HUNGARIAN BANKING ASSOCIATION

REPORT

Activities of the Hungarian Banking Association in 2015

Budapest, March 2016

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I. Executive Summary

The most significant ***global economic processes*** in 2015 were low raw material prices; an even more significant fall in oil prices compared to before; the gradual slowing of the growth of the Chinese economy, followed by intense capital market reactions; the start of stricter monetary measures in the USA and the expectations that preceded it; and concerning the EU, the deepening of the Greek financial crisis at the beginning of the year and its later resolution, as well as the ECB's aggressive monetary easing. The European Union's economy continues to grow slowly, however, after having avoided Greece exiting the Eurozone (Grexit) and despite the refugee crisis, there is little risk of recession processes starting. The USA's economy continued to perform quite well, fueled by the increase in internal consumption. The Russian economy fell further into recession, due primarily to the dropping of oil prices and American and EU sanctions; the country's foreign currency reserves were considerably depleted. The Chinese economy is still on its prolonged path of adjustment; according to official statistics, growth rate is now the lowest since 2009.

In 2015, the external environment of the ***Hungarian economy*** was of a more supportive nature despite the diverse crisis phenomena. The GDP grew by 2.9% on an annual basis. On the production side, all sectors, save for the agricultural and construction industry, contributed to fine performance, while on the consumption side, net export remained the primary driving force. By the end of the year foreign trade reached a record in surplus. In addition to this, growth was also fueled by a dynamic increase internal consumption. By the end of the year, inflation slowly started to increase, however, average annual inflation stayed slightly negative (at -0.1%). Core inflation remained within a range of 1.2-1.5% for most of the year. Balance indicators continue to be favorable and it is probable that the central government deficit will be less than the planned 2.4%. Current account surplus is lastingly high. The central bank reduced the base rate from 1.95% to 1.35% in four steps. The forint weakened considerably compared to the American dollar and the Swiss franc, while it very slightly strengthened compared to the Euro.

The financial situation of the ***credit institutions sector*** in 2015 was primarily determined by: the balance sheet change and loss in connection with HUF conversion; expenses due to the execution of extra tasks relating to retail loans; adjustment processes due to the self-financing program of MNB; and a financial environment with decreasing interest rate. In terms of collective capital in the sector, strengthening was visible: the capital adequacy ratio rose to 19.7%. The increase in balance sheet total, which was a minimal 0.4% in nominal terms, was primarily due to the weakening of the forint; activity actually decreased. Gross loan portfolio shrank by 8%, corporate loan portfolio by 12%, and retail loan portfolio by 13%. The decrease in lending was compensated for by the increase in liquid assets, within which significant structural changes took place. The quality of loan portfolios improved significantly in corporate loans and slightly in retail loans (at the end of the year the ratio of non-performing portfolio was 9.8% in the former and 17.6% in the latter). The clearing of bank balance sheets, a drop in impairment loss and provisions (totaling almost HUF 900 billion), an accounted profit of HUF 39 billion before taxes in the entire sector – meager compared to data from the former quarters – and the announcement that banking surtax will be cut give hope that in 2016 banks may once again operate normally.

In 2015, the ***MNB growth incentive schemes*** could only moderate the severe degradation in corporate lending. At the end of the year the contract signing period of Phase II of the FGS and the Funding for Growth Scheme Plus (FGS+) was concluded. In the different phases of the FGS, nearly 31,000 enterprises received financing, amounting to HUF 2,126 billion. In November, 2015, as part of the Growth Supporting Programme (GSP – a program to help banks switch to market lending), MNB announced Phase III of the FGS, for phasing out the program.

In 2015, the ***settlement of consumer loans*** and in relation to this, the ***HUF conversion of foreign currency and foreign currency denominated mortgage loans*** were major challenges for banks, and the most demanding in terms of financial and human resources; the process consisted of several rounds and lasted throughout almost the entire year. The Banking Association continues to disagree with the settlement, and some of our members turned to the Court of Justice of the European Communities for legal remedy. The simultaneous ***implementation of fair banking rules*** only added to the complexity of this process. More than 4 million loan agreements were involved in the settlement and the credits and payments made to clients reached HUF 734 billion in relation to foreign currency denominated loans and approximately HUF 200 billion concerning forint and actual foreign currency loans. Due to the complexity of the task, the rapid drafting of the legislation and short implementation deadlines, there were still a number of legal interpretation issues on the agenda at the beginning of the year. We actively collaborated with the Ministry of Justice (in charge of the legislation process), several departments of MNB (consumer protection, financial stability, FAB) and other organizations concerned (Chamber of Bailiffs, Association of Debt Collectors, BISZ – the credit bureau of Hungary).

The ***HUF conversion of other retail (vehicle, personal) loan agreements that remained in foreign currencies*** was initiated by the Banking Association at the government, as encouraged by MNB. According to the compromise, also included in the promulgated act, the HUF conversion took place at market interest rate, but creditors had to deduct from their receivables an amount equal to the difference in their receivables between the sum during the HUF conversion of mortgage loans and the sum at the exchange rate on August 19, 2015.. Similarly to the HUF conversion of foreign currency mortgage loans, creditors could not increase the cost of funding/reference rate increment due to the conversion. A new regulation – made by consensus – was created for the conversion of foreign currency loans with fixed HUF repayments into loans with equal repayments (annuity loans). The deadline of December 1, 2015 for the value date (which leaves a very short period of time for preparation) was also set with the agreement of the parties concerned. *Act CXLV of 2015 on resolving issues concerning the HUF conversion of receivables from certain consumer loan agreements* was promulgated on October 2nd and entered into force on October 5th. The scope of the Act covered a portfolio worth almost HUF 110 billion and approximately 115,000 contracts in the banking sector. The HUF conversion of the contracts generated more than HUF 30 billion loss to the sector.

Another important task within retail lending was the ***implementation of the Mortgage Credit Directive***, which in Hungary took place by amending the *Act on consumer loans (Act CLXII of 2009),* the *Act on credit institutions* and the adoption of the implementing decrees to the Act. The relevant laws have to be applied by credit institutions as of March 21, 2016. The Banking Association was involved in the consultations aimed at implementation from their onset. Although we achieved that the regulator will choose those solutions from the Directive that are more manageable for banks, the implementation of these new, stricter, consumer protection natured rules will clearly render lending more expensive and more complicated.,

The ***Family Housing Allowance Scheme (CSOK)*** was launched on July 1, 2015. The government expected the active involvement of banks in the execution of the scheme both in terms of the administration of state subsidies and in the supply of the loans related to the subsidy.
The subsidy varies between HUF 500,000 and HUF 3,250,000, depending on the number of children, the size of the home and the degree of energy efficiency, and gave a noticeable push to the housing market. In its decree towards the end of the 2015, the government approved a new support package (of much bigger value than previous one). The subsidy tries to incentivize families to have at least three children by offering a HUF 10 million support, which does not have to be repaid when moving into a newly built home and is complemented by a loan of HUF 10 million that has a preferable interest rate, and is tied to the previously mentioned support, as well as VAT relief. It was a

tremendous task for banks to prepare for the new, extensive legislation – with a short deadline – and to professionally inform the vast array of clients who wished to apply for it.

Introducing ***personal insolvency regulation*** has long been the intention of political actors. *Act CV of 2015 on Debt Settlement Procedure for Private Individuals* (commonly known as the personal insolvency act) was approved by Parliament on June 30, 2015. Though the Banking Association supports the institution of personal insolvency, we consider its introduction to have been hasty. Nevertheless, our expert working group took an active part in preparing the legislation, and the Ministry of Justice accepted several of our proposals concerning the institution's concept and its normative text. The time granted from early July when the law was created to September 1st, when it entered into force, proved not enough to publish the decrees necessary for its execution, training the Family Insolvency Service (FIS), and creating all the standard forms necessary. Even with the initial problems resolved, interest in personal insolvency is little. According to information available to the public, around 200 printed applications were submitted by debtors, and procedure initiations were published on the FIS's website only in very few cases.

In 2015, the most influential event in terms of banks' future profitability was the ***increase in OBA and BEVA fees*** due to the bankruptcy of brokerage firms, and the decision in relation to the phase-out of the banking surtax. Early in the year four small banks emerging from savings cooperatives and merging with the DRB Bank group were liquidated as a result of the bankruptcy of their owner: the brokerage firm, Buda-Cash. On that basis OBA paid HUF 103 billion in compensation to depositors of the respective banks. BEVA's situation became even worse when the brokerage firm Hungária Értékpapír was closed and the Quaestor Group went bankrupt. Since both funds were exhausted, it was necessary to raise the fee to several times the previous amount: in 2016 for both funds, the fee will be 1.75 thousandth of the insured stock.

The ***rules of compensation for damages caused by the default of the Quaestor Group*** were established with retroactive force in Act XXXIX of 2015 (*Quaestor Act*) – passed at record speed at the beginning of April – presented further severe burdens for BEVA members. According to the legislation, Quaestor victims would have been compensated from a designated fund into which investment service providers (primarily universal banks) would have contributed the required amounts and victims would have been compensated for up to HUF 30 million. Several serious constitutional complaints arose in connection with the content of the Questor Act, which caused some of our member banks to submit a constitutional complaint. The Constitutional Court found that multiple provisions of the Quaestor Act were contrary to the Fundamental Law and annulled these. *Act CCXIV of 2015 on certain damage compensation measures taken in order to strengthen the stability of the capital market,* known as the "new Questor Act" replaced the old one in December. The scope of this new act applies not only to the buyers of Quaestor bonds, but also those of Hungária bonds. For BEVA members, the new law resolves the issues related to payment obligations in a more advantageous way than earlier (it considers the returns paid since the beginning of 2008; in claims exceeding HUF 3 million 11% counts as own contribution; the annual payments by BEVA members to the Compensation Fund is maximized at HUF 7 billion), and makes it possible to deduct the amounts paid to the Fund from tax payment obligations in the same year that the payment was made.

Several newly included provisions of *Act LXXXV of 2015* are also related to the Quaestor scandal, and aim to prevent such cases in the future, as well as to ***restore the trust of investors***. The Act wishes to prevent the issuing of fictional bonds by granting investors the right and possibility to check on their stocks. The Act raises the compensation sum given by BEVA to the same amount as that of OBA (EUR 100,000). Considering the amounts valid in the European Union, the Banking Association continues to believe that this is unjustified. We did not support the provision of the package which required BEVA by law to compensate fictional bonds either.

In compliance with the Memorandum of Understanding between the Government and the European Bank for Reconstruction and Development (EBRD), in the legislation adopted in the summer, the Government reduced the rate of ***banking surtax*** (above HUF 50 billion adjusted total assets) from 0.53 per cent to 0.31 per cent (to 0.21 per cent in 2017 and 2018) and made the 2014 adjusted total assets the tax base instead of the 2009 adjusted total assets. It was another major amendment that credit institutions which have expanded the portfolio of their corporate loans since 2009 would have been eligible for an up to no more than HUF 10 billion refund from their banking surtax at a national economy level. However, the competition department of the European Commission objected to this rule and therefore the potential tax credit as an incentive of lending was canceled. For 2016, the 2009 adjusted total assets remained the banking surtax base, while the tax rate was reduced to 0.24%. By gradually decreasing the banking surtax, the government is fulfilling an old expectation of the sector and its own promise made at the introduction of the tax.

The ***Magyar Nemzeti Bank*** (the central bank of Hungary) created the regulatory environment for bank operation conditionality with micro and macroprudential risks in mind. To moderate the stress in the balance sheet systems of banks, the central bank decided to introduce the Mortgage Funding Adequacy Ratio (MFAR), to modify the FEAA ratio and to introduce a new FX position balance ratio, as well as to implement macroprudential capital buffers. It repealed the provisions of the CRR related to transitional regulation (beneficial for banks), and initiated consultations to fine-tune the payment-to-income ratio (PTI). The MNB seemed open to including banks' comments made during the consultation on the Supervisory Review and Evaluation Process, while, when giving information on liquidity stress tests, it requested that banks apply the tests it developed. MARK, which helps in cleansing bank portfolios (and operates under MNB), has not yet reached the goals that were set out upon its establishment.

Preparing for the transition to IFRS in 2017 is a challenging task for banks, in terms of both accountancy and data supply.

Concerning ***payments***, an important development of 2015 was the introduction of the new 10,000 and 20,000 banknotes. There are now over 4.5 million contactless payment cards and they constitute over half of the entire Hungarian bank card portfolio. Hungary continues to perform well in the security of electronic payments. According to the European Central Banks's comparative report published in July, from the 30 inspected countries, Hungary is the one with the lowest number of bank card frauds committed – the number here is one tenth of that in larger European countries. As initiated by the central bank, two significant changes were made concerning GIRO: the number of clearing cycles doubled (from 5 to 10), and a so-called "cycle 0" was introduced that shifted the payments made by the Hungarian State Treasury over to the up-to-date platform, which operates according to EU standards. The amended sectoral and payment service legislation regulates managing the mass transfer of clients between retail infrastructural service providers concerning direct debit satisfactorily. The forint was successfully included in the Continuous Linked Settlement (CLS) as its 18th foreign currency. The Hungarian SEPA Association has been wound up; the Banking Association has been completing the tasks of SEPA's Hungarian member association since 2014. Commencing preparations for the SEPA End-Date Regulation and supporting it were priorities in 2015.

Concerning the organization and the financing of the European Payments Council (EPC) – also responsible for SEPA payments – important changes were made in 2015. In October they amended the Payment Service Directive, the main purpose of which was to sort out the role of the Third Party Provider, a key player in e-commerce. Concerning the Payment Accounts Directive, published in July 2014 and to be implemented by September 2016, consultations on the Directive's implementation have begun between the Banking Association and the financial department of the government.

No radically new initiatives were made in 2015 in terms of ***global regulation***; the year was mainly spent finalizing previously determined regulations. The Financial Stability Board indicated the following three priorities for 2015: full, consistent and immediate implementation of the approved reforms; finalization of the reform actions still outstanding; and managing new risks and vulnerabilities. Finishing the reforms affected three areas: measures relating to the capital adequacy framework of banks and the too-big-to-fail (TBTF) banks, as well as finalization of the regulations boosting the security of derivative markets. In managing new risks and vulnerabilities, the FSB put an emphasis on relevant data collection, assessing and managing risks and improving market structures. In addition to the general report, compiled for the first time in 2015, the FSB published separate reports on reforms to OTC derivatives markets and shadow banking activities. To promote resolvability, it compiled a complete regulation package; the regulation of total loss absorbing capacity (TLAC) applicable in the resolution of global systematically important banks is also a part of this. The Basel Committee on Banking Supervision (BCBS) created 2-year work program for 2015 and 2016. Its activities in these two years will concentrate on policy development; finding the right balance among the simplicity, comparability and risk sensitivity of regulatory frameworks; monitoring and evaluation of the Basel Accords; and improving the efficiency of supervision. Among the Committee's 2015 documents, the criteria for simple, transparent and comparable securitization; the capital requirements for this; the revisions to the standardized approach for credit risk; management of interest rate risk in the banking book; report on the regulatory consistency of risk-weighted assets; and documents related to TLAC regulation should be highlighted.

The political framework of ***European regulation*** was mainly determined by, in addition to the European Commission's work program established in the fall of 2014, the plan to complete the European economic and monetary union (reported by the Five Presidents in June), the agenda for Better regulation, and the State of the Union addressed by the president of the Commission. From a practical approach, the most significant step forward was the measures taken to create the banking union. Within the Single Supervisory Mechanism the ECB has now been directly supervising the large banks of the Eurozone for over a year. In 2015, the ECB focused on the prioritized supervision of credit risk and risk management practice; the supervisory review and evaluation process; unifying the validation of the internal models of banks; and reducing the number of options and national discretions in the capital requirements regulation. The Single Resolution Board was established in January, 2015 and prepared the operations of the Single Resolution Mechanism and the Single Resolution Fund, starting in 2016. The banking union will be completed by the European Deposit Insurance Scheme (EDIS); the Commission published a press release in November on its gradual introduction. A first step towards the Capital Markets Union was the Green Paper, published by the Commission in February. It was supported by both the Parliament and the Council. The action plan which followed includes the building blocks for making the capital markets union fully operational by 2019. As part of the Action plan, the Commission announced a public consultation on the regulatory framework of financial services, published its proposal for the regulation on securitization and for amending the Capital Requirements Regulation (CRR), and initiated consultation on covered bonds in October. In 2015, decision makers once again did not accept the structural reform of the banking sector (separating the lending and commercial function of big banks).

II. Macroeconomic outlook, the banking sector's operating criteria

The most significant ***global economic processes*** in 2015 were low raw material prices; an even more significant fall in oil prices compared to before; the gradual slowing of the growth of the Chinese economy, followed by intense capital market reactions; the start of stricter monetary measures in the USA; and concerning the EU, the deepening of the Greek financial crisis at the beginning of the year and its later resolution, as well as the ECB's aggressive monetary easing.

The ***European Union***'s economy continues to grow slowly, however, after having resolved the Greek debt crisis and despite the refugee crisis, there is little risk of recession processes starting. Despite the ECB's monetary easing measures, the weakening of the Euro and significantly lower oil prices than in 2014, there was only gradual improvement in Europe's economic situation. New twists in the Greek debt crisis and concerns about the growth of the Chinese economy unsettled economic actors. This was also visible – even in countries with considerable output – through relatively low productive investment. The engines of growth are primarily export and internal consumption, incentivized by the weakening Euro and low energy prices. The growth in internal consumption is mainly fueled by better employment, low raw material prices, and the positive effects low interest rates have on real income. The biggest economies of the EU developed at different rates. Germany's growth was stable, driven fundamentally by domestic demand; however, the weak Euro also had a positive effect on its traditionally strong export performance. Nevertheless, the low level of investments may cause problems medium-term and migrational burdens and the auto industry's emission scandal pose a risk. Spain showed outstanding growth, Italy visibly overcame its recession, while France's economy is still weak. The pound, being stronger than the Euro, had a negative impact on the United Kingdom's export performance, but its other macroeconomic indicators are positive.

The **USA**'s economy continues to perform quite well. Due to further improvement in the labor market, low raw material prices and low inflation, the state of incomes improved, thus, domestic consumption is the engine of growth. In contrast, investments are low on a national economy level, which is fundamentally the result of cutbacks in the extractive industry's significant capacity, in reaction to low raw material prices. In contrast, leading technological industries saw a considerable increase in investments. The Fed's floating monetary restrictions until the end of the year kept the dollar's exchange rate strong throughout the year, which had a negative influence on the performance of the export industries. The actual interest rate increase cycle was started in mid-December – late, according to some. Political debates on the sustainability and ceiling of the federal budget once again became prevalent through towards the end of this period.

