



HUNGARIAN BANKING ASSOCIATION

REPORT
on Activities of the Hungarian Banking Association
4th Quarter 2011

Budapest, January 2012

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Executive Summary

In the fourth quarter of 2011, the Hungarian Banking Association was faced with one of the most challenging tasks ever in its history, when at the initiative of the government it started negotiations to address the issue of debtors with foreign-currency denominated mortgage loans. During the negotiations, a compromise agreement, mainly corresponding to the proposals presented by us, and also acceptable for banks, was reached. In addition to ending the early repayment scheme (objected to by banks and still subject to legal action), the agreement provides adequate guarantees that the special burdens imposed on the sector will not be increased.

- The agreement reached in December allows banks to offset against the special bank levy a part of their losses arising from early repayments and from the reactivation of the loans by converting them into HUF and forgiving a part of the debt.
- Another forward-looking element of the agreement is that the burdens arising from the exchange rate cap scheme, made available for a significantly widened range of performing debtors, will be shared between the banking sector and the government. The growth pact stipulated in the agreement, currently under drafting, also signals increased cooperation between the parties.
- Activities in the fourth quarter were also determined by accounting issues related to the early repayment scheme. Here, the Association conducted several consultations with the competent ministries, PSZÁF and the MNB, putting forward a number of technical proposals.
- Based on the decision of the Board, the Association and the affected banks (on a voluntary basis) turned to the Constitutional Court. Due to changes in the legislation, it is now necessary and expedient that individual banks, as the parties directly affected by the early repayment scheme, file a constitutional complaint with the Constitutional Court. The Association will continue to assist members in the process, the text of the complaint has been drafted, now is being confirmed. In addition, some mother banks initiated legal action at the European Court of Justice.
- Upon indications from the Association, the government amended the statute on the National Asset Management Agency (NAMA), extending the range of those eligible and increasing (also at our request) the number of real estates to be purchased by NAMA in 2012 from 5,000 to 8,000.

Also in the fourth quarter, the Association launched a project for setting up the comprehensive data base of the Central Credit Bureau. Under the extremely tight timetable set, we conducted ongoing coordination, developed proposals for customer information and provided assistance to member banks in developing the legal requisites for data transmission.

The Association carried out consultations on the proposed basic bank account facility and on PSZÁF's consumer protection plan of creating a bank account selection calculator. The Association's Secretary-General, as member of the National Deposit Insurance Fund's Board, successfully defended banks' interests against the customer notification proposed by the Fund's Board and the proposal to increase the Fund's fees.

Our Legal Working Group carried out an ongoing analyses of new laws enacted. Preparations for the implementation of the new bankruptcy and data protection acts were key issues addressed by the working group. Also, the Association provided legal assistance to Partiscum XI Savings Cooperative in drafting its review petition to the Supreme Court. Naturally, we offered our legal assistance to Partiscum in the restarted litigation, as well.

In December, the Association's IT Security and Cards Working Groups held several consultations on actions to be taken in relation to recent bank card data thefts. It was agreed that communications in the matter will be managed by the Association. Thanks to the effective solutions identified and prompt and proactive communications, the issue was solved with minimum losses and (despite the Christmas season) without major attacks from the media.

The Association actively participates in all committees of the Intergiro2 (IG2) project, aimed at introducing intra-day settlements in Hungary. As a result of effective work and cooperation, the project is expected to be implemented according to schedule.

The Association's staff is actively involved in operations of the EBF's working committees. We are also represented through delegates from member banks in the newly formed working groups of the EBF (the Financial Sector Tax WG and the Risk Assessment WG). In response to the growing negative sentiment against banks, the EBF gives special emphasis to adopting a new communications strategy. The drafting of the new strategy is led by our colleague, as Chair of the EBF Communications Committee. Other EBF activities include the developing of common stances on the proposed capital requirements and liquidity rules (CDD/CRD4), work related to the proposed financial transaction tax, and regulation proposals and draft directives aimed at the regulation of capital markets.

International regulatory efforts are focused on Basel III implementation, the regulation of systemically important financial institutions (SIFIs, G-SIBs) and the enhancement of the core principles for effective financial supervision (including the effective supervision of financial conglomerates).

MACROECONOMIC REVIEW

In the 4th quarter of 2011,

- at its December meeting, the Macroeconomics Committee analysed the state of the economy in 2011 and the outlooks for 2012;
- Analyses on the performance of the global and Hungarian economy and the Hungarian banking system were compiled. The main findings were as follows:

1. The world economy in the autumn of 2011

- The IMF's September World Economic Outlook was basically optimistic regarding the outlook for the world economy for the next five years, projecting an annual 4 to 5 percent GDP growth (4 percent in 2012 and growing each year).

- Inflation is projected to drop to around 3%. The rate of investment is projected at 25%, exports are forecast to grow from 6% in 2012 to 7% over the next five years.

- Using retrospective data series, we examined the correlation between export growth and GDP growth. We found that world economic growth can be described as $\text{GDP growth rate} = 0.25 * \text{export growth rate} + 2\%$. (The argument is based on growth theory correlations).

- We attempted to explain the export/GDP ratio by level of development, population and trade policy. Based on this, we classified countries into two groups: underexporters and overexporters in the past 50 years. Underexporters have a low export/GDP ratio relative to their development level and population. The main countries in this group include the U.S., the so-called offshoot states, the former EFTA countries and the Mediterranean and South American countries.

- Average or overexporters include the founders of the Common Market, the European post-socialist countries, Japan, and the emerging economies of South-East Asia. The two groups diverge from each other in a V-shape, the implications are hard to quantify.

- It cannot be said that underexporters were worse off during the crisis (notwithstanding that this group includes Greece, Portugal and Ireland)

Since the U.S. was the epicentre of the crisis, we looked into whether the low U.S. savings rate can be traced back to high asset prices and whether high asset prices can be linked to the global liquidity situation. China was a key contributor to the savings glut, where due to the lack of a pension system, it is advisable to save even if the savings are not used for investment.

- With ample liquidity, overconsumption at high prices created a dangerous current account deficit in the U.S and had a self-perpetuating effect.

- We also examined the potential for a corporate lending boom. The loans-to-assets ratio of manufacturing companies in the U.S. has grown from 1/3 to 2/3 over the past half-decade,

which may be attributed either to the low tax rates, with companies borrowing under a tax-shield, or the financial difficulties may have decreased to a degree where it is worthwhile to finance an increasingly higher part of the assets from borrowing.

- We analysed the external threats for the Hungarian economy: Germany's CDS spread is fluctuating due to external effects. Hungary's CDS, while closely linked to the German CDS, shows an unprecedented 4 times higher fluctuation rate than that of the German CDS (as opposed to a 1-2 times higher fluctuation rate in the Czech Republic, Poland or Slovakia).

- The CDS spread affects the exchange rate of the forint, causing a significant impairment and capital loss for banks due to the high ratio of foreign currency-denominated loans. This could ultimately lead to a significant decrease in lending.

- The issue of Greece is still pending and the tolerance of the rescuing banks and governments is unclear, as is that of the citizens to be rescued, therefore, the outlooks for the euro and the EU are hard to project.

2. Performance of the Hungarian economy in Q1-Q3 2011

- Hungary's GDP growth rate in Q1-Q3 2011 (1.8%) corresponded to that of the EU-27.

- At the same time, this growth rate is 1%-2% lower than that warranted when compared to that of the post-socialist countries or to the potential pace of return to the growth trend before the decline in 2009.

- The stagnation in consumption (-0.1%) compared to the 1.8% GDP growth rate can be considered as moderate, other countries showed a similar correlation.

- The rate of unemployment was 11.3%, 1.6% higher than the EU-27 average. Only the PIGS countries, the Baltic States, Bulgaria and Slovakia had a higher unemployment rate than Hungary. A high unemployment rate, if attributable to structural factors, does not reduce the GDP growth rate.

- The 5.9% decline in investment will make future growth difficult. Only in the PIGS countries was the gap between investment and GDP growth so high.

- The 15% rate of increase in exports is not outstanding. However, only Germany and seven smaller countries had a positive, and annually growing, balance of trade.

- Industrial production declined in the PIGS countries, stagnated and fell in Japan, the U.S. and the EU, while growing in Germany, Austria and the post-socialist countries over the past five years. Hungary's industrial production grew at a monthly rate of 1.1 percent on average over the past five years, a 0.06 percentage points lower growth rate than in Germany.

- As for inflation, Japan had a deflation over the past five years. The U.S. and the EU had an inflation rate of 2%, respectively. Hungary's average inflation rate was triple that, often showing the highest inflation rate in its group, sometimes only exceeded by the Baltic and Balkan States.

- In the period Q3 2011/Q3 2010: the number of full time **employees** continued to decrease, while the number of part-time employees grew (at a higher pace than that of the decrease in the number of full-time employees);
- the number of those **unemployed** basically stagnated,
- **real net wages** grew by 3%,
- retail sales and total consumption stagnated,
- **investments** fell by another 5%.
- Agricultural purchases grew by 4% after a 16% decline in 2010.
- In industry, while exports had stagnated and sales (including domestic) had fallen since the beginning of 2011, production rose by 3.2% in the period between Q3 2010 and Q3 2011.
- Construction declined by 12% in Q3 2011 over Q3 2010.
- GDP grew by 1.4% in Q3 2011 over Q3 2010, as the decline in imports (7.4 percentage points) exceeded that in exports (4.4 percentage points).
- Government debt grew from 81.9% in Q1 2011 to 82% in Q3 2011.

