminary announcements, on 4 November the European Central Bank assumed the supervisory tasks of the 120 significant institutions/groups. Then SSM's Chair Daniele Nouy emphasised that in performing its day-to-day supervisory operations, the ECB would largely build on the experience of the AQR and takes into account all prudential elements in the key Supervisory Review and Evaluation Process (SREP[27]). The review of internal models and the application of microprudential instruments were also mentioned among the priorities.

Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM[28])

Apart from the SSM establishment, the other important cornerstone of the banking union is the Single Resolution Mechanism. (The separation of supervision and resolution from Member State decisions can ensure that potential bankruptcies will not impose any threat to the solvency of the individual countries.) As intended, on its April session, the European Parliament adopted the Bank Recovery and Resolution Directive (BRRD), the Regulation on the Single Resolution Mechanism and the Deposit Guarantee Scheme Directive (DGSD[29]) in one package. The agreement had already been reached on the professional content of the BRRD and the new version of DGSD was also easily adopted due to lack of efforts towards single European deposit protection. At the beginning of 2014, essential disputes were dedicated to the SRM regulation. At the end of March, the Council and the Parliament agreed on previously disputed issues concerning primarily the correlation between the SRM regulation and inter-governmental agreements, the scope of the Single Resolution Board (SRB[30]) and the funding of the Single Resolution Fund (SRF[31]). (The period of building the SRF will be shortened from 10 to 8 years and the funds will also become a common fund more quickly. 40% of the member states' payments is to be mutualised in the first year, 20% in the second year, then the mutual part will increase evenly each year. By the end of the eighth year national compartments will cease and only the common fund will exist. The SRF target figure is EUR 55 billion.) The member states must ratify the intergovernmental agreement on the Single Resolution Fund by 1 January.

In relation to the package the European Commission and the European Banking Authority must produce a number of detailed rules in the form of delegated acts and technical standards. The European Commission applied the principle of risk proportionate fee payment and drafted a delegated act on contributions to resolution funds and an implementation regulation on contributions to the Single Resolution Fund.

In June 2014, the 18 Member States of the euro zone reached a preliminary agreement on the ESM Direct Recapitalisation Instrument (DRI[32]), which was also approved by the Board of Directors of the ESM, i.e., the finance ministers of the euro zone countries. This financial instrument allows the ESM to recapitalise failing euro zone banks as a last resort measure. The ESM, in accordance with the BRRD, can recapitalise banks directly only if private

[27] Supervisory Review and Evaluation Process
[28] Single Resolution Mechanism
[29] Deposit Guarantee Scheme Directive
[30] Single Resolution Board
[31] Single Resolution Fund
[32] European Stability Mechanism direct recapitalisation instrument

creditors have been bailed-in, and contribution has been provided from the National Resolution Fund (SRF from 2016). With a view to preserving the ESM's credibility and lending capacity for other purposes, the total amount of ESM resources available for the new instrument is limited to EUR 60 billion. The direct recapitalisation instrument is another key element of the banking union. It contributes to breaking the link between the bank bailout and member state indebtedness ("the vicious circle").

Other developments in the EU regulations

The other regulatory developments of the EU related mainly to the capital requirement and liquidity regulations (CRR/CRD4). The Commission approved the regulation on the leverage ratios and liquidity coverage ratio. The EU banks must reach 100% LCR already by January 2018.
In relation to capital adequacy regulation, the European Systemic Risk Board published an important recommendation on guidance for setting countercyclical buffer rates.
In May, the Implementation Technical Standard on supervisory reporting obligations was finalised. Institutions had to perform the reporting requirements by the end of June, on capital, leverage ratio and liquidity ratios for the first time for reports on the period ending 31 March 2014. Inter alia, the Commission also adopted a regulation on information to be disclosed by the competent authorities (supervisors) and on the individuals deemed risk takers for remuneration purposes.

The ECB – also in relation to its supervisory role – is accelerating its work to create a central credit register. It would like to set up an Analytical Credit Dataset[33] by December 2016. This database would be uploaded with data from central credit bureaus operating in some member states and data obtained from direct bank reports.

Among the significant prudential regulatory projects of the European Union, only the initiative on the structural reform was left unfinished. The new Commission also keeps it on the agenda despite the fact that the sector would argue for the preservation of the universal banking system. Of the priorities outlined by the new Commission, the Capital Market Union should be highlighted, in relation to which the Green Book was already launched for consultation by the Commission.

In line with its mandate, the European Banking Authority's operation in 2014 was focused on three main areas: regulation, oversight of the European banking sector and consumer protection. The EBA plays a central role in the development of the Single Rulebook in banking, which is key to the operation of the Banking Union and to achieve a level playing field and a single financial market. Last year's regulatory work related mainly to CRR/CRD4 and the BRRD, with special focus on detailed rules on credit and market risk, liquidity, the leverage ratio and recovery and resolution. As the observer of the sector, EBA prepares semi-annual risk assessments and a Risk Dashboard. It also focuses more intensively on consumer protection, which is also marked by the consumer protection day, organised in co-operation with the other two EU supervisory authorities for the second time last year.

The European Banking Federation and its Banking Supervision Committee continued to actively lobby for influencing global and European regulation in 2014. Its activities were

[33] Analytical Credit Dataset (AnaCredit)

focused on Basel III Accord, the detailed CRR/CRD4 rules, the Banking Union (the single supervisory and resolution mechanisms) and the bank structural reform.