REPORT

on Activities of the Hungarian Banking Association

2nd Quarter 2013

Budapest, September 2013

CONTENTS

1. EXECUTIVE SUMMARY 3
   Operating environment, performance of the banking sector 3
   International regulation 4
2. RETAIL LENDING 5
   Association working group on litigations related to consumer loan contracts 5
   Negotiations on resolving the situation of non-performing debtors 6
   Proposals related to the Act on Judicial Foreclosures 6
   Campaign to publicise the Exchange Rate Cap Scheme 6
3. CORPORATE LENDING 7
   Funding for Growth Scheme 7
4. MUNICIPALITIES 8
5. PAYMENTS 8
   Tax law changes related to the Financial Transaction Levy and interest income 8
   Proposed regulation on interbank interchange fees 9
   Tax certificates 9
   Other taxation issues 10
   FATCA 10
6. HUNGARIAN FINANCIAL SUPERVISORY AUTHORITY (PSZÁF) 11
   Financial Arbitration Board (FAB) 11
   BUBOR reform 11
   Changes in supervisory reporting requirements 11
7. REGULATORY CHANGES, AUTHORITY MEASURES 12
   Draft laws related to the entry into force of the new Civil Code 12
   Preparations for the new Civil Code – Seminar for banks' legal counsels 13
   Prohibition of fiduciary collaterals – preparations for the new Civil Code 13
   Review of the draft law on amendments to the Act on the MNB and other Acts 13
   Report to the Board on the legislation on the integration of co-operative credit institutions 14
   Changes affecting the accounting framework 15
   Online securities account opening 15
   Inheritance by the state 16

ANNEX 17

1. Executive summary

Operating environment, performance of the banking sector

The macroeconomic environment did not change significantly in the second quarter. Analysts consider it positive that the recession has technically ceased, with the economy showing a modest, 0.1%, growth in Q2 over the previous quarter and a 0.5% growth year-on-year.

Another positive microeconomic data is the inflation rate: 1.8% in July (1.9% in June). The unemployment rate fell by the end of the second quarter, to 10.3% over the previous year's 10.9%. Industrial production and consumption stagnated, while investment continued to fall. The deficit of general government grew slightly compared to the previous quarter.

The MNB continued its rate-cutting cycle started in August 2012, lowering the base rate to 4% in July. This low base rate had a perceivable impact on banks' deposit and lending rates, reducing them, but failed to substantively impact on economic growth.

The activity of banks did not change significantly in the second quarter. Non-financial companies were net repayers in HUF and net borrowers in foreign currency, so, their stock of loans fell as of the end of June. The stock of retail loans also dropped, with households being net borrowers in HUF and net repayers in foreign currency.

According to PSZÁF's July flash report, "the drop in the direct foreign funding of credit institutions was significantly less in May (6.4%) than in April (14.5%), however, even this drop may be considered as a significant withdrawal of funding, which the 0.4% growth in domestic deposits failed to offset".

Corporate and retail deposits grew modestly, by 1.0-1.5% in the first six months of the year. In retail deposits, government securities and investment units with high yields posed significant competition to bank deposits with low – and declining – interest rates, reducing banks' fundraising opportunities in the domestic market.

The rate of delinquent debts in banks' loan portfolios fell from 25.5% to 24.5% in the second quarter. At the same time, the rate of debts past due for more than 90 days rose from 17.2% to 18%.

Then banking sector's profitability was adverse in the second quarter: as opposed to the HUF 79.4 billion profit in the first quarter, banks posted a HUF 43.5 billion loss in the second quarter, thus, the sector's profit after tax shrank HUF 35.9 billion. This was partly due to the increase in banks' provisioning requirements for impairment, in addition to other burdens imposed on them, added to by the extra Financial Transaction Levy payment imposed retrospectively.

The sector's capital adequacy ratio was close to 17% at the end of H1.

Lending did not show any sign of picking up in the second quarter. According to data of the MNB, the stock of corporate loans hit a seven-year low as of the end of June. Households continued to be net repayers in the second quarter, which signals that the trend of the last more than three years continues.