The ***Russian economy*** fell further into recession. This was primarily brought about by the fall of oil prices and American and EU sanctions in reaction to the Russian-Ukrainian territorial dispute. At the beginning of the year the country was heading towards a financial catastrophe; inflation suddenly rose and the exchange rate of the ruble fell steeply. The Russian central bank's political monetary measures succeeded in limiting the further dropping of the ruble by the middle of the year, however, the country's foreign currency reserves were considerably depleted. Economic fundamentals worsened badly: the labor market declined, Russia was unable to mitigate its oil and gas export dependency, and the state's exaggerated influence on the economy distorted capital structure.

Economic activity declined and the dried up financial channels, caused by the indebtedness of the private sector (primarily large companies) and sanctions, deepened the crisis even further. The Russian government used fiscal easing to mitigate the effects of economic and financial recession, and thus, greatly depleted its reserves (accumulated from oil income in the previous years). To compensate for this loss, the state contemplates partly privatizing its largest oil industry companies. In addition to this, the structure for expenses in the state budget has been changed considerably.

The ***Chinese*** economy is still on its prolonged path of adjustment. According to official statistics, growth rate is now the smallest since 2009, but some analysts say that growth rate decreased more than it was revealed. There are two important factors behind this. First, a large amount of capacity in

the heavy and building industries is idle; a significant part of their previous performance is now financed by official commercial bank or shadow banking loans. Because of the excess capacity, investment activity decreased considerably, especially on the part of foreign investors. Second, due to moderate global demand, China's export sector has also become weaker than before. This is reinforced by the fact that despite Chinese efforts, the RMB remains stronger than the USD, and therefore has grown significantly stronger than the Euro and the Yen – this gave it a disadvantage in terms of export competition. So far, Chinese authorities tried to put a stop to these unfavorable processes with monetary easing (decreasing the base rate and cutting bank reserve ratios), and by interfering in the capital market.

In 2015, the external environment of the ***Hungarian economy*** – despite the diverse crisis phenomena (Russian-Ukrainian conflict, Russian recession, migration crisis, Greek debt crisis, slowing of the economy in China, the emission scandal in the German auto industry) – was of a more supportive nature, due to low energy and raw material prices, favorable financing conditions, and the gradual strengthening of the European Union's economy. In 2015, as a result of larger growth than expected in the fourth quarter, the ***GDP*** grew by 2.9% on an annual basis. On the production side, all sectors, save for the agricultural and construction industry, contributed to fine performance; industrial production in 2015 surpassed last year's value by 7.5%.
On the consumption side, ***net export*** remains the primary driving force. By the end of the year foreign trade reached a surplus record (HUF 2,512 billion in current prices), which exceeds 2014 data by more than 30% (HUF 570 billion in current prices). In addition to this, growth was also fueled by a dynamic increase in internal consumption. ***Household consumption*** strengthened as well, due to improving employment (by 2.1%), and a significant increase in real wage (4.3% for the whole year). Retail sales grew by over 5.5% in 2015. ***Investments***, after a decrease during the year, will probably rise to the same level as last year, due to the drawdown of EU funds at the end of the year.
By the end of 2015, ***inflation*** slowly started to increase. By December it had grown to 0.9% on a year-to-year basis, however, this was not enough to raise average annual inflation into the positives (it stayed at -0.1%). Core inflation, after an increase early in the year, remained within a range of 1.2-1.5% for the rest of the year, staying close to the low end of the range at the end of the year. Its stable value indicates that domestically caused deflation risks are unlikely.

The ***balance indicators*** of the Hungarian ***economy*** continue to be favorable. The ***central government deficit*** at the end of December (HUF 1,219 billion) seems very high compared to the annual amended legal appropriation (HUF 892 billion), however, what caused this was the considerably late drawdown of EU funds (HUF 560 billion). The government pre-financed this amount in order to complete the affected investments. Though it is possible that the drawdown will be of lower value, it is still probable that the result at the end of the year will be better than the planned 2.4%. Significantly higher tax income from main taxes (VAT, personal income tax, corporate tax) play a substantial role in the likely outcome of favorable indicators. The gross budget deficit indicator improved as well: it has decreased to 75.5% from last year's 76.2%.

External balance also continued to improve. Current account surplus is lastingly high, external financing capacity remains 10% of the quarter's GDP.

In March, the central bank restarted its ***base rate*** reduction cycle: the benchmark interest decreased from 1.95% to 1.35% by July (in four stages), and it may stay at this rate for a longer period of time. Compared to the American dollar and the Euro, the forint is at an exchange rate range of 10%. (The last day of the year, the dollar was worth 286.63 forint, and the Euro 313.12 forint at MNB's exchange rate.) Due to the steps taken by the Swiss central bank in January, 2015, the exchange rate of the Swiss franc changed within a 20% range and grew to be worth 289.38 forint by the end of the year.

The financial situation of the ***credit institutions sector*** in 2015 was mainly determined by: the balance sheet change/decrease in connection with HUF conversion and settlement and the loss due to the HUF conversion of FX car and personal loans; expenses due to the extra tasks relating to retail loans; adjustment processes due to the self-financing program of MNB; and a financial environment with decreasing interests.
In terms of collective capital, strengthening was visible (the capital adequacy ratio went from 19.3% in 2014 to 19.7% in 2015), which is favorable in terms of safe operation. However, it is unfavorable that this improvement was partly the result of the flow of freed liabilities into risk-free assets due to the decrease in retail loan portfolio and the loan portfolio of non-financial corporations.
In 2015 the ***balance sheet total of credit institutions*** was at the same level as the previous year, the 0.4% growth (also low in nominal terms) was primarily due to the weakening of the forint compared to the Swiss franc and the American dollar. Significant structural changes took place, however, within the balance sheet. This is mainly visible in the decrease in ***gross loan portfolio*** (-8%). The decrease in loans was compensated for by the increase in liquid assets, the structural change of which also continued, due primarily to the self-financing measures of the central bank.

The decrease in FX loan portfolio in households is a natural consequence of the two FX loan conversions implemented during the year, however it is also visible in corporate lending.
The decrease in loan portfolio is visible in almost all loans granted to more important sectors, only financing given to the domestic and to foreign financial sectors increased.
Corporate loan portfolio decreased by 12% (HUF 820 billion) and this was caused not just by the erosion of FX portfolios, but also the decrease in forint portfolios of all maturities. The most important element of this decrease is probably that on the basis of portfolio cleansing, a HUF 780 billion net book value of problematic loans was written off, and sold. The SME loan portfolio within corporate loan portfolio could not be maintained – not even with the help of MNB's credit program; it shrank by 6%.
Retail loans decreased at a somewhat faster rate (by 13%, nearly HUF 850 billion), which is mainly due to settlement and the settled waiver of debt during the HUF conversion in December. Mortgage loan portfolio shrank by 13%. This value, which seems low in terms of settlement was also contributed to by the growth in lending at the end of the year. During this same period vehicle loans fell by 24%. However, short-term loans like (product and personal) grew by 16% and 1%, respectively.
Compared to 2014, the ***quality of loan portfolios*** improved in almost all sectors. Concerning corporate loans, after a 4 percentage point improvement, non-performing loan portfolio decreased to less than 10% (9.8%). At the end of the year, the portfolio of loans that expired over 90 days ago was 17.6%, less than in 2014 (19%) even in the household sector, more, however, than at the first round of accounts in the first quarter (16.2%). As a result of improving portfolio quality, accounted loss in connection with lending decreased by 17% (by almost HUF 340 billion).

Liquid assets grew by a total of 10% (HUF 1,309 billion) compared to 2014. No significant change was visible within the structure of liquid assets. The deposit portfolio at the central bank decreased by 23% (HUF 1,300 billion) as a result of its self-financing program, and that becoming stricter in September. This, together with the liabilities freed-up from lending were put into other liquid assets, generally into short-term deposits at foreign banks (HUF 720 billion, +160%) and the securities issued by these (HUF 240 billion, +25%), as well as Hungarian government bonds (HUF 1,850 billion, +46%) – as supported by MNB's interest rate swap tenders.
The stock of deposits grew significantly (by 6.1%, HUF 970 billion), however, negative changes in the structure of deposits continued. The growth in stock of deposits came from an increase in ***non-financial corporate deposits*** and the ***deposits of private entrepreneurs***, amounting to nearly HUF 880 billion. However, among these, there was a significant shift towards current account deposits and non-term deposits. The resources received from the FGS program most probably largely contributed to this growth. Despite unfavorable interest rates, ***retail deposit*** portfolio grew (HUF

+105 billion). The sum of money paid during the settlement, which already amounted to over HUF 100 million at the time of the February accounts, likely played a big part in this. Due to low interest rates, significant restructuring took place here too; a shift towards sight and current account deposits from term deposits (concerning HUF 650's worth of portfolio).
The above processes had an unfavorable influence on stability. Thus, by the end of 2015, corporate deposit portfolio (private entrepreneurial deposits included) were nearing the volume of retail deposits (reaching 94% of the latter), as opposed to the 82% of the previous year. Before, the average of this ratio ranged from 50 to 60% for multiple years.
The net loan-to-deposit ratio of the sector at the end of 2015 fell by another 12 percentage points, to 87% from the 99% in 2014. Yet, the change in the ratio may be subject to false interpretation, since the majority of deposits are volatile current account and sight deposits.

Interbank funds in 2015(expressed in HUF) decreased significantly (by a total of almost HUF 500 billion). The primary reason for this was a significant reduction in loans and deposits made available by foreign financial institutions (HUF -750 billion). However, funds from MNB's FGS program reduced this drop considerably. Loans from the central bank increased liability portfolio by HUF 380 billion by the end of the year.
The stock of ***securities issued by banks*** themselves grew by 5% (HUF 150 million, which may be interpreted as a positive process.

A significant change within the liability portfolio is the release of the ***provisions*** made for probable net loss (HUF -530 billion) in accounts, due to which the actually accounted loss in asset portfolio did not influence profitability.

According to ***preliminary***, unaudited, ***profit*** figures, the entire credit institutions sector closed 2015 with an after-tax profit of HUF 39 billion. Based on this, the credit institutions sector's average return on assets was 0.1%, and return on equity was 1.5%. Due to low interest rates, net interest income was 16% (HUF 154 billion) less than in the previous year, which had a negative effect on profit. Increased profit on fees and commissions (+3.3%, HUF 15 billion) could only compensate for this slightly. In 2015, accounted net loss and the risk provisioning value only increased minimally as opposed to previous years, impairing profit by only HUF 5 billion. In 2015, the expenses-reducing process was interrupted (expenses grew by 3.7%), which was not caused by lack of effort on the part of banks, but by the extra resources used up for the implementation of government measures on retail loans.

III. Corporate lending –MNB's growth incentive programs

According to MNB's lending report from December, in the third quarter of 2015, credit institutions' outstanding loans to corporations increased by HUF 28 billion as a result of disbursements and repayments. However, in annual terms, outstanding loans fell by 4.4 percent due to base effects. Corporate lending was fundamentally characterized by a dual trend: while lending in the SME sector continued to expand due to the Funding for Growth Scheme (FGS), corporate loan portfolio greatly decreased due to some individual effects.
In 2016, during the phase-out part of the FGS program, liabilities with favorable conditions will remain attainable to SMEs, though they will be more targeted and will be available in smaller volume. MNB will grant an important role to lending incentivizing instruments to be introduced from 2016. An important result of all of these could be that corporations may receive long-term financing at a fixed interest rate, and in forint. MNB expects that Growth Supporting Programme (GSP) measures may potentially increase corporate lending by HUF 250-400 billion, therefore corporate and especially SME lending may increase by 5-10% in 2016.

- *The results of the first two phases of the Funding for Growth Scheme and the FGS+*

In late 2015, the contract signing period of Phase II of the FGS and the FGS+ was concluded. In phase I, over a period of three months, HUF 701 billion's worth of contracts were signed. In phase II of the FGS, SMEs received HUF 1402 billion's worth in contracts, and HUF 23 million in the FGS+, with MNB assuming part of the risk. The two programs yielded HUF 1425 billion's worth total in contracts, with 46 thousand transactions and 27 thousand enterprises.
Since the start of the FGS, roughly 31,000 enterprises received financing – amounting to about HUF 2,126 billion – as part of the programs, thus over 95% of the available budget was used.

- *Phase III of the Funding for Growth Scheme*

In November, 2015, as part of the Growth Supporting Programme (GSP), MNB announced Phase III of the FGS, for phasing out the program. Signing loan contracts is possible from January 1, 2016 to December 30, 2016 as part of the two pillars of the FGS's third phase, up to a budget of HUF 300 billion each. Similarly to the previous phase, MNB provides refinancing to credit institutions. These sums can be lent to SMEs exclusively for new investments. In the second pillar, MNB will do a cross-currency interest rate swap at market price, and will make it possible for credit institutions to lend in FX to SMEs, which possess natural FX reserves.
MNB consulted with the Hungarian Banking Association while it worked out detailed arrangements and included those recommendations of banks in the product information sheets which were compatible with central bank aims.

- *New instruments of the Market-based Lending Scheme*

The central bank announced a HUF 200 billion transaction for the first interest rate swap conditional on lending activity (LIRS) of the Market-based Lending Scheme. However, the demand of the participating 11 banks was more than three times this amount: HUF 618 billion. MNB, to support the upswing of economic growth and SME lending, accepted all offers submitted by banks. By signing the contract, banks agree to increase their lending to the SME sector by HUF 154.5 million every year for the next three years, in order to uphold their transactions. MNB agreed to publish the LIRS tenders every two weeks until the end of March, 2016, the budget of which is HUF 1000 billion.

IV. Retail lending

The Settlement Act and the HUF Conversion Act

In 2015, the settlement of consumer loans and the HUF conversion of foreign currency and foreign currency denominated mortgage loans were major challenges for banks, and the most demanding in terms of financial and human resources; the process consisted of several rounds and lasted throughout almost the entire year. The Banking Association continues to disagree with the settlement, and some of our members turned to the Court of Justice of the European Communities for legal remedy. The simultaneous implementation of fair banking rules only added to the complexity of the process. More than 4 million loan agreements were involved in the settlement and the credits and payments made to clients reached HUF 734 billion in relation to foreign currency denominated loans and approximately HUF 200 billion concerning forint and actual foreign currency loans.
Due to the complexity of the task, the rapid legislation drafting and short implementation deadlines, there were still a number of legal interpretations issued on the agenda at the beginning of the year,

which made it impossible to close the preparations required for implementation. In order to resolve the issues, our Association actively co-operated with the Ministry of Justice in charge of the legislation process, several departments of the MNB (consumer protection, financial stability, FAB) and other organizations concerned (Chamber of Bailiffs, Association of Debt Collectors, BISZ) in the first half of the year in order to resolve the issues.

Main issues requiring legal amendments and interpretation of the law and the results:

- In January, the work on the interpretation of the law in terms of the implementation of the acts continued and we approached the Ministry of Justice, the Ministry for National Economy and the MNB with a number of issues. In the most important questions interpretation was requested for the process and deadlines of the joint implementation of the settlement, HUF conversion and fair banking regulations, the management of the change of currency during the tenor, the performance of third parties on behalf of the client, the fair interest rate, the date and process of reinstatement of interest, the application of new interest fee and cost regulations, the management of transactions subject to the exchange rate gap scheme, the coherence problems relating to the negative effect and new temporary provisions of the Act on Consumer Loans and the lack of application of the GCTCs, declared unfair.

  Even though the written response of the Ministry of Justice in the second week of January provided some guidance on the legislator's intentions in almost every topic, it failed to provide clear and practical guidance for the exact application of the provisions of the law in several cases, hence we sent further enquires to the MoJ and MNB. The authorities resolved certain issues with amendments to the legal regulations, others with position statements and by publishing frequently asked questions (FAQ) and answers.
- During the preparations for the implementation of the settlement there was some uncertainty in the interpretation of the law as to whether or not collection orders submitted against debtors pursuant to the Act on Payment Services had a priority over the offsetting of the consumer claims against the outstanding principal of the loan. In response to the problem we received a negative response from the Ministry of Justice which was reassuring to clients, as well as to banks.
- The introduction of the fair banking regulations raised doubts about the rules pertaining to the amendment of interest rate and fees and charges of loan agreements not falling within the scope of mandatory settlement. According to the position statement issued by the MNE, those conditions must also be managed in the spirit of the new regulations.
- In relation to the special features of mortgage registration, we received guidance from the Ministry of Agriculture i.e., the authority responsible for property registration.
- The rule of the Exchange Rate Cap Scheme stated that the instalment could not be increased due to the switch but the HUF conversion of the debt and the accumulated credit on the buffer accounts raised the principal and interest debt, causing tension to the banks in the management of such loans in their operation and to clients due to the disproportionate extension in the tenor. The regulation prepared jointly with the MNE provided flexible solutions for both parties.
- The accuracy and timeliness of the data of the loans stored in the KHR gives its fundamental value. Due to the settlement/HUF conversion, the collection of new loan data changed in almost every condition and matching them with the existing data was a major challenge. The procedure developed with BISZ, the manager of KHR, without any amendment to the legal regulations resolved the problem with the elaboration of detailed guidelines for the banks.
- At the beginning of the year, our Association also had a consultation with the Financial Arbitration Board on the open issues of their procedure. Three main topics were discussed, and there was consensus in relation to two of them: if there are several obligors, the main debtor may initiate an FAB procedure and that in the case of any disputed settlement, the FAB was able to request either the bank concerned or the MNB to prepare the right settlement. However, no position was adopted on how to handle situations where the debtor dies and there are several heirs and the FAB did not develop one later either.

- We held several separate consultations with the executors concerning the technical suspension of executions proceedings during the settlement process, and on its later recommencement.
- We also consulted several times with the professional organization of debt collectors, the Association of Hungarian CMS Companies and Business Information Providers (MAKISZ) on the collaboration of creditors during the settlement of debt collection at banks granted to debt collectors involved in the settlement, and the technical management of the process.

In relation to the tasks relating to the open issues of the interpretation of the law, other issues also required the involvement of the Banking Association and the banks:

- The Banking Association had a draft submission form compiled on the problems of the constitutionality of the settlement act. The completed draft was passed to our member associations. Several of the submitted a constitutional complaint, but the Constitutional Court rejected these.
- Based on an initiative of the MNB the central bank and the banks agreed that the banks intending to take part in the MNB development process would make available to MNB experts the data required for development and testing of MNB's settlement control program in the framework of bilateral cooperation. The central bank moved forward the thematic examinations of all banks involved in the settlement for the applicant banks, which created a framework for the action. At those banks the MNB reviewed by the middle of March whether or not their applications developed for settlement complied with the statutory requirements and then communicated its experience.
- The MNB approached the credit institutions involved in the settlement to supply detailed data and documents within the framework of an extraordinary data supply in order to launch the public interest proceedings referred to in Act XXXVIII of 2014. The requested information showed significant overlaps with the document supply obligation, already fulfilled in relation to the lawsuits of the banks. After the consultations initiated by the Banking Association, the number of documents to be submitted was reduced significantly.
- In May the MNB intended to significantly expand the data supply on settlement within a very short deadline, but in response to a request of the institutions concerned, the deadline for the submission of data was extended to August.

