HUNGARIAN BANKING ASSOCIATION

REPORT
on Activities of the Hungarian Banking Association
2nd Quarter 2011

Budapest, July 2011

Contents

I. LEGISLATION, SELF-REGULATION

1 Home loans

1.1 Home Protection Act

The Board commissioned Board members Dániel Gyuris (OTP Mortgage Bank and OTP Building Society) és László Harmati (FHB) to represent the banking community in the negotiations with the government. The principles for the proposed solution were reviewed during several consultations with members' CEOs. Expert-level consultations with the government on the details of the concept adopted by the large majority of members were conducted by a working group made up of delegates from member banks. As a result of these consultations, the Act on the fixing of repayment rates for foreign currency loans and on rules for foreclosures was adopted. The Act consists of two parts: the first part provides for a special overflow account for mortgage debtors with debts denominated in CHF, EUR or JPY. The second part introduces common rules for foreclosures, replacing the former provisions on moratoriums on foreclosures and evictions.

The details of the measures adopted are as follows:

Banks shall, for a period of 36 months and no longer than December 31, 2014, apply fixed exchange rates for mortgage loans denominated in CHF, EUR, or JPY, should the customer so request by December 31, 2011, at the latest. For the difference between the fixed exchange rate and market rates, banks shall open an overflow account for the customer. The exchange rates shall be as follows: 1 CHF=HUF 180, 1 EUR = HUF 250 and 1 JPY = HUF 200. This scheme will only be available for borrowers with no or less than 90 days in past due debts. However, borrowers who reduce their overdue debts may also join the scheme. The scheme may be applied for if the market value of the collateral on conclusion of the loan agreement did not exceed HUF 30 million. The interest rate of the overflow account shall be the 3-month BUBOR. Should the market rate fall below the fixed rate, the difference shall be used for repayment of the overflow account loan, until fully repaid, after which the repayments shall be made at market exchange rates.

After the end of the 36-month period (that is, from 2015), debtors shall make the repayments on their CHF/EUR/JPY loans at market rates and shall start repaying their overflow account loans. The final expiry date of the overflow account loan agreement may not be earlier than the expiry date of the foreign currency loan. The bank shall set the overflow account loan period – by also taking into account the debtor's age – in such a way that the repayment amounts (by taking also into account the repayment amounts under the underlying foreign currency loan) do not impose a disproportionately high repayment burden on the debtor. The definition for a "disproportionately high repayment burden" will be provided by government decree. During the repayment period, the interest rate of the overflow account loan may not be higher than the market rate applied by the bank for a forint loan provided for the same purpose as that of the foreign currency loan in question.

Banks may avail themselves of a government guarantee for the overflow account loan. The guarantee fee will be specified by a government decree. The government shall provide a 100% unconditional guarantee for the overflow account loan for the fixed exchange rate period and a guarantee subject to priority ranking for the subsequent period, not to exceed 25% of the debt outstanding at the end of the fixed exchange rate period. The debtor may terminate the overflow account loan only if he or she early repays the overflow account loan and the foreign currency loan at the same time. The bank may terminate the overflow account

loan if the debtor's overdue debt exceeds 90 days, or upon the institution of a foreclosure proceeding against the real estate provided as collateral. For early repayments, the CHF/EUR/JPY market rates shall apply.

The second part of the Act introduces a quota system for foreclosures for the period between October 1, 2011 and December 31, 2014, with transitional provisions for the period before October 1, 2011. The Act extends to all debts arising from home loan contracts secured by mortgaged real estate. Accordingly, any creditor that has a claim arising from a home loan contract must act in accordance with the Act, no creditor is exempt from the quotas. Bank groups shall be considered as a single creditor.

In the period between October 1, 2011 and December 31, 2014, creditor banks may only initiate foreclosures in respect of real estates which they have designated for this purpose in accordance with the Act. Foreclosures may be initiated according to a quota system, applied on a regional basis (19 counties and Budapest) for home loan debts more than 90 days past due. The quotas shall be increased progressively with time: Q4 2011: 2%; 2012: 3%; 2013: 4%; 2014: 5% of the total number of real estates serving as collateral for home loans past due more than 90 days. Foreclosures initiated by other creditors (for example, utility companies) shall not be included in the number of foreclosure proceedings initiated by banks. The number of real estates provided as collateral and the number and exact location, floor space and collateral value of those real estates designated for foreclosure shall be reported to the Hungarian Financial Supervisory Authority on a quarterly basis. The eviction moratorium will be abolished effective October 31, 2011. From July 1 to October 31, 2011, evictions may be carried out in the case of real estate collaterals with a market value exceeding HUF 30 million and a loan value exceeding HUF 20 million on conclusion of the loan agreement.

1.2 Notary fees

Consultations continued with the Hungarian Chamber of Notaries on the rationalisation of notary fees related to home lending and foreclosure proceedings.

The Association's Board was briefed on these consultations at its May meeting. The consultations affected the following fees:

- the minimum fee for the institution of foreclosure proceedings,
- increasing the upper limit for the fee for the institution of foreclosure proceedings,
- a reduced standard fee for contract amendments related to the government's debtor rescue package (by using a standard form).
- in accordance with the relevant decision of the Board, a request for a legal unity decision regarding multiple notary fees charged in the case of several debtors was submitted to the Supreme Court by one of our member banks rather than by the Association.

The consultations with the Hungarian Chamber of Notaries are now stalled, given that no agreement has been reached on any of the reductions requested.

On July 12, we held a meeting on the reduction of notary fees related to the home protection scheme with the Ministry of Justice, the Ministry for National Economy and the Hungarian Chamber of Notaries. The meeting was aimed at developing a common stance on those contract terms and conditions and legal statements that should be included in a public deed in respect of the overflow account loan contract an amendments to the old contract, in order to develop special fees for the scheme. It would be expedient to amend the decree on notary fees in such a way that the decree provide a sample deed, specifying the main elements to be

included. The Ministry of Justice will contact the Ministry for National Economy to accelerate the government decrees related to implementation and to obtain decisions on interpretation issues related to certain provisions of the Act. Consultations with the Hungarian Chamber of Notaries continued in early August with a meeting on the contents of the required notary deeds. This was followed by a meeting with the Ministry of Justice, the Ministry for National Economy and the Hungarian Chamber of Notaries on the contents of the unilateral commitment to be provided in the notary deed. The Chamber of Notaries explained the main costs to be considered in calculating the notary fees. The Ministry of Justice will draft an amendment to the decree on notary fees. The amendment is expected to be published before August 20.

1.3 Red sludge victim borrowers

Mortgages instituted on real estates destroyed by the red sludge disaster had to be re-registered to the new homes of the debtors affected. In a number of cases, the re-registration procedure was delayed, mainly for reasons beyond the control of banks (e.g. debtors divorcing, absence of demolition permits, etc.). In accordance with the Interior Ministry's request, we asked member banks to accelerate administration and informed the Ministry on successful re-registrations.

1.4 Debate with the Ministry for National Economy on settlements related to home subsidies

The Ministry for National Economy sent us for review its proposal for reporting and settlements under the legislation on home subsidies. The proposal includes a trilateral agreement providing rules for data and funds flows between the Ministry for National Economy, as the authority responsible for professional supervision, the Hungarian State Treasury, as the body responsible for financial management and control, and banks, as lenders.

In our response, compiled based on comments from member banks, we pointed out that in addition to the disbursement of due interest subsidies, late interest should also be included in the legislation. We submitted a number of important proposals for making the rules for information flows between the three parties more specific (in terms of contents, deadlines and secrecy rules).

The Ministry took into account most of our proposal, but rejected our request regarding late interest. After more consultations, we wrote a letter to the competent deputy state secretary. In this letter, we submitted a specific text proposal with detailed arguments and requested the Ministry to reconsider its position.

No response was received from the Ministry until the closing date of this report.

2. Draft law on special rules for bankruptcy and liquidation proceedings for companies of national importance

The proposed law was submitted to Parliament under an individual MP motion. This law creates legal uncertainty by authorising the government to designate companies as nationally important on an ad hoc basis, by decree rather than by normative rules, and to subject companies, against which proceedings are already in process, to liquidation by a state-owned liquidator. This liquidation proceeding will be governed by special rules that will basically

affect the rights of creditors. The deadlines for the liquidation proceeding will be shortened (for example, contrary to the general rule, the time window for enforcing the security will be reduced to 2 months).