In retail lending, the issue of debtors with foreign currency-denominated loans continued to be in the focus. The renewed Exchange Rate Cap Scheme has been open for debtors in financial difficulties since April 2012. The deadline for joining the scheme was extended. As of the end of June, banks concluded 150,000 contracts, with more than 37% of those eligible joining the Scheme (representing 51% of the portfolio). In cooperation with member banks, the Ministry for National Economy and the MNB conducted an extensive communications campaign to raise awareness of the scheme. As a result of this campaign, the number of debtors joining the scheme grew progressively.

A major development was the legislative proposal submitted by the government and adopted by Parliament to increase the Financial Transaction Levy rates (see details later in this report) and the imposition of an extra contribution (HUF 75 billion) retrospectively, due to the shortfall in the expected revenues from the FTL.

A key issue in retail banking affecting the entire sector was the development by the Association of a position and a set of arguments in relation to the litigations filed for establishing the voidness of foreign currency-denominated loan contracts.

The decision to impose a 6% healthcare contribution on interest income effective August 1, in addition to the 16% personal income tax, did not yet affect banks' operations overall in the second quarter, but its effects were felt very soon after its adoption.

The MNB launched its Funding for Growth Scheme, with preferential central bank interest rates, aimed at promoting lending, primarily to SMEs. Another objective of the Scheme is to reduce the external foreign exchange exposure of the banking sector.

The initial allocation for the Scheme was HUF 500 billion, later raised to HUF 750 billion, with a central bank funding cost of 0%. Banks can provide this loan facility at a 2.5% margin, including the credit guarantee fee. The terms and conditions for the loan were developed in consultation with the affected banks. The end-date for lending under the Scheme was extended to the end of September, hence, the impacts of the scheme cannot yet be assessed. Banks and companies welcomed the Scheme, applications for the Scheme exceeded the allocation for the Scheme. Experience shows that it is primarily performing corporate debtors who use the Scheme, replacing their current loans with this preferential loan facility.

An unexpected development for the entire banking sector was the new law on the integration of co-operative credit institutions. The legislation, adopted by Parliament under urgency, took effect on July 13, 2013. The new law puts co-operative credit institutions under state control and establishes the Integration Organisation of Co-Operative Credit Institutions. The institution protection funds of co-operative credit institutions will be dissolved and the Integration Organisation of Co-Operative Credit Institutions will take over their assets as their legal successor.

International regulation

In the area of global and European regulation, the drafting of the details of key regulatory issues arisen in the wake of the financial crisis continued. The Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (BCBS) focused on the monitoring of the

adopted frameworks, including the Basel III capital and liquidity framework, the bank resolution framework and the regulation on OTC derivatives. In relation to Basel III, the Basel Committee made a proposal for the calculation of the leverage ratio.

In the European Union, the Regulation and Directive on capital and liquidity requirements were adopted with a significant delay. They were promulgated in the EU Official Journal in June. Significant progress was made regarding the bank recovery and resolution framework: the European Parliament and the Council gave their positions on the proposal. The trilogue (discussion between the Council, the Parliament and the Commission) is hoped to be concluded in the autumn. The legislation on a Single Supervisory Mechanism is also expected to be adopted in the autumn, as the first step in implementing the banking union. As a next step, the Commission published its proposal for a Single Resolution Mechanism in early July. Proposals for reforming the structure of the European banking sector and counter-opinions from the sector continued to be at issue. The European Parliament and the Commission are actively working on proposals aimed at the ring-fencing of risky activities. (Find further details connected to regulation in the annex.)

2. Retail lending

Association working group on litigations related to consumer loan contracts

This working group was set up to develop a common position on issues raised in litigations and by consumer organisations, which could be used not only in lawsuits, but also in customer communications and high-level lobbying.