HUF conversion of loan agreements that remained in foreign currencies

In May the MNB announced that it intended to introduce an additional capital requirement under the systemic risk buffer for banks managing retail loans still denominated in foreign currencies. The Banking Association conveyed the unanimous position of the banks involved in the issue and proposed to the government and the MNB the HUF conversion of the respective loan portfolio. The Banking Association proposed converting the consumer foreign currency loans that remained in foreign currency at market rate and, in order to secure extensive participation and to compensate consumers for the increase in interest rate stemming from different reference rates, the *supply of state interest subsidy* and simultaneously requested the postponement of the MNB regulation on the systemic risk buffer. The government discussed the HUF conversion option during its session on July 1, 2015 which was followed by negotiations between the Banking Association, the central bank and the ministries involved (MoJ, MNE).

The conversion of the loans still denominated in foreign currencies of the respective customers under conditions, similar to those applied during the HUF conversion of the foreign currency mortgage loans in February was a basic condition of the negotiations set by the government. As it is a fundamental thesis of all Curia decisions on foreign currency loans that the exchange rate risk included in the contract must be borne by the debtor in exchange for a favorable interest rate, the Banking Association consistently argued that the HUF conversion must take place at the market interest rate. According to the compromise, also included in the promulgated act, the HUF

conversion took place at market interest rate, but creditors had to deduct from their receivables an amount equal to the difference in their receivables between the sum during the HUF conversion of mortgage loans (the average official exchange rate market by MNB between June 16, 2014 and Novebmer 7, 2014 or the official exchange rate market by MNB on November 7, 2014) and the sum at the exchange rate on August 19, 2015. According to another important condition set by the government, the HUF conversion losses should be borne only by the government and the banking sector without the involvement of the debtors. Similarly to the HUF conversion of foreign currency mortgage loans, the government also demanded on this occasion that the conversion could not be associated with any modification in the terms and conditions of the loans, detrimental to the customers, i.e. the creditors could not increase the cost of funding/reference rate increment due to the conversion. The management of foreign currency loans with fixed HUF repayments was another important issue because a large portfolio, collected on separate accounts, has been accumulated in relation to these loans which would have significantly increased the repayments and the tenor of the loans when they fell due later. According to the agreed solution, such contracts could be converted into loans with equal repayments (annuity loans) on condition that the repayments could rise by no more than 15 or 25 percent reflecting the extension in the tenor, also allowed under the original contract.
The completion of the HUF conversion in a short time was a further requirement of the government. The steps of execution were already known to the institutions also providing mortgage loans, which shortened the time required for preparations, and therefore the HUF conversion deadline of 1 December 2015 was set with the agreement of the parties concerned.
Similarly to foreign currency mortgage loans, the MNB supplied the foreign exchange amount required for HUF conversion for its foreign exchange reserves, only in the form of unconditional instruments on this occasion. The central bank issued a tender on 19 August 2015, the exchange rate of which had to be applied during HUF conversion.
Based on the further negative experience related to the legal interpretation of foreign exchange risk, our Association presented an important request, namely that the exact text of information on interest rate risk should be included in the act that was also approved by the legislator.

Act CXLV of 2015 on resolving issues concerning the HUF conversion of receivables from certain consumer loan agreements was promulgated on 2 October and entered into force on 5 October. The scope of the Act covered a portfolio worth almost HUF 110 billion and approximately 115,000 contracts in the banking sector. The HUF conversion of the contracts generated more than HUF 30 billion loss to the sector.

In early October, the MNB issued a draft recommendation to detail the act's annexes on information, which was consulted on in three rounds with the Banking Association and the Leasing Association. The majority of the uncertainties in the application of the law were clarified during the consultations. The solutions established jointly were published by the MNB in the FAQ and in its Recommendation published at the end of October. In the remaining open issues, the MNB requested the MNE to interpret the law and then completed its FAQ reflecting the consistent position that developed from the consultations.

Implementing the Mortgage Credit Directive (MCD)

The Mortgage Credit Directive was announced in February, 2014 in the Official Journal of the European Union. Member states had a relatively long period for the implementation of the Directive. In Hungary the implementation of the MCD took place *with the acceptance of the modification of the Act on consumer loans (Act CLXII of 2009)* and the *Act on credit institutions* and the implementation of the decrees to the Act in late December, 2015. The relevant laws have to be applied by credit institutions as of March 21, 2016.

The Ministry for National Economy, in charge of the preparation of this Act, has involved the Banking Association in the consultations from the outset. Since this Directive is primarily of a consumer protection nature, credit institutions and authorities approached it very differently and consultations were characterized by fierce debates. Although we achieved significant results during the negotiations, the application of this Act obviously makes lending by banks more costly and complicated. The key issues during the negotiations were as follows:

- *Informing customers in advance* The current legislation already poured an excessive amount of information on customers; the new standards increased it even further. Customers must be informed in four phases, orally and in writing, both in general and tailored to the customer. We succeeded in enabling the bank to perform this information provision electronically for three of these four phases.
- *Regulation of credit intermediaries* The Directive provided for significantly more detailed and strict rules for credit intermediaries, from which it must be highlighted that the commission is capped at 2%.
- *Remuneration* The Directive has strict provisions on the remuneration of bank employees who influence loan decisions and come into direct contact with clients. During the negotiations, banks tried to achieve that the interest of those employees in direct contact with the customers be maintained, since they are key players in sales.
- *Ban on bundle* We managed to achieve that the legislator will not consider it a bundle if the bank requires holding a (free) payment account to be used for the repayment. A requirement for a savings account is also not subject to the ban (building savings account combined loan). Prescribing a savings account (building society combined loan) is not prohibited either. It is possible to prescribe asset or life insurance as a condition to the loan, but, contrary to our intentions, the banks can only apply one of these.
- *Vocational training* The Directive's priority is to ensure a high standard of professional knowledge for those engaged in mortgage lending, therefore it provides for training requirements and participation in continuous training. During the negotiations, our efforts meant that exams will take place less frequently.
- *Early repayment* The Directive enables the lender to enforce its actual costs in the event of early repayment. On this basis, we managed to achieve a simplified regulation of fees and to delete a few disproportionate customer discounts.

The implementing decrees gave detailed guidance on the important parts of the mortgage lending process from vocational training requirements in credit counseling to tables for comparing loan conditions to help with informing clients. The Banking Association received several indications from member banks in connection with the interpretation of the Directive, therefore the mortgage lending working group looked over and answered part of the questions raised. As for the remaining questions, the WG asked the Ministry for National Economy to send its answer to them writing.

Introducing and extending the Family Housing Allowance Scheme (CSOK)

The Family Housing Allowance Scheme (CSOK) was launched on July 1, 2015. The government expected the active involvement of banks in the execution of the scheme both in terms of the administration of state subsidies and in the supply of the loans related to the subsidy.

Compared to the previous products with interest subsidy which generated only moderate interest, this non-repayable subsidy scheme gave a clear impetus to the stagnating housing market. The subsidy varies between HUF 500,000 and HUF 3,250,000, depending on the number of children, the size of the home and the degree of energy efficiency. It is an important positive aspect that the amount of subsidy is included in the own funds of the potential loan and that the purchase of a used home and home extension are also included among the objectives eligible for the subsidy. Similarly

to former successful schemes, the subsidy is available not only for existing children, but also for children "promised" to be born in future.
Though the housing promotion allowances that came into effect in July also brought a great revival for housing loans, the government approved a new support package (of much bigger value than previous ones) in its decree towards the end of the 2015. The amendments particularly incentivize having three children in the family. For these families, moving into a new home will be aided by the following:

- maximum HUF 10 million support, which does not have to be repaid;
- another HUF 10 million loan – tied to the previously mentioned support – with lower interest;
- VAT relief.

In order for the support to be accessible to a wider audience, several limitations have been canceled:

- Energy-saving requirements have been removed;
- There is no longer a maximum floor space ratio for new homes;
- There is no longer a maximum price for one square meter;
- Ownership or the renting of another real estate no longer presents an obstacle, and one does not have to terminate ownership of these when moving into the new home;
- Existing children can be considered when applying for the allowance (however, any previous support will be deducted from the sum of the newly determined one).

It was a tremendous task for banks to prepare for the new, extensive legislation – with a short deadline – and to professionally inform the vast array of clients who wished to apply for it.
In February, 2016 the CSOK was complemented by further benefits.

V. Further important regulatory events influencing the operations of the banking sector

Drafting, entry into force and practical implementation of the Personal Insolvency Act

Parliament approved *Act CV of 2015 on Debt Settlement Procedure for Private Individuals* (Debt Settlement Act) on June 30, 2015. The expert working group of the Banking Association also took an active part in drafting the Act, known to the general public as the Personal Insolvency Act. The Ministry of Justice, which drafted the legal regulation, accepted a number of our proposals for the concept and the text of the legislation.
The act defines two types of proceedings: out of court debt settlement and in-court debt settlement. If any main creditor has a mortgage or a financial lease agreement pertaining to the debtor's residential property (or the debtor has a leasing contract on it) an out of court debt settlement procedure may be conducted and the debtor must first apply for it. In the case of out of court debt settlement, the debt settlement agreement is prepared under the coordination of the main creditor. The main creditor must perform the out of court debt settlement tasks if the debts are owed only to the main creditor and affiliated companies, as defined in the accounting regulations. In other cases, the main creditor can decide whether or not to undertake to perform the main creditor's tasks. When an out of court debt settlement procedure fails, the Family Insolvency Service forwards the debtor's application for debt settlement to the court, competent according to the debtor's address.

The in-court debt settlement procedure is an out of court procedure. The performance of the tasks of the court is assisted by the *Judicial Office, Family Insolvency Service (FIS)* which will prepare the court decision, supervise the debtor's fund and asset management, prepared the bankruptcy agreement and, whenever any asset is sold, distribute the proceeds from the sale among the creditors. The costs of the proceedings must be paid by the debtors and the creditors. The agreement prepared by the FIS between the debtor and the creditors is approved by the court. The agreement may also include the separation of the mortgaged pledged asset, in the course of which the debtor will pay only the

interests on the loan for the real property which is the debtor's place of residence and repay any other debt accumulated towards other creditors on a pro rata basis for a temporary period for two years. The family receiver prepares a debt repayment plan which may also establish the rules of sale of the individual assets and the distribution of the proceeds among the creditors by taking into account the assets and proceeds that can be left at the debtor. The debt repayment plan is approved by the court. If the five-year debt repayment period was successful, a final settlement is prepared and the debtor is relieved from the payment of further debts with the exception of the mortgage loan.
The system was introduced gradually. In the first phase those debtors could apply for bankruptcy protection in the autumn of 2015 whose loan agreement was terminated in spring 2015 or whose property was expected to be subject to a forced sale. The amendment of the act adopted in the autumn of 2015 extended the deadline for launching debt settlement proceedings in the first phase to 1 March 2016 as a one-off measure.
The draft legislation does not violate the soundness of mortgage lending and does not limit the enforceability of the mortgage. Within the framework of in-court debt settlement, no decision can be made on the separation or sale of the mortgaged asset without the main creditor's consent, while in the case of an out of court debt settlement procedure the main creditor decides on every important issue.

The time between the publication of the Act at the beginning of July and its entry into force on September 1st was not enough to publish the decrees required for its implementation, to train the Family Insolvency Service and to design (the hard and electronic copies of) the forms to be used in the procedure.
The Act has authorized the legislator to draft ten Government Decrees and seven Decrees of the Minister of Justice. Our association assisted in the drafting of the implementation decrees with proposals and consultations with the ministry.
Upon request, we held consultations, prior to the approval of the Act, with the experts of the National Institute for Family Policy, who conducted a research commissioned by the Ministry of Human Capacities on the conditions and social correlations of indebtedness. The professional working group which deals with personal insolvency presented at and moderated several conferences, professional forums in connection with the interpretation and implementation of the legislation.
At the end of 2015, we submitted a detailed comprehensive proposal for the amendment to the Act on Personal Insolvency to the Ministry of Justice, in view of the fact that in the first half of 2016 the Government envisages the comprehensive amendment to the Act on Personal Insolvency. The material sent to the Ministry of Justice included numerous proposals for the amendment to the Act on Court Enforcement.
Interest in personal insolvency was low. According to publicly available information 200 printed applications were submitted by debtors, and due to the sluggish processing of these, procedure initiations were published on the Family Insolvency Service's website only in very few cases.

Depletion of the OBA and BEVA due to the bankruptcy of brokerage firms, the Questor Act replaced by the Act "On certain damage compensation measures taken in order to strengthen the stability of the capital market"

Following the bankruptcies of savings cooperatives and the closing of Széchenyi Bank in 2014, four small banks emerging from the savings cooperatives and merging into the DRB Bank group were liquidated as a result of the bankruptcy of their owner, the brokerage firm, Buda-Cash. On that basis OBA paid out HUF 103 billion compensation to depositors of the respective banks.

The Buda-Cash bankruptcy depleted both the OBA and BEVA and the closing of Hungária Értékpapír brokerage firm made the situation of Beva even worse.
The rules of compensation for damages caused by the default of the Quaestor Group were established with retroactive force in Act XXXIX of 2015, passed at record speed at the beginning of April (hereinafter referred to as *Quaestor Act*) pursuant to which Quaestor victims would have been compensated from a designated fund into which investment service providers (primarily universal banks) would have contributed the required amounts. The Quaestor Act stated that the losses of subscribers of Quaestor bonds (irrespective of the fictitious status or existence of the bonds) had to be compensated for up to HUF 30 million. The act authorized the Fund to take a loan or issue bonds under state guarantee in order to conduct a smooth compensation process.
Several serious constitutional complaints arose in connection with the content of the Questor Act. In our opinion the Act violated the principle of legal certainty, the right to property of investment service providers falling under the scope of the act and violated the principle of non-discrimination. Some of our members submitted constitutional complaints.
The Constitutional Court ruled in November 2015 that Sections 1, 4 (5)–(9), 6 *(d)* and 13 of the *Act on the establishment of a debt management fund for the compensation of the parties injured in the Quaestor case* were contrary to the Fundamental Law in view of the inaccuracy of the obligation, the arbitrary definition of eligibility and the disproportionate limitation of the right to property, therefore it annulled the affected provisions.
In view of the above the Government drafted, still in December 2015, *Act CCXIV of 2015 on certain damage compensation measures taken in order to strengthen the stability of the capital market,* known as the "new Questor Act", the essential provisions different from the earlier law of which are as follows:
On the basis of the re-drafted personal scope, it relates not only to the buyers of Quaestor bonds, but also those of Hungária bonds.
For BEVA members, the new law resolves the issues related to payment obligations in a more advantageous way than earlier, essentially in four aspects:

- The amount payable from the Compensation Fund is to be decreased by the returns paid since the beginning of 2008.
- 11% of the claims exceeding HUF 3 million is considered as quasi own contribution and not charged to BEVA members.
- The annual payments by BEVA members to the Compensation Fund can be a maximum of HUF 7 billion; the first payment takes place in March 2017.
- BEVA members can deduct the amounts paid to the Fund from their tax payment obligation.

Amendments to the Hpt. (Credit Institutions Act) and Tpt. (Capital Market Act) (with special regard to changes in the regulations on deposit insurance and investor protection)

The spring legislative package on the amendment of several acts dedicated to financial subjects was submitted to Parliament under No. T/4393 "*on the amendment of certain acts in order to promote the development of the financial intermediary system*". The Banking Association also reviewed the draft bill during the prior technical discussions in the phase of the administrative consultations. We managed to have modifications included in the draft that were important to the banks and rationalized the new information supply rules on deposit insurance.
Several provisions of the approved Act LXXXV of 2015 added subsequently relates to the Quaestor scandal with the aim of preventing the occurrence of similar situations in future. The act intends to prevent the issue of fictitious dematerialized securities by giving a right and option to investors to verify whether or not the securities included in the statement received from the service provider keeping the securities account actually exist, and were effectively generated in KELER. These provisions again impose new burden on companies operating according to the law even though their

objective i.e., to restore trust in investments services, is understandable and worthy of support. The increase of the amount of compensation from Beva to the amount available under OBA (EUR 100,000) served the same objective, yet the Banking Association continues to deem it unreasonable in view of the values effective in the European Union. Our Association did not support the provisions of the package either that imposed a statutory obligation on Beva to provide compensation for fictitious bonds. The spring legislative package also introduced a provision to merge the operative organizations of the funds compensating depositors and investors into one operative organization from 2016 (operative organization of OBA).
Parliament approved the autumn "financial omnibus legislation" in December 2015 under the title of *Act CCXV of 2015.* The material provisions of the *Act on the amendment of acts pertaining to certain actors of the financial intermediary system* for the purpose of law approximation related to the amendment of Act CLXII of 2009 on Consumer Loans, and introduced only minor changes in the provisions of the other acts on financial subjects.

Review of the application of the Ptk., Ptké., and related legal regulations, the Ptk.

In January 2015 the MNE involved the professional interest groups of the financial sector and proposed a discussion and review of the experiences and problems of the entry into force of the new Civil Code and related laws and regulations. In that context, regular expert discussions were held with the involvement of the MNE, MNB, the HBA and the Ministry of Justice. In order to resolve the problems identified during the consultations several draft bills were prepared on the amendment of the acts on consumer loan agreements of financial institutions and other acts dedicated to private law issues. amending the acts on settlement, but the Hpt. and *Act CLXXVII of 2013* on Transitional and Authorizing Provisions related to the entry into force of Act V of 2013 on the Civil Code (Hungarian abbreviation: Ptké.) were also amended. (The act was promulgated as Act II of 2015.) The rest of the proposals were integrated into *Act LXXXV of 2015 on the amendment of certain acts in order to promote the development of the financial intermediary system.*

In the second half of 2015, the Ministry of Justice initiated consultations with the involvement of the stakeholder organizations (MNB, Ministry for National Development, Chamber of Public Notaries, Banking Association) on the amendment to the Civil Code, with particular attention to the rules of mortgage and the new regulation of the individual lien. The working group held several meetings. The Banking Association also expressed its opinion on the most important issues, considering each disputed item given by the intention that the main purpose of the collateral system is to promote secure lending. We proposed easing the fiduciary ban in relation to regulated financial institutions and agreed with the attempts that the law should regulate the foundation and establishment of a pledge as a legal act again. We recommended a more accurate definition of the subject of a collateral deposit; our association agreed with the re-regulation of the blanket mortgage and floating charge. We urged restoring an individual pledge and correcting the currently active collateral register.