3. Performance of the banking sector in Q1-Q3 2011

- Looking at the correlation between GDP growth and growth in lending, both cross sectional (international) and longitudinal (20-year domestic time series) figures reveal that the loans-to-GDP ratio grows in direct proportion to GDP, that is, there is a square relation between the stock of loans and GDP, which in terms of growth rates means that one unit of GDP growth requires two units of lending growth.
- Total domestic lending continues to grow at current prices (rising by 1.38% between September 2010 and September 2011), corporate loans have declined for the second consecutive year now (falling by 0.83% between September 2010 and September 2011). Total loans, excluding exchange rate effects and inflation, have decreased by 10%-11% each year since 2008 (with a 10% decline in the last 12 months), the rate of decline in corporate loans exceeding this rate by an additional 1%-3% (the decline was 11% in the last 12 months).
- The share of foreign currency loans in both total loans and corporate loans is high (67% and 58%, respectively). This ratio rose particularly rapidly in 2008 and 2009. Since then, it has been stagnant, which means that through strong balance sheet management, banks were able to ensure that their FX exposure does not increase despite a 50% weakening of the exchange rate.
- In the credit institutions sector, banks provide 91% of all loans and 89% of all corporate loans. The share of branches of foreign banks is 6% in total loans and 7% in corporate loans. Cooperatives take up 3% of all loans and 5% of all corporate loans (The share of

cooperatives in total FX lending and FX corporate lending is 1%, respectively. In the case of branches of foreign banks, there is no perceivable difference between their share in terms of HUF or FX lending).

- Total assets in the banking sector grew by 1.8% at current prices in the period between September 2010 and September 2011. Total loans fell by 1.2%, with corporate loans dropping by 5.2% and retail loans growing by 2.1%.
- Looking at the development of banks' balance sheet structure compared to 2003, the share of corporate loans in total assets fell by 12%, from 32% to 20%, while the share of retail loans in total assets rose by 10 percentage points from 15% to 25%; notably, the share of securities in total assets grew by 6 percentage points, from 18% to 24%.
- The proportion of foreign currency assets grew in all important asset types in the period between 2003 and 2008. Since then, it has stagnated. (The share of foreign currency assets in total assets grew from 31% in 2003 to 52% in 2008 and then to 54% by September 2011. The share of foreign currency assets in retail loans rose from 3% in 2003 to 66% by 2008, rising by another 4 percentage points by 2011.
- In the period between 2008-2011, the share of corporate loans in total loans to large companies fell by 15%, from 57% to 42%. The share of medium-sized companies, small businesses and micro-enterprises rose by 8, 4 and 3 percentage points, respectively. The NPL (more than 90 days overdue loans) ratio of corporate loans deteriorated from 8.92% in March 2010 to 13.85% in September 2011, with the ratio of foreign currency-denominated NPL being always 4-5 percentage points lower than that of HUF NPL. As for portfolio quality, by multiplying the volume of loans in each classification category by the relevant provisioning weights and comparing the results to the total corporate loan portfolio, the NPL ratio was 3% in the period between 2006 and 2008, 5% between 2009 and 2010 and 10% in September 2011.
- Total retail loans grew by 4.1% at current prices between September 2010 and September 2011, with home loans, consumer loans, and overdrafts rising by 4.9%, 4.55% and 3.1%, respectively. The share of foreign currency loans varied by loan type, taking up 83% in total consumer loans, 67% in total home loans and 2% in total overdrafts. Although increasing, the share of NPL in retail loans was 1.5-2.5 percentage points lower than in corporate loans. The NPL ratio of retail loans grew from 7.4% in March 2010 to 11.5% in September 2011. The NPL ratio of foreign currency loans has been 0.6 percentage points lower than that of the total retail loan portfolio for the past one and a half years. By today, the order has turned around, with the FX NPL ratio being 0.2 percentage points lower than the total retail NPL ratio. The ratio of provisions to total retail loans was better than that for corporate loans, rising from (a rounded) 2% in 2006-2008 to 3% in 2009, 5% in 2010 and 7% in September 2011. A special factor reducing banks' profits is the one off repayment scheme: the effect was HUF 44 billion at the end of October, growing to 90.5 billion at the end of November and projected to rise to HUF 140 billion as of the end of 2011 and to grow further until the end of February 2012.
- As a basic trend in liabilities, the share of deposits fell by 18 percentage points between 2003 and September 2011. This was offset by a 12 percentage-point increase in interbank deposits and a 3 percentage-point increase in loans taken. Foreign currency liabilities rose from 28% to 40% over the past eight years. The loans-to-deposits ratio grew from 110% in 2003 to

157% in 2008, then decreased to 150% in September 2011. The retail loans-to-deposits ratio rose from 50% to 117% in 2008. It was the same in 2011. The corporate loans-to-deposit ratio, rising to more than 190% between 2003 and 2008, declined to 168% by September 2011.

- Looking at the structure of **ROA** between Q1-Q3 2003 and Q1-Q3 2011 (unannualised):

- Net interest income fell by 1 percentage point

- Operating expenses decreased by 1.3%

- The 1 percentage point decline in non-interest income in 2010-2011 was due to the special bank tax, reported in the Other Non-Interest Income line

- Impairment and provisions deteriorated by 0.7-0.8 percentage points since the crisis

- ROA fell by 1.5 percentage points to close to 0 in nominal terms.

- Changes in ROA components in 2011 over 2010:

- Net interest income fell by 0.1 percentage point

- Operating expenses dropped by 0.1 percentage point, offsetting the decline in net interest income,

- Non-interest income fell by 0.2 percentage points (mainly due to the special bank tax),

- Impairment and provisions improved by 0.1 percentage point

- With all this,

- ROA and unannualised ROE fell by 0.1 and 0.95 percentage points, respectively, in Q1-Q3 2011

- Unannualised real ROE declined by 0.6% percentage points (from -0,6% to -1,2%) in Q1-Q3 2011

II. LEGISLATION, SELF REGULATION

1. Regulations and measures related to retail foreign-currency mortgage loans

1.1 Agreements under the Minutes of Understanding concluded between the Association and the government

At the government's initiative, negotiations commenced in October between the government and the Association, with the MNB and the Hungarian Financial Supervisory Authority (PSZÁF) being briefed on an ongoing basis. The Association started drafting a cooperation agreement with the government aimed at mitigating the impacts of the Act on Early Repayment. A high-level working group was set up, chaired by Dániel Gyuris, President of OTP Mortgage bank, with the CEOs of CIB, ERSTE, FHB, K&H Bank and Raiffeisen Bank and the Association's Secretary-General as members.

The proposals developed by the high-level working group were sent to the Prime Minister and the Minister for National Economy on November 17, with copies to the MNB and PSZÁF.

After the proposals were sent and before conclusion of the negotiations, new amendment proposals to the Act on Early Repayment were submitted to Parliament under individual MP motions, extending the scope of early repayments to the detriment of banks. During the negotiation, the Association's delegation requested that the amendments to be adopted be restricted and confined in their application.

As a result of the negotiations, the agreement was signed as Minutes of Understanding on December 15. The most important elements of the agreement include the further limitation of the deadlines for the early repayment scheme and the significant narrowing of the scope of application of the mentioned amendments submitted under MP motions. The agreement allows banks to deduct from their 2011 special bank tax 30% of their losses arising from the final repayment scheme. Furthermore, it enables the reactivation of loans delinquent for more than 90 days by converting the loans into forints and forgiving a part of the debt (25%). Also, the agreement significantly extends the range of performing debtors benefiting from the exchange rate cap scheme, with a partial forgiveness of the interest and the provision of government subsidies. (The full text of the agreement is available on the website of the Ministry for National Economy).

The government met its time-proportional regulatory commitments by submitting amendments to the Act on investment fund managers and collective investment schemes and in the Act on water utilities.

1.2 Accounting issues related to the agreement with the government

While the new schemes introduced from 2012 provide favourable repayment conditions for debtors, the final repayment scheme and the conversion of the loans cause additional huge losses for banks. Hence, the agreement with the government allows banks to deduct from their 2011 special bank tax 30% of their losses arising from the final repayment scheme. Expected losses arising from the new schemes in 2012 can also be mitigated against the special bank tax.

The Credit Institutions Act and the Act on Special Bank Tax were amended accordingly. A consultation on the relevant taxation and accounting issues was held with specialists from member banks to ensure consistent interpretation and application of the new regulations. Specific issues were raised regarding the recognition in the 2011 special bank tax of losses arising from early repayments initiated in 2011 but carried out in fiscal year 2012 and the recognition of losses between related companies.

We sent our interpretations of the regulations to the Ministry for National Economy and the Tax Authority, requesting their position. Upon technical consultations it became clear that the issues raised are unclear not only for banks but also for auditors.

1.3 Legal measures related to the Early Repayments Act

As reported in detail in our 3rd quarter report, the Early Repayment Act, enacted on September 29, 2011, was drafted and adopted without any consultation with the Association. In our 3rd quarter report we also gave detailed information on the motion filed with the Constitutional Court and on actions taken in October in relation to accounting and taxation issues related to the Act.

We consulted with the European Commission Representation in Hungary on options for action on the various European forums. Based on this, in November, we drafted letter to Michel Barnier, the EU Commissioner for Internal Market, expressing our concerns over the Act and offering our support for the Commission's investigations by providing data and other evidences.

The right for any citizen to file a complaint with the Constitutional Court in respect of a promulgated law has been terminated under the new Fundamental Law and the new legislation on the Constitutional Court. All ongoing proceedings of such nature were terminated. However, those directly affected may file a constitutional complaint with the Constitutional Court by March 31, 2012. Our constitutional complaint has been drafted, now is being confirmed and will be made available to members for joining.