We compiled a document with answers to those questions which are raised the most frequently during litigations and by organisations acting on behalf of the debtors. This document provides answers to specific questions and references to precedence-setting court decisions, including the arguments made in these decisions. Based on this document, we also prepared a short summary document of the most important arguments. This document formulates messages to the wider public. These background documents were used in high-level statements and in the drafting of publications on the issue.

In accordance with the Board's decision of July 1, 2013, we requested data from member banks (on an informal basis and mindful of the relevant privacy rules) on ongoing litigations related to consumer loan contracts. The figures received revealed that there were some 1,800 litigations in process. Out of these, less than 3% were concluded, none of those concluded were lost by the defendant bank.

On July 4, the Supreme Court made an important decision in a litigation related to a foreign-currency-denominated loan contract by establishing that the exchange rate spread (the difference between the buying and selling rate) is a cost for the customer, which could have only been changed in accordance with the rules for unilateral contract amendments. Else, the spread cannot be changed and the spread in effect at the time of the conclusion of the contract should be applied.

Following the Supreme Court's decision, the association initiated that member banks reset the exchange rate spread applied to retail foreign currency loans to that applied at the time of the conclusion of the loan contract.

Negotiations on resolving the situation of non-performing debtors

The government requested a proposal from the Association to resolve the situation of debtors in arrears for more than 90 days. The Association set up a working group from senior specialists from member banks. The working group proposed that the affected debtor groups should be categorised and then addressed accordingly:

- Debtors whose ability to pay cannot be restored anymore should be removed from the portfolio as simply and as soon as possible. To achieve this, proposals were made to simplify the handover of cases to the National Asset Management Company and to simplify the rules for foreclosures. The bilateral closure of the cases could be accelerated if banks could receive a state subsidy to mitigate their losses from the forgiveness of a part of the principal.
- Debtors whose ability to pay can be restored: the goal of restoring the debtor's ability to pay can be achieved through the forgiveness of a part of the principal, thereby reducing the monthly repayment amount. This preference, to be granted by the bank and the state, should be conditional upon the debtor proving his ability and willingness to pay for an initial period (3 to 6 months).
- The willingness of debtors participating in payment alleviation schemes (restructured loans) to pay should also be strengthened, or this group of customers may also stop paying, if they see that only those in default are supported.

The Association's extended Board Meeting, attended by CEOs of the affected banks, reviewed and adopted the proposals made by the working group. Negotiations with the government have not yet led to any result.

Proposals related to the Act on Judicial Foreclosures

The Association, in consultation with member banks, compiled a proposal addressing issues related to judicial foreclosures, including the reduction of bailiff fees. (The proposal was presented as part of the package proposed for resolving the situation of non-performing debtors). While pointing out the need for a comprehensive review of the Act on Judicial Foreclosures, we made a number of proposals to improve the efficiency of bailiffs' operations without the need to comprehensively amend the legislation. We suggested that the Decree on Bailiff Fees should be amended to eliminate unwarranted fees. We also proposed that the Decree on bailiff fees should clearly specify the costs to be paid by the party requesting the foreclosure at the start of the foreclosure proceeding and that these costs should be reasonable and capped by law.

Campaign to publicise the Exchange Rate Cap Scheme

Despite expectations of the government and bank specialists, the number of debtors joining the Exchange Rate Cap Scheme at its start was rather low. With the deadline extensions not leading to the expected results, the Ministry for National Economy, the MNB and the Association launched a joint campaign in the hope of increasing the take up. The task of organising and managing the campaign was assumed by the Association. Exchange Rate Cap contracts concluded by debtors by the end-date of the campaign (end-June) represented 38% of the portfolio (167,000 debtors). With the campaign concluded, the government decided to allow customers to join the Scheme at any time, with no end-date.