Assets of a company of national importance under liquidation shall be sold under special rules. Taking into consideration public interest in the continued operation of the company, the liquidator shall try to sell the company as a going concern at the highest attainable market price. If necessary for achieving this goal, the sale may be carried out by private disposition, through a private tender or direct negotiations by invitation. In this case, three independent expert's appraisals of the sales price will be required, and the sales price may not be less than the mathematical average of these appraisals. In the case of an important, state or municipality-owned, public utility or transport company, one can imagine how unrealistic a task it would be to determine a realistic sales price without any comparative prices or sales information.

In case of a private disposition, the liquidator will not be obliged to inform the creditors on the sale and the creditor may not request the revision of the appraisal. The lien-holding creditor will no longer have the right to acquire the asset at the appraised sales price after three failed tenders or auctions.

Due to the lack of normativity of the regulation and its retrospective effect, creditors will not know whether or not the borrower company would be subject to the new regulation in case of any potential future insolvency proceeding. This is an extra risk, which due to capital adequacy and prudential regulations, bank will be forced to price in. This would be dysfunctional and against the objectives of economic stimulus and job creation.

In addition to providing special rules for companies designated as nationally important, the new legislation, which has been adopted in the meantime, has amended the rules for bankruptcy proceedings in a number of important points. These new rules will have far-reaching implications. A provision has been added to the relevant section of the Bankruptcy Act to say that the composition shall not extend to creditors that have not filed claims in the bankruptcy proceeding, however, these creditors may not enforce their claims against the debtor and may only file their still valid claims under liquidation proceedings initiated by another party, and then, without the right to late penalty and late interest. Under the previous legislation, a creditor that has not filed its claim in a bankruptcy proceeding was not prejudiced in relation to foreclosure and was also free to initiate a liquidation proceeding. This is a serious issue, given that the shortcomings of the new legislation may give rise to fraudulent bankruptcy. In the wake of the 2009 revision of the Bankruptcy Act, fraudulent and malicious attempts have been frequently encountered, where new creditors show up behind the lien holding creditor in respect of the same asset and, with their votes, the real creditor may be outvoted. Namely, the priority ranking is not applicable in bankruptcy proceedings, in other words, in the case of creditors of the same class, revenues from the sale of the asset are divided between the creditors in proportion to their claims. Given that the Bankruptcy Act fails to provide adequate protection against these cases, the practice has evolved that creditors do not register for the bankruptcy proceeding: thus, they can avoid that a fraudulent composition is extended to them. In our comments we emphasised that tightening the rules for bankruptcy proceedings would only make sense if, concurrently, guarantees protecting creditors against fraudulent bankruptcy are incorporated in the legislation. Accordingly, during the debate on the draft law we requested that the proposal be revoked, or alternatively,

a provision be added to protect claims secured by security deposits, lien, or foreclosure rights as per Section 49/D of the Act. Unfortunately, our request was not accepted.

The key message of our warning was - and this cannot be emphasised enough - that if secured creditors in a bankruptcy proceeding can be outvoted and a composition detrimental to them can be made, that is the end of security in lending. Under the new legislation, the creditor will have two options: file its claim under the bankruptcy proceeding and, in case of a fraudulent bankruptcy, face the risk of being outvoted, without recourse to appeal, or not file its claim, in which case the claim may only be enforced under a liquidation proceeding initiated by another party, and even then, at a reduced rate. Both solutions are unacceptable. A comprehensive review of the legislation would be needed to solve this problem.

The new legislation fundamentally affects legal relations in lending and creditors involved in bankruptcy and liquidation proceedings. During the parliamentary debate, we initiated amendments to the text of the legislation. We wrote letters to the drafters, to the Minister for National Economy, to the Minister of Justice and subsequently, to the Prime Minister. We also consulted with leaders of the Hungarian Association of Solvency Practitioners and solicited our Work-Out Committee's opinion.

The time is ripe for a comprehensive professional review of the Bankruptcy Act. The revision of the Bankruptcy Act is set out in the Száll Kálmán Plan and in the government's autumn work plan. That is why we consider it unwarranted and risky that the recently adopted amendment tries to regulate certain issues by taking them out of contex - and this, without any prior consultation.

The legislation law was passed by Parliament on July 11, 2011.

3. Supervisory and central bank reporting

The consultations conducted with the Hungarian Financial Supervisory Authority since March on COREP have been concluded. The revised reporting requirements will be introduced effective August 31, 2011. A product register on new deposit and savings facilities and related key consumer information has been published on the Supervisory Authority's website. The structure of the legal framework for reporting has been changed: the Supervisory Authority has been vested with decree rights and took over the relevant legislative tasks from the Ministry for National Economy. According to plans, further important changes are expected from 2013 in view of the European Banking Authority's new common statistical reporting requirements. In this context a new EU regulation is expected to be issued at the end of 2011. The Association's Reporting Working Group plans to hold a meeting in July with a view to developing future reporting requirements in cooperation with the Supervisory Authority's specialists.

At the beginning of the summer (earlier than in the previous years), the MNB invited banks' specialists for a consultation on the proposed central bank reporting requirements for 2012. Pursuant to these, the common supervisory and central bank reports, mainly including balance sheets and profit-and-loss accounts will remain (to the satisfaction of banks), with some minor changes in the related reporting tables. The reporting tables will be extended with information aimed at monitoring retail loans, revaluation and interest rates. The MNB had sent banks a questionnaire to assess the cost impacts of the proposed changes. The results were not yet

available during the consultation. The results of the assessment are expected to be taken into account before finalising the new reporting requirements.

4. Consultation ahead of the launch of the Financial Arbitration Board

On May 24, we held a consultation for banks' legal counsels and consumer protection officers with the Financial Arbitration Board's Chair, Dr Géza Nadrai, in preparation for the Financial Arbitration Board's start of operations on July 1, 2011. Preparations are also in process at banks for implementation of the relevant new regulations. The Financial Arbitration Board is charged with the out-of-court settlement of legal disputes related to the conclusion and fulfilment of contracts between financial service providers and consumers.

The Financial Arbitration Board (FAB) may adopt three types of decisions: establish an agreement between the parties, adopt a binding decision, if the bank subjects itself to the procedure, or issue a recommendation, if the bank does not subjects itself to the procedure. Agreements endorsed by the decision of the FAB and the FAB's binding decisions may be enforced by law. The Hungarian Financial Supervisory Authority has urged banks to file a submission statement with the FAB and to represent themselves with competent staff in the FAB'S proceedings. The Supervisory Authority may sanction non-cooperating organisations.

At the consultation, the FAB's Chair sought to dispel the concerns voiced in connection with the FAB's operations. Participants reviewed in detail the FAB's Rules of Procedure. The FAB's Rules of Procedure were also published for public consultation by the Hungarian Financial Supervisory Authority and we provided several comments on them. The Association's Board, at its June meeting, decided to recommend member banks to file a submission statement for cases where the contract value is less than HUF 3 million and the claim is less than HUF 1 million. Filing such a statement is the discretion of each individual bank. Until the middle of August, nine banks decided to file submission statements.

5. Report to the Hungarian Financial Supervisory Authority concerning the operations of Vár-Holding Kft.

The Association's Intermediaries Working Group drew our attention to the operations of Vár-Holding Kft. This company, under a "national loan rescue operation", offers business and legal assistance to borrowers in trouble, be it about impending financial difficulties or foreclosure due to past due debts.

Vár-Holding takes a one-time fee (HUF 25,000) from the customer, payable on start of the procedure. For this fee, the company, on behalf of the customer, contacts the creditor bank/s or financial firm/s for the restructuring of the debt in a way that is also acceptable for the customer, thus promoting the repayment of the loan. The company takes an additional HUF 35,000 if the procedure is successful and the loan is restructured. In view of the business nature and incidence of this activity, we were of the view that this is a new type of business that involves consumer risks, and therefore, should be regulated. We contacted the competent department of the Hungarian Financial Supervisory Authority, indicating that while such activities are most probably subject to supervisory licensing, the company presumably does not have a licence.

The Supervisory Authority recently adopted a resolution banning the company from these activities and sanctioning the company. The Authority's investigation revealed that Vár-

Holding's activities included all those statutory elements of what the law defines as brokerage. Brokerage has been subject to licensing since October 1, 2010. Given that Vár-Holding had no license to engage in brokerage, the Supervisory Authority banned the company from these activities. It forwarded the documents of the investigation to the competent investigation authority and imposed a HUF 5 million fine on the company.