1.4 Data collection on early repayments

Monitoring the early repayment process and its impacts is important for the sector in terms of both information and planning. For this reason we requested PSZÁF and the MNB to return to the sector the aggregate data of the weekly reports provided by banks on the early repayment scheme. The regulators were receptive to our request and said PSZÁF would make available on its website the figures on actual early repayments on a monthly basis.

Analysts from member banks said the monthly frequency was inadequate for measuring their positions. Hence, we requested members to send us a copy of their weekly reports and undertook to summarise the data in the same structure as provided in the reports and to return them to those banks that have voluntarily signed up to the data exchange. Banks' analysts have found the Association's action valuable and useful. In addition to regularly furnishing their reports, they are also sharing their latest experiences of the process.

At our request, the MNB had the templates for the early repayment reports and the related completion guide translated and published the English version on its website.

1.5 Accounting rules related to the repayment of foreign currency loans at a fixed exchange rate

After lengthy negotiations, the issues related to the accounting rules for the scheme, introduced by law in the summer, allowing the repayment of foreign currency loans at a fixed exchange rate, were brought to a favourable conclusion in the third quarter of 2011. The relevant legal text was received from the Ministry for National Economy in November. We welcomed the fact that our arguments were accepted.

Pursuant to the adopted accounting rules, overflow account products, where the underlying debt was rated as problem-free before entering the exchange rate protection scheme, will be reclassified into the restructured category, but will not be subject to automatic provisioning.

The issue of the treatment of interests accumulated in the overflow account until December 31, 2014 was also settled: the provisioning requirements for deferred-interest mortgage loans and student loans will not apply. The deferred interest in the overflow account is not the same as that on a conventional deferred interest mortgage loan or a student loan, where the customer does not have to pay interest for a long period of time, while the creditor bank has no information on the debtor's ability or willingness to pay. In the case of overflow accounts, customers are required to make regular monthly repayments at the fixed exchange rate set by the law. Any default on this obligation would immediately be realised by the bank, so the different treatment is underpinned.

We proposed that the issue of the treatment of the risks arising from the accumulated debt in the overflow account becoming repayable from the end of 2014 should be revisited in 2013.

1.6 National Asset Management Agency (NAMA)

The Act on the National Management Agency has taken effect. Shortly after its enactment, an amendment proposal was drafted to provide that those with one child are also eligible to offer through their creditor bank their mortgaged home for sale to NAMA. This widening of the scope of those eligible will pose extra tasks for NAMA. About 8,000 homes are expected to be offered for purchase by NAMA in 2012 under the scheme.

2. Payments

2.1 Payments Glossary

The project for creating a payments glossary started with activities of the Payments Working Group (responsible for issues related to account management, payments and interbank settlements). First, the working method had to be agreed on, including:

- identification the areas to be addressed and breaking down the task accordingly,
- criteria for selecting the terms to be included in the glossary (whether to only include terms affecting the public or also technical/banking terms), and

- determining the character (legal/plain language) and depth of the definitions to be provided.

The list of definitions to be included in the glossary (and to be later updated on a regular basis) will be finalised after thorough discussion by the working group. In accordance with the agreed working method, the other working group involved, the Cards and other Electronic Banking Services Working Group also started working on the project.

2.2 Basic bank account

The Basic Bank Account Working Group compiled a draft recommendation on a basic payment account. The recommendation was sent to the Ministry for National Economy. (The Ministry had requested the Association to draft a self-regulation). Once the Ministry's answer is received, we will decide on proposing to the Association's Board the issue of the recommendation. The draft recommendation does not create a new basic payment account: it just defines it as an account meeting a set of criteria, based on which any account product meeting these criteria can be qualified as a basic bank account. A list of these products and their availability will be published on the Association's website and we will request PSZÁF to do the same.

2.3 Payments made by postal payment vouchers to closed accounts

In the wake of an MNB ruling providing that, as opposed to the current practice, the Hungarian Post Office should accept returned payments made to closed accounts, consultations were started between the Association and the Hungarian Post Office on the conditions for rejecting and returning these payments.

The key issue was that according to the Post Office, returning the payment to the customer instead of getting it to the intended destination (and in addition, doing so after deducting an intermediary fee), would trigger a flood of complaints. The Post Office proposed that clients receiving payments by postal payment vouchers should only be "released" after a 3-month termination period, to allow customers to get used to using postal payment vouchers with the beneficiary's new account number.

Banks rejected this proposal, given that extending the current, normally 1-month, termination period would be a customer-unfriendly move and also - if introduced simultaneously by all banks - violate competition laws. In our view, it is the interest of the beneficiary of the postal payment voucher to notify in due course and manner its customers on its new account number. Banks have no legal means to enforce this responsible practice.

The consultations on the technical issues related to rejected payments were more successful. Agreement was reached regarding the channel to be used for the rejections (the VIBER system), the information to be included in the rejection, and the fees. Discussions are in an advanced stage on the settlement of fees, the data to be provided in the information and the communication channels to be used.

2.4 PSZÁF plan to introduce a bank account selection calculator

Following the pattern of the existing loan and deposit calculators, PSZÁF plans to introduce a bank account selection calculator. PSZÁF initiated a consultation with the Association on the proposed calculator. The following schedule was agreed:

- PSZÁF will issue a decree in June 2012, specifying the data to be provided for the calculator;
- the first data upload will be carried out in October 2012, and
- the calculator will go live in November 2012.

According to PSZÁF's concept, the calculator would be focused on basic bank accounts. However - and somewhat contradicting this concept - PSZÁF said the comparison should be based on various customer profiles. We support this latter idea, given that one of the shortcomings of a basic bank account is that according to the relevant EU Recommendation it cannot be tied to regular salary payments to the account. This is a major obstacle for the account to be competitive with other, existing, low-cost or free bank account products. The Association's competent working group is in ongoing consultation with PSZÁF. PSZÁF appears to be receptive to our proposals.

2.5 Gaming Act

The provision on the prohibition of payments under the proposed amendment to the Act on Gaming was reviewed with the Payments Working Group, the Cards Working Group and legal experts. Act CXX of 2011 amending certain tax laws promoting the stability of general government has amended the Act on personal income tax. Pursuant to the amendment, taking effect on January 1, 2012, the Tax Authority may, with a view to preventing unauthorised gaming, invite the financial service provider **"not to be instrumental in executing credit transfer, collection or other payment orders or transactions to or from the account specified by the Tax Authority until the lifting of this prohibition, which may not exceed 90 days."**

To determine the specific tasks required from financial service providers, we requested a ruling from the Ministry for National Economy and consulted with the National Tax and Customs Administration's Department for Gaming Supervision on the possible implementation solutions.

3. Central Credit Bureau

The project on comprehensive data base of Central Credit Bureau was set up under the leadership of the Association from representatives from member banks, and is supported by BISZ. In its initial stage, the project focused on drafting amendment proposals to the Act on Central Credit Bureau (containing several serious errors) and having them accepted by the Ministry responsible for drafting the legislation and seeking temporary solutions to implement the currently impracticable provisions of the Act until the Act is amended.

The project's efforts were successful:

Temporary best practices were developed and recommended to member banks, offering information and data processing solutions that can be managed preferably without infringing the letter of the law.

At the beginning of November, the Act was amended basically in accordance with our proposals, providing manageable preparation and implementation deadlines, eliminating excessive reporting requirements (bank accounts, closed loan contracts) and enabling reasonable system management.

With this initial work, the project has become a major setting for the development of a comprehensive credit bureau. As a result of activities of the working group

- a sample customer information document was developed,
- a recommendation for the method of customer consent for data inquiries was drafted,
- the contents of the data fields to be sent to the Central Credit Bureau were identified,
- the complex method for a single-step transfer (initial upload) of loan contracts into the Credit Information System was shaped through professional consultations.

The Association briefed banks on results of work of the Banking and IT Working Groups partly directly and partly through BISZ. Regarding those provisions of the Act on Central Credit Bureau where no satisfactory solutions had been identified, rulings were requested from or amendment proposals were submitted to the Ministry responsible for drafting the legislation.

4. Taxation issues

4.1 Tax law changes

We reviewed the proposed tax laws for 2012, presented to Parliament in the autumn. In consultation with the Association's Taxation Working Group, we submitted several proposals to the Ministry for National Economy to make the provisions of the law more specific and to simplify administration.

Our proposals affected, inter alia, the personal income, corporate and dividend taxes and the duties related to the final repayment scheme and to debts voluntarily forgiven by banks. We drew attention to the lack of transitional provisions regarding the new taxation rules for R&D, which causes unclarity regarding the treatment of ongoing contracts spanning several years. In relation to the special bank tax, the taxation rules related to succession and mergers and acquisitions have changed. Here, we requested that the law is only applied from 2012 rather than retrospectively and made text proposals to avoid double taxation in the case of de-mergers.

The original proposal presented to Parliament included a provision to reinstate the revenue limit for tax exemption for leasing, an issue which we had lobbied against for long and had managed to have more simple system put in place. Upon our objection, drawing attention to the unnecessary administrative burdens, the proposal was dropped.

We also succeeded in relation to another proposal, which would have caused increased administrative burdens in connection with non-financial contributions for business policy and marketing purposes. The relevant proposal was also dropped.

We welcomed the incorporation into the Act on Taxation - in accordance with our earlier request - of a provision requiring the Tax Authority to publish the list of taxpayers availing themselves of the choice under Section 88 of the VAT Act. In enforcing mortgages, banks thus far have had to investigate and find out the VAT status of the debtor/mortgagee when it came to the sale of the real estate. This new provision will allow faster administration.