The theses published by the Ministry of Justice emphasize that the acceleration of the domestic mortgage bond market and the bank refinancing market, and the increase of the safety of the mortgage bond issuance would also require the amendment of the regulation of lien. In addition to the new regulation of the individual lien, the amendment concerns the review of the ban on fiduciary collateral, the register of loan collateral and the rules on the transfer of contracts. Amongst the contract law provisions, rules on limitation periods, lump-sum collection costs, rent, lease and, from the banking contracts, the rules on payment accounts need to be corrected. Also, the necessity to amend the rules on financial leasing and factoring was raised. With regard to the rules on legal persons, the optionality rule and the liability of senior officers cause interpretation problems.

The Ministry of Justice, after several rounds of consultations with the above participants, launched a wider debate on the theses of this amendment. The amendment to the Civil Code is on the agenda of the spring session of the Parliament.

Electronic liaison with courts, the amendment of the Act on Civil Procedure

As of July 1, 2015, the Act on Civil Procedure (Pp.) provided for compulsory electronic communication in litigation procedures between business organizations. According to an amendment adopted in the meantime, the parties and their representatives may choose the possibility of electronic communication from July 1, 2015 not only in cases belonging to the first degree authority of the tribunals, but in all levels and sections of civil procedures, thus it may be applied also in case of appeal procedures. The introduction of compulsory use was postponed to 1 January 2016, while an amendment later postponed it until 1 July 2016. The platform for electronic communication will be the Client Portal. Registration of the Client Portal may be initiated only by a private person in his/her own name by giving an e-mail address, therefore the use of the system prompts problems in case of large organizations such as banks, where several legal counsels operate. We believe that the problem could be resolved with a company port or office port. The amendment to the Civil Procedure only provided a solution for the legalization of the office ports opened earlier, but the entities of the Ministry of Interior Affairs do not authorize new office ports, with reference to the unchanged implementing decrees, which have not been harmonized with the Civil Procedure. For clarifying and resolving the problems we contacted the Ministry of Justice, the Ministry of the Interior, and the National Office for the Judiciary and initiated consultations, which were successful. According to the Minister of Interior, work on a special new service, the “e-perkapu” (“e-lawsuit port”), is in progress, which can be used by the representatives of business organizations as well and will be created based on the office port.

Court enforcement, review of the Decree of the Minister of Justice on the fees of court bailiffs

In the context of the amendment of the Act on Private Bankruptcy, we made several proposals for the amendments to the Act on Court Enforcement to the Ministry of Justice. For such purpose the Ministry of Justice initiated the establishment of a codification committee and requested the Banking Association to also participate. According to preliminary ideas, the proposal for the complex modification of the Act on Judicial Enforcement will be submitted to Parliament in the second half of 2016.
Our Association, the Chamber of Bailiffs and the Section of Bailiffs, established in September, held several consultations on general enforcement problems and the judicial enforcement issues concerning the settlement of foreign currency loans.

In the framework of preliminary professional consultations, we issued an opinion on the draft amendment to the *Decree on the tariff of bailiffs.* We recommended maximizing the cost of enforcement at 50% of the collected amount in the sale of real properties and vehicles similarly to the expenses of a liquidation procedure. In the case of any judicial enforcement procedure applied on payment accounts in relation to wages we also proposed maximizing the working fee of bailiffs. We also proposed reducing the eligible expenses and reviewing the flat rate cost ratio of the Chamber. We suggested preventing the bailiff from charging any collection commission on debts cancelled for the debtor by the party requesting judicial enforcement.
The Decree of the Minister of Justice *35/2015. (XI.10.) IM* is more favorable than the previous tariff decree, yet unfortunately it took a step back to the detriment of the parties requesting judicial

enforcement compared to the provisions contained in the draft circulated for discussion. Certain fee items are still very high, and in general it can still be concluded that the fees due to bailiffs are not proportionate to the work done but are established pro rata to the claim.

VI. Development in connection with Magyar Nemzeti Bank (MNB – the central bank of Hungary)

Introduction of the Mortgage Funding Adequacy Ratio (MFAR) and the legal amendments triggered by it

Following the HUF conversion of retail currency mortgage loans the MNB concluded that the maturity mismatch between the long-term HUF loans and short-term HUF funds could also entail a risk. In order to mitigate that risk it initiated the introduction of a new Mortgage Funding Adequacy Ratio. According to the original concept the numerator of the MFAR ratio contained the long-term HUF funds existing only in the form of securities instruments that were used for financing and re-financing mortgage loans, while the denominator included the retail HUF mortgage loan portfolio. Despite the expected extensive and major impacts on the market, the MNB finalized the proposed decree after a short consultation period.
According to the MNB Decree, published at the end of June on the basis of the consultations held in spring and in agreement with the ECB:

- the securities with 1-year original tenor could also include securities, not only denominated in HUF, but also in foreign currency prior to 2015 could also be included in the nominator,
- mortgage bonds eligible as collateral at the ECB and MNB were also eligible to the specified extent if they were held by group members,
- the long-term portfolio of mortgage loans shall be taken into account at net value, less impairment, in the denominator of the ratio,
- due to the one-year preparation period, the date of entry into force, originally planned for April 2016 was postponed to October 2016.

Our proposals, according to which the long-term deposits could also have been included in the indicator and that the gross amount of loans overdue for more than 90 days should not be included in the calculation, were not included in the Decree.

In a position statement on securities instruments eligible for HUF funds the MNB stated that issuing securities that comply with Article 129 of the CRR was not possible, due to the limitations of Hungary's legal environment, therefore the requirements stated within the regulation could only be met through mortgage bonds. Then the Ministry for National Economy declared that it would develop the legal background for the issue of covered securities complying with the CRR only simultaneously with the EU legislation developed in relation to the capital market union, i.e., the credit institutions will not be able to issue such an instrument by the implementation of the MFAR indicator. Consequently, from October 2016, the MFAR requirements can only be met with the issue of mortgage bonds and by using refinancing mortgage loans. Consequently, the founding commercial banks announced the establishment of three further institutions to be added to the existing three mortgage banks.

Having recognized the reducing number of opportunities and the adjustment problems of the market actors, in August the MNB requested the Banking Association to assess the market adjustment process concerning the implementation of the MFAR ratio, the related difficulties and the legal impediments that prevent the issue of mortgage bonds secured by the existing loans or mortgage loans taken for refinancing purposes. The detected problems, some of which went beyond the MFAR,

related primarily to the lack of the accessories required under the Mortgage Banks Act (Jht.)[1] in the banks' mortgage loan agreements (restraint on alienation and encumbrances, notarial deed, lack of authorization for the transfer of the personal data of debtors to the mortgage bank), the different lending process (method of establishing the collateral value, the provisions of the new Civil Code concerning pledges (also including compatibility with the CRR) as well as the size of the capital market.

The problems exceed the competence of the MNB and therefore in September a legislative process began under the control of the MNE and the MoJ that focuses on the Jht., the Ptk. [2]and the Ptké.[3] for the purpose of removing the impediments from the refinancing of the existing loans and to facilitate secure refinancing for future loans. (The amendment of the Ptk. [Civil Code] is included in the 2016 spring schedule of parliamentary sessions.) The MNB accepted the argument that banks required at least one year for secure preparations and therefore, without the promised amendments to the legislation, in the last week of February, it postponed the entry into force of the MFAR Decree to 1 April 2017. Simultaneously it also introduced a de minimis rule, taking out from the scope of the decree systemically insignificant institutions with less than three billion forints net retail mortgage loan portfolios.

Modification of the FEAA (Foreign Exchange Funding Adequacy) ratio and the introduction of a new FX position balance ratio

At the end of March, the MNB indicated its intention to modify the FEAA indicator and to introduce a new FX position/balance ratio to limit the on-balance sheet open FX positions as a percentage of the balance sheet total. The central bank expected the market to adjust to the new rules by phasing out their short-term FX funds and replacing them by long-term funds as well as the long-term continuation of the situation resulting from the termination of the SWAP files. We proposed resolving that issue with self-regulation coordinated by the Banking Association in order to have a more effective method for the phasing out of the short-term FX funds, referred to as the primary objective, and in order to avoid any changes affecting the SWAP and restricting flexible liquidity management. Despite its initial openness, the MNB still decided to amend the legislation and modified the Decree of the FEAA indicator and published a decree for the new FX balance ratio on 30 July totally ignoring our proposals for the contents of the Decree.
The modified FEAA ratio does not contain the long-term SWAP portfolios and, compared to the schedule announced on May 2014, the introduction of 100% of the ratio was moved forward. What we managed to achieve was that the new rules entered into force later than originally envisaged, only on 1 January 2016.

Repeal of the MNB decree on the CRR-related transitional rules

The MNB contacted the Banking Association in early July 2015, indicating that it intended to repeal *Decree 10/2014 of the MNB on the transitional national rules related to the introduction of the CRR* as of 1 January 2016 The MNB justified the intention to withdraw the temporary easing with the lack of data in appropriate breakdown to prepare the impact assessment studies. This repeal would have

[1]Act XXX of 1997 on Mortgage Banks and Mortgage Bonds
[2] Act V of 2013 on the Civil Code,
[3] Act CLXXVII of 2013 on the Transitional and Authorizing Measures related to the Entry into Force of Act V of 2013 on the Civil Code

little effect on the credit institutions' capital position, but it would have a positive impact on the international views on the stability of the Hungarian financial system and it would be in line with the similar measures of several EU Member States.
In our reply sent to the central bank we indicated that the repeal of the transitional rules could question predictability, which was a step decreasing financial stability. Albeit the measure is neutral for institutions already compliant with the CRR rules but it can have adverse effects on institutions that are able to comply with it in the long term only.
The MNB published the amendment of the Decree on 15 October, disregarding our objections. Although the decree will remain formally effective during the entire transition period, as of 1 January 2016, in practice, it will provide no easing compared to the final CRR rules, due to the amendment of the temporary weights assigned to individual items.

Consultations in connection with SREP

As requested by MNB in the beginning of October, the Hungarian Banking Association compiled its observations in connection with the ***Supervisory Review and Evaluation Process (SREP)***. MNB held a consultation on November 26th for these. During these the Deputy Governor of MNB emphasized that they consider SREP to be a constantly ongoing consultation between the institutions and MNB, the ultimate goal of which is for the supervisors not to have to contribute to the private, internal supervisory process within credit institutions [Internal Capital and Liquidity Adequacy Assessment Processes (ICAAP/ILAAP)]. The Deputy Governor added that, in terms of SREP rates, the central bank is quite conservative in its practice even compared to other neighboring countries, however, the SREP review is currently underway. The head of the Special Supervisory Competencies Directorate responded to the problems indicated in the HBA's letter by demonstrating the directions taken in connection with the changes to SREP and promised that they would publish the ICAAP/ILAAP handbook as soon as possible.

Applying the macroprudential capital buffers

In December, MNB held a verbal consultation on the ***application of macroprudential capital buffers***. European regulation provides that the *anticyclical capital buffer*, which reflects the economic trend, will need to be applied from January, 2016, at a rate between 0% and 2.5%. Concerning Hungary's exposure, the Financial Stability Board set the anticyclical capital buffer at 0% from January. The requirement will be reviewed each quarter and it will need to be met after one year.
The *aim of the capital buffer prescribable for other systemically important institutions (O-SII)* is to increase the stability of systemically significant institutions. It may range from 0 to 2%. This capital reserve will be activated from January 1, 2017. Its specific values will be determined according to the guidelines of the European Banking Authority, taking into account specific Hungarian features.
The national authority may apply the *systemic risk buffer* to manage risk, which causes problems within a given member state. The European Commission must be notified of the introduction of a 1-3% buffer, while its consent is needed for the application of a systemic risk buffer that exceeds this (which may be maximum 5%). The Financial Stability Board – following the HUF conversion of FX loans – only wishes to introduce the systemic risk buffer at the range of 0-2% in the case of real estate included in the balance sheet of banks, and problematic project loans, with the expiration date passed by over 90 days. This would be done from January 1, 2017, in the case of portfolios over HUF 5 billion, and based on data from the end of the year 2016.
From January 1, 2016 credit institutions will also have to phase-in a *capital conservation buffer*, as provided in Article 298 of the Act on Credit Institutions and Financial Enterprises.

Probable changes regarding the payment-to-income ratio (PTI)

After introducing the PTI ratio in January, MNB started fine-tuning its regulation (decrees, which do not endanger limiting excessive stream of credit but limit retail lending) from August and included the Banking Association in the process.
As a result of this work, proposals concerning three questions of strategy were sent to the Financial Stability Board. The FSB – depending on the agreement of the ECB – decided as follows:

- the top rate threshold of the PTI ratio will not be limited;
- the de minimis threshold will probably increase from HUF 200 thousand to HFU 200 thousand; and
- in the case of interest periods of several years, PTI ratios will be calculated by considering a decreased installment value (i.e. 85%).

The smaller portion of further – mostly technical – proposals requires for MNB the decree to be modified, while the majorities are issues which can be resolved by consulting the Frequently Asked Questions page on MNB's website. Central bank experts promised to publish the modified MNB decree in Q2 of 2016.

MNB liquidity stress tests

In the third and fourth quarter of 2015, MNB carried out a stress test on the basis of the data from mandatory reporting and extraordinary data reporting. MNB established the methodology of the supervisory liquidity stress test (SLST) based on the LCR[4] indicator; however, it amended the range and the assessment of liquid assets to be taken into account in view of the stress scenario, as well as the various outflow factors affecting liquidity.
According to the outcome of these calculations, liquid assets grew by HUF 1,192 billion and outflows by HUF 2,368 billion at a sectoral level.
The Supervisor indicated that the SLST methodology will be integrated in the 2016 review of the supervised institutions' own ILAAP methodology, then after the experience-based fine tuning, the methodology will be finalized as of 2017. It asked the institutions to make calculations, in addition to the calculations provided for by banking methods, by entering their own institutions' parameters into MNB methodology.

The cleansing of bank portfolios, MARK's operations

MARK Zrt. and the Banking Association established a joint expert group (with the involvement of a few member banks), which began its work in January, 2015. The group aims to work out the details of portfolios and property to be transferred, as well as the implementation and documentation of the transfer – in relation to the reduction of the banks' not soundly performing commercial real property loan portfolios.
The working group set it as its goal to review the following topics:

- Definition issues: definition of portfolio components, potentially used in various transfer methods ("accelerated and normal") to be applied by MARK.
- Pricing and valuation mechanism of portfolios, portfolio elements and real properties.
- Legal issues and documentation.
- Operational implementation and transaction issues.

As, given the role of the state played by MNB, the pricing and valuation methods defining the transfer prices constituted the most sensitive issue (they were likely to generate a dispute in consultations with the European Central Bank and the European Commission), the working group

[4] liquidity coverage ratio

began to review the portfolio definition and operative implementation issues. The working group discussions on the portfolio definition and the technical issues of the due diligence process were successfully concluded, and negotiations continued on the technical issues of the process of purchasing receivables, when MARK suspended consultations, due to the significant delay in EU consultations and the considerable number of changes requested during these.
Mark initiated re-establishing contact in late October, and its experts granted information on how work was coming along in connection with starting their activities. They indicated that in addition to the acquisition of receivables and debt management, as well as real estate management and development related to it, they will start a new activity: contractual debt servicing to third parties, for which they have already acquired the necessary MNB permit. In connection with their other two activities, they were awaiting the permission of European authorities, which they received in early February. MARK – based on its series of consultations with European institutions – significantly modified the previously mutually established portfolio definition rules, which will now be tied to the NPL concept known in EU law. The originally agreed methodology of creating the portfolios-to-be-taken over also changed. Elements of receivable portfolio offered by banks and satisfying MARK requirements will be chosen randomly and filtered into HUF 50 billion portfolios. MARK will make an offer for these and the bank will decide whether it will accept it and have it marketed as a unit within the given portfolio or deny it, and stop the portfolio from being marketed. As previously planned, with granted EU permission, MARK will contact all banks concerned and give them a document package, based on which the acquisition process of bad debt may start.

Data supply (ad hoc data supplies, changes in 2016, preparations for the switch to IFRS in 2017)

At the beginning of 2015, our Association approached the central bank mainly in relation to the extraordinary and regular data supplies ordered in relation to the implementation of the phasing out of the retail mortgage loans denominated in foreign currencies (unfair interest and fee increase, settlement related to the exchange rate margin, HUF conversion). The central bank accepted the methodology adjustments and deadline modifications requested by us on a number of occasions.

During the year we also reviewed the draft legislation on the data supply obligations envisaged for 2016-2017 and also requested modifications and clarifications. In order to reduce the data supply burden, we approached the competent Vice Governor of the MNB asking him to take into account the data available for the central bank in the new data requirements and not to request data that are not even collected by the credit institutions. We requested the involvement of practicing banking experts in the preparation for the data requests and also asked for enough time for preparation in relation to the set deadlines. Our Association also requested the central bank to co-ordinate any new order for extraordinary reports. The reporting obligations impose unreasonable burdens on the reporting units and complying with the orders by the deadline is often impossible due to physical restrictions. The MNB promised to pay more attention to co-ordination within the central bank in relation to any request for data supply.

In line with the transition process to the International Financial Reporting Standards (IFRS), the National Bank of Hungary prepared and distributed for commenting the new draft data supply to be applied from 2017. Our Association and the MNB Statistics Department agreed to establish a joint operational group to discuss the issues relating to the data supplies, which will change completely due to the switch to IFRS, obligatory for the credit institutions from 2017. Initially, 11 member institutions expressed an intention to take part in the joint expert group and others joined later. The technical work, which started at the end of November, will also continue in 2016. The joint working group discusses all proposals and issues raised at the meetings and the memos of the meetings, agreed with the MNB, are sent to the data supply units of all member institutions.

VII. Payments

Developments regarding GIRO (more cycles, the introduction of cycle 0, the review of direct debit)

As initiated by the central bank, two significant changes were made in domestic clearing processes in 2015: the number of clearing cycles doubled (from 5 to 10), and a so-called "cycle 0" was introduced, which shifts the large number of (fundamentally social) payments made by the Hungarian State Treasury – aids, subsidies, pensions – over to the up-to-date platform, which operates according to EU standards.

Due to the increase in the number of cycles in 2015:

- The clearing of payment instructions was sped up;
- Client liquidity management became easier;
- The earlier first and later closing cycle is also more convenient for clients.

A doubled number of cycles meant additional work for credit institutions, for which they prepared themselves adequately.
Cycle 0 was introduced on January 1, 2016, since it is not practical to operate two simultaneous platforms within GIRO that are based on different technology and a different set of rules for clearing. The new, up-to-date clearing system only had "room" for the Hungarian State Treasury's items – until now carried out through the platform, which shall soon be terminated – in its cycle 0, the night cycle. This is beneficial for banks, since they thus have enough time to process the items forwarded to them at dawn.
GIRO Zrt. consulted in detail with banking experts on both projects (through the working group established for this purpose) and the developments made were also approved by the GIRO Consultation Board – the members of which include the managements of banks' payments departments.