6. Decision by the Szeged Court of Appeal

At the request of the Csongrád County Chief Prosecutor's Office, the Szeged Court of Appeal annulled a number of provisions of Partiscum XI Savings Cooperative's business terms and conditions related to the right to unilateral contract amendments, which the Court considered as unfair. The annulled provisions are fully compliant with the Code of Conduct for Retail Lending and the Credit Institutions Act. As an extraordinary remedy, a request for the review of a final court of appeal decision may be filed with the Supreme Court. We provided the savings cooperative assistance in drafting the request. Also, we wrote a letter to the Chair of the Supreme Court, who (independent of our letter) ordered an extraordinary proceeding in the case.

It should be mentioned here that we have offered our information dissemination and education capacities to the Hungarian Judge Academy, which currently organises training courses on baking law, as well. The Academy welcomed our offer.

7. Simplifying taxation

The government in 2010 launched a programme to reduce administration. A key element of this program is the simplification of taxation. Reducing the administrative burdens of businesses, in particular, those of SMEs, is a main priority of the programme. In addition to representatives from chambers and other interest representation organisations, the Association's Taxation Working Group is also represented in the Tax Simplification Working Group set up under the programme. We consider it important that the banking sector, as a key player in the collection of taxes is given a major role and banks' views are taken into account in the programme. To achieve this, we summarised banks' proposals and forwarded them to the government officers managing the working group.

8. Ombudsman investigations

8.1 Investigation regarding the retrospective registration in the Land Registry of right-of-way to utility lines

The Civil Rights Ombudsman conducted an investigation regarding the retrospective registration in the Land Registry of right-of-way to utility lines. Specifically, the issue relates to electricity lines built in the past 10 years. The Electricity Act provides that such lines must be registered by 2012. Registration is done under a simplified process and in many cases, the owner of the property as well the creditor learn of the existence of a right-of-way from the Land Registration Decision. The Electricity Act clearly provides that the registration of a right-of-way does not entail any additional rights to the property and may not serve as a ground for compensation.
The problem is of a general character and an issue of public concern, but it was not primarily banking reasons that have brought the problem to the forefront. The Association's Board

addressed the issue in the spring of 2010 in the context of a question it received from one of the major electricity companies.

The Ombudsman, inter alia, requested our answer as to how the registration of the right-of-way for utility lines affected a bank's mortgage rights on the property in question and borrowing, and whether or not the registration of such rights would be deemed as a breach of the loan agreement if done without the creditor's prior consent. In our response, we informed the Ombudsman on the practice followed by banks regarding the registration of right-of-way in the Land Registry.

According to banks' internal rules and procedures, the effect on the property value of easements, survey signs, right of use related to electrical utility installations, the right of way to electricity lines, easements related to water disposal and mines, prohibitions of site alterations and construction and other construction restrictions are taken into account during the appraisal of the property.

Assessing the issue in general: the right-of-way for electric lines does not hinder the enforcement of mortgage rights. Banks would not consider the registration of such rights as a breach of agreement reducing the value of the collateral, provided the existence of such rights has been known prior to the conclusion of the loan agreement. In other words, the right-of-way easement reduces or may reduce the value of the collateral, but it does not affect its acceptability. We have no knowledge of any instance where a loan agreement has been terminated for such a reason. However, it may happen that if the existence of a right-of-way has not been previously known and such right substantially reduces the value of the collateral, the bank may ask for an additional collateral. Also, we provided a proposals, primarily for electricity companies, to solve the procedural problems related to the registration of right-of-way.

8.2 Investigation on legal representative's fees in judicial foreclosure proceedings

The Civil Rights Ombudsman contacted the Association to obtain information on banks' practices related to Justice Ministry Decree No. 12/1994 (IX 8) on legal representative's fees in judicial foreclosure proceedings and a possible revision to the decree. In our response, we pointed out that in the context of the government's debtor rescue package, all fee regulations related to lending and foreclosure proceedings should be reviewed, including those on notary, bailiff, legal counsel and lawyer fees and fees for authentic proprietary register copies, given the disproportions between the various fees applied. We shared the ombudsman's view that Justice Ministry Decree No. 12/1994 (IX 8) and its application should be reviewed.

We solicited members' opinions in the matter. The answers showed that the most banks apply the fees as specified by the Decree.

One bank, out of self-regulation, charges a lump sum fee of HUF 15,000, irrespective of the value of the case. This fee is a fraction of the fee that could be charged based on the Decree. We have no information on any higher fees charged than those specified by the Decree. Overall, it can be established that banks have diverse practices. Some apply extremely customer-friendly fees for business policy reasons, however, this is not common. At the same time, the various fees and costs specified by law together may be unduly burdensome on debtors.
We answered the Ombudsman's questions in detail, our response was copied to all members.

8.3 Investigation on bailiff fees

The Civil Rights Ombudsman launched an investigation on bailiff fees. Based on citizen complaints, the investigation was also extended to other costs and fees related to the enforcement of claims by banks. The Ombudsman's questions also addressed the fees charged in the case of joint and several debtors, whether there is any extra fee charged in the case of the suspension of the proceedings and what the fee is if an extension or instalment payments are agreed for the main claim. We answered the Ombudsman's questions in detail. In our answer, we also drew attention to a number of anomalies and made a proposal for amendments to the relevant legislation. The investigation is still in process, no closing report has been received yet.

9. Cooperation in the examination of bank clerks

Under a new regulation, the Hungarian Banking Association has to nominate members to examination boards for bank clerk ad other banking professional examinations. We asked some major banks to provide nominations. Examination board members delegated by the Association reported back on their experiences of the examinations and the relevant training courses.

II. EU LEGISLATION - EUROPEAN BANKING FEDERATION COMMITTEES AND WORKING GROUPS

1. Proposed EU directive on mortgage lending

After several years of drafting, the European Commission published a proposal for a directive on mortgage lending. As is the case with the Consumer Credit Directive, the proposal covers the entire lending process basically by taking a consumer protection approach, from advertising, through the provision of personal customer information and mandatory explanation of the product, to early repayments.

Already during the preparatory debates, it became clear that the biased consumer protection approach of the proposal and its conflict with mortgage laws adopted in member states in the wake of the financial crisis will cause problems for the banks.

Member states (at government level) and industry organisations were also involved in the review of the proposal. The Hungarian Banking Association submitted its position, developed based on comments received from members, to the Ministry for National Economy and the European Banking Federation. We drew attention that although the relevant Hungarian legislation was in a number of points tighter than the EU requirements, a number of provisions of the proposal would be hard to implement:

- We did not support the automatic rejection of loan applications of customers with negative credit ratings, as there are some other important factors to be taken into in making credit decisions (for example, a low-scoring career starter may later become a prospective customer). Also, an automatic rejection of customers with negative credit ratings may send a wrong message to customers with positive credit ratings, namely, that they do not have to do everything they can to repay the loan, since they have been rated by the bank as creditworthy (that is: let the bank bear the consequences of its decision).
- We also challenged the requirement of mandatory explanation of the rejection of the loan application. This would allow the customer to learn of information that he or she could then conceal when applying for a loan at another bank and thus, have a better chance to, unfoundedly, be awarded a loan. Also, competitors may, through test shoppings, find out the bank's confidential internal credit appraisal methods.
- We also expressed our objection to the requirement for the bank to "assess the customer's level of knowledge and experience with credit 'by any means necessary' and adjust the explanation accordingly".
- The amount of information to be provided in advertisements may make advertisements as a genre impossible. Also, it would be inappropriate to threaten in an advertisement the customer with the risk of losing his or her property if the loan repayments are not met.
- We welcomed the fact that the consumer's responsibility now appears in the proposal (by allowing sanctions to be imposed in the case of the customer providing false or deficient information). However, we raised that a positive debtor list would provide a more flexible solution.

The Hungarian position was broadly consistent with the position taken by other banking associations. The EBF continues to actively represent the industry's position at the consultations on the proposed Directive in the EU Parliament and Council.