We approached the Ministry to clarify issues related to long-term investment facilities (offering favourable taxation terms for individuals), which, in addition to HUF, may also be kept in foreign currency from 2012. Banks' information systems must be updated and properly set up to manage the new facilities. We requested clarifications from the Ministry regarding the conversion (vica versa) of foreign currency and HUF products and the rules for the exchange rate to be applied for conversions and for computing the income and the related tax.

4.2 Conference on 2012 tax changes

In keeping with the tradition of previous years, we organised a seminar for banks' taxation officers on major tax law changes affecting the sector, in cooperation with Deloitte. An audience of more than 50 heard presentations on main tax changes taking effect in 2012 (personal income tax, corporate tax, bank tax, VAT, duties, social security contributions). The presenters also reviewed major accounting changes in 2012.

An important change in personal income tax is the abolition of the tax credit on salaries. The minimum wage will be raised to HUF 93,000 (HUF 108,000 for qualified workers). Super grossing will be abolished, salaries over HUF 202,000 will be subject to half super grossing. The rate of health insurance and labour market contribution has been raised by 1 percentage point to 8.5%. The social security contribution payable by employers will be renamed social contribution tax, with an unchanged rate of 27%. Businesses will be required to preserve the net value of wages below HUF 300,000, those non-compliant will be banned from public procurement tenders and excluded from state aid for 2 years. A 10% health insurance contribution will be payable on fringe benefits subject to preferential taxation. Employers may grant employees a non-refundable support of HUF 7,500,000 for the purpose of the early repayment of foreign currency home loans.

VAT will be raised from 25% in 2011 to 27% in 2012 (from 20% to 20.6% of the gross price). The tax on company cars will increase depending on the environment rating and power of the car. Tax fines will be increased up to 200%.

4.3 Developments regarding the Financial Transaction Tax (FTT)

The European Banking Federation is strongly opposed to the proposed Directive on the implementation of the Financial Transaction Tax, announced by the European Commission on September 28.

The EBF's Financial Sector Tax Working Group (to which the Association's Board delegated a member in October) was requested to review in detail the negative impacts of the proposed introduction of the FTT. The most important impacts were reviewed with the European Commission's Tax and Customs Union Directorate-General (TAXUD) on October 20:

- Avoiding severe damages to GDP and competitiveness is only possible if a global approach is applied (both in the EU and globally) in implementing the FTT. In economic terms it is unreasonable to introduce an FTT in the Eurozone (this was informally admitted by the TAXUD).
- In its current form, the proposed FTT may cause significant changes in certain lines of business. It may even result in a structural breakdown in some of these business lines, which may directly affect employment in some member states. (The Commission's impact study assesses the effects considering all trading activities together, it does not assess the impacts in terms of individual products or activities).
- It cannot be ruled out that for example, 70%-90% of the derivative transactions would abandon the EU markets. This is especially valid for hedges, where even the FX and interest rate risks would not be covered at the current low margins. It is a confirmed fact that with the decrease of low-margin hedges, liquidity also significantly falls in the market. In particular, smaller players may reduce their hedging operations and even terminate their foreign investments. Financial institutions in the EU would probably turn to more complex deals, including higher risks, but providing higher margins, which would significantly decrease the instruments available for other, non-institutional market participants to hedge their risks.
- The geographical balance of an FTT would be better, if only applied to stock and bond transactions, compared to the case where it is also extended to derivatives.

Following the discussion with the TAXUD, the EBF requested further analysis from the working group, to provide convincing arguments against the implementation of an FTT in either a narrow scope (only applied to regulated markets) or a wider scope. This work is now in progress.

At its December 9 meeting, the European Council requested a progress report on FTT implementation from the European Commission and ECOFIN by June 2012.

5. Regulations related to risk management

5.1 Review of the proposed FSZÁF recommendation on the management of operational risks in trading activities

PSZÁF sent us for review its proposed recommendation on the management of operational risks in trading activities. Summarising the comments made by banks, we indicated to PSZÁF that while we supported the objective, the proposed recommendation was too general. We raised a number of specific issues and proposals and requested PSZÁF to draft a more specific guide with practical answers, including examples and solutions.

5.2 Government Decree No. 366/2011(XII 30) on liquidity coverage requirements for credit institutions and on the maturity mismatch of foreign currency positions of credit institutions

The regulation of liquidity coverage requirements and maturity mismatch of foreign currency positions is a belated regulatory reaction to the crisis and at the same time an unnecessary early measure regarding the implementation of Basel III.

To regulate banks' liquidity levels, the Government Decree introduces two new ratios (a deposit coverage ratio, to be a minimum 0.2, and a balance sheet coverage ratio, to be a minimum 0.1). Effective January 16, 2012, all credit institutions operating as joint stock companies must calculate these ratios on a daily basis based on their data reported to PSZÁF and meet one of the two ratios at all times.

The FX Funding Adequacy Ratio is aimed at regulating the maturity mismatch of banks' assets and liabilities. The ratio, set at 0.65%, should be met at all times, effective July 1, 2012. There had been extensive discussions with the MNB on the size and contents of this ratio, with only moderate success in having the aspects of the sector taken into account. We did not manage to obtain a reduction either in the proposed liquidity ratios or in the FX Funding Adequacy Ratio, and our efforts to achieve a longer preparation time and postponement of the introduction of these measures also failed.

A key question in applying the new ratios will be the correction time to be allowed in the case of non-compliance and the sanctions that may be applied by PSZÁF. Given that the Government Decree does not address these issue, the relevant provisions of the Credit Institutions Act will be governing

6. Consultations on customer information on deposits covered by the National Deposit Insurance Fund (OBA) and on the OBA's fees

In relation to the provision of customer information on deposits covered by the National Deposit Insurance Fund (OBA), we requested a consultation, as OBA had sought to amend its previous Board Resolution to provide that the information, which thus far has had to be provided only if so requested by the customer, should be issued by banks once a year on a mandatory basis.

Putting together the data to be provided in the information and setting up the necessary automatic processes is an extra IT task. Thus far, issuing the requested information has not been a problem, as clerks have had enough time to retrieve the necessary information and hand it over to the customer, along with additional oral explanations. Changing the method of provision of this information would have imposed additional burdens on the banks, which have already sustained significant losses. Also, the requirement imposed by the resolution is against a level playing field: branches of foreign banks are not required to issue these customer notifications.

At the meeting we managed to convince the OBA Board to revoke the proposed decision. Accordingly, the information provision will continue to be subject to the customer's request in 2012.

As another important achievement, we managed to prevent an increase in the OBA fees for 2012 from 0.06 percent to 0.1 percent. The OBA had cited the proposed EU coverage level as the reason for the proposed increase. However, the relevant EU Directive is still under consultation and we do not believe Hungary should be a pioneer in introducing the proposed, and debated, requirements of the draft Directive. The Hungarian coverage level is not critical, anyway, compared to the requirement provided in the Draft directive.

7. Corporate lending

7.1 Agricultural lending

The Ministry for Rural Development initiated a Government Decree on the rescheduling of loans granted to agricultural producers under the New Hungary Working Capital Loan Programme for Agricultural Producers (Új Magyarország TÉSZ Forgóeszközhitel Program).

According to the proposal, the 2-year grace period would be increased to 4 years and the repayment period extended from 5 years to 7 years.

We proposed that the following text, included in the explanation of the proposal, should be added to the Decree:

"Should the credit institution not commit to the rescheduling, the Hungarian Development Bank (MFB) may take over the rescheduling of the loan."

7.2 SME lending

It had been raised several times that the SME loan reporting system is not practicable, as the reports also include loans to housing cooperatives, project loans and unauthorised overdrafts. In consultation with the banks involved, we agreed that the reports should be cleaned up.

In the meantime, PSZÁF's issued an order to exclude unauthorised overdrafts from current account overdrafts. We considered that this could be done together with the exclusion of housing cooperative and project loans in one go.

Banks agreed to implement the required changes and we sent our proposal to PSZÁF. PSZÁF supported the proposal and forwarded it to the Ministry for National Economy for approval.

8. Legal issues

8.1 Amendments to the Acts on Judicial Dstraint (Act LIII of 1994) and the Act on Bankruptcy and Liquidation Procedures (Act XLIX of 1991)

The proposed amendments to the Act on Judicial Dstraint were aimed at accelerating the enforcement of claims and increasing the transparency of dstraint procedures. The scope of electronic administration will be widened, real estate auctions may be managed electronically. Bailiff data requests will be required to be submitted electronically. The rules for collection by administrative transfer orders will change with a view to accelerating the process.

Despite the extremely short notice given for reviewing and commenting on this extensive draft legislation, we made numerous comments, in view of the multitude of critiques raised by banks regarding the operations of bailiffs. We provided proposals in relation to bailiff procedures, the ordering of distraint by notaries, and court procedures. In relation to real estate foreclosures, we proposed that the rules for take-over by the party requesting the foreclosure after repeatedly unsuccessful auctions should be changed to prevent frauds. Also, we submitted proposals to make the provisions on payments more specific.

Amendments to the Bankruptcy, Company Registration and Company Acts were drafted in the context of the Széll Kálmán Plan. The amendments are aimed at preventing company frauds, including the fraudulent sale of businesses with high debts and the swift removal of phantom businesses from the market. In relation to bankruptcy proceedings, the main objective is to strengthen debt settlement. Legal representation of the debtor in a bankruptcy proceeding will be mandatory. Creditors may not initiate bankruptcy proceedings.