3. Corporate lending

Funding for Growth Scheme

On April 4, 2013, the MNB Monetary Council adopted its Funding for Growth Scheme, aimed at stimulating economic growth and reducing the short-term foreign currency exposure of the banking sector. Initially, the first pillar of the Scheme made available a HUF 250 billion refinancing facility for SME loans to be granted for new investment projects, working capital or own resource requirements related to EU grants and for the replacement of SME loans taken for these purposes. Another HUF 250 billion was made available under the second pillar, for replacing SMEs' foreign currency loans taken for the same purposes with HUF loans. The main conditions for both pillars are as follows:

- financing banks can apply for refinancing to the extent of 5% to 100% of their SME loan portfolios as at December 31, 2012,
- financing banks may relend the central bank funds at an interest margin of 2.5%, including the guarantee fee,
- the facility cannot be used for the repayment of debts delinquent for more than 90 days or for the replacement of restructured loans,
- the MNB has a right of security over the collateral securing the loan.

With a view to reducing Hungary's short-term debt, in the case of FX loan replacements under the second pillar, banks are required to reduce their short-term external FX funding. Under the third pillar of the scheme, the MNB makes available short-term euro financing facilities for banks under FX swap and CIRS tenders.

Originally, the Scheme was open for banks for a period from June to August.

With keen interest shown in the scheme, the allocations for the first and second pillars were raised on May 29 to HUF 425 billion and 325 billion, respectively.

In early August, the Scheme was modified: the disbursement deadline for the loans was extended to end-September and unused funds allocated to banks under the second pillar were allowed to be reallocated to the first pillar.

Following the announcement of the Scheme, the MNB held a consultation for the heads of major banks on the details of the Scheme.

After the publication of the details of the Scheme, specialists from member banks raised a number of legal, contractual, accounting and reporting issues. These were addressed at a

consultation forum held by the Association on June 6. The main questions were related to how the loan replacement should be implemented from a contractual point of view (whether by amending the current contract or by concluding a new contract), the issue of giving the MNB a right of security over the collateral, the checking of the purposes of the contracts, the interpretation of the scope of restructured loans excluded from the Scheme and the certification of the SME status.

4. MUNICIPALITIES

As a result of the consultations conducted between the Association and the Ministry for National Economy, the second stage of municipal debt consolidation was successfully concluded on June 28, 2013. This affected 277 municipalities with more than 5,000 inhabitants, to a total value of HUF 610 billion. Debts of 222 municipalities were consolidated by the state under debt assumption agreements concluded with the involvement of 21 banks and the Government Debt Management Agency (ÁKK), while in the case of 55 municipalities, the consolidation of debts under HUF 250 million, related to some 500 contracts, was carried out through a repayment subsidy granted by the state.

Earlier, until December 28, 2012, the state consolidated debts of municipalities with less than 5,000 inhabitants, assuming municipal debts arising from 3,848 contracts to a total value of HUF 74 billion. Thus, a total of HUF 684 billion in municipal debt was consolidated.

In the case of municipalities with more than 5,000 inhabitants, around HUF 400 billion debt remained after the consolidation. Further indebtedness is aimed to be prevented by restrictions built into the system: a municipality may only borrow overdrafts during the year, which it must repay by the end of the year. Furthermore, the borrowing by the municipality of any investment loan is subject to government approval (except for loans under HUF 25 million, granted from EU funds).

Municipalities that had no high debts (around 1,200 in number) and were therefore left out of the consolidation were promised to get a compensation from the state.

5. PAYMENTS

Tax law changes related to the Financial Transaction Levy and interest income

The budget revenues expected for the first half of the year from the Financial Transaction levy were not met. The shortfall can partly be explained by the fact that customers have rationalised their payment operations: customers with multiple bank accounts have closed their redundant accounts with other banks and a number of large corporate customers moved their high-volume treasury operations abroad (primarily those denominated in foreign currency).

Due to the shortfall in revenues and in order to keep the deficit of general government low, the government submitted and Parliament adopted a law to increase the Financial Transaction Levy rates. Accordingly, effective August 1, 2013, the general levy rate has been

increased from 0.2% to 0.3%, with the cap of HUF 6,000 remaining. At the same time, the levy rate for cash withdrawals and currency exchange has been doubled (from 0.3% to 0.6%) and the former HUF 6,000 cap removed. In addition, a requirement has been imposed on all financial services providers to pay a one-off extra contribution of 208% of the levy paid on transactions executed between January and April 2013.