2. Amendments to the EU rules for Annual Percentage Rate (APR)

Several member states initiated amendments to the EU Consumer Credit Directive, due to interpretation and consistency problems. The amendments were adopted by representatives from member states' governments through a comitology proceeding. The comitology meetings were coordinated by the European Commission. Delegates of the Ministry for National Economy attending the comitology meetings provided the MNB, the Hungarian Financial Supervisory Authority and the Banking Association with regular information on the meetings and regularly solicited their position. The amendment proposal proposed a set of new assumptions to better calculate unforeseen factors related to the loan (time of drawdown, repayment amounts). In its comments, the Association primarily drew on the comments received from its APR Working Group. During its oral and written consultations with the Ministry for National Economy, the Association pointed out the following:

- the assumption of 3 months for overdraft versus 12 months for credit cards as a loan period is inexpedient. However, if the APRs calculated based on these assumptions only appear in the loan contracts, while the APRs stated in advertisements can be calculated based a 12-month loan period for both products, the comparability of the products would be ensured;

- Although it is not realistic to calculate the APR for credit cards by assuming 12 equal instalments, this distortion would basically affect all players equally and hence, may not negatively influence the customer's decision;

- the assumptions should not prohibit calculating real promotional allowances in the APRs in advertisements.

In relation to the first item, we received a moderately positive response from the Ministry for National Economy. Although supported by the Ministry, the second item was not supported at the EU level. Regarding the third item, a partial solution was adopted at the consultation with the Ministry.
The amendments were adopted by the EU at the end of July and should be transposed into national legislation by the end of 2011.

3. TARGET2-Securities National User Group set up

Led by the ECB, the TARGET2-Securities (T2S) project is aimed to create a single European platform for the settlement of cross-border securities transactions. By using a common platform, all cross border transactions will become domestic. The simplification of settlements and the increase in competition between central depositories will reduce the costs of cross-border securities settlements and thus, promote the free movement of money and capital in the single European market.

4. EBF Committees and Working Groups[1]

4.1 EBF Payments Systems Committee meeting in Budapest

With Hungary holding the EU presidency, the EBF Payments Systems Committee held its 93rd meeting in Budapest.

Members of the Committee were briefed by representatives from the Ministry for National Economy and the MNB on results of the consultation on the proposed EU legislation aimed at setting a SEPA End Date and on planned developments in the Hungarian domestic payments system, including the project for intraday settlements. Members of the PSC found the Committee's meeting in Budapest highly informative and successful and expressed their thanks in a letter to the Association.

4.2 Physical Security Working Group meeting in Budapest

At the EBF Physical Security Working Group's meeting in Budapest, the Working Group's new Chair announced his programme and, on behalf of the Association, as the host of the meeting, a lecture was held by a Hungarian security specialist from the National Police Headquarters' Crime Prevention Unit.

The presenter presented through an animation film the massacre that took place during the Mór bank robbery and the defence measures taken afterwards. He also presented experiences of the bank robbery alarm system.

The Working Group's new Chair plans to focus the Working Group's meetings on three main standard agenda items:

- new trends and developments in banking security,
- new perpetration methods,
- information exchange on national experiences.

The 2010 statistics on bank robberies in the EU show an improvement. However, there was an increase in assaults on ATMs in some countries, while in others, the number of assaults on gaming rooms, department stores and pharmacies rose radically. There are some countries (Italy, Latvia), where legislation is in place to require banks to apply more efficient defence tools (high-resolution cameras, time lock tills). This measure proved to be quite effective. In some countries, banks try mitigate the losses that could be caused by potential bank robberies by keeping less cash and optimising cash deliveries (Ireland, Netherlands). In Luxembourg, the police organises training sessions for bank employees to prepare them for unexpected attacks by improving their observation skills. Participants expressed their thanks to the Association for its organisation.

4.3 Communications Committee

After several months of drafting and consultations, on June 10 the Communications Committee presented to the Executive Committee its proposal for a communications strategy. Based on an assessment of the situation of the European banking sector and on members'

[1] Activities of the Banking Supervision Committee are presented in the Annex.

comments, the proposal concluded that three years after the outbreak of the financial and economic crisis the EBF should adopt a stronger communications approach. The Committee undertook to manage, based on national needs, proposals and inputs, a communications system to satisfy members' day-to-day communications needs. The Committee also undertook to draft and present to the Executive Committee proposals for the implementation of the new communications strategy. The Committee's proposals for the new strategy are based on an „explain to engage" approach. The Executive Committee requested the Chair of the Communications Committee to develop guidelines for the new communications strategy.

4.4 Economic and Monetary Committee

The Economic and Monetary Committee's June meeting reviewed three main items. The first was economic forecasts for the euro-zone for 2011. Members of the Committee agreed that the due to the Greek, Irish and Portuguese crises and the war in North-Africa, growth forecasts for the euro-zone should be reduced, notwithstanding the encouraging growth of the German economy in the past 5 months. Forecasts expect a 1.5% GDP growth in the euro-zone in 2011. The Committee reviewed in detail the situation in Greece.

The second key issue was a report on a research conducted on the correlation between lending cycles and economic growth and its impact on macro-prudential policy.

The discussion of the third agenda item was attended by the EBF Secretary-General, Guido Ravoet. The topic was the question how the Economic and Monetary Committee's activities could be better used in promoting the interests of the European banking industry and the related communications. It was agreed that the EBF Secretariat would publicise the Committee's forecasts and from time to time request from the Committee analyses, background information and arguments for its lobbying activities.

4.5 Legal Committee

At the Legal Committee's meeting, the meeting's guest presenter, Yvan Balensi from the EBIC, held a presentation on work related to European contract law. The key question is the genre of the proposed document: the European Committee evisages it as an optional tool, providing a set of common definitions, confined to commerce (sale and purchase), and primarily, to remote commerce. Most member states disagree with this concept.

In relation to crisis resolution and special taxes, participants concluded that special taxes on financial institutions should serve bank resolution purposes.

CRD4 is expected to be issued partly as a directive and partly as a regulation. The directive will contain a definition for "gold plating", although this will not be applied in other contexts, such as consumer protection issues. CRD4 will probably also contain a *corporate governance* chapter. Compliance with this chapter may pose problems for banks, for example, regarding the separation of the positions of chairman and CEO, restrictions on the number of offices that can be held by the same person, mandatory diversification by sex, age and geographical origin, etc.

III. ASSOCIATION EVENTS, WORKING GROUPS, COMMUNICATIONS

1. Conferences

1.1 FATCA conference

The Association held a conference in cooperation with Hungarian and foreign experts from Deloitte on the requirements of the U.S. Foreign Account Tax Compliance Act (FATCA).

The FATCA is aimed to prevent tax avoidance by U.S. citizens by allowing the IRS to identify funds held by U.S. citizens on foreign accounts. Foreign financial service providers failing to enter into an agreement with the IRS and report U.S. source payments will be subject to a 30% withholding tax on all payments made.

Although entering into an agreement with the IRS is not mandatory, financial institution failing to enter into an agreement with the IRS and comply with its requirements would be put at a competitive disadvantage, given that U.S. source payments would only be credited with a 30% discount to their nostro accounts.

With the short time left until its entry into force, Hungarian banks will also have to address in detail the requirements of the FATCA.

Preparations for compliance with the FATCA poses a considerable challenge for non-U.S. financial institutions, given that:

- the relevant implementation guides are not complete yet;
- the transposition of the FATCA requirements into national legislation is not mandatory, no government-level regulation is expected;
- U.S. and national laws differ (bank secrecy, payments, tax laws, etc.);
- the required preparations are complex and time consuming (customer and owner identification, human check on private banking items, monitoring of limits and transit payments, data consolidation).

Representatives from the government and the Hungarian Financial Supervisory Authority attending the conference promised to promote FATCA implementation by providing rulings for the issues that may arise. We will continue to update members on European and global developments regarding FATCA implementation and we stand ready to coordinate members' related tasks.

1.2 Accounting conference for banks' lending and risk management officers

The Association organised a conference for banks' lending and risk management officers to help banks in interpreting borrowers' IFRS and Hungarian financial statements. The conference was aimed to address issues and financial transactions where the financial report does not fully reflect the actual risks involved in the various operations of the company. Consultants experienced in international accounting say the Hungarian Accounting Act is in a number of points not clear enough and the Hungarian accounting rules do not always reflect the underlying risks. Experience shows that banks' analysts have problems in interpreting the IFRS reports regarding certain items and in recognising the actual contents of the relevant disclosures, accounts and related risks. The conference, organised in cooperation with KPMG, was focused on critical accounting issues related to investment project contracts and trading

house transactions. The event was in a sense a continuation of the series of presentations launched last year in cooperation with the Hungarian Chamber of Auditors on how to read Hungarian financial reports. The conference, providing a number of practical examples, was attended by more than 100 specialists from member banks. Participants found the presentations highly professional and useful.