Furthermore, a separate GIRO working group had the task to update direct debit, with the help of banking experts. These professional experts examined the direct debit process in detail and elaborated numerous proposals (that fundamentally require legal changes), which they forwarded to MNB. From the content of the proposals it is important that:

- it will be mandatory for the payee to send the payor's bank an answer on the received mandate within a given time period, in order to provide the proper information to the client who authorized the payment (on whether the authorization was accepted or not); and
- in case of a change on the payee's side which concerns a large number of clients (e.g. transfer of ownership, transfer of clients), the payee's bank must investigate whether this is legal, and based on this, the payor's bank is on a legal basis entitled to modify the authorization without the consent of its client.

Managing the mass transfer of clientele between service providers in direct debit

In, 2015 a strategic restructuring process began in the retail public utility system. The state-owned ***Első Nemzeti Közműszolgáltató Zrt.*** entered the market as a new actor. The utility holding is responsible for the coordinated central control of the national utility sector, for the development of utility services and for ensuring long-term sustainable operation of the *supply of natural gas, electricity and district heat to retail consumers*. With the approval of the Hungarian Energy and Public Utility Regulatory Authority, the first unified service provider, ELMŰ-ÉMÁSZ Zrt., was established with a resolution of the authority first in the supply of electricity, and then it was followed by FŐGÁZ Zrt. in the gas supply. On the turn of 2015 and 2016, hundreds of thousands of electricity and gas consumes were

transferred to the two new service providers. The change of service providers raised problems in the execution of the related direct debits.
(Pursuant to the effective regulations on payments, the authorizations granted by direct debit customers to their payment service providers became null and void and the consumers should have granted new authorizations for the new beneficiaries.) The "switch" of this vast volume of direct debit authorizations to the new beneficiaries required the amendment of the current payment service and other sectoral legislation, on the one hand, and a coordinated transfer of the data of authorizations between service providers and the affected banks, on the other hand.
In order to achieve these two goals, experts from the Banking Association's Payment working group engaged in intense consultations with regulators, energy service providers, and the representatives of banks providing the direct debit. In the framework of this consultation, we succeeded in developing the timetables for the transition processes and, within the framework of those timetables, to organize the coordination of data transmission between service providers and banks required for new individual *authorizations* to be created in bulk, as well as information to customers concerning the change in their service provider. We succeeded in achieving the amendment of sectoral and payment services legislation, which serves as a sound basis for the effective management of future service provider changes (e.g. electricity, gas, district heating, possibly waste treatment).

MNB survey on the security of online payments

Back in late 2014, MNB invited the Hungarian Banking Association to help conduct a self-assessment in the form of a questionnaire, based on the content of the European Banking Authority's (EBA) "*Final Guidelines on the security of internet payments"* recommendation. In connection with this, the HBA's IT security working group consulted with the competent departments of MNB several times: first on the uniform interpretation of the questionnaire's content, second, after its assessment by the authorities, and third, before the issue of MNB recommendation based on the results of the questionnaire.
Based on the information gained from central bank experts, the questionnaires produced mixed results, and the majority of payment service providers need to make developments in order to fully meet the EBA recommendations' criteria. At the same time, MNB fully endorses the scope of the EBA guidelines, agreeing that clients should be protected from fraud, and recognizing the importance of sensitive payment data. MNB declared to EBA that it wishes to comply with the online payment security guidelines and issued its own, central bank recommendations for this purpose.

Keeping to the recommendation is not a legal obligation, however based on MNB's experience and in its opinion, it is indispensable for providing secure internet payment service and helps institutions significantly in fulfilling their legal obligations concerning IT security. The guidelines given in the recommendation are minimum expectations, and when they refer to a result, this result can be achieved through different, other means as well. Supervision of the actual realization of the content of the EBA's and MNB's recommendations will already be incorporated into the 2016 on-site verification plan.

Bank Cards and Fraud

Based on the data published by MNB on December 31, 2015, the number of bank cards in Hungary has not changed significantly over the past year: according to the status report of 2015's third quarter, there are about 8,960,000 cards that were issued domestically. The constant and dynamic increase in the number of contactless payment cards saw a significant change; there are now over

4.5 million, and they constitute over half of the entire Hungarian bank card portfolio. In addition, contactless payment is now possible at 60% of POS terminals. The number of acceptance points in Hungary is 80,000; POS terminals at these points amount to 99,000. The increase in electronic payments is visible from quarterly statistics since 2014. In the third quarter of 2015, the number and value of card transactions grew by over 20% each.

An important development this year was that on March 10, 2015 the European Parliament approved a proposal for the regulation of bank card multilateral interchange fees. According to the regulation, a maximum 0.2% interbank commission may be charged on debit card transactions and maximum 0.3% on credit card transactions. The same ceilings had already been introduced in Hungary a year before, yet, despite what supporters of the regulation had predicted – no positive effect on the spread of POS terminals was visible. Introducing "transparent" pricing in connection with the EU regulation presented a significant administrative task for acquirer banks. To meet legal criteria, we consulted with MNB several times.

We dedicated intensified attention to fraud; its review and its prevention. We organized a wide-range professional forum, consultation in late January and November for the experts of our member banks. These included presentations by Europol, MNB, the National Bureau of Investigation and card companies. The primary objective was to summarize typical fraud events and an overview of international patterns (preventing fraud migration). According to MNB assessments, despite the moderate increase both in the number of fraud events and in the amount involved in them over the last year, Hungary continues to perform well in the security of electronic payments and is among the best in Europe. According to the European Central Banks's comparative report, from the 30 inspected countries, Hungary is the one with the lowest number of bank card frauds committed – the number here is one tenth of that in larger European countries. According to the professional analysis, there are 20 frauds committed for every 1 million card transactions; therefore fraud prevention and management is effective.

In 2015, in collaborating with the police, we published several warnings for bank card holders on current fraud attempts and events. This information reached a wide range of audiences and efficiently helped decrease losses from fraud, as well as making clients' more conscious and careful when using bank cards.

Introducing the new 10,000 and 20,000 banknotes

The new 10,000 banknote was put into circulation in December 2014 (substantially in 2015), the new 20,000 in 2015 (substantially in 2016). Several consultations were held to dispute the appearance of the banknotes. During these, our Cash working group clarified essential logistical and regulatory issues with the manufacturers of banknote processing machines, cash in transit companies, and mainly the central bank.
Fine-tuning the regulations which help introduce the new banknotes and incentivize the removal of the old ones, was a hard task since the old 10,000 banknotes will remain in circulation for a longer period of time (though the new bills will dominate cash flow), while the there is only a short period of time (1 year) to entirely replace the old 20,000 banknotes. The radical increase in cash in the economy compared to when the banknote switch was launched presents further complications. This is partly due to the low interest on bank deposits and partly to the possibility of free cash withdrawal (twice per month).

The successful inclusion of the forint in CLS[5]

Back in early 2014, the Financial Stability Board of MNB issued a letter of intent to the CLS Bank to make the Forint a settlement currency in the continuous linked settlement system, in cooperation with the Board. By including the *forint* in the Continuous Linked Settlement granted by CLS Bank, MNB aimed to have domestic banks eliminate the settlement risk of their FX transactions, since the CLS, within the framework of its settlement method, accounts FX transactions with versatile netting, finally and irreversibly.
MNB did not wish to create a formal project for including the forint in CLS, instead, it prioritized the participation of professional interbank organizations and continuous collaboration with banks that are active in the FX market, and which were mobilized by these organizations.
Thus, the Banking Association received an important role. During these nearly two years, the HBA contributed to the organization of several fora and conferences and to the surveys preparing the implementation phase by following up the preparation phases and providing continuous information to its member banks. This informal way of collaboration also proved to be useful later, since the lack of IT capacity due to the additional burdens on banks in connection with the termination of FX loans was thus manageable through the flexible determination of the joining deadline. Finally, the end date of November 16, 2015 was determined, keeping in mind how long CLS Bank procedure takes and considering banks' request for delay. At the same time, CLS system commenced the settlement of payment orders in Hungarian Forint, its 18th settlement currency, and the first independent foreign currency from Central Eastern Europe.

Domestic developments in connection with SEPA

The activities of the SEPA working committee were marked by a sort of duplicity. On the one hand – since its members are mostly the same as that of the Hungarian SEPA Association's – it had to make decisions concerning the winding up process of the Association. On the other, it had to elaborate the content and method of the moral/professional support necessary for the preparation for the requirements of the so-called *End-Date Regulation*. In addition to completing these tasks, the WG working on the *SEPA-conform statement of account standards* entered into the last phase of its mission: the publication of these standards. The prerequisite to this publication, a suitable software (GEFEG), was provided by GIRO Zrt., an active member of the WG in Q4. The WG which deals with *the maintenance and development of SEPA payment models*, and the WG which *supports joining these models* ensured the practical completion of all tasks arising from EPC membership.

The SEPA working committee established a migrations working group to prepare for the End-Date Regulation (the deadline of which is October 31, 2016). The working group's task was to identify the difficulties of meeting these requirements and to propose solutions. It created an *Information Packet*[6], which was presented not just to Banking Association members, but to other representatives of financial service providers, at a professional forum. Representatives of the Banking Association and MNB experts – a year before the Regulation entered into force – held presentations to draw attention to the importance of the costly and time-consuming preparation that must accompany the migration phenomenon. The Forum was the first step of the *communications plan* and the professional support program through which the Banking Association wishes to aid the preparation of not just payment service providers, but their clients as well. This will be done from 2015 to 2016 thematically, and with the help of media publicity.

[5] CLS: Continuous Linked Settlement

[6] Accessible in Hungarian through the Banking Association's website

On September 9, 2013 the ***Hungarian SEPA Association*** (HSA) made the decision to cease its activities through a ***winding up process***. Following this, the HSA initiated the commencement of the winding up process and made an agreement on December 16, 2013 with the Hungarian Banking Association. According to this, the HBA will take over the HSA's ongoing activities and future SEPA-related activities. During the winding up process, the HBA – in support of the activities of the liquidator – completed the terminated HSA's secretarial tasks. At the final meeting, members unequivocally accepted the final report, opening and closing balance sheet of the winding up process, tax returns, the accountancy report on the final business year, the balance sheet as well as profit and loss account, and decided on the distribution of assets proposed by the liquidator. (During the phase of the distribution of assets, ex-members duly transferred the sum shares of members to the Banking Association either directly or indirectly – satisfying the agreement between the HSA and the HBA.) After the settlement, the documents concerning the winding up process of the HSA were also handed to the HBA for safekeeping.

EPC developments

The EPC President announced at the beginning of February that the Royal Decree approving the new EPC Charter had been published on 28 January 2015. That date marked the beginning of important organizational changes. The plenary session transformed into a General Assembly, the Co-ordination Committee was terminated, the Nominating and Governance Committee as well as the Audit Committee were revised, the Legal Support Group was reorganized and the new Board and its Secretariat entered into office.
The new organization began its operation with two modules in April when the operational rules of the specific schemes entered into force (SMIRs[7]); Module1 with its Scheme Management Board and Module 2 under the direct control of the EPC Board. The tasks of operation of the existing schemes are performed smoothly and continuously under Module 1, while existing schemes are developed and new models are designed under Module 2.

When ERPB[8] replaced the SEPA Council, the external relations of the new EPC also changed significantly. The ERPB, chaired by the ECB, is the institution defining the strategic directions in SEPA development and the "main client" of EPC. The ERPB and EPC co-operation extended to several other fields during the year, including the monitoring of implementation of the SEPA End-Date Regulation within the euro zone and the issues of electronic authorization relating to the direct debit scheme and thereby was also integrated into the operation of EPC. Upon the request of ERPB, the EPC first assessed, and then started developing a new *SEPA Credit Transfer scheme* (SCT Inst), suitable for the implementation of *instant payments*. In the scheme the execution time is expected to be 10 seconds and the beneficiary's bank will have no more than 20 seconds to send a response message to the sender's bank. The top limit of the transfer will be EUR 15,000.
The organizational restructuring of EPC also entailed the restructuring of its financing. From this year, membership in each individual payment scheme will be subject to the payment of the annual membership fee. The EPC membership fee has also changed depending on whether the member was part of both modules or only Module1. The Hungarian banks, in total twenty one banks, also including the Hungarian State Treasury and Magyar Nemzeti Bank, are typically members of the *transfer scheme*. The two different direct debit schemes have so far only one member from Hungary. The EPC publishes the fees for the subsequent year for the scheme members on its website immediately after the general meeting held in December.

[7] Scheme Management Internal Rules
[8] European Retail Payments Board

Amendment of the EU Payment Service Directive (PSD [9]2)

In October 2015, the European Parliament and the European Council approved the amended Payment Service Directive. The main purpose of the Directive is to introduce a satisfactory payment environment for e-commerce, which is one of the most dynamic areas of the economy. The third party provider (TPP), who manages the exchange of information and payment between the parties among the merchant, the client and the client's account managing bank is the key actor of e-commerce. The TPP provides information to the client on the free balances available on the client's bank accounts and starts the payment to the merchant if the client requests it. As the TPP proceeds at the Bank on behalf of the client, it must have access to the client's secret e-banking identification information to proceed. While the legislation was drafted, the banking sector raised its concerns about the disclosure of the secret ID to a third party but the legislator deemed the issue resolved by

- adding the two disputed services (supply of account information and launch of payment) to the regulated payment services,
- defining TPPs as institutions obliged to have a license and supervised by the authorities, and
- setting a requirement for the EBA to develop standards for the contents of the secret client identification codes and the method of their disclosure to TPPs as well as the communication among the TPPs, banks and clients.

The European banks and banking associations aim their lobbying efforts at EBA to ensure that the new standards still fully guarantee the security of payments.

Consultation on the Payment Accounts Directive (PAD[10])

The Member States must transpose and implement the Payment Accounts Directive, published in July 2014, by 18 September 2016. Within the framework of the preparations for the implementation, the Ministry for National Economy requested the Banking Association to inform the ministry on the views of the banking sector on the self-regulation concerning the basic account and the switching of banks; the bank account fee comparing services operated by authorities and private companies as well as the purpose and feasibility of the directive.
According to the opinion of the bank account working group described below:

- The type of bank switching included in the directive is rare when clients ask for the exact same bank account service at their new bank, and switch only because it costs a little less. Typically the new service pack is worked out together, based on the client's situation/profile and the new bank's available products.
- Almost all banks have a basic account-like service (which is low-cost and diverse), but it is not the reason why very few people choose this type of service. This is mostly due to tax evasion (envelope wages) and to the „bank dodging" mentality of the elderly.
- Out of the currently used bank account comparing services, banks prefer those of private enterprises, since these, as opposed to those of the authorities do not require a separate data reporting (they collect data from banks' websites instead).

The European Banking Authority (EBA) prepares a common European list of banking services from the national recommendations in order to ensure the comparability of bank account fees and charges. This would make the bank account prices comparable among the EU banks. In Hungary, the MNB is responsible for this process, and before sending its list of 19 items to the EBA, it asked the Banking Association for comments. In the opinion of the Cards working group, the Banking Association raised the following points to the MNB:

[9] Payment Systems Directive
[10] Payment Accounts Directive

- the list contains several items (e.g. VIBER transfer, demand for bank account verification), which are entirely marginal services, and will probably not make the EU list;
- certain increasingly popular services were missing from the list (e.g. ATM payment with bank card).
- it is a problem in principle that the document does not contain fee-lowering conditions in addition to fee cancellation.

The MNB added a number of the Banking Association's suggestions to the final Hungarian proposal, which was sent to the EBA.

VIII. Tax and Accountancy

Changes in the tax regulations in 2015

Several tax regulations concerning credit institutions were amended in 2015, in relation to which the Taxation Working Group of the Banking Association was involved in several consultations. The main changes and events are listed below:

- The rules pertaining to the banking surtax in 2016 were changed on a number of occasions during the year. In compliance with the Memorandum of Understanding between the Government and the European Bank for Reconstruction and Development (EBRD), in summer the Government reduced the tax rate from 0.53 per cent to 0.31 per cent (to 0.21 per cent in 2017 and 2018) (above HUF 50 billion adjusted total assets) and made the 2014 adjusted total assets the tax base instead of the 2009 adjusted total assets. It was another major amendment that credit institutions that expanded the portfolio of their corporate loans since 2009 would have been eligible to refund from the banking surtax up to no more than HUF 10 billion at national economy level. However, the competition authority of the European Commission objected to this rule that made the tax credit available subject to an increase in lending and several versions of modification were developed in the last quarter of the year. In the end, the potential tax credit as an incentive of lending was cancelled and the 2009 adjusted total assets remained the banking surtax base for 2016, while the tax rate was reduced to 0.24% above HUF 50 billion.

- A new tax type has been introduced as a special tax on the profit of investment services, which will be added to the banking surtax charged to credit institutions from 2016 and will almost offset the surtax reduction. This supplementation was the "result" of the motion for amendment, submitted during the parliamentary discussion on the overall tax legislation for 2016 without any consultations with the banking sector. Our association objected on a number of occasions to the new legislation that introduced dual taxation with an erroneous text to the Ministry for National Economy, which is responsible for the legislation. The uncertainty stems from the fact that the government decree regulating the bookkeeping of investment enterprise does not apply to credit institutions, yet the text of the act refers to it in relation to the calculation of the tax base.

- The Constitutional Court declared the legal regulation on the Quaestor Victims Compensation Fund to be contrary to the Fundamental Law at several points and the act was revised. *The Act on Certain Compensation Measures Introduced to Strengthen the Stability of the Capital Market (Act CCXIV of 2015)* also altered the rule pertaining to the tax refund on contributions required from BEVA members.

- The effect of the Settlement Act, retroactive to 2004, and the potential adjustments going back to 2008 in various tax types related to the almost HUF 1,000 billion loss stemming from the act generated a lot of issues which were discussed on several occasions by our Taxation Working Group and in relation to which we also requested a position statement from the Ministry for National Economy.

- the Taxation Working Group also held consultations on the extension of the tax exempt long-term investment accounts (LTIA) launched in 2010 and maturing first on 31 December 2015. The relevant modifications of *Act CXVII of 1995 on Personal Income Tax* (PIT Act) do not provide clear guidance for all technical issues of extension. The issues had to be clarified urgently also in order to enable credit institutions to provide information to clients in time and to make the required system developments, in relation to which we approached the Ministry for National Economy.

- Starting from 2016 the tax rate of personal income tax will be reduced by 1%, becoming 15%, and interest income tax will change accordingly. When calculating the tax, in the case of interest income the interest relating to 2016 and the amount in the preceding year must be distinguished.