As an additional measure, a healthcare contribution of 6% has been imposed on interest income earned after August 1, 2013, in addition to the 16% personal income tax. HUF-denominated government securities, investment units of investment funds investing at least 80% the funds managed by them in government securities, deposits in long-term savings accounts (if held to expiry) and preliminary pension savings accounts are exempt from the 6% healthcare contribution.

The Association's Board protested to the Minister for National Economy against imposing an additional tax burden on the banking sector due to inaccurate planning. To ensure consistent application of the healthcare contribution on interest income, we conducted expert level consultations and requested the Ministry's clarifications on related banking technical issues. The 30-day period between the adoption and entry into force of the legislation dictated a tight schedule for banks to adapt their systems.

Proposed regulation on interbank interchange fees

The regulation and reduction of interbank interchange fees continues to be at issue in Hungary as well as at the EU level.

The Association drew attention at several forums that a further substantial reduction of interchange fees would entail serious risks.

We achieved the postponement of the regulation with a view to awaiting the relevant EU proposals. Also, we proposed the conducting of more discussions between the government and market players to avoid any measure that would harm the development of the bank card market.

The Association and its members fully agree that promoting the use of cashless payment instruments is an important task and a common economic interest. However, this should be achieved through well-prepared and well-founded measures and tools. Accordingly, we provide professional assistance in the development of the POS deployment project initiated by the MNB, mindful of the principle of a level playing field.

At the same time, we emphasised that the imposition and increase of the Financial Transaction Levy would make payments shift into the shadow economy. To prevent this, we proposed the drastic reduction or abolition of the Financial Transaction Levy on electronic and card payment transactions.

Tax certificates

Specialists from member banks have indicated at several forums the problems encountered regarding the contents of tax certificates and their verification.

A consultation between the Tax Authority, the Association and specialists from the bank initiating the meeting was held in the second half of June.

At the meeting, we reviewed the solutions currently in place with a view to ensuring that the tax certificates provided to banks contain the information needed. The means for verifying the certificates were also discussed. Also, it was agreed that the Tax Authority would standardise the contents of the certificates to be issued by its regional units. We confirmed this request in a letter to the Tax Authority in early July.

The Tax Authority modified its information systems in July, in accordance with the requirements agreed during the consultation. Member banks were informed on an ongoing basis on the details and developments of the consultation.

Other taxation issues

Within the framework of consultations on taxation issue, the Taxation Working Group reviewed the personal income tax rules for the partial redemption at the end of the third year of deposits held in Long-Term Investment Accounts (due for the first time in 2013) and codification deficiencies in the laws regulating preliminary pension savings and in the personal income tax law. We sent text proposals to amend the relevant regulations. Also, we reviewed the verdicts of the European Court of Justice on VAT on consulting and portfolio management services provided to investment fund managers in the context of previous rulings on the issue.

A legislative solution has been reached regarding forgiven debt (long urged by the Association): mortgage loan debts forgiven to private individuals in compliance with the principle of equal treatment of those in equal circumstances are now exempt from tax, social security contributions and stamp duty.

FATCA

While the proposed intergovernmental agreement with the U.S. government has not yet been concluded, the timelines for the implementation of the FATCA have been revised. Pursuant to the relevant notice of the U.S. Treasury

- the start of the withholding requirements has been postponed to July 1, 2014.
- No reporting will be required with respect to the 2013 calendar year. The first report of information continues to be due in 2015 and will include information about accounts maintained during 2014.
- The FATCA registration website will be accessible from August 19, 2013, and until December 31, 2013 will run in a "test mode". Foreign financial institutions (FFIs) can finalise their registration information after January 1, 2014. To ensure inclusion in the first IRS Foreign Financial Institutions (FFI) List, foreign financial institutions will need to finalize their registration by April 25, 2014. However, financial institutions located in jurisdictions that have signed intergovernmental agreements for the implementation of FATCA will not have to register by April 25, 2014.
- The Hungarian government has decided to enter into an intergovernmental agreement with the U.S. government, the relevant negotiations are underway.