2. Association working groups

2.1 Agricultural lending

We reviewed our proposal for amendments to the Warehousing Act with competent officials of the Ministry for National Economy. The Ministry's representatives agreed that the proposed amendments were needed. They promised to consult on the issue within the Ministry and (if authorised) to initiate an administrative review of the proposal. The amendment proposal may be presented to Parliament in the spring of 2012.

We initiated an amendment to the cooperation agreement between banks and the National Land Fund. There is more chance for the amendment now that the National Land Fund has been returned to the Ministry for Rural Development. The Ministry did not promise a quick solution, given that they are waiting for the proposed amendment to the Land Act to be adopted before proceeding with the issue.

At the request of milling companies, several meetings were held at the Ministry of Agriculture with banks involved with a view to improving the terms and conditions of loans granted to finance grain stocks. As a result of these consultations, the Hungarian Development Bank (MFB) made a proposal for the reduction of guarantee fees for certain food industry products. The MFB undertook to apply guarantee fees adjusted to the risk and not to exceed 1.5%. The MFB will make a proposal for the maximum interest rates to be applied subject to the rate of the guarantee.

2.2 SME Lending

At the National Development Agency's initiative, we held an information and consultation meeting at the Association on the new Széchenyi Plan and the related funding schemes.

2.3 Energy sector lending

The new energy laws substantially affect combined heat and power plants and banks financing them. After contacting the competent Ministry, we are now involved in the drafting of the relevant detailed regulations.

2.4 Macroeconomics Working Group

The Macroeconomics Working Group meets four times a year (in the middle of March, June, September and December) to review global and Hungarian economic developments and the situation of the Hungarian banking sector. The Working Group makes forecasts (including 20-25 figures) for the current and next year. The first (experimental) forecast was completed. The autumn forecast will be made public for members.

2.5 Payments Working Group

Progress was made on the following issues:

- At the Working Group's request, the MNB held another consultation to clarify issues related to the order of transactions in the context of implementation of the new InterGiro2 (IG2) system.
Replacing the current Interbank Clearing System (IG1), IG2 will allow same-day execution of electronic retail payment orders (except for payments by administrative order) effective July 2, 2012. The order of transactions was raised as a question by several banks. Namely, it may happen that payment orders that are received during the last settlement cycle in IG2 but cannot be executed on the current day for lack of funds would be preceded by payment orders received from IG1 which would then take away the funds from queued IG2 transactions, while customers would be under the belief that their payment orders have been duly executed. The MNB says it will not be possible in IG2 to block funds for payment orders that could not be executed on the current day. The order of transactions is governed by rather complex rules. The formulation of these rules in a straightforward way for customers will be a difficult task. This problem should be addressed by the Association's newly set up Communications Committee. Banks are concerned that there will be a lot of complaints in the initial period of implementation of IG2.

- The development of a solution to the problem of inadequate payment orders received from the Hungarian Post Office is now in process. Four banks are involved in the work. The objective is to develop a system that is acceptable for all participants.

2.6 IT Security Working Group

At its meeting in May, the Working Group agreed that, as was the case in the previous year, an incident management drill will be held in 2011, as well. The Working Group commissioned Dr István Lőrinc again to plan and manage the drill (COMEX-2011). The Working Group adopted the terms of reference for the drill and agreed that the drill should again be held at the Analytical Laboratory of CERT Hungary. Preparatory meetings for the drill will be held during the summer, the drill will take place in September or October.

2.7 Cards Working Group

Negative experiences encountered in the context of the windup of Aeroviva Travel Agency in December 2010 (some customers filing claims with the insurance company as well as with their banks) prompted banks to develop and agree on a set of domestic chargeback rules between each other instead of the chargeback rules applied by the international card associations, and to have those rules accepted by MasterCard and Visa. According to the rules of MasterCard and Visa, domestic chargeback rules may be made agreed on provided the majority of banks involved in card transactions agree to those rules. Consultations between banks on the proposed rules are still in process.

2.8 Work-Out Working Group

At the request of the Ministry of Justice, we reviewed the technical concept for bankruptcy proceedings for groups of companies. The essence of the concept was that if a company has a qualified majority in other members of the group or is a dominant member of the group, the

court may be requested to institute a bankruptcy proceeding against the group as a whole. The Work-Out Committee drew attention that the proposal was unelaborate and dangerous and proposed that due to the various interrelations, it would be expedient to wait with the proposal until the adoption of the new Companies Act.

At its May meeting, the Working Committee reviewed experiences of the application of the new bankruptcy regulations and the precautions creditors may take to prevent fraudulent bankruptcy. Written comments received from members were sent to competent staff at the Ministry of Justice. At the same time, the Working Committee proposed that a detailed and elaborate proposal, including a specific text proposal should be drafted and sent as an official amendment proposal to the Bankruptcy Act.

2.9 Human and Physical Security Working Group

The Human and Physical Security Working Group's meeting focused on analysing the latest statistics on bank robberies. The guest presenter from the National Police Headquarters reported improved statistics, with a number of serial robbers caught. A problem for the police is that the statistics do not reveal any trends to focus on regarding the size of the institutions attacked, their location, the number of security guards, the time of the attacks, age of the perpetrators, their professions and motives.

The meeting also addressed the renewed agreement between the Association and the National Police Headquarters, which, in addition to physical security related issues, now also puts more focus on other types of fraud and on information security issues.

2.10 Compliance Working Group

The Compliance Working Group's May meeting was attended by Zsolt Wermeser, Managing Director of the Markets Supervision Directorate of the Hungarian Financial Supervisory Authority and Gergő Szeniczey, Head of the Supervisory Authority's Market Surveillance Department, who presented the Directorate's main tasks and the main supervisory expectations regarding compliance. The presenters pointed out that according to their experience, compliance can only be successful if it is taken seriously within an organisation and if this is reflected in its position in the organisation. Although the Supervisory Authority sees a significant improvement in compliance culture, there are still major differences between the various sectors. The Authority plans to help raise the standard in compliance by providing training materials, similarly to what the FSA does in the U.K.

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

The EU-USA anti-terrorism conference was held in the premises of the Hungarian Parliament. The conference was also attended by representatives from banks. A presentation at the conference was held by the head of the Association's Anti-Money Laundering and Anti-Terrorist Financing Working Group. There was also a consultation session with representatives from the private sector. In relation to difficulties in the application of sanction lists, representatives of the U.S. Treasury agreed that there was a need for consistent standards.

At the proposal of the Working Group, we initiated that the International Training Center for Bankers and the Association launch a regular anti-money laundering training course, to be

concluded by an examination and a certificate, which would be recognised as a qualification requirement for those working in this area.

2.12 Ad hoc legal committee on the government's rescue package for borrowers with foreign currency loans

The Association set up an ad hoc working committee from legal counsels from major banks involved in retail lending to prepare implementation tasks related to the government's action plan presented at the CEO meeting of April 1.

The committee reviewed the various points of the action plan. It concluded that the proposed overflow account was a complex facility, the details of which should be carefully considered from legal points of view, as well. There may be regulatory needs in relation to the regulations on government guarantees. It would be a legitimate expectation that the necessary contract amendments are carried out at the least possible costs and as simply as possible. At the same time, it is the interest of banks and of the central budget that the restructuring of the contracts is done in a legally sound manner. The working group will continue its work by making amendment proposals to the regulations on notary deeds and notary fees following adoption of the legislation on the rescue package.

3. Communications

3.1 Informing the general public

In the past quarter, the Association's communications activities were focused on two key issues. One was presenting the decisions adopted by the Association's Annual General Meeting and introducing the Association's new president and Board and the Association' new Secretary-General. Our main message to the public was that the Association's new president considered it its main task to improve the Association's professional relations with the government and with customers and thereby, to improve the prestige of the banking profession and strengthen public confidence in banks.