- The provisions of the Personal Income Tax Act were also changed, whereby the rule applied to the cancellation of receivables from a financial loan, i.e., tax exemption, must also be applied to receivables from financial leasing. The Taxation Working Group of the Banking Association had already urged on several occasions this amendment in order to achieve equal competition.

- On 29th October 2014 Hungary also signed the Multilateral Agreement of the Competent Authorities of OECD countries on the automatic exchange of financial account information. Thereby Hungary undertook to implement the automatic exchange of tax information and to take the required steps in legislation and law enforcement. Following a number of consultations with the Banking Association, in the last quarter of 2015 Parliament adopted the Hungarian legislation on CRS[11]/DAC2[12] taxation data exchange in an amendment to *Act XXXVII of 2013 on Certain Rules Related to International Administrative Cooperation in the Matters of Taxation and Other Public Charges*.

Accounting changes (Switching to IFRS, Amendment to the Accounting Act)

Pursuant to a Government Resolution issued in 2014 on the transition to IFRS, the Ministry for National Economy had to review the impacts of implementation by 31 March 2015 and make proposals for legislative changes, the impacts on budget revenues and the required translation and training tasks by 31 May 2015. In order to implement the resolution, operational preparations began for the transition to IFRS in five expert working groups in January 2015 (Accounting, Taxation, Statistics, Budget, Training and Translation and Financial Institutions). The Banking Association was able to delegate experts to the financial institutional and taxation work groups.
We sent our clarification recommendations on the detailed draft proposal and called attention to the issues that had to be dealt with when forming the related legislative background as well as emphasized our request to ensure the one year transitional grace period not only for the Integration Organization of Cooperative Credit Institutions, but also for other credit institutions having a special position. The Banking Association urged for competition neutral regulations for the transition

[11] Common reporting standard of OECD
[12] Directive on Administrative Cooperation

because it is an important aspect that derogation should be granted within a sufficiently defined scope and not making decisions according to individual assessment. In the end, the Government Resolution and the published Act provided that it was compulsory for credit institutions to apply IFRS from 2017 with the exception of the integration of cooperative credit institutions, credit institutions with less than HUF 5 billion total assets and Exim Bank Zrt. Entities granted the transitional grace period shall implement the conversion as of 1 January 2018. The application of IFRS would be optional for money and capital market operators other than credit institutions (including financial enterprises, insurance companies and investment service providers) also from 2017. The MNB requires a certificate/statement from the auditor on the adequacy of the application of IFRS as a condition of choice. The submission of the auditor statement specified in the published act applies to all business associations switching to IFRS, including also those who are obliged to switch. The Hungarian Chamber of Auditors issued a recommendation for auditors on the terms and conditions of the certification of the switch.

Our Association prepared a technical proposal for the net sales revenues, which are the basis of the local business tax, for the I*FRS Transition Taxation Working Group* of the MNE, especially focusing on the criteria of tax neutral transition. We did not support the too excessive revenue definition proposed by the ministry for the calculation of the local business tax. We formed a request that regulators should not prepare a new IFRS-based profit and loss structure to define the base of the local business tax and apply the FINREP report from the single rulebook of the European Banking Authority instead, because it was based on a methodology, consistent and regulated at Community level, where the data content was also regularly controlled by the central bank. (There is no standard structure of a profit and loss account under IFRS.) We indicated that we did not support the provision of the draft bill either that introduced the minimum tax base for the local business tax and the minimum payable tax amount for the corporation tax. We also requested numerous clarifications and adjustments, a minor part of which were integrated into the version published at the end of the year. However, numerous provisions of the published legal regulation are still uncertain and work will continue on them in 2016 too.

In 2015 Parliament also approved the amendment of *Act (C of 2000) on Accounting* in order to comply with EU Directives and to reduce the administrative burdens on smaller institutions and businesses. Among others, the amendment states that the category of extraordinary items will be terminated and such economic events are to be recorded under the profit/loss on financial transactions. Rules pertaining to the accounting of dividend and goodwill are also changing and the net profit/loss of the year category will be called after tax profit. Amendments also affect the structure of the profit and loss account and the content of the Notes to the Financial Statements. In relation to the Accounting Act, Government Decree 250/2000 on the bookkeeping obligations of credit institutions was also amended.

IX. Developments within the Banking Association

Main decisions of the 2015 General Meeting

During the 2015 General Meeting the Basic Rules of the Banking Association (Charter) were modified due to the fact that the new Civil Code entered into force, since according to this, a Supervisory Board is required at all associations. The obligation to modify the Charter granted the possibility of a full review: this is how the associate member status was established, which makes it possible for financial companies (e.g. payment service institutions, card companies) to join the work of a maximum of two working groups or working committees in a consultative capacity. To become an associate member, it is required that the institution carry on the same activities as banks at least in

part, that it pay the associate member fee, and that the working group or working committee agree to its involvement.
Due to the above, it also became necessary to modify the rules on membership fee payment. The General Meeting determined that the annual fee for associate members will be the same as for observing members i.e. HUF 2.2 million.
The General Meeting elected the president, vice-president and three members of the five-member Supervisory Board from those employees of member institutions who possessed legal and economic degrees. Tibor Gáspár, president-elect, Erzsébet Páli, vice-president-elect and Bálint Csere, Zoltán Fényi, Marianna Sándor, member-elects all won their positions with the number of votes in their favor above forty. Due to their positions, SB members cannot be given orders by their employers, and do not receive financial compensation for their activities.
At the end of 2014, Zoltán Urbán, CEO of the Hungarian Export Import-Bank Plc., was elected as the new president, with a mandate until the 2017 general assembly for the election of officials.

The Hungarian Banking Association's Golden Beehive Awards were presented for the fourth time at the 2015 General Meeting. The following colleagues received the award:
— Zsuzsanna Csáki Gáspárné (Raiffeisen Bank) - for the management of standardization efforts performed in Hungary in the context of SEPA, as well as for her role in the drafting of a single, standard account statement;
— Zsófia Kutas (K&H Bank) - for her active participation in the successful resolution of payment, lending and bank regulation issues affecting the banking community;
— Ferenc Rolek (Budapest Bank) - for his performance in the development and sector-level implementation of best practices concerning human resources in the banking sector;
— Magdolna Szőke (Takarékbank) - for her outstanding and versatile work in the development of banking regulations and the adaptation of European guidelines;
— Endre Eölyüs (MasterCard) - in recognition of his innovative professional activities and results achieved in the development of the Hungarian payments system;
— Erika Marsi (Institute for Training and Consulting in Banking) - for editing the Hungarian Banking Association's professional periodicals, as well as her performance in the development and dissemination of financial knowledge and culture.

Modification of the Code of Conduct

The previous Code of Conduct came into effect in 2010. It regulated fair conduct towards a smaller group of clients, tied to lending. In 2015, a significantly shorter, revised text came into effect and replaced the previous one. The parties – based on continuous legislative work, which raised the Code's provisions to be on the level of law – declared the revised Code to be in effect, as of December, 2015.

In fall of 2015, the Board decided that instead of "derecognizing" the Code of Conduct, it will introduce a new one, which will regulate, which lays down the fundamental principles of member institutions' conduct towards clients. In addition to lending, the scope of the recently adopted Code applies to all financial and investment service providers, as well as to other partner relations of the institutions, besides their clients.

The revised Code of Conduct contains solely the principles of conduct to be followed, and no longer directly regulates the trade practices of financial institutions. Therefore, the Code no longer classifies as a Code of Conduct referred to in Act XLVII of 2008 on the Prohibition of Unfair Commercial Practices against Consumers. The special legislative requirements – among others, those concerning submission declarations or government approvals – therefore will not be applicable to the Code in the future.

After the Board approved the Code, the Secretary General published it as a recommendation of the Banking Association, which may be applied after January 1, 2016 by member institutions without any further measures.

The GVH proceedings in connection with BankAdat

In April, 2012, the Hungarian Competition Authority (GVH) initiated proceedings against the Hungarian Banking Association and the Institute for Training and Consulting in Banking Ltd. (ITCB) about an assumedly prohibited agreement. Within the same year, it extended the proceedings to include the banks participating in the data exchange. The Competition Authority revealed its initially decided position on the case to the parties concerned in early February. According to this preliminary position the Banking Association, the ITCB, and banks participating in the data exchange operated BankAdat in a way that restricted competition, since through it, they passed information to each other which was unattainable from any other source and which classifies as business secrets. The preliminary position envisaged that the Competition Authority, in its decision, would most likely declare infringement and impose a fine on the parties concerned.

The Banking Association and the banks concerned substantially disputed and confuted the Competition Authority's claims, in their comments to the preliminary decision and during the consultations in June. (They hired an acclaimed international consultant, with experience in EU competition law (RBB Economics) to compile a background study which proved their arguments.) In order to avoid/soften the upcoming sanction, the banks and the Banking Association offered GVH a public interest commitment. The commitment was aimed at BankAdat being able to continue operating publicly for the benefit of the public and offered to aid in the general development of financial literacy. BankAdat participants expressed their willingness to work out the content of the commitment together with GVH. The Competition Authority ignored the initiative in relation to the public interest commitment.
The Competition Authority modified and added to its original position, indicating in advance that it would only accuse Banking Association and the Institute for Training and Consulting in Banking Ltd. of offense and apply the fine to these two, while participating banks would be named in the decision and these would be obliged under joint and several liability to pay the fine, since payment is not executable by the Banking Association. The Banking Association, in its written comments on the Competition Authority's modified and complemented preliminary position, emphasized that there was no criminal intent and objected that there was no proof – no restriction of competition caused. The GVH ignored the fact that the market concerned (with many actors, complex products, an asymmetrical structure) made collusion unlikely, and did not adequately consider that the goal of creating BankAdat was to meet legislation criteria (setting credit limits), as well as the fact that supervisory bodies knew that BankAdat existed. At the negotiation on December 7th, the secretary general of the Banking Association pointed out that during proceedings the Hungarian Banking Association always collaborated with the Competition Authority. Furthermore, it had already suspended operating the database in 2012; in addition to having indicated multiple times that it was ready to assume a common commitment with the banks in the proceedings, despite the fact that it is convinced that BankAdat is useful and legal.
The Competition Authority did not substantially change its position, despite the banks' and the Banking Association's comments. On January 11th, it imposed a HUF 4 billion fine on the Banking Association, to be paid over a period of 20 months, in equal installments. (Failure to pay would result in the entire sum having to be paid all at once.) The Banking Association appealed to the Administrative and Labour Court of Budapest to have the decision reviewed and to suspend payment of the fine. Those banks enumerated in the proceedings also submitted a statement of claim against the decision.

Use of databases such as BankAdat in the future is justified by the new Section 166/B inserted into Act CXII of 1996 on Credit Institutions and Financial Enterprises, according to which banks – if other conditions are met – are eligible, either directly or through an advocacy group or another organization, to create and operate a database which includes aggregated data that does not classify as business secrets, and contain personal data handled by them. The database should aim to provide better service to consumers, and to promote improvement in these services, as well as to improve competitiveness for individual financial service providers or complementary financial services, and to do so by ensuring that needs, and assumed risks are assessed.

Money Week: the events of 2015 and preparing for 2016

The very first "Pénz7" program series was started on March 9, 2015 with the participation of prestigious professional institutions, teachers, students and financial experts with presentations, and flashmobs by students. The program aims to teach the basics of finance to primary and secondary school students. The program which was organized by the Hungarian Banking Association and received professional support from the Money Compass Foundation meant that Hungary joined a Pan-European initiative, happening at the very same time in 24 countries. In Hungary nearly 90,000 students were given the chance to get acquainted with everyday financial topics and the basic issues of family budget –something which also concerns them – through electives. The teaching materials have been reviewed and are supported by the Ministry of Human Capacities and the Hungarian Institute for Educational Research and Development and the professional group of teachers worked on them for several months and tested them in trial classes. 200 financial expert volunteers have joined the program from the banking sector, the Hungarian Society of Economists and the central bank of Hungary. The program is complemented by competitions, contests and an adventure game on Facebook. Pénz7 was introduced as "good practice" in the Ministry for National Economy's and the Ministry of Human Capacities' roadshow, named "Counting the Future". This program was organized for a new, financially conscious generation, to promote and diffuse economic studies in schools and to give incentive to and encourage teachers.
Last Spring's success and experience were what preparation and organizational tasks for 2016 were based on. The program, which aims to develop financial literacy in schools, is once again being organized by the Banking Association and with the help of the Money Compass Foundation, supported by the Ministry of Human Capacities. In 2016, the main topics will be the conscious management of financial affairs and savings. Different age-specific materials were developed for four different age groups. The Hungarian Money Week will take place from March 7 to 11, 2016.

Previously not mentioned working committees and working groups

- *Data Protection Working Group*

The Data Protection Working Group made a number of proposals for the clarification of the provisions of the Financial Institutions Act concerning data protection in 2015. From practical aspects, the most important modification related to Section 164.y) of the Hpt. (information to the relatives of a deceased on the data of the loan agreement of the deceased). The amendment narrows down the obligation of notification to close relatives, clarifies which data can be released, and will restrict data release until the date the bank is notified of the inheritance decision.

In addition, the Data Protection Working Committee discussed the following topics:
- data control based on lawful interests, handling of personal data of other - "not client" - data subjects,
- lessons learnt from the "Optimusz" Resolution of NAIH in 2014,

- the NAIH resolutions on receivables management,
- NAIH recommendation for the data protection requirements of prior information,
- problems of record keeping at the data protection authority and the internal data protection records of banks from the point of data controllers,
- data control information internal system, regulatory issues concerning the business regulations,
- confiscation of documents also containing personal data at the financial institution and transferring them in market surveillance proceedings with regard to the amendment to MNB Act,
- records of data protection incidents,
- position statement of the Deputy Minister of State of the Ministry of Justice for Public Law on the legal succession of the mortgage bank and the rights and obligations of the legal predecessor data controller.

A number of members of the working committee participated in the national conference for internal data protection supervisors organized by NAIH.

- *Agricultural working group*

In 2015 the Agricultural Working Group with the participation of the representatives of the Ministry of Agriculture held several consultations on the extension of data collection covering the total loan portfolio of individual farmers, which came into effect this year. (The data collection form was published on the website of the Hungarian Central Statistical Office.) The working group received information about the conditions of the direct farmer support system for 2015-2020, the electronic interface of the *Single Application* for agricultural support and the changes regarding the period from 2014 to 2020 of the Rural Development Program.
The Agricultural working group also addressed the agricultural issues concerning the introduction of the FGS+, which has been expanded to include loan guarantee. It consulted with MNB's and the Agriculture and Rural Development Agency's representatives several times, the result of which is that a cooperation agreement between the Agricultural and Rural Development Agency and those financial institutions which participate in the FGS+ was elaborated and signed in August.
As initiated by the Hungarian Development Bank, the working group – having included the Prime Minister's Office and the representative of the National Land Fund Management Organization – consulted several times in the past quarter on the interpretation of land auction notice and the relevant government decrees. It also commented on the to-be-signed cooperation agreement between the National Land Fund Management Organization and credit institutions. As a result of the consultation, in December 2015 the National Land Fund Management Organization and ten commercial banks signed a cooperation agreement within the framework of the "Land for farmers" program, in connection with selling state owned lands to farmers. Other commercial banks also indicated that they would like to join.

- *e-working group*

The NFC Mobile Wallet Service was launched in February, 2015 as a result of collaboration between the Hungarian Banking Association and the Hungarian Mobile Wallet Association. The main goal of this project is to provide a comprehensive professional training program in the field of mobile payments. Active interest was taken in the first phase of the innovative themed project; professionals from 7 of our member banks participated in the training program series, which had four parts, a half-a-day each. Out of the participating banks, 3 decided to continue and participate in the second phase of the program, which had a more "individual company-based" approach with individual professional consultations for each participating bank. Based on the positive feedback from participants, the program saw a high-quality exchange of knowledge and innovational work. This success means that the mobile wallet program may also be announced next year, for those banks that are interested.

- *Energy working group*

At the first meeting of the Energy working group in 2015, the representatives of the Association of Hungarian District Heating Enterprises informed us that as they are participating in the developmental framework for 2015 as the strategic partner of the Ministry of National Development, and therefore in the review of the Environmental and Energy Efficiency Operative Program's (EEEOP) projects. They told us about the simultaneous compiling of the EEEOP project list for 2016-2020; the review of the experience gained from operating the pricing regulation currently in effect and its influence on the financing of investments; as well as the work on the proposals for solving systemic problems that have been discovered and the submission of these to the Hungarian Energy and Public Utility Regulatory Authority (MEKH) and to the Ministry of National Development.
The Energy working group invited MEKH representatives to its second meeting. The reason the consultation was called was that Act LVII of 2015 on reaching the aims for national energy efficiency was completed, which required MEKH to create a website providing information on energy efficiency. At the meeting the working group made suggestions about what the website content should include. The website was launched in December 2015.

- *Void FX loan contracts working group*

The working group dedicated to dealing with lawsuits on void of loan contracts discussed the developments in FX loan lawsuits, and the analysis of court decisions made after the act on settlement entered into force. New risks arose in connection with the decency and legality of the general terms and conditions of bank contracts. Civil Division judgment 2/2012 and civil uniformity decision2/2014 pose stricter requirements towards bank contracts' general terms and conditions. Thus, banks must prepare for this. The Supreme Court's group which analyzes legal practice summarized its opinions in the following topics: the possible application of the legal consequences of void loan contracts in loan agreements and the lawsuits for terminating a simultaneous void loan contract lawsuit and execution.

- *EXIM sub-working group*

In 2015, it was an important task for EXIM Bank to elaborate the method for applying the tools that would decrease different limit guarantees, in order to resolve the stressful limit situation; a result of the surge in lending activity with banks. The EXIM sub-working group held a separate meeting for this topic. The working group discussed the 2015 modifications to the pre-finance refinancing framework contracts for export over and within 2 years, as well as the system of conditions for the leasing and factoring design. The recommendations of bank experts were put into the refinancing framework contracts. The sub-working group looked over the product concept, the relevant contract models and the relevant procedure methods for banks of the recently introduced Credit Program for the Improvement of Competitiveness, as well as the first product concept for the Loan Guarantee Program.
These consultations contributed to the fact that EXIM Bank could sign separate refinancing framework contracts concerning different refinancing designs, with 16 domestic commercial banks. During the meetings, EXIM Bank representatives regularly informed us about current news regarding EXIM's refinancing, and developmental directions for 2016.

- *Human and Physical Safety working group*

During the year, the Human and Physical Safety working group addressed the demonstrations in connection with FX loans and – in view of them becoming more frequent – especially the management of their new forms, which aim to disrupt administration at individual banks. The

working group consulted with the Budapest Police Chief and the professional leaders of the Budapest Police Department concerned. At the meeting, the physical safety managers learned which practice to follow; due to which police are now more effective in handling demonstrations. After the consultation, the quality of relevant police measures noticeably improved.