In our comments on the draft law, we objected to the fact that while the legislation fails to provide adequate protection against fraudulent bankruptcies, the proposed amendment extends the scope of the bankruptcy agreement to parties not involved in the agreement. We made proposals regarding the operation of the creditors' committee, disbursements during a bankruptcy moratorium and the implementation of bankruptcy agreements. We also provided several proposals in relation to the Companies Act and the Company Registration Act.

8.2 Preparations for implementation of the new Data Protection Act

(Act CXII of on informational autonomy and freedom of information)

The new data protection law sets new requirements for financial companies. One such requirement is the registration with the data protection registry. The institution of Data Protection Ombudsman has been abolished, the powers related to data protection are now exercised by the new data protection authority, the National Authority for Data Protection and Freedom of Information.

In preparing for the related new tasks, we organised a data protection consultation, attended a conference, and the Association's competent working groups reviewed the tasks arising from the new legislation.

We developed a common stance and a proposal for registration with the data protection registry. Also, we organised a consultation with an independent data protection expert to clarify some uncertain points.

8.3 Consultation on the new Civil Code

We held consultations with banks' legal counsels on regulations on collaterals and transactions affecting banks in the proposed new Civil Code. We wrote a letter to the head of the Codification Committee and the Ministry for Administration and Justice, urging the launch of the consultation on the proposed legislation and pointing out that the consultation period should not be less than six months, given the extensive volume of the Code and the importance of the proposed legislation.

In relation to credit institution activities we drew attention to our concerns over the new **lien regulations**. These would basically upset the current banking practices and if the legislation were adopted in its current form, economic actors would face huge losses.

The current system of home financing is based on the institution of **independent lien**, which would be abolished by the proposed legislation. The current contracts will continue to be parts of the legal system for several decades, therefore, we presume that they will not have to be retrospectively amended (the number of existing contracts is in the range of millions). However, home lending based on the issue of mortgage bonds is unresolved under the proposed regulatory model. In addition, this step would lead to serious investor uncertainty in relation to Hungarian mortgage bonds offered on the stock exchange, given that a wide range of these mortgage bonds are secured by an independent lien. As the proposal does not contain explanations, it is hard to guess the reasons that have prompted the legislators to propose this solution.

A similar, or even more serious, problem is the **abolition of floating charge**. Floating charge is a proven solution, frequently used in corporate lending. It is a well-known and well-functioning type of collateral. Given that it is a proven instrument internationally, an important advantage in financing arrangements involving foreign elements is that it is also recognised and applied by Hungarian law.

The concept that can be observed throughout the proposed new legislation is that only a lien is acceptable as collateral, and full transparency can only be ensured through registration of the lien in the registry. **This restriction on the range of acceptable collaterals will lead to the crowding out from the "official" lending market of applicants who are unable to provide for this type of collateral.** The affected wide groups of customers would increase the business of usurers, or be left without access to borrowing. All this would make recovery from the current crisis difficult for both households and businesses. Furthermore, due to scarce lending, it may significantly slow growth after the crisis, and thirdly, it would increase the shadow economy and debtors' vulnerability without control.

In relation to Contract Law, Particular Rules, Title XX: Loan and Account Relations, we drew attention to inconsistencies in the regulatory concept. It is hoped that these issues can be clarified during the consultation process.

8.4 Partiscum XI Savings Cooperative

Consultations were held with banks' legal counsels on the litigation related to the provisions on unilateral contract amendments of Partiscum XI Savings Cooperative's business terms and conditions, and proposals were developed on the issue. The Association's legal staff attended the Supreme Court hearing and the verdict was analysed with banks' legal counsels.

The litigation was launched upon a claim filed by the Csongrád County Chief Prosecutor's Office, which considered certain provisions relating to the unilateral amendment of contracts in the Business Terms and Conditions of Partiscum XI Savings Cooperative as unfair. The Supreme Court adopted a partial verdict, ordering a new proceeding in respect of certain elements of the first instance verdict, while upholding others. The litigation started again. The Csongrád County Prosecutor's Office's motion, submitted at the invitation of the court, considered the conditions specified in the list of reasons in the savings cooperative's General Contract Terms and Conditions (which are based on the Code of Conduct adopted jointly by the Association, PSZÁF and the government) as parts of the normal business risks of banks,

ones that may not serve as a ground for the unilateral amendment of a contract. The Association provided professional assistance to the Savings Cooperative in the litigation.

9. Review of the National Training Register

The government initiated a comprehensive review of the training courses included in the National Training Register (OKJ). The ministry responsible for the training programmes commissioned the Hungarian Chambers of Commerce & Industry to coordinate the related tasks. One of the expectations from the review is to significantly reduce the number of training courses in the OKJ and that no higher education is included in the OKJ. In addition, a full review of the training and examination requirements of the restructured training programme will be carried out.

The Ministry for National Economy organised a consultation on the proposed changes in the OKJ training courses for the financial sector. The agreement reached at the consultation was submitted to by the competent department of the ministry to the minister for approval.

The Human Resources Working Group of HBA also reviewed the proposal. The Working group offered professional support to the ministry for developing the detailed training and examination requirements ; three experts were selected for this work.

III. ASSOCIATION EVENTS, WORKING GROUPS, COMMUNICATIONS? OTHER CONTACTS

1. IT Security Working Group

The Association' IT Working group held two meetings in the fourth quarter of 2011.

At its meeting in October, the Working Group reviewed the proposed PSZÁF methodology guide for internet banking security, published on September 23, 2011. The meeting was attended by representatives from PSZÁF. The most important proposals of the Working Group were incorporated in the final guide and the guide was issued on October 25.

At its meeting in December, the Working Group reviewed the new Data Protection Act, in particular, the relevant changes in IT data processing and procedures. The Working Group also reviewed the ISACA survey on applied IT security schemes and formulated recommendations for ISACA for future use of the results of the survey. The Association's IT Working Group is a founder of the Incident Management Working Group managing the COMEX drills. In this capacity, the Working Group endorsed the plan for the 2012 COMEX drill.

2. Physical Security Working Group

At its meeting in October, attended by representatives from the Budapest Police Headquarters, the Working Group reviewed the bank robbery statistics for Budapest in Q1-Q3 2011. The most important finding was that the number of bank robbery attempts has significantly decreased compared to the figures of 2009 and 2010 and went down to the level before the economic crisis. The Working Group reviewed the challenges posed by the negative sentiment against banks and security risks arising from the increased administration at bank branches due to the early repayment scheme. Also, a consultation was held on the latest technologies supporting the checking of identification documents of customers.

3. Human Resources Working Group

At its meeting in October, Association's Human Resources Working Group reviewed experience of the application of the various elements of the regulations on remuneration policies, the expected business environment and labour market developments in 2012 and their potential impact on workforce management and recruitment. The Working Group decided to participate in the drafting of the new training and examination requirements of the financial training courses during the restructuring of the training programmes under the National Training Register (OKJ).

4. Cards Working Group

At its regular monthly meetings, the Cards Working Group reviewed regulatory requirements related to bank card operations and the PSZÁF's CEO letter on expected bank card practices. The group also reviewed the latest market trends and ongoing development projects, including the introduction of chip cards and sticker-cards. To promote effective cooperation, the Working Group regularly invites specialists from the MNB and PSZÁF to its meetings. The Association's weekly newsletter Bank Cards News, launched six months ago, is an increasingly popular information sharing tool.

5. Communications, media relations

The Association's communications were focused on the Early Repayment Act enacted on September 29, 2011 and its consequences for the banking sector. A special chapter in our communications process was the Association's motion with the Constitutional Court regarding the Early Repayment Act and the announcements made on November 3 by the Minister for National Economy and the Association's President on joint efforts to seek solutions to the problems of debtors with foreign-currency denominated mortgage loans.

Media attention regarding this issue became even more intense following the conclusion of the agreement between the Government and the Association on December 15.

In terms of communications, this period can be split into two parts. In the first stage, between September 9 (the announcement of the political decision on the early repayment scheme) and November 3 (the joint press conference), the Association's communications were confined to press releases. Then, from the second half of November, a series of intense and highly successful media communications were conducted.

Addressing the high number of bank card data thefts and explaining how banks manage the issue was a new challenge in our communications in December. All these issues were followed with keen attention by the foreign media.

We paid visits to selected editorial offices and editorial meetings with a view to further strengthening our relations with the media.

6. Foreign Bankers' Club

The Association's Foreign Bankers' Club held its 4th quarter meeting in October. The guest presenter of the meeting was the Governor of MNB, who briefed participants on monetary policy and current issues affecting the banking sector.

7. European Banking Federation

We worked actively with the European Banking Federation in the 3rd quarter. Based on our previous discussions and exchange of letters, we informed the EBF on the agreement concluded with the government in December. Also, we participated in the preparation of forecasts for year-end 2011 and for 2012 in the EBF Economic and Monetary Committee. Also under the auspices of the Economic and Monetary Committee, we met with the head of the European Systemic Risk Board and the outgoing ECB Deputy Governor responsible for monetary policy.

Our János Müller, as Chair of the EBF Communications Committee, finalised the proposal for a new communications strategy for the EBF, mandated by the EBF Executive Committee. The proposal will be presented to the Executive Committee on February 3, 2012.

A detailed review of regulatory issues being addressed by the EBF is provided in the Annex.

8. International inquiries, information requests

We continued to receive many inquiries and requests from international experts (such as Nomura London, J.P. Morgan, Société Générale, BACE) and foreign embassies in Hungary (China, France, Korea, Switzerland, U.K, USA) for consultations and information meetings. Several inquiries were also received from the European Banking Federation and the European Commission Representation in Hungary.