Regarding the new Board, our key message was that the new Board includes the most recognised leaders in the industry. Foreign bankers and small and medium-sized banks are also represented on the Board. Thus, a body strongly representing the interests of the sector and capable of creating consensus has been formed.

The second key issue was the agreement made between the Government and the Association on the lifting of the eviction and foreclosure moratoriums and the proposed legislation on the fixing of exchange rates for the repayment of FX mortgage loans and on rules for foreclosures. The principle adopted by the Board for the Association's President, Board members and representatives to communicate in a coordinated manner and by covering the entire range of the media was fully met. Our communications were also successful in terms of their contents: we highlighted our endeavour to have fair cooperation with the government and also provided customers with straightforward and meaningful information on the terms and conditions and the benefits and potential risks of the government's debtor rescue package.

3.2 Complaint letters from customers

As a result of our active external communications, an increasingly high number of customers have turned to us with requests to solve their problems related to their various dealings with their banks.

Although we are trying to respond to all these complaint letters, it would be expedient to establish, even if orally, an agreement with the Hungarian Financial Supervisory Authority, based on which we could forward the complaint letters received from customers to the Supervisory Authority, being sure that they will be answered. In a number of cases, customers indicate their willingness to continue their repayments but say that to do so, they need assistance. It would also be expedient to solicit from our major retail bank members their customer service addresses to which we could electronically forward these letters.

3.3 Consumer groups

The Association publicly spoke up against the activities of customer groups. We called for early regulation of the activities of consumer groups in several articles in our e-Newsletters. As a result, we received calls from several radio and television stations.

ANNEX

INTERNATIONAL DEVELOPMENTS: REGULATION, SUPERVISION - EBF BANKING SUPERVISION COMMITTEE

1. Capital requirements and liquidity framework (Basel III)

1.1 Basel III revised version[2]

At the beginning of June, the Basel Committee published the revised version of the Basel III framework. This contains minor modifications compared to the original version, published in December 2010. The Committee reviewed and finalised the requirements for counterparty credit risk. The review resulted in a minor modification of the credit valuation adjustment (CVA), which is the risk of loss caused by changes in the credit spread of a counterparty due to changes in its credit quality. (During the financial crisis, roughly two-thirds of losses attributed to counterparty credit risk were due to CVA losses and only about one-third were due to actual defaults). The Basel III framework, published in December 2010, sets out capital rules for CVA risk that include standardised and advanced methods. The impact study completed in the first quarter of 2011 showed that the standardised method as originally set out in the December 2010 rules text could be unduly punitive for low-rated counterparties with long maturity transactions. To narrow the gap between the capital required for CCC-rated counterparties under the standardised and the advanced methods, the Basel Committee reduced the weight applied to CCC-rated counterparties from 18% to 10%. All other aspects of the regulatory capital treatment for counterparty credit risk and CVA risk remained unchanged from the December 2010 Basel III rules text. Overall, the Committee estimates that, with the addition of the CVA risk capital charge, the capital requirements for counterparty credit risk under Basel III will double the level required under Basel II (i.e. when counterparty credit risk was capitalised for default risk only).

The Committee is in the process of completing the review of capitalisation of bank exposures to central counterparties (CCPs) and expects to finalise its December 2010 proposals before the end of the year.

1.2 Measures for global systemically important banks (G-SIBs)

At its June 25, 2011 meeting, the Group of Governors and Heads of Supervision (GHOS), the oversight body of the Basel Committee, agreed on a consultative document setting out measures for global systemically important banks (G-SIBs). These measures include the methodology for assessing systemic importance, the additional required loss absorbency and the arrangements by which they will be phased in. The GHOS submitted the consultative document to the Financial Stability Board (FSB), which is coordinating the overall set of measures to reduce the moral

[2] Basel III: A global regulatory framework for more resilient banks and banking systems

hazard posed by global systemically important financial institutions. The consultative document will be issued at the end of July.

The additional loss absorbency requirements for S-SIBS are to be met with a progressive Common Equity Tier 1 (CET1) capital requirement ranging from 1% to 2.5%, depending on a bank's systemic importance. To provide a disincentive for banks facing the highest charge to increase materially their global systemic importance in the future, an additional 1% loss absorbency requirement would be applied in such cases. The higher loss absorbency requirements will be introduced between January 1, 2016 and year-end 2018 and become fully effective on January 1, 2019.

1.3 Reporting tables on the implementation of Basel III

The Basel Committee published a set of reporting tables aimed at monitoring the implementation of the Basel III framework. According to the explanation provided, this information collection would allow the monitoring of compliance with the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) requirements.

The IBFed[3] wrote a letter to the Basel Committee, drawing attention that the objective of the reporting tables to monitor compliance with the LCR and NSFR requirements was against the provisions of the December liquidity document and might suggest that the liquidity coverage ratios would be introduced from January 2015 in an unchanged form, whereas the purpose of the monitoring period is to monitor the impacts of the proposed standards on financial markets, credit supply and economic growth with a view to fine-tuning the regulation.

The European Banking Federation's Liquidity Management Working Group compiled a summary of European specifics to be raised during the negotiations with the European Banking Authority (EBA).

2. Lobbying concerning EU implementation of Basel III (CRD4)

The European Commission on July 20 published its still unofficial text proposal for CRD4[4]. The European Banking Federation had carried out active and extensive lobbying to influence the contents of the proposed legislation.

2.1 EBF high-level letter on CRD 4 – Meeting with European Commission officials

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

[4] Details of the proposal will be presented in our next quarter report.

The EBF wrote a high-level letter to the European Commission on CRD4. In the EBF's opinion, the following basic guiding principles should be observed during the drafting of the legislation:

- *The legislation should take into account its impact.* Supervisory authorities in various member states appear to consider the Liquidity Coverage Ratio observation period as a mere transitory phase on the path to its adoption by the industry at the beginning of 2015. The EBF believes that the observation period must be used to ensure that the design of the LCR is optimised by collecting further empirical evidence on the behaviour of possible components of the liquidity buffer.
- *European market specificities need to be taken into account.* The requirements set in the current proposal (such as those on mortgage lending, Credit Value Adjustment [CVA], the runoff factor for corporate deposits, the treatment of software, export financing) would increase the unlevel playing field with other jurisdictions.
- *The industry needs the time to prepare itself and grandfathering arrangements should be put in place.*

The letter points out that the short-term liquidity requirements in the CRD4 need special scrutiny. The possible interaction between intra-group liquidity and the Large Exposure regime and the legal requirements for covered bonds should be taken into account. The EBF supports the proposal that institutions will be entitled to identify themselves transferable assets that are respectively of high and extremely high liquidity and credit quality.

The EBF strongly supports the intention to achieve a Single Rulebook in the EU. Nevertheless, in relation to mortgage lending practices it believes that it would be inappropriate to introduce a cap on loan-to-value (LTV) ratios and recommends that this proposal should be removed.

In his response, the EU Commissioner said he was looking forward to continued information on any undesirable impacts of Basel III, including the impacts on SME lending. At the same time, he made it clear that in drafting CRD4 the Commission does not intend to depart from the text of Basel III and seeks to ensure that other jurisdictions act likewise.

In connection with the EBF high-level letter, the chair of the EBF Banking Supervision Committee (BSC) and representatives of the EBF Secretariat met with competent officers of the European Commission. The EU officials informed the EBF representatives that the inter-services consultation on CRD4 had commenced and the proposed text was expected to be published either at the end of ~~June~~ July or early September. They confirmed that although this may not necessarily be reflected in the CRD4 text, it was also the Commission's firm intention to use the monitoring period for testing the liquidity requirements. The proposed text should by no means be considered as final. They said they would propose to the Basel Committee that the treatment of covered bond should be revised.

The chair of the EBF BSC raised that the proposed treatment of mortgage lending would put European banks at a competitive disadvantage, as U.S. banks can move

mortgage loans off their balance sheets. The proposed requirements would create a paradoxical situation: banks lending their deposits as mortgage loans will need to switch to a more complex and more risky business model. The EU officials proposed that banks should collect data to substantiate that proven business models do not imply any significant deposit runoff. Also, it is important that the Basel Committee, which had set up a working committee on export credits, is provided with convincing data. The European Commission understands the unlevel playing field concerns related to differences in the treatment of software and of export credits. In the European Commission's opinion, the leverage ratio may not be a problem for banks compliant with the capital and liquidity requirements (unless for those with a high ratio of zero-weighted assets).