- *Leasing Working Group*

According to a decision of the Board of the Hungarian Banking Association, the Leasing Working Group was established in Q4 2015 by 13 commercial banks and leasing companies owned by banks. The working group defined the review of regulations on lease financing and consultations on the problems of the interpretation of the law as its primary tasks.
At the meeting of the working group, the Exim Bank representatives summarized the results of export lease financing and also presented a future concept for the direct conclusion of master agreements for export lease financing by leasing companies.
The working group reviewed the draft copy of the *Loan or Leasing Financial Navigator brochure* intended to be published by the Magyar Nemzeti Bank. The group reviewed the MNB *Recommendation 14/2015. (X. 27.) on resolving certain issues of HUF conversion of receivables from certain consumer loan agreements*, prepared for information purposes*;* and also contributed to the drafting of the frequently asked questions and answers for the implementation of *Act CXLV of 2015* and published on the MNB website.

- *Documentary Credits working group*

The Documentary credits working group discussed the professional issues on the letters of risk guarantee of the National Tax and Customs Administration (NAV) in connection with the Electronic Public Road Trade Control System. As a result of this, the text of the risk guarantee drafts accepted by NAV were modified and call-off criteria were clarified.
The working group held a multilateral professional consultation on completion, expiry and warranty guarantees, which are most often used in construction. The TSZTSZ ("Professional Organization for the Verification of Completion") and the National Federation of Hungarian Building Contractors were also invited to participate in these. During the meetings TSZSZ representatives informed us about the laws that govern the operation and proceedings of the TSZSZ, its scope of application, tasks, and the proceedings process. The working group also commented on the TSZSZ's guidelines for construction companies and market actors.

Communications: activities and statistics

The most prominent banking communications topic for 2015 was information on the settlement of consumer loans. We emphasized that a truly exceptional process had been concluded within the banking sector, bringing about changes in decade-old contracts. Banks accomplished the settlement precisely, according to legislation, and met the deadline. The process demanded nearly a year's worth of extra developmental and administrative work.
In Spring, we informed the media about the Banking Association's annual general meeting, which was held on April 24th, published the names of those professionals, who won the Hungarian Banking Association's Golden Beehive Award, and informed the media regularly about the Money Week program's events. We issued a press release together with MNB about the modification of our Code of Conduct.

In H1, banks' preparation and information in connection with the Act on personal insolvency coming into effect received much attention. HBA's vice-president and secretary general gave a summary of information useful to clients in connection with the introduction of personal insolvency legislation –

including the practical elements of the system. The vice-president emphasized that, even though the HBA supports the institution of personal insolvency, he considers its introduction to have been hasty. In connection with the HUF conversion of car loans, they emphasized that the Banking Association has already recommended introducing the new legislation and that it deems this a logical step from a consumer's point of view.
Aside from the previously mentioned topics, there was intense media interest concerning the development of SME lending, the events regarding the compensation of Quaestor victims – we addressed these in interviews and speeches. We drew card holders' attention to current fraud attempts and the fundamentals of careful, conscious card use through several press releases and speeches.
In December, our president, Mihály Patai, and secretary general, Levente Kovács held a press conference to evaluate the year; here they summarized the most important events that concerned the banking sector. It was mentioned that confidence in the banking sector is still little, which is preventing banks from contributing to the growth of the national economy, and creates great uncertainty for economic actors.

As done successfully before, we held 5 press conferences, where we summarized current information. The occasions when we summarized sector-level information very important for clients together with the consumer protection department of MNB were especially effective.

The activities of the Hungarian Banking Association continued to draw intense media attention in 2015. We had approximately 2430 online media appearances, followed by over 1000 in print media, and roughly 960 appearances in electronic media. Throughout the entire quarter, the Hungarian Banking Association's standpoint was communicated over 4400 times to the media and to the public.

International relations: the V6 convention

In addition to the Visgerád countries (Czech Republic, Poland, Slovakia, and Hungary), Croatia and Slovenia also participated in the V6 professional consultation forum. In 2015, it was held in Croatia and Poland. Those banking associations and bank representatives of the counties, who joined the consultation carry out their activities on a common economic basis, and often face very similar or uniform challenges. Therefore an exchange of experience facilitates the tracking of regional international events and makes it easier to work out adequate and effective professional solutions. The main points of focus for the 2015 consultation were: cybersecurity overview; payments (PSD2, Payments Accounts Directive, the likely impact of European MIF regulation); experience concerning SME lending development, obstacles; going through the effects of the Capital Markets Union; the impact of banking surtax and other burdens on banks.

INTERNATIONAL OUTLOOK: REGULATION AND SUPERVISION

In the following chapter we will provide a summary of 2015's most important developments in prudential regulation, presenting global and European processes separately. The detailed accounts of these events are available in the appendices of 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) and the Basel Committee on Banking Supervision (BCBS), which aim to establish a consistent and effective regulatory framework.

The Financial Stability Board

The Financial Stability Board indicated the following three priorities for 2015: full, consistent and immediate implementation of the approved reforms; finalization of the reform actions, still outstanding after the crisis; and managing new risks and vulnerabilities.
Finishing the reforms affected three areas: measures relating to the capital adequacy framework of banks, and the too-big-to-fail (TBTF) banks, as well as finalization of the regulations boosting the security of derivative markets. In managing new risks and vulnerabilities, the FSB put an emphasis on relevant data acquisition, assessing and managing risks and improving market structures. It primarily focused on risks arising in market-based financing, and misconduct risks, which may be the potential cause of systemic risk.

The FSB published for the first time, an ***annual report on the implementation and effects of regulatory reforms agreed in the wake of the crisis***. The report notes that implementation of the reforms has been steady, but uneven. The implementation of the Basel III reforms to bank capital and liquidity is ahead of schedule, the OTC derivatives reform is well underway but behind schedule, shadow banking reforms are at an early stage, while there is substantial work remaining to implement effective resolution regimes. The most tangible effect of the reforms has been to make the global banking sector more resilient, which has been achieved while maintaining the overall provision of credit to the real economy. In the report, the FSB asked G20 Leaders to help put in place legal powers to enable resolution authorities to share information across borders and to be able to give prompt effect to resolution actions by foreign authorities; to promote cooperation to address duplicative or overlapping requirements to cross-border OTC derivatives transactions; remove legal barriers to the reporting of OTC derivatives transactions to trade repositories; and ensure that national authorities are adequately resourced.

The FSB discussed more important regulatory solutions and proposals in independent documents:

The ***peer review on supervisory frameworks for systemically important banks (SIBs)*** was published to manage the TBTF problem and systemic risks. The peer review recommends that supervisory authorities clearly define their own supervisory strategy and priorities; increase their dialogue with

the institutions supervised; urge the banks to improve their IT and management information systems; and ensure that data requests are performed purposefully and in a coordinated way between the home and host supervisory authorities.

The Financial Stability Board compiled a questionnaire to complete a ***peer review on resolution regimes***, the aim of which was to assess the range of instruments available in the jurisdictions represented by the FSB (institutional frameworks, scopes, factors that affect implementation, recovery and resolution planning and resolvability assessments). The peer review, put together based on the collected responses, will be published in early 2016.

In November, the FSB released two finalized guidance papers and three consultative documents to promote the ***resolvability of all financial institutions that could be systemic in failure***.
The ***Principles for Cross-border Effectiveness of Resolution Actions*** set out statutory and contractual mechanisms that jurisdictions should consider including in their legal frameworks to give cross-border effect to resolution. The other guidance paper regulates how to ***cooperate and share information*** with the authorities of countries where G-SIFIs[13] pose a systemic risk, but host countries are not members of the CMG[14]. One of the three consultative documents lays down the ***guiding principles for the temporary funding needed to support the orderly resolution of a G-SIB***[15], the other deals with the ***arrangements to support operation continuity in resolution***, while the third one aids the ***development of effective resolution strategies and plans for systemically important insurers***.

In 2015, the ***fundamental principles of the regulations on the total loss absorbing capacity (TLAC) applicable in the resolution of G-SIBs*** and the corresponding ***Term Sheet*** were both finalized. The regulation has to be implemented for G-SIBs from 1 January 2019; therefore, G-SIBs will have 36 months to meet TLAC requirements. The minimum TLAC requirement will be set at 16% of risk-weighted assets (18% from 2022). The minimum TLAC leverage ratio will be 6% (6.75% from 2022). (The FSB published the ***list of G-SIBs*** in 2015 as well: one item out of the 30 changed.

The ***FSB and IOSCO***[16] ***valuation methodology for the identification of Non-Bank Non-Insurer Global Systemically Important Financial Institutions*** (NBNI G-SIFIs) concerns both TBTF and shadow banking regulation. The purpose of the document is to identify the NBNI financial institutions, the crisis or operational fault of which imposes a threat to the stability of the whole system based on their size, complexity or their interconnectedness with the financial system. At the end of July, the FSB decided that it will wait until work on ***financial stability risks from asset management activities*** is completed, before it finalizes the assessment methodologies. They will make asset management activity-based policy recommendations next Spring.

During the summer, the FSB conducted a ***survey*** on the ***implementation of its policy framework for Shadow Banking Entities.*** The survey concerned institutional arrangements deemed necessary; types of information that may be necessary to assess shadow banking; ways to enhance public disclosure requirements; and the design of economic policy tools to mitigate financial stability risks. The ***peer review*** – compiled based from the results collected – will be published in early 2016. Further documents published within this topic before the G20 summit were: report on ***transforming shadow banking into resilient market-based finance*** and the ***global shadow banking monitoring report 2015***.

[13] Global systemically important financial institutions
[14] Crisis Management Group
[15] Global systemically important banks
[16] International Organization of Securities Commissions: the international organization of securities supervisions

In addition, they elaborated the ***regulatory framework for haircuts (value decrease) on non-centrally cleared securities financing*** and published the document entitled ***Standards and processes for global securities financing data collection and aggregation***. Two reports were released on the progress of the reforms to OTC derivatives markets and the further work that needs to be undertaken: the ***Thematic Peer Review of OTC Derivatives Trade Reporting*** and the ***OTC Derivatives Market Reforms: Tenth Progress Report on Implementation.***

Significant progress was made concerning the ***reform of major interest rate benchmarks*** in both strengthening existing benchmarks (LIBOR, EURIBOR, TIBOR – all together the "IBORs"), and in developing an alternative benchmark, an RFR[17] – to be used with nearly risk-free transactions.

The FSB put together a report entitled ***"Corporate Funding Structures and Incentives"*** on the factors that shape the liability structure of corporates, and the influence of financial structure on financial stability. Together, the FSB and the IMF published their sixth common progress report on the ***data gaps initiative (DGI*** program, started in 2009. The implementation of the DGI recommendations will be almost fully completed by late 2015/early 2016. The data gained from the program is increasingly being used to support financial stability analysis and macro-policy decision making at national, regional and international levels. The FSB, BIS and IMF also compiled further reports on the ***data reporting related to foreign currency exposure***.

The ***fourth progress report on implementing the FSB principles for sound compensation practices and their implementation standards*** was also published in the fourth quarter. In addition, progress reports were made on the ***measures to reduce misconduct risk*** and on ***actions taken to assess and address the decline in correspondent banking***.

Basel Committee on Banking Supervision

In relation to the FSB's report, through its report to G20 leaders, the Basel Committee on Banking Supervision presented in detail how much progress has been made over the course of a year by individual jurisdictions in ***the implementation of the Basel III regulatory reforms***. The Committee also reported on the ***completion of post-crisis reforms***. Reviewing standardized methods and reducing the excessive variability of risk-weighted assets are important elements of completing the reforms. According to the evaluation, the finalization of the regulation of global banks is on track.

The BCBS created **two 1-year work programs for 2015 and 2016**. Its activities will concentrate on the following four topics in these two years:

- Policy development;
- Finding the right balance among the simplicity, comparability and risk sensitivity of regulatory frameworks;
- Monitoring and evaluation of the Basel Accords (II, III);
- Improving the efficiency of supervision.

In addition to the proposals prepared earlier/in the progress of consultations, the Committee also assessed the correlation, coherence and calibration of the rules adopted after the crisis; it is reviewing the regulations on sovereign risk management; and is also reviewing the role of the stress tests in the regulation based on national developments. The Committee is focusing on stress tests, valuation practices and Pillar 2 in the spirit of supervisory efficiency.

In ***developing the regulation***, the Committee published the ***reviewed version of the Pillar 3 disclosure requirements***, based on which market operators can compare information better on risk

[17] risk-free interest rate benchmark

weighted assets disclosed by the banks. The revision aimed to improve the transparency of the internal models used for defining the minimum regulatory capital requirements.
In cooperation with IOSCO, the Committee also reviewed the ***application of custody (margin) requirements of derivative transactions settled with non-central counterparties***.
The Committee published consultation documents on the ***accounting of expected credit loss (ECL)*** to substitute the supervisory guide introduced in June 2006.
The ***BCBS guidance on credit risk and accounting for expected credit losses*** sets out supervisory guidance on sound credit risk practices associated with the implementation and ongoing application of expected credit loss (ECL) accounting frameworks.
The ***review the Credit Valuation Adjustment (CVA) Risk Framework*** has three main objectives: (i) ensure that all important drivers of CVA risk and CVA hedges are covered in the Basel regulatory capital standard; (ii) align the capital standard with the fair value measurement of CVA employed under various accounting regimes; and (iii) ensure consistency with the proposed revisions to the market risk framework under the fundamental review of the trading book.
In collaboration with IOSCO, the Basel Committee released the criteria for ***simple, transparent and comparable securitizations (STC)***. The document aims to help institutions create STC structures, but is not meant to substitute a detailed review. The consultative document, which discusses the ***capital requirements for STC securitizations*** provides additional criteria, which – if satisfied – leads to a reduced capital requirement for STC securitizations.
Several of the Committee's 2015 documents concern TLAC regulation. A ***report*** was made on the ***TLAC Quantitative Impact Study***, which analyzes the TLAC levels and shortfalls of G-SIBs based. The Committee took the results of this study into account while creating the ***TLAC Holdings*** consultative document, which regulates the treatment of TLAC instruments. The proposed treatment in *TLAC Holdings* is for banks to deduct holdings of TLAC instruments from their regulatory capital above a certain threshold in order to limit contagion. At the request of the FSB a document was compiled to **assess the economic costs and benefits of TLAC implementation**.
The consultative document on the ***identification and measuring of step-in risk*** is part of the G20 initiative to strengthen the oversight and regulation of shadow banking system and mitigate the associated potential systemic risks. The objective of the concept of regulation on the identification and measurement of step-in risk is to mitigate potential spillover effects from the shadow banking system to banks.

The ***revisions to the standardized approach for credit risk*** form part of the Committee's broader review of the capital framework to balance simplicity and risk sensitivity, and to promote comparability by reducing variability in risk-weighted assets across banks and jurisdictions. The second consultative document proposal, which was published in December, 2015, among other things, reintroduces the use of external ratings, in a non-mechanistic manner, modifies the risk weighting of mortgage loans and introduces new risk classes.

The majority of the Basel documents serve the purpose of **developing regulation and improving supervisory efficiency.**
The Joint Forum[18] of global financial regulatory authorities issued a report on ***cross-sector credit risk management*** (affecting banks, investment service providers and insurers).
The document presents the supervisory framework of credit risk management in the financial sector, company practices, as well as credit risk management regulation and supervision.

The consultative document discussing the management ***of interest rate risk in the banking book (IRRBB)*** is aimed at completing and superseding the Committee's guidance set out in the 2004 "Principles for the management and supervision of interest rate risk." The supervision of the guidance has been motivated by two factors. First, to help ensure that banks have appropriate

[18] the global supervisory organization of the financial sector, constituted by BCBS, IOSCO and IAIS

capital to cover potential losses from exposures to changes in interest rates. Second, to limit the possibility of capital arbitrage between the banking book and the trading book as well as between banking book portfolios that are subject to different accounting treatments.

The ***Corporate governance principles for banks*** will supersede the guidance published in 2010. The revised principles draw attention to the role of the board of directors in risk management systems and collective competence; the importance of risk governance and sound risk culture within a bank; and compensation systems as key components of governance and incentive structure. Supervisors will receive guidance for working out the processes to use in banks when electing members of directorates and upper leaders.
In light of the significant post-crisis developments in financial markets, the BCBS updated its 2002 Supervisory guidance on dealing with weak banks, and published the ***Guidelines for identifying and dealing with weak banks***, extending it to cooperation between relevant authorities and information-sharing.

Well determined data supply requirements are key in ***improving the effectiveness of supervisory work***. The ***second report on the application of aggregated data reporting on risks*** examined whether G-SIBs had prepared for executing data supply, fully in effect from 2016. According to the ***third progress report,*** banks' compliance with the Principles published in 2013 should be subject to an independent evaluation in early 2016.
The ***Net Stable Funding Ratio (NSFR) disclosure standard***– similar to the disclosure standards of the LCR – shall guarantee the usefulness and consistency of reported data between institutions.
The ***report on the impact and accountability of banking supervision*** describes supervisory trends, objectives of supervision, measuring impact, accountability management, and the observations made based on the submitted answers to the questionnaire.
In 2014, the BCBS revised the 2010 good practice principles on the operation of supervisory colleges, and in July, 2015 published its ***progress report on the implementation of principles for the effective supervisory colleges.*** According to the progress report, one of the biggest implementation challenges is caused by the colleges' preparedness for the management of crisis situations.
Another consultative document discusses the ***application of the core principles for effective banking supervision in the case of those institutions which play an important role in financial integration***.
As part of its Regulatory Consistency Assessment Programme (RCAP), the BCBS published a ***report on the regulatory consistency of risk-weighted assets (RWAs) for counterparty credit risk (CCR).*** This is the last report on trading book-related internal models to be studied by the Committee.
The Committee presents the ***results of the impact study of the implementation of the Basel III rules*** twice per year. (The monitoring report, which is based on the implementation of the entire regulation package, was published for the 7th time in March and the 8th time in September, 2015.)
As part of its RCAP, the Basel Committee on Banking Supervision provided information for the eighth and ninth time in April on the ***implementation of Basel II, Based 2.5 and Basel III standard***s. The reports, which are based on the information supplied by national authorities, contain information on the status of adoption of the risk-based capital standards, the standards for global and domestic systemically important banks, the leverage ratio, and the liquidity coverage ratio (LCR).
In addition to its regular analyses, the Committee conducted an ***interim impact analysis*** of its ***fundamental review of the trading book***. The data shows that the new standards significantly increase the capital requirement of market risks in all scenarios

European regulation

The political framework of European regulation was mainly determined by, in addition to the ***plan to complete the European economic and monetary union*** (***reported by the Five Presidents*** in June), the ***agenda for better results***[19], and the State of the Union addressed by the president of the Commission.