6. Hungarian Financial Supervisory Authority (PSZÁF)

Financial Arbitration Board (FAB)

We reviewed the Financial Arbitration Board's report on its first year of operation at a meeting with the FAB's Chair. We agreed that some of our initial concerns regarding this new body had been unwarranted: the FAB makes its decisions in an unbiased, professional, consistent and fast manner, the average decision time is 51 days. Out of the 3,149 cases concluded in 2012, 2,120 consumer complaints were by definition rejected for one reason or another, mandatory resolutions were adopted in 24 cases and 847 cases were concluded with a composition between the parties. It was also mentioned that many lawyers talk their clients out of using this fast and cheap dispute resolution forum, since they are interested in long litigations bringing more revenues.

BUBOR reform

Based on our comments on the supervisory authority's draft recommendation on the BUBOR rate-setting process, PSZÁF held quadrilateral meetings with the MNB, the Hungarian Banking Association and the Hungarian Forex Association in April, addressing the contents of the recommendation and self-regulatory issues related to the BUBOR rate-setting process. At the meetings, special emphasis was given to the development of the organisation of the sponsor of the rate-setting process (currently the Hungarian Forex Association's Technical Committee) and the further development of BUBOR as a product. PSZÁF issued its recommendation on April 29 (see attached – in Hungarian only). The recommendation supports the strengthening of the organisation of the responsible committee of the current sponsor (Hungarian Forex Association) and the introduction of a mandatory contracting requirement in the future. A proposal for the detailed rules of the BUBOR rate-setting process and other related rules are being drafted by Hungarian Forex Association.

Changes in supervisory reporting requirements

The CRR/CRDIV, taking effect in 2014 will bring significant changes to the prudential regulatory framework and the related reporting requirements. Under the new COREP template package, Hungarian banks will have to file their first quarterly reports for the period ending March 31, 2014. Around 13 bank groups will be required to file FINREP reports (previously not applied in Hungary), the first reports will be due on the period ending September 30, 2014. The situation is made difficult by the fact that the EU process is still pending, the EBA submitted to the European Commission the relevant Implementing Technical Standards at the end of July. Banks listed on the stock exchange will have to compile their reports according to the IFRS. The decision on whether systemically important banks should prepare their reports according to the IFRS or according to the Hungarian Accounting Standards (HAS) will rest with the competent authority. Here, a problem is that decisions assigned to the competent authority are not expected to be made before the

merger of PSZÁF with the MNB (expected by October 1), which means that there will be no sufficient time left for preparations.

The Association launched a series of consultations for specialists from member banks in the summer to identify the related tasks.

7. Regulatory changes, authority measures

Draft laws related to the entry into force of the new Civil Code

The new Civil Code is a major issue of the Hungarian legal system. Therefore, it is important that it is implemented as smoothly as possible. We requested the Ministry of Justice to involve the Association in all phases of the process so that it is not the Ministry's website where we learn of the relevant legislative proposals.

In view of the many changes and related regulatory amendments, we drew attention to the importance for the codification process to progress at a good pace and for the relevant laws to be published a few months before the entry into force of the new Civil Code. For the entities applying the law, preparatory time not only means the time needed for them to prepare themselves theoretically, but also the time needed for the redrafting of the terms and conditions of several thousand types of consumer contracts, the drafting of new internal rules, the design and implementation of IT developments, the training of thousands of staff members and the redesign of banks' administrative processes. All these tasks must be completed by the day the new Civil Code takes effect and the various phases of the work cannot be accelerated without the related regulations being available. For example, to ensure smooth lending, the collateral register should be operable by the time the legislation takes effect.

Concurrently with the entry into force of the new Civil Code, all the affected laws should be amended. Given that the changes in these laws will generate a multitude of tasks, we