The EU officials pointed out that the U.S. regulators had on several occasions expressed their commitment to implementing Basel III. The Basel Committee's Standard Implementation Group will have a key role to play in the consistent global implementation of the new capital framework.

2.2 EBF position on the potential impact of the Basel III proposal on export finance

The EBF is concerned that the new capital standards under Basel III would threaten international trade and trade finance, running counter the goals for global economic recovery. The EBF conducted an in-depth analysis on the issue and sent a position paper to the Basel Committee and the competent European institutions and officials. The EBF proposals focus on the following key recommendations:

- To fully evaluate the effects of the Leverage Ratio on the availability of trade and export finance;
- To recognize the normal liquidity profile of export credits (cash inflows/repayments and undrawn portion);
- To achieve a real global level playing field in the implementation of Basel III, in particular by harmonising provisions that allow export credits to be eligible for central bank refinancing.

It should also be taken into account that export finance is also characterised by government support for a significant proportion of the loan, through the guarantee or insurance of a national Export Credit Agency.

2.3 BusinessEurope and EBF joint letter on CRD 4 and on liquidity ratios

BusinessEurope and the EBF wrote a joint letter to the Commissioner for the Internal Market on unintended impacts of the proposed liquidity regime. The letter cites the impact study conducted by the CEBS, which concluded that the banks involved would need EUR 1,800 billion in additional long term funding and EUR 1,000 billion in additional liquid assets to meet the ~~Nest Stable Funding Rate (NSFR) and LCR~~new standards~~, respectively .~~(~~or~~ 15% and 8% of EU GDP). The letter points out that although the objective of the liquidity framework is acceptable, the methodology and the calibration of the ratios are far from elaborate. The proposed regulation in its

current form would be expressly detrimental to SMEs and municipalities and would have a negative impact on trade, export finance and project-based infrastructure development. It would threaten the issue of commercial securities and result in a general interest rate increase in the business sector. To avoid these ~~undesired~~ unintended impacts, the signatories request that the minimum liquidity requirements should not be included for the time being in the proposed European legislation. CRD4 should only provide for the reporting requirements, without ~~providing~~ the details of the calculation. The appropriate liquidity ratios should be finalised after an observation period, by taking into account how the liquidity and financing conditions react to other changes in the regulatory framework.

2.4 Italian Banking Association proposal for an offsetting factor for SME loans

The Italian Banking Association proposed the introduction of a correction factor of 76.19% for risk-weighted assets for SMEs to offset the 31.25% increase in capital requirements resulting from Basel III.

The EBF Executive Committee was ~~of~~ on the view that it would be more appropriate for the proposal to be submitted to the EU authorities by the SME associations themselves.

The competent EU body (DG Enterprise and Industry) has a different approach: either to reduce the risk weight for SME loans (under EUR 1 million) under the standardised approach from 75% to 50%, or to raise the maximum limit for SME loans from EUR 3 million to EUR 5 million.

2.5 Directive or regulation - debate on the Single European Rulebook

Seven member states (Bulgaria, Estonia, Lithuania, Slovakia, Spain, Sweden and the U.K.) wrote a letter to EU commissioners, requesting the Commission to reconsider once again the plan to implement Basel III through a regulation rather than through a directive. The proposed Regulation (the Single European Rulebook) would prevent member states from introducing more stringent rules and tighter deadlines than those agreed. The signatories consider that the solution supported by the Commission is contrary to the Basel principle (the Basel requirements are minimum requirements and the various jurisdictions may apply stricter rules). Also, it limits member states in their ability to introduce additional requirements for market or macroprudential reasons.

Five member states (Austria, Denmark, Germany, France and Luxembourg) disagree with the above view and support the Commission's approach (regulation + directive) and the Single Rulebook. In their view, CRD4 does not mean any loosening of Basel III: its is merely an adjustment to the EU specificities. Any restrictions that may become necessary for prudential reasons may be imposed under Pillar 2 and under the countercyclical capital buffer requirements. Consistency between Basel III and current European ~~regulations~~ lrgislations (e.g., grandfathering) is the responsibility of the EBA.

In view of the criterion of a level playing field, the EBF supports this latter position. To strengthen the Commission's position, the EBF sent a letter to the commissioners, urging them to resist any member state endeavours aimed at discretionary prudential legislation.

2.6 Regulatory treatment of software

Under Basel III, intangible assets should be deducted from Core Tier 1 Capital. This is a much tighter requirement than what the current regulation provides (deduction from total capital). Therefore, the accounting treatment of software is an important issue. Under European accounting standards, software is classified as an intangible asset, while in the U.S. and in Switzerland, it is considered as a tangible asset (sites, assets, equipment). This puts European banks at a significant competitive disadvantage.

Nevertheless, the Banking Supervision Committee's Capital Adequacy Working Group did not support the proposal for the EBF to initiate a change in the treatment of software, given that

- the market value of software is probably low,
- supervisors would probably take the conservative approach.

2.7 Treatment of ratings issued by third-country credit rating agencies (CRAs)

Under the EU regulation on credit rating agencies, after a transitional period only ratings issued by CRAs registered in compliance with the regulation may be used for regulatory purposes. On expiry of the deadline, Japan was the only jurisdiction recognised as one whose regulations are equivalent to those of the EU. This may pose a serious problem for banks, although supervisors say that until their final decision, ratings issued by third-country CRAs may continue to be used.

The EBF wrote a letter to the Commission and the EBA to clarify the issue.

3. Other regulatory issues

3.1 Financial Stability Board note on shadow banking

In response to the G20 Seoul summit, the Financial Stability Board (FSB) set up a task force to develop initial recommendations for discussion that would:

- clarify what is meant by the “shadow banking system”;
- set out potential approaches for monitoring the shadow banking system; and
- explore possible regulatory measures to address the systemic risk and regulatory arbitrage concerns posed by the shadow banking system.

The FSB in April issued a document scoping the issue. Comments on the document were invited by the middle of May. The document proposes to narrow the focus on

risks created by maturity/liquidity transformation, flawed credit risk transfer and leverage.

In its comments, the IBFed emphasises that the formation of the shadow banking system is closely linked to regulation and the unintended results of actions taken in this sphere. The letter recommends policy principles that should be recognised in pursuing the regulation of shadow banking: promoting proper functioning of markets, reducing the likelihood of duplication, minimising economic impacts, promoting a level playing field, enhancing transparency, targeting regulatory supervision, and supporting financial stability. To ensure a level playing field, shadow banking should be made subject to the same rules as those applicable to regular banks. The IBFed notes that any regulatory response to the shadow banking system is likely to negatively impact the ease of lending to economic activity and with it, economic recovery. The IBFed is of the view that a holistic approach to the regulation of credit intermediation justifies a reconsideration of the prudential requirements imposed on the regulated banking sector.

3.2 Results of the 2011 EU-wide stress test

The European Banking Authority on July 15 published the results of its 2011 EU-wide stress test of 90 banks in 21 countries. The aim of the 2011 stress test was to assess the resilience of the banks involved in the exercise against an adverse but plausible scenario. (The test was based on the assumption of a 4 percentage point GDP fall from the baseline forecasts and some country-specific shocks, such as a decline in real estate prices, changes in interest rates and sovereign spreads, etc.). For the 2011 exercise, the EBA allowed specific capital increases in the first four months of 2011 to be considered in the results. Banks were therefore incentivised to strengthen their capital positions ahead of the stress test.

The 2011 EU-wide stress test results show that:

- At the end of 2010, twenty banks would fall below the 5% Core Tier 1 Ratio (CT1R) threshold over the two-year horizon of the exercise. The overall shortfall would be EUR 26.8 billion.
- Between January and April 2011, a further net amount of some EUR 50 billion of capital was raised.
- Taking into account these capital raising actions implemented by end April 2011
    - Eight banks fall below the capital threshold of 5% CT1R over the two-year time horizon, with an overall CT1 shortfall of EUR 2.5 billion.
    - Sixteen banks display a CT1R of between 5% and 6%.
- The adverse scenario has a significant impact on loss figures. The stress shows provisions of around EUR 200 billion in each of the two years. The high level of provisions is coupled with reduced profitability under the adverse scenario: both net interest income and pre-provision income are roughly one third lower than the 2009 equivalent levels for the two years of the stress test exercise.