As emphasized at the Euro Summit of October 2014, "closer coordination of economic policies is essential to ensure the smooth functioning of the Economic and Monetary Union". To this end, the President of the European Commission, in close cooperation with the President of the Euro Summit, the President of the Eurogroup, the President of the European Central Bank, and the President of the European Parliament prepared a report, which was published on June 22nd. The report presents the nature of a *"**deep, genuine and fair economic and monetary union**",* which is to be organized in two stages. In Stage, which lasts from 1 July 2015 to 30 June 2017 and is referred to as *"deepening by doing"*, the EU institutions and euro area Member States will build on existing instruments and make the best possible use of the existing Treaties. Important steps are to be taken already in this stage to create the economic, financial and fiscal union. The architecture of the economic and monetary union should be completed latest by 2025.

In the phase that lasts until mid-2017, the development of a *financial union* requires, first of all, to complete the Banking Union, including the following major elements: setting up a bridge financing mechanism for the Single Resolution Fund (SRF); implementing concrete steps towards the common backstop to the SRF; agreeing on a common Deposit Insurance Scheme; improving the effectiveness of the instrument for direct bank recapitalization in the European Stability Mechanism (ESM).

The European Commission adopted on 19 May an ***agenda for better regulation*** *(Better Regulation for Better Results – An EU Agenda)*. The list of tasks contains, among other things, the revision of the Inter-institutional Agreement (IIA*)* by and between the Commission, the Parliament and the Council, dated 2003, from times before adopting the Treaty of Lisbon. According to the program, in order to achieve better results, it is necessary to change the work on an EU level, i.e. not only what the EU does but also how the work is accomplished. The Commission must only concentrate on the most important issue. The consistent enforcement of openness and transparency assumes more consultations and enhanced attention. The Commission intends to listen more closely to citizens and stakeholders. Better tools are needed for better action and for the implementation of better policies. The EU institutions (Parliament, Council, and Member States) have to share a commitment to better regulations. Refreshing the existing stock of legislation is another basic requirement to be ensured by the REFIT programme.

On September 9th, Jean-Claude Juncker, President of the European Commission presented the current State of the Union Address, entitled ***"Time for Honesty, Unity and Solidarity***". At the same time the Commission gave a written review of the progress made in the past year by the EU, regarding the ***ten priorities given in June, 2014***. In his parliamentary speech, Juncker highlighted that this is not the time for business as usual, in the Union. He emphasized that those problems, which the EU now faces must be addressed openly, and that in the current situation there is not enough Europe or Union in the European Union, which needs to be changed.

In the fall, the Commission ***started the implementation of Stage 1 of the "Five Presidents' Report" and announced that it will take concrete steps to strengthen the EMU***. The package, which was

[19] Better Regulation for Better Results – An EU Agenda

adopted by the College of Commissioners, contains strengthening the external representation of the euro area, steps towards a financial union (including the creation of a common system for deposit insurance), a revamped European Semester, and improving the tools of economic governance.

The Banking Union – The Single Supervisory Mechanism (SSM)

The Single Supervisory Mechanism began its actual operation legally in November, 2014. The ECB, which directly supervises the global systematically important banks in the Eurozone set the following priorities for 2015: emphasis on the supervision of credit risk and risk management practice; examining business models and profitability incentives; controlling aggressive yield hunting strategies; the supervisory review and evaluation process (SREP); unifying the validation (authentication) of the internal models of banks; and to reduce the number of options and national discretions in the capital requirements regulation. In relation to indirectly supervised, less significant institutions, the complex target was to finalize the structure and organization of the supervisory methodology in cooperation with the competent national authorities.

In 2015, the ECB dedicated special attention to the management, and, if possible, termination of ***options and national discretions (ONDs)***. During its supervisory tasks, the ECB realized that the rules and supervisory practices implemented in each member country differ from each other in many ways, despite the Single Rulebook. The widely used Options and National Discretions (ONDs) significantly influence strictness in prudential regulation; make the comparability of capital ratios more difficult; make it hard for investors to price capital and funding; render regulation even more complex and complicated; are a source of regulatory arbitrage; create competitive disadvantages for banks in those member countries which have stricter regulation; pose a risk to the financial sector; and make the job of the SSM supervisory authority more difficult.
On July 2nd, the ECB Supervisory Board approved the work program, which envisages the harmonization of ONDs. The program contains nearly 100 ONDs and does not concern transitional ONDs, which expire within the next three years. During the preparation period general discretions must be disentangled from individual discretion, since they require different legal acts. The legal phase-out of ONDs is being carried out in the form of an ECB Decision, for which the ECB announced a public consultation in November, which lasted five weeks. The work did not stop with the adoption of the decision; the SSM is initiating the total harmonization of differences under the authority of national legislatures, and of the Capital Requirements Regulation (CRR).

In connection with the ***first anniversary of the official date of implementation of the SSM***, numerous evaluations on single supervisory operations were published. Sabine Lautenschläger member of the ECB Executive Board and Vice-President of the SSM highlighted the following SSM activities carried out so far:

- Recruiting over 1,000 ECB supervisors and support staff;
- Setting up central supervisory infrastructures;
- Carrying out the comprehensive assessment and translating the results into supervisory actions;
- Developing and implementing the SSM's legal and methodological framework;
- Setting up the joint supervisory teams (JSTs) and establishing a consistent and standardized database;
- Identifying key risks within Europe's banking sector, drawing up our strategic plan for 2015 and planning our supervisory activities accordingly;

- Enhancing our supervisory methodology further, in particular regarding the Supervisory Review and Evaluation Process (SREP)
- Harmonizing supervisory approaches and perspectives, going beyond options and national discretions;
- Gaining an overview of the 19 national banking sectors with their 3,500 less significant banks; and
- Conducting day-to-day supervision of the 123 banking groups with 1,100 directly supervised banks.

The ECB realizes the importance of feedback concerning supervisory activities. It is operating a sort of round table with the participation of the European Banking Federation, where, together with the leaders of large banks, they discuss their experience on single supervisory practice and current tasks, with the intention of improving these.

The Banking Union – The Single Resolution Mechanism (SRM)

The SRB started its operation as an independent EU agency on January 1, 2015. The appointment of the Chair and five further members of the Board was approved by the European Parliament at its session in December, 2014. (Elke König, Chair of the Board, was appointed for three years, which is renewable for a further five years, while the Vice-Chair and other members of the Board are appointed for five years, and their mandate is not renewable.) In March, the SRB published its preliminary annual budget plan for 2015. The total expenditures are estimated to amount to EUR 22 million, 55% of which are related to staff. All expenditure is fully covered by contributions from the banking sector. The SRB aims to employ 122 staff by the end of 2015.

The SRB is the central decision-making body in the network of designated national resolution authorities. It is empowered to apply, as of January 2016, the full set of resolution tools (sale of business, bridge institution, asset separation, and bail-in) according to the BRRD[20]. In 2015, the SRB focused on structuring the organization, establishing the framework of constructive cooperation with national resolution authorities and collecting information for the elaboration of resolution planning and resolvability assessment.

According to the agreement made between the Council and the Parliament in 2014, the single resolution mechanism will start its activities fully in January, 2016. To prepare for this, the Single Resolution Board published its 2016 work program in November; signed the Intergovernmental Agreement (IGA - this complements the SRM regulation) to replenish the Single Resolution Fund (SRF), which was ratified by the majority of participating member states by the end of the year; and worked out the system for contributing to SRF. (As agreed on previously, the fund will be replenished over the course of eight years, by 2024). To ensure that the SRM can operate during this period of transition, member states of the banking union agreed on its bridge financing back in 2013. Thus, as of 2016, participating member states provide the SRF with a harmonized credit line of EUR 55 billion maximum. The Fund will use this when it deems necessary.
The SRB signed a Memorandum of Understanding (MoU) with the European Central Bank in respect of cooperation and information exchange between the two. An agreement was also made between the SRB and the European Parliament on the practical modalities of the exercise of democratic accountability and oversight over the exercise of the tasks conferred on the Single Resolution Board.
The SRB'S 2016 work program sets the following priorities: finalizing resolution plans, working out the resolution planning manual, preparing for resolution action, elaborating the crisis management manual, and putting in place tools and policies for resolution.

[20] Bank Recovery and Resolution Directive

The problem-free start of the Single Resolution Mechanism is being held back by the fact that some member states under its scope have failed to transpose the Bank Recovery and Resolution Directive (BRRD). In October, the European Commission referred the Czech Republic, Luxembourg, the Netherlands, Poland, Romania and Sweden to the Court of Justice of the EU, as despite the reasoned opinion sent to them on May 28th, they failed to fully implement the BRRD Directive.

***Banking Union* – The European Deposit Insurance Scheme (EDIS)**

When the Banking Union was announced, the establishment of integrated deposit insurance was an important element, but when SSM was created – due to a lack of political consensus – this was temporarily taken off the agenda. Establishing a common deposit insurance system came up once again in the program aimed at completing the European economic and monetary union – reported by the Five Presidents – and the European Commission published its proposal for the European Deposit Insurance Scheme.
The proposed scheme will be:

- built on the existing system, composed of national deposit guarantee schemes set up in line with European rules; individual depositors will continue to enjoy the same level of protection (€100 000);
- introduced gradually, step by step;
- overall cost-neutral for the banking sector:;
- funded directly through risk-weighted contributions by banks;
- managed in terms of governance by the Single Resolution Board (SRB);
- accompanied by strict safeguards: for example it will only insure those national systems, which comply with the DGSD[21] and are being built up in line with EU rules;
- Mandatory for euro area Member States whose banks are today covered by the Single Supervisory Mechanism; but open to other EU Member States who want to join the Banking Union.

To establish EDIS the Commission recommended the following timing:

***Phase 1: Re-insurance** (until 2020*)
A national DGS can access EDIS funds only when it has first exhausted all its own resources. EDIS funds would provide extra funds to a national scheme, but only up to a certain level. The share contributed by the European Deposit Insurance Scheme will start at a relatively low level (20%) and will gradually increase over a four year period.

Phase 2: Co-insurance

After 3 years as a re-insurance scheme, in 2020 EDIS will become a progressively mutualized system. Compared to the previous phase, the key difference in this phase is that a national scheme would not be required to exhaust its own funds before accessing EDIS funds.

Phase 3: Full insurance

The share of risk that EDIS assumes will increase to 100% by 2024; from then on, member states will only pay into the common trust. This is the same year when the Single Resolution Fund and the requirements on finances of the current DGS Directive will be fully phased in (target level: 0.8%).
The European Banking Federation presented a communication on the day the Commission's proposal was published. The Communication emphasized – in addition to voicing the Federation's surprise –

[21] Deposit Guarantee Scheme Directive

the importance of the national implementation of the DGSD, and the need to thoroughly examine the EDIS proposal.

The Capital Markets Union (CMU)

In the fall of 2014, creating a capital markets union (which would apply to all members of the integrated EU) received a main role in the program of the newly established European Commission. The purpose of the Green Paper published by the European Commission in February was to lay the foundations for the elaboration of an action plan to establish the CMU, based on the versatile views and opinions collected during the consultation process.
According to the Commission's intentions, the CMU will:

- unlock more investment sources for companies, especially SMEs, and for infrastructure projects;
- attract more investment into the EU from the rest of the world; and
- make the financial system more stable by opening up a wider range of funding sources.

The implementation of the Capital Markets Union will be a long-term project, requiring sustained effort over many years but does not cancel out the necessity of introducing short-term measures which were also included in the Green Paper.

In its ***resolution*** released in the middle of June 2015, the ***European Council*** welcomed the initiative of building a CMU. As short-term tasks, in addition to creating a framework for simple, transparent and standardized securitization, it noted the importance of rendering access to credit information easier and simplifying the requirements related to the prospectus.
The ***European Parliament supported with a great majority of votes*** (552 votes in favor, 111 against, and 32 abstentions) the initiative for building a Capital Markets Union. According to the resolution, the EP intends to follow a genuine European approach to building a CMU, ensuring equal competitive conditions; urges to apply the building blocks model; intends to improve access by SMEs to the capital markets, offering an adequate alternative to bank credit; and intends to create a coherent European regulatory environment for capital markets and proposes to review the rules that represent excessive administrative burdens. The Parliament asked the Commission to speed up its work on the legislative work necessary for creating the CMU, in order to achieve the objective of a fully integrated single EU Capital Markets Union by the end of 2018 (a year earlier). The ***European Banking Federation*** welcomed the Green Paper and made it clear that integrated European capital markets can foster sustainable economic growth, reaching growth and employment goals, and increasing corporate investment. While creating the CMU the following should definitely be kept in mind: ensuring a level playing-field; proportionality as a key principle; establishing market-led standards and realizing best practices.

On September 30th, the European Commission introduced the ***Action Plan on Building a Capital Markets Union***, which sets out to build a true single market for capital. (The action plan includes building blocks which would make the capital markets union completely operational by 2019.) One of the most important goals of the Commission is job creation, stimulating growth in the economy and investment. The Capital Markets Union is a key pillar of the Investment Plan, aiming to tackle investment shortages by increasing and diversifying funding sources. The Capital Markets Union Action plan is based on the following four principles:

- Creating more and bigger opportunities for investors.
- Connecting financing to the real economy.
- Fostering a stronger and more resilient financial system.
- Deepening financial integration and increasing competition.

The Action plan contains the following set of early actions:

- Establishing new rules on securitization.
- New rules on Solvency II treatment of infrastructure projects.
- Public consultation on venture capital regulation.
- Public consultation on the role of covered bonds.
- The cumulative impact assessment of financial regulation.

In the CMU realization process, the Commission maintains an ambitious, pragmatic step-by-step approach, based on rigorous economic analysis and mindful of financial stability risks.

The Capital Markets Union is closely related to the Investment Plan for Europe as well as to creating the European Fund for Strategic Investments (EFSI). In order that the EFSI can effectively support investments, the European Union provides a EUR 16 billion guarantee, which is complemented by a further EUR 5 billion by the European Investment Bank. Between 2015 and 2017, the EFSI is expected to generate investments in a total value of EUR 315 billion in the European Union.

The Commission – as part of the CMU Action plan – announced a ***public call for evidence on the regulatory framework of financial services***. In the wake of the crisis, the EU put in place more than 40 regulatory measures over a short period, to restore financial stability and public confidence in the financial system. As a result of this intensive rulemaking and improved supervision, the sector became more resilient. However, it is still important for EU legislation to find the right balance between reducing risk and enabling growth, and to not create new, unintended barriers. The aim of this call for evidence is to help establish the efficiency, consistency and coherence of the regulatory framework for financial services. The call for evidence is an essential part of the Commission's "Better Regulation Agenda and is coherent with the global efforts of international regulatory bodies.

At the same time, the European Commission also published its proposal ***for amending the Capital Requirements Regulation (CRR)***. Through the need for sustainable securitization, they clearly defined the set of criteria for ***simple, standardized and transparent securitization (STS[22]).*** (Simple securitization criteria include homogeneity, prohibition of resecuritization, requirement for loans to have a long credit history, and transfer of loan ownership to the securitization issuer. Satisfying transparent and standardized securitization criteria means that loans packaged in securitization must have been created using the same lending standards as any other loan (no "cherry-picking" is allowed); at least 5% of the loans portfolio must be retained by the originator, information is sufficiently detailed and data is published on an ongoing basis; and the contractual obligations, duties and responsibilities are clearly defined).
In addition to the securitization regulation, a proposal for amending the Capital Requirements Directive was published, which prescribes a capital requirement for managing STS securitizations that is more favorable than the current one. Solvency II, which regulates capital requirement for insurance companies will also be amended for the same reason, however this will only happen after the securitization regulation has been adopted. The Commission will publish an easy-to-understand Fact Sheet on securitization facts at the same time as the proposal, to provide information to a wider audience.

In October, *the European Commission* also initiated consultation on ***covered bonds***.

Structural reform (BSR[23])

The structural reform of the banking sector (separating the lending and commercial function of big banks) was meant to be one of the key elements of the regulatory measures in the wake of the

[22] Simple, transparent and standardized (Global and European regulatory authorities do not use the exact same terminology, but STC and STS securitizations are the same in content, since standardized products are the ones that can be compared).
[23] Banking Structural Reform

financial crisis. Though the containment of basic commercial bank activities (deposit collection, lending, credit transfers) and the mandatory separation of other functions has already happened in the USA and several EU countries (United Kingdom, Belgium, France, Germany), EU decision makers still did not accept the relevant regulation in 2015. The reason for this lack of success can probably be traced to the European traditions of the universal banking system.

Parliamentary rapporteur Gunnar Hökmark published a ***report in January 2015*** where he recognized the advantages of the universal banking system, and therefore did not truly support mandatory separation. He urged a risk-based approach that cannot lead to the removal of transactions from the regulated and supervised sector. He believed it important that the solution should be in line with the BRRD, pursuant to which the separation of the trading activity is only one way to resolution besides capital increase and reduced activity. According to his critics, the modifications proposed by the rapporteur in the spirit outlined above, could soften the original proposal and may render the structural reform ineffective. (Yet, according to the European Banking Federation getting away from automatic split and applying a broader range of tools was a step in the right direction.)

On May 26th, the ***Economic and Monetary Affairs Committee (ECON) of the EP*** voted on the structural reforms that seek to split the largest European banks. The parliamentary rapporteur and the shadow rapporteur both maintained their respective contrary approaches, i.e. risk-based assessment with a flexible supervisory toolkit *vs* size-based triggering with automatic separation. The rapporteur was unable to find a compromise on the proposal, and therefore a "smorgasbord" text was put to vote, which contained a random selection of amendments formerly put onto the table, without the final text showing any coherence. Finally, the report was rejected by ECON, bringing the BSR back to square one. The competent negotiating team was commissioned to draft a new schedule so that an agreement could be reached during the summer and the trialogue could start in autumn.

After the unsuccessful vote, the EBF, through a press release, called for political decision makers to rethink their priorities, and therefore the BSR as well.

After the failed vote in the European Parliament, the Latvian Presidency took the lead in finalizing the BSR. Under the compromise, the banks affected by the BSR are allocated into two tiers with regard to their respective trading activities. Banks allocated to either of these tiers will be subjected to differentiated reporting requirements, risk assessment and subsequent supervisory actions. G-SIBs and banks with over EUR 100 billion of trading activities will be placed in Tier 2 to undergo an even more granular risk assessment. If the granular assessment identifies excessive risk, supervisory action follows in a way that is proportionate to the risk identified. To this end while the possibility to separate excessively risky activities remains, supervisors can also opt to increase own funds requirements or to take other prudential measures. Instead of a ban on proprietary trading as proposed originally by the Commission, the Council opts for a mandatory separation of proprietary trading activity. Acknowledging its beneficial function, specific rules have been laid down for market making, which has been defined as an allowed activity.

After reaching this compromise in the Council, no further relevant steps were taken. The adoption of the BSR by parliament (which was expected to take place at the end of the year) did not happen.