ANNEX

INTERNATIONAL DEVELOPMENTS: REGULATION, SUPERVISION - EUROPEAN BANKING FEDERATION

I. Global regulations

I.1 Basel Committee (BSBC) progress report on Basel III implementation

In October, the Basel Committee issued a report on its members' progress in adopting Basel II, Basel II.5 and Basel III, as of end September 2011. The Committee plans to provide similar status reports on a regular basis to ensure that its capital standards are transformed into national law or regulation according to the internationally agreed timeframes and to provide additional incentive for members to fully comply with the international agreement.

The Committee has developed a comprehensive framework to monitor members' implementation of the Basel regulatory capital framework. The objective is to review the consistency of members' national rules or regulations with the international minimum standard and identify differences that could raise prudential or level playing field concerns. The framework will also review the measurement of risk-weighted assets in the banking book and the trading book to ensure consistency in practice across banks and jurisdictions. The Committee's preparations are well advanced, the reviews can commence at the beginning of 2012.

I.2 Regulations on Global Systemically Important Banks (G-SIBs)

I.2.1 FSB¹-BSBC assessment of the macroeconomic impact of higher loss absorbency for G-SIBs

In October, the Financial Stability Board and the Basel Committee carried out a joint assessment of the macroeconomic impact of higher loss absorbency (additional capital requirements) for global systemically important banks. The assessment was conducted in close collaboration with the IMF. The results of the analysis show that the impact of stronger G-SIB capital requirements leads to only a modest slowdown in growth, while reducing the risks of distress has significant benefits. Raising the capital requirements for G-SIBs by 1 percentage point over eight years reduces growth by 0.01 percentage points per year, while lending spreads increase by 5-6 basis points. Looking at the combined effect of the full package of the Basel Committee's proposals for stronger capital requirements and the additional buffers to be carried by G-SIBs, GDP falls by 0.34% (0.04% per year) relative to its baseline level over eight years, while lending spreads rise by 0.31 basis points. Reducing the annual probability of a systemic crisis may result in an annual benefit of up to 2.5% of

¹ Financial Stability Board

GDP, many times the costs of the reforms in terms of temporarily slower annual growth. (The BSBC points out that variations in the key assumptions used for the assessment would not markedly change the results. If the impact of stronger capital requirements for G-SIBs on economic growth is assumed to be greater, the benefits from increased financial stability are also greater).

I.2.2 FSB consultation paper on a common reporting template for G-SIBs

In October, the FSB published a consultation paper a common reporting template for G-SIBs². The consultation paper points out that in the recent crisis, the lack of timely, accurate information has proved very costly. The current data architecture lags well behind the forces driving increased complexity and globalisation of financial systems, institutions and markets. As a consequence, there is a poor understanding of the global financial network, which continues to hamper policy responses.

The consultation paper identifies the key information gaps (concentration risk, market risk, funding risk, contagion/spill-over risk and sovereign risk), provides proposals for the types of information to be collected and illustrates with questions the issues the proposed template can address. The consultation paper puts 31 questions regarding the costs, frequency, deadlines, availability/production, extension, granularity, sector breakdown, etc., of the reports.

In its response to the consultation paper, the *IBFed*³, expresses its support for efforts to gather data on financial linkages in a consistent manner, but also voices a number of concerns. These, inter alia, include the following: the end of 2012 as Phase 1 of the implementation process is too early and the weekly reporting frequency and 3 days reporting lag are of great concerns; it may be useful to conduct a cost/benefit analysis on the different data items requested; expenditures could be reduced substantially by creating synergies with existing reporting requirements; the overall objective of harmonization of data definitions is a crucial point for the industry; the proposed reporting requirements may need to be legally underpinned; full consideration needs to be given to data protection and security, confidentiality and consumer protection regulations; transitory measures need to be set to avoid compliance issues.

I.2.3 Global systemically important banks: Assessment methodology and the additional loss absorbency requirement - final document⁴

The Basel Committee published the final document on its rules for G-SIBs in November. The final document contains no substantive changes compared to the proposal submitted to consultation. The assessment methodology for G-SIBs is based on an indicator-based approach and comprises five broad categories: size, interconnectedness, lack of readily available substitutes or financial institution infrastructure, global (cross-jurisdictional) activity

² Understanding Financial Linkages: A Common Data Template for Global Systemically Important Banks (FSB, 6 October 2011). According to the consultation paper, the number of global systemically important banks will initially be 28. A subset of data will be collected by the Basel Committee for a wider sample of large banks to support its ongoing assessment of their global systemic importance.

³ International Banking Federation: 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 See details of the proposed measures for G-SIBs in our 3rd Quarter 2011 report.

and complexity. G-SIBs will be grouped into five categories (buckets) of systemic importance, providing for additional loss absorbency requirements between 1.0% and 2.5% for the first four categories. For the fifth bucket (initially empty), there will be an additional loss absorbency requirement of 3.5% (to discourage banks from material growth). The additional loss absorbency requirement is to be met with Common Equity Tier 1 at the consolidated group level. The additional loss absorbency requirement will be introduced in parallel with the capital conservation and countercyclical buffers, i.e. between January 1, 2016 and year-end 2018, becoming fully effective on January 1, 2019.

I.3 Treatment of trade finance under the Basel capital framework

The Basel Committee on Banking Supervision evaluated the impact of Basel II and Basel III on trade finance in the context of low income countries and in October published its solution proposals to promote trade with low income countries. In consultation with the World Bank, the World Trade Organisation and the International Chamber of Commerce, the Committee adopted two technical changes to the Basel regulatory capital adequacy framework related to the treatment of trade finance, as follows:

- waiving the one-year maturity floor for certain trade finance instruments under the advanced internal ratings-based approach (AIRB) for credit risk; and
- waiving the sovereign floor for certain trade-finance related claims on banks using the standardised approach for credit risk.

In their joint response letter, **23 financial and trade organisations** welcomed the Basel Committee' and the G20's recognition of the importance of the distinctive treatment of trade finance. However, they emphasised that the proposed changes were not sufficient and more changes to the capital framework were needed to take account of the short term and the low risk of these instruments, or Basel III would cause an unintended drop in trade finance and economic growth.

I.4 BSBC second consultation paper on capitalisation of bank exposures to central counterparties

At the beginning of November, the Basel Committee published its second consultation paper on capitalisation of bank exposures to central counterparties (CCPs). The relevant rules (adopted after a short consultation period lasting until November 25) should be applied from January 2013. The second consultation document only contained minor changes compared to the December 2010 version, although the Committee stated that it had taken into account the responses received as well as the results of the various impact assessments. The proposal addresses trade exposures to central counterparties (providing a 2% risk weight for qualifying CCPs) as well as the capital requirements for default funds.

In its response, the **European Banking Federation (EBF)** emphasises that the rules fall short of providing sufficient incentives for banks to increase their use of central counterparties and there is also a potential risk that clients will develop new products to circumnavigate the need for clearing which will defeat the objective and also potentially increase risk. The EBF also points out that the capitalisation of default fund contributions is based on a non risk-sensitive and too conservative method and the capital requirement for the default fund is overstated. The result might be that no bank will choose to be clearing member, leaving the role of clearing to entities with weaker risk management standards and lighter supervisory oversight.

I.5 Consultative paper on principles for the supervision of financial conglomerates

In December, the Joint Forum⁵ launched a consultation on principles for the supervision of financial conglomerates. The proposed principles, which revise the Joint Forum's 1999 principles, provide a set of internationally agreed principles that support consistent and effective supervision of financial conglomerates and in particular those financial conglomerates that are active across borders, including risks arising from unregulated financial activities and entities. The financial crisis that began in 2007 exposed situations in which regulatory requirements and oversight did not fully capture all the activities of financial conglomerates or fully consider the impact and cost these activities may pose to the financial system. The proposed principles address complexities and gaps resulting from cross-sectoral activities with a scope of application based on a revised and broader definition of a financial conglomerate. Supplementing the 1999 Principles, the proposed principles are organised into five sections:

- supervisory powers and authority (including resources),
- supervisory responsibility,
- corporate governance,
- capital adequacy and liquidity,
- risk management.

In its annex, the paper provides a comparison of the 1999 Principles and the current draft Principles.

I.6 BSBC consultation on capital disclosure requirements

At the end of December, the Basel Committee published a consultative document on capital disclosure requirements, aimed to improve the transparency and comparability of a bank's capital base. During the financial crisis, market participants and supervisors were hampered in their efforts to undertake detailed assessments of banks' capital positions due to insufficiently detailed disclosure and a lack of consistency in reporting. The proposed disclosure requirements are aimed to address this lack of sufficient information. The Basel Committee proposes a disclosure template of 82 items, each defined in detail, to be introduced from January 1, 2018. (Comments on the consultative document are invited by February 17, 2012).

I.7 BSBC consultation on the internal audit function in banks

This consultative document, which is the revised version of the Basel Committee's 2001 guidance⁶, incorporates lessons drawn from the recent financial crisis and is aimed at assisting supervisors in assessing the effectiveness of the internal audit function in banks. The document takes stock of supervisory expectations relevant to the internal audit function, defines the relationship of the supervisory authority with the internal audit function, and sets out principles for supervisory assessment of the internal audit function. An annex to the consultative document details responsibilities of a bank's audit committee. The consultation runs until March 2, 2012. In the context of this consultative document, the Basel Committee will review its guidance on external auditors in 2012.

⁵ The Joint Forum is a joint committee of the Basel Committee on Banking Supervision (BSBC), the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS)

⁶ Internal Audit in Banks and the Supervisor's Relationship with Auditors

I.8 BSBC consultation on core principles for effective banking supervision

The BCBS's consultative document, published on December 20, updates the Committee's 2006 Core principles for effective banking supervision and the associated Core Principles methodology, and merges the two documents into one. The core principles are used by countries as a benchmark for assessing the quality of their supervisory systems and for identifying future work to achieve a baseline level of sound supervisory practices. The core principles have been reorganised into a more logical structure, categorising the principles into two groups: the first group (Principles 1 to 13) focuses on powers, responsibilities and functions of supervisors, while the second group (Principles 14 to 29) focuses on prudential regulations and requirements for banks. The principles have been enhanced in several areas. Some additional criteria have been upgraded to essential criteria, and new assessment criteria have been added. (Now, there are 36 new assessment criteria, including 31 new essential criteria and 5 new additional criteria). Special attention has been given to addressing the significant risk management weaknesses and other vulnerabilities highlighted in the recent crisis, including the need to deal effectively with systemically important banks and the increasing focus on effective crisis management, recovery and resolution measures in reducing both the probability and impact of a bank failure. With a new Core Principle on corporate governance added and an existing Core Principle expanded into two new ones (dedicated respectively to greater public disclosure and transparency, and enhanced financial reporting and external audit), the number of Core Principles has increased from 25 to 29.

According to the Committee, the enhanced Core Principles, updated in collaboration with the IMF and the World Bank, will strengthen supervisory standards, contribute to improving financial stability domestically and internationally and provide a good basis for further development of effective supervisory systems.

The consultation runs until March 20.

I.9 Application of own credit risk adjustments to derivatives

Paragraph 75 of the Basel III rules requires a bank to (de)recognise in the calculation of Common Equity Tier 1 all unrealised gains and losses that have resulted from changes in the fair value of liabilities due to changes in the bank's own credit risk. This rule seeks to ensure that a deterioration in a bank's own creditworthiness does not at the same time lead to an increase in its common equity as a result of a reduction in the value of the bank's liabilities. The application of paragraph 75 to fair valued derivatives is not straightforward since the valuations of OTC and Securities Financing Transactions (SFTs) depend on a range of factors other than the bank's own creditworthiness (such as interest rates, exchange rates, and other market factors). The consultative paper proposes that debit valuation adjustments (DVAs) for over-the-counter derivatives and securities financing transactions should be fully deducted in the calculation of Common Equity Tier 1. The consultation runs until February 17.

I.10 U.S. regulatory developments

In November, the U.S. regulatory agencies published for consultation a proposed regulation making certain restrictions more specific in the legislative package adopted in the wake of the financial crisis (the Dodd-Frank Act). The proposed legislation prohibits (subject to some narrow exceptions) banks from

- engaging in short-term proprietary trading of any security, derivative, and certain other financial instruments for a banking entity's own account,
- owning, sponsoring, or having certain relationships with, a hedge fund or private equity fund.

Since the new regulation will affect foreign banks' subsidiaries and parent banks operating in the U.S., the European Banking Federation is now looking into how the overextension of the proposed regulation could be reduced and the scope of exceptions broadened. The consultation on the proposed new regulation ran until January 13.

II. European Union

II.1 Public hearing on the proposed Capital Requirements Directive and Capital Requirements Regulation (CRD4/CRR)

A public hearing on the proposed Capital Requirements Directive and Regulation (CRD4/CRR) was held in October. The proposed leverage ratio and the new regulations' impact on credit supply were the two issues that were given the most focus during the hearing. The EBA's president announced that due to its limited resources, the EBA would involve national supervisors in carrying out the tasks related to the legislative process. The EBA president considers the strengthening of capital requirements as an important element of the reform. In his view, financial innovation must not lead to the dilution of regulatory capital and there is no room for "engineering" in relation to financial instruments. He said the EBA would ensure that national implementation rules do not water down capital requirements and the leverage ratio and risk-weighted assets well complemented each other in capturing (quantifying) risks.

There were conflicting opinions regarding the proposed leverage ratio: some said the leverage ratio could only be used as a supplementary tool under Pillar 2, others opined that it should be a key regulatory tool.

The EP rapporteur was surprised at the leverage ratio being the main focus of the debate and at the lack of consensus on its application. He said that given that the EBA needs to develop around a 150 delegated regulations and technical standards, the involvement of the Parliament and the Council (due to the short time) might be needed. He pointed out that the new regulation should ensure a level playing field for SMEs.

Following the public hearing, at the end of December the EP rapporteur, Ottmar Karas, published his proposals regarding CRR and CRD4 and, in January, the Council issued its compromise proposal (taking into account member states' opinions) on its website:

http://register.consilium.europa.eu/servlet/driver?page=Result&lang=EN&ssf=DATE_DOCUMENT+DESC&fc=REGAISEN&srm=25&md=400&typ=Simple&cmsid=638&ff_COTE_DOCUMENT=&ff_TITRE=compromise&ff_FT_TEXT=&ff_SOUS_COTE_MATIERE=&dd_DATE_REUNION=&single_comparator=&single_date=&from_date=&to_date=

According to information, the Danish presidency would like to have the final text adopted by the Council in the spring and agreed on with the Parliament in June.⁷

⁷ The proposals will be addresses in detail in our next quarter report.

II.2 European Commission consultation on amending Regulation 1060/2009/EC on credit rating agencies

The European Commission's proposal amends the 2009 Regulation in the following areas:

- the use of ratings,
- the independence of credit rating agencies,
- the disclosure of information on methodologies of CRAs, credit ratings and rating outlooks,
- sovereign ratings,
- the comparability of ratings and fees for credit ratings,
- the civil liability of CRAs vis-à-vis investors,
- provisions related to recognised ("certified) credit rating agencies established in third countries,
- extension of the scope of application of the Regulation to cover rating outlooks.

The amended Regulation provides for the mandatory rotation of CRAs. A CRA may only rate an issuer for three years (or one year if the CRA rates more than ten consecutive rated debt instruments of the issuer). After expiry of this maximum period, the CRA may not enter into a contract with the issuer for a period of four years (cooling-off period). Also, a CRA may not rate an issuer and its products simultaneously. (These restrictions only apply to ratings solicited and paid for by the issuer). Through these provisions the Commission seeks to bring new diversity into the current, highly concentrated rating market.

Banks and other institutions may not rely solely or mechanically on external credit ratings for assessing the creditworthiness of assets: they will be required to make their own credit risk assessment. The competent authorities will supervise the adequacy of institutions' credit assessment processes.

The proposal seeks to improve the transparency of ratings, strengthen the disclosure requirements and provide for the use of harmonised rating scales. The European Parliament's Economic and Monetary Committee (ECON) will hold a public hearing on the proposal on January 24.

III. European Banking Authority (EBA)

III.1 Follow-up review of banks' transparency in their 2010 Pillar 3 reports

The European Banking Authority (EBA), taking up a work carried by its predecessor CEBS, published in October its follow-up review of banks' transparency in their 2010 Pillar 3 reports. The review welcomes the efforts made by banks to improve their disclosures and to convey their risk profile in a comprehensive way to market participants. At the same time, the EBA calls for further improvements and for a greater harmonisation of the disclosures provided.

The EBA concludes that best practice disclosures have been identified in all areas under review, and encourages banks to follow them. The analysis establishes that some of the findings included in the 2010 report call for further improvements in relation to specific requirements of the CRD (e.g., quantitative back-testing information for credit risk, information on counterparty credit risk covering the issue of wrong-way risk, etc.). The EBA calls for further efforts to be made for a greater harmonisation of the disclosures in terms of both timeline and standardisation in the presentation of public data. This would benefit both

supervisors and market participants. The report also includes some observations on how banks dealt with the interactions between International Financial Reporting Standards (IFRS) and Pillar 3 requirements in the specific disclosure areas considered.

III.2 Details of the EU measures aimed to restore confidence in the banking sector and strengthen banks' capital positions

Following the agreement reached in the ECOFIN, on October 26 the EBA issued a communication on proposed EU measures to restore confidence in the banking sector. The communication addresses the issue of meeting banks' short-term funding needs at reasonable conditions. (In developing these conditions, the EBA will work with the European Commission, the ECB and the European Investment Bank).

In light of the substantial increase in systemic risk triggered by the sovereign debt crisis in the euro area, the EBA has designed a capital package which, while recognising the significant steps already taken to strengthen capital positions in the EU, aims at providing a further capital buffer for the EU banking system. Banks are required to strengthen their capital positions by building up a temporary capital buffer against sovereign debt exposures to reflect current market prices. In addition, banks are required to establish a buffer such that the Core Tier 1 capital ratio reaches 9%. Banks are expected to build these buffers by the end of June 2012. A preliminary and indicative aggregated capital target at the EU level is EUR 106 billion, including EUR 26 billion for Spain, EUR 30 billion for Greece, EUR 15 billion for Italy, and EUR 8 billion for Portugal.

In a press release issued one day after the decision, the *EBF* welcomed the EU decision on strengthening banks' capital positions. It stressed that the current crisis was predominantly a sovereign debt crisis, not a banking crisis. The 50% nominal discount on the Greek debt was a huge burden on banks and the extra capitalisation of banks to a Core Tier 1 ratio of 9% was another substantial demand placed on banks, which went beyond the initial plans put forward by regulators. The EBF stressed that while banks would of course take the necessary steps to adapt to the extra capitalization, they expected European governments to play their part too and to continue implementing budgetary consolidation and improving Eurozone governance. The EBF President Christian Clausen pointed out that it was not governments rescuing banks: it was the banking sector taking on an additional capital buffer. Banks would, nevertheless, continue to do their utmost to lend to households and enterprises despite the increasing capital requirements and costs. He emphasised that long-term stability and certainty about the new regulatory framework were pre-requisites for banks to play their part and enable growth and prosperity in Europe.

According to new *EBA* estimates based on September figures, the capital shortfall in the European banking sector, including sovereign buffer was EUR 115 billion, including a shortfall of EUR 4 billion for Austria, EUR 6 billion for Belgium, EUR 7 billion for France, EUR 30 billion for Greece, EUR 13 billion euros for Germany, EUR 15 billion for Italy, EUR 7 billion for Portugal and EUR 26 billion for Spain. Banks are required to submit their plans detailing the actions they intend to take to reach the set targets to their national supervisors by January 20, 2012. These plans will have to be agreed with national authorities and reviewed with the EBA. The target level should be reached through measures that do not lead to a significant reduction in leverage: banks should use private sources to meet the required target,

including retained earnings and reduced bonus payments. The capital plans will have to be agreed with the competent colleges of supervisors. During the colleges' discussions of capital plans the need to maintain exposure levels of banking groups in all member states should be taken into account (while a bank's capital position may be improved through the transfer of assets to third parties). The capital needs should be met with capital of the highest quality, in accordance with the EBA's stringent and commonly applicable criteria.

It should be noted that while the EBA communication speaks about building an exceptional and temporary capital buffer, it does not say how this buffer can be reduced later on.

III.3 EBA consultation papers on guidelines to the Stressed Value at Risk (CP48) and to the incremental default and migration risk charge (CP49)

These consultation papers are related to the amendments to the CRD by Directive 2010/76/EC (CRD3) relating to stressed VaR and incremental Risk Capital Charge (IRC) in the trading book. The relevant amendments require the EBA to monitor the range of practices in these areas and to draw up guidelines in order to ensure convergence of supervisory practices and to secure a level playing field across Europe. Providing guidance on the Stressed VaR and IRC modelling to credit institutions using the internal model method (IMM) for the calculation of the required capital for market risk in the trading book is crucial. The EBA's guidance is fundamental for identifying and addressing weaknesses in the regulatory capital framework and in the risk management of financial institutions as well as for reducing their reliance on cyclical VaR-based capital estimates and for ultimately contributing to a more robust financial system.

A public hearing on the proposed guidelines was held on December 13. The consultation ran until January 15, 2012.

III.4 EBA Consultation on draft Implementation Technical Standards (ITS) for supervisory reporting requirements (CP50)

In December, the EBA published a consultation paper on draft Implementing Technical Standards (ITS) on supervisory reporting requirements for institutions (CP50). The consultation runs until 20 March 2012. A public hearing will be held on March 20.

The proposed ITS aims at implementing uniform reporting requirements to ensure fair conditions of competition between comparable groups of credit institutions and investment firms. The ITS was developed based on the COREP and FINREP guidelines, its scope and level of application are in line with the Capital Requirements Regulation (CCR), currently under discussion by the EU legislators. However, in relation to financial information (FINREP), the consultation is currently limited to the requirements to be submitted by credit institutions at the consolidated level only. The reporting requirements were developed by taking into account the nature, scale and complexity of institutions' activities, mindful of the principles of proportionality, with certain reporting requirements being applicable only to institutions using complex approaches to measure own funds requirements or to institutions that have significant risk exposures. The proposed ITS does not intend to harmonise the underlying accounting frameworks and valuation measures. The ITS will be part of the single rulebook, specifying uniform formats, frequencies and dates of prudential reporting to be applied by credit institutions and investment firms in Europe.

According to the European Commission proposals, institutions will be required to comply with new CRR requirements as of January 1, 2013. Accordingly, the first regular reporting period is expected to be Q1 2013 with the first reporting reference date being 31 March 2013.

Institutions will have to submit a first set of data related to the reference date to national authorities by 13 May 2013. The EBA intends to finalise the draft ITS and submit it to the Commission by June 30, 2012. The proposed submission date assumes that a final CRR will be available beforehand.

IV. European Banking Federation

IV.1 Capital Requirements Directive, Capital Requirements Regulation (CRD4/CRR)

IV.1.1 Comparison of Basel III and the EU regulatory package

The European capital requirements framework is often criticised for diluting the Basel III requirements. To examine these criticisms, the EBF undertook a comparison of the CRD4/CRR and the Basel requirements. Mindful of the principle of a level playing field, the EBF analysed the following issues:

- Status of implementation of the Basel capital accords in the U.S.,
- Areas where the European framework is tighter than Basel III,
- Areas, where CRD4/CRR reportedly deviate from the Basel III rules,
- Structural specifics of the European market; areas, where flexibility in regulation is needed.

The EBF points out that the implementation of the Basel III package in Europe will have a more severe economic impact than elsewhere because of its specificities, including the structure of Europe's financial markets, the importance of SMEs for European recovery and growth, the absence of government-sponsored institutions and the lack of alignment of accounting practices. In the EBF's opinion, the European authorities should take into account these market specificities in some well defined areas, such as the treatment of covered bonds, minority interests, software, liquidity, hybrid capital instruments, by applying a flexible approach.

At the same time, the EBF concludes that the differences identified are only minor technical deviations that do not jeopardise the global consistency of Basel III. The EBF welcomes that the Basel Committee's Standard Implementation Group has been mandated to monitor deviations from the capital accord and to issue rulings on such deviations.

IV.1.2 EBF amendment proposals – Top ten priorities for the EP rapporteur

The EBF Banking Supervision Committee's (BSC) operations in the fourth quarter were focused on reviewing the proposed capital and liquidity regulations and making amendment proposals to them. Proposals were drafted by the competent BSC working groups (the Liquidity Working Group, the Own Funds Working Group and the Capital Adequacy Working Group) and approved by the BSC. Then, the most important proposals were selected by the EBF Executive Committee. Accordingly, the EBF submitted the following amendment proposals (Top 10 Priorities):

1. Own Funds – Minority interest should be included in consolidated Common Equity Tier 1 capital (CRR, Article 79)
2. Own Funds - The Basel I floors should not be extended (CRR, Article 476)
3. Liquidity – The liquidity requirements should automatically be applied at the consolidated group level (CRR, Article 7)
4. Liquidity – All central bank eligible assets should be considered part of the liquidity buffer and reported accordingly (CRR, Article 404)
5. Liquidity – Operational requirements for holdings of liquid assets should be less restrictive to help diversify liquid assets and allow the use of assets for normal operations. (CRR, Article 405)
6. Liquidity - Outflows of corporate deposits should be distinguished based on their relationship with the bank and considered more stable and eligible for a lower outflow factor than 75%, i.e., 25-50% . (CRR, Article 410)
7. Liquidity – The 75% cap on inflows, which Basel II had recommended and which CRD IV has copied, is not justified and should be lowered. (CRR, Article 413)
8. Own Funds - The treatment proposed for SME lending should be extended to IRB banks. (CRR, Article 485)
9. Own Funds – Software should be treated consistently as in other jurisdictions. (CRR, Article 34)
10. Disclosure of the Leverage Ratio – Disclosure of the Leverage Ratio should not be mandated before the final recalibration of the leverage ratio. (CRR, Article 487)

In its letter to the EP rapporteur, the EBF reiterated the following:

- there is need to maintain a more flexible definition of core capital and liquid assets,
- the competitive position of the European industry should not be put at risk,
- CRD IV should refrain from creating new competitive distortions across the EU.

The EBF submitted to the competent European authorities text proposals with detailed explanations in relation to more than 70 articles of the CRR and more than 10 articles of CRD4.

IV.2 CRD3 revision clause - Response of the EU Commissioner

Michel Barnier, the EU Commissioner on Internal Market, sent a response to the EBF's letter regarding CRD3 revision in November⁸. In its response, the EU Commissioner recognises that Basel II.5 is unlikely to be implemented in the U.S. by the agreed deadline. However, he argues for the timely implementation of CRD3. In his opinion, in the current situation, where European banks are required to strengthen their capital positions, the postponement of CRD3 implementation is not a realistic option. While sharing the concerns about the risk of regulatory arbitrage, the EU Commissioner emphasises that his primary responsibility is to ensure the stability and security of the European market and European banks, a key element of which is the implementation of Basel II.5 according to the internationally agreed timeframe.

IV.3 EMAC report on credit cycles and their role in macroprudential economic policy

⁸See our 3rd Quarter 2011 report.

The EBF European and Monetary Affairs Committee (EMAC) in November published a report credit cycles and their role in macroprudential economic policy. The findings of the report are as follows:

- Stronger economic and financial market integration over the past 10-15 years has led to stronger co-movement of credit growth across countries, in particular, within the euro area.
- Credit cycles are largely independent of the business cycles, at least in terms of synchronicity and amplitude. However, the amplitude of the credit cycle has decreased substantially in most countries since the second half of the 1990s, implying that credit creation has been increasingly aligned with the real economy.
- In most countries, there is an identifiable lead-lag relationship from real Gross Domestic Product (GDP) growth to real credit growth, in that stronger GDP growth feeds into credit growth in the future. In other words, in the majority of cases, availability of commercial bank credit responds to the demand arising from stronger growth. In turn, there also seems to be a feedback relationship from credit expansion to economic activity, although this relationship is not uniform across countries.
- There are significant spill-over effects from credit expansion across countries, suggesting that macro-prudential policies need to be international in nature.

IV.4 Trade associations' letter in support of the Legal Entity Identifier ((LEI)

The EBF joined other trade associations in writing a letter to the G20 finance ministers to update them on the industry's contribution to developing a uniform and global Legal Entity Identifier. The letter requests the G20 finance ministers to support a coordinated global LEI. The creators of the system would like the LEI to be used in future regulation.