On the basis of these results, the EBA issued its first formal recommendation stating that national supervisory authorities should require banks whose CT1R falls below the 5% threshold to promptly remedy their capital shortfall. The EBA also noted that this was not sufficient to address all potential vulnerabilities at this point. Therefore, the EBA also recommended that national supervisory authorities request all banks whose CT1R is above but close to 5%, and which have sizeable exposures to sovereigns under stress, to take specific steps to strengthen their capital position. These would include, where necessary, restrictions on dividends, de-leveraging, issuance of fresh capital or conversion of lower-quality instruments into Core Tier 1 capital.

The affected banks are expected to plan remedial actions within three months (by October 15, 2011). National authorities should provide detailed overviews of measures to be taken by the banks in question to the EBA by October 31, 2011.

The EBA will review the actions undertaken by banks and national authorities and will publish reports in February and June 2012 on the implementation of its recommendations.

According to the EBA, the 2011 EU-wide stress test contains an unprecedented level of transparency on banks' exposures and capital composition to allow investors, analysts and other market participants to develop an informed view on the resilience of the EU banking sector.

However, the European Banking Federation objected to disclosing the individual results of banks, as the capital shortfalls calculated based on extreme scenarios might lead non-expert readers to draw false conclusions.

3.3 ECON vote on the Investor Compensation Schemes Directive

The European Parliament's Economic and Monetary Committee (ECON) voted on proposed amendments to the Investor Compensation Schemes Directive on April 13. According to the results of the vote, the European Commission would be requested to look into the possibility of replacing or complementing the current investor compensation schemes with guarantee schemes. UCITS would be excluded from the scope of the directive and the Commission should make a proposal for amending the UCITS Directive in respect of the obligations of custodians. At the same time, the directive would be extended to protection against bad advice and the coverage level raised to EUR 100,000. The proposed borrowing mechanism between national schemes was dropped for the time being, as it would require some additional conditions.

Given the differences between the views of the Parliament and of the Council (Member States), the amendments are unlikely to be adopted anytime soon.

In relation to bad advice, the EBF wrote a letter to MEPs involved in the issue, presenting the problems the proposal would pose. The letter points out the main differences between investor compensation schemes and deposit guarantee schemes.

Investor compensation schemes are not aimed to protect customers from the depreciation of their securities but rather to protect against fraud by investment firms and against the disappearance of securities. The extension of the protection to bad advice is inconsistent with this concept. Also, investment advisory services are regulated by the MiFID, under which bad advice falls under the scope of contractual responsibility. Contractual responsibility is a national competence, not subject to EU law harmonisation, and the enforcement of contractual obligation is a matter for national courts. It is only the U.K., where bad advice is part of investor compensation. The adoption of this model at the EU level is undesirable and would even be impossible due to the differences in national laws. The definition (practical identification) of bad advice and of the damage caused by it would also be difficult.

3.4 COREP revision

At the end April, the EBA published a revision of its Common Reporting Framewor (COREP rev.3), taking account of the CRD 3 amendments of November 24, 2010.

The changes to the COREP templates reflect

- the reviewed frameworks for securitisations (including re-securitisations) in the banking and the trading book;
- the revised provisions with regard to market risk (reviewed provisions for internal models, VaR);
- the extension of settlement/delivery risks requirements to the non-trading book.

The new templates will be applicable as of December 31, 2011.

The EBA is currently working on the development of uniform reporting standards in accordance with Article 74 (2) of the CRD (Directive 2006/48/EC) to ensure uniform conditions of application of the Directive in terms of contents, formats, frequencies and dates of reporting.

4. Other EBF és EBIC[5] developments

4.1 Policy statement by the EBF's new president

Christian Clausen, the EBF's new president, in April issued a policy statement, outlining the main priorities for the two years of his mandate as president of the EBF. According to the statement, the European Banking Federation (EBF) is determined to cooperate with policy-makers, companies and citizens to enhance economic growth and resilience. The EBF seeks to actively contribute to the drafting of the international standards for capital and liquidity, the new European supervisory structures and the European framework for crisis prevention and management. Stability can only be achieved if the right balance is struck between capital increase, liquidity requirements and lending capacity. The EBF seeks to engage with policy-makers, supervisors, regulators, financial institutions and consumer representatives in more regular dialogue with a view to ensuring a constructive and pragmatic approach.

[5] European Banking Industry Committee: the joint committee of European industry associations.

The statement stresses that the EBF is traditionally supportive of strong and effective supervision. It is committed to contributing to the success of the new agencies, especially the EBA. The new regulatory regime will require successful and effective cooperation between national supervisors. It will promote consistent implementation of the new standards and ensure a level playing field. The EBF believes that with an effective crisis management framework and strong supervision, special rules around Systemically Important Financial Institutions will become less meaningful and needed.

The statement points out that the integration of European financial services remains a mid-term objective. It emphasises that without this, that is, if national rules were adopted versus coordinated European ones, the EU economy would become weaker. However, it is important to ensure that the economic environment does not become excessively strict or over-regulated, since that would adversely affect all economic players.

The statement underlines that banking should be based on trust and transparency. These dimensions have been eroded in recent years, and the consequences will take some time to be remedied. The policy statement reiterates the EBF's commitment to supporting cooperation and integration, and thus to fostering stability and a more resilient banking sector.

4.2 Meeting with representatives of the European Systemic Risk Board

Delegates of the European Banking Federation in May met with representatives from the European Systemic Risk Board (ESRB). Established in January 2011, the ESRB has a secretariat of 25 staff, mainly ECB employees. The ESRB is tasked to develop a set of tools to prevent the build-up of systemic risk. (According to the ESRB representatives, this work may take two years). In addition, the ESRB is actively involved in the development of stress tests and the drafting of a framework for countercyclical capital buffers. The ESRB is not directly involved in the drafting of CRD4, the proposed crisis resolution framework or the regulations on systemically important financial institutions (SIFIs).

The ESRB seeks to develop a set of indicators of at least 200 components to monitor the build-up of systemic risk, with some key indicators that may serve as a basis for intervention. In the ESRB's interpretation, national supervisors may not only impose additional capital requirements under Pillar 2, but may also intervene more directly if they observe signs of vulnerability of the financial system (by setting LTV ratios, risk weights). The ESRB obtains the data required for its assessments from national supervisors and the European Supervisory Authorites (ESAs), including data for the individual institutions. It may obtain additional information through questionnaires.

The ESRB considers that the global framework for SIFIs is appropriate and sees no need for a separate European regulation. At the same time, it supports the proposal for

a three percentage-point capital surcharge for SIFIs and a national discretion to increase it.

4.3 EBF position on amendments proposed by the European Parliament to the Directive on Deposit Guarantee Schemes

The EBF compiled detailed comments and a voting list on amendments proposed by the European Parliament to the Directive on Deposit Guarantee Schemes.

The EBF supported the following:

- the need for harmonised rules and a level playing;
- only the covered deposits should be the base for the required ex-ante funding rather than eligible deposits; a standard, risk-based contribution system should be developed;
- deposit guarantee schemes should have more operational freedom;
- the scope of deposit guarantee should be further simplified.

The EBF objected to the following:

- the 1.5% target level for ex-ante funds, and the annual contributions;
- the inclusion of municipality deposits, as this would make the systems too complicated;
- the unrealistically short payout timeframe
- the provision on a EUR 5,000 advance payout.

Meanwhile, Austria, France, Germany and the U.K. in a joint document expressed their view that a harmonised target level was neither useful, nor efficient and gave rise to concerns.

4.4 EBIC position on the proposed EU framework for bank recovery and resolution

The EBIC sent a separate response to the European Commission's working document on the proposed EU bank resolution framework[6]. The EBIC made the following key comments:

- Resolution frameworks need to be introduced globally to ensure a level playing field.
- Proportionality should be a guiding principle for the use of the different tools and powers of supervisors and resolution authorities.
- The designation of resolution authorities and the allocation of responsibilities should be left to national discretion.
- It should be ensured that the triggers for prevention, early intervention and resolution actions are clearly defined and transparent and provide legal certainty.
- The possible measures to be taken at the various stages should be proportionate to the impact of the breach of the relevant requirements and compatible with the overall business model of the bank.

[6] For the EBF's position, see our 1st quarter report .

- The EBIC objects to introducing or maintaining additional national bank levies in parallel with contributions to resolution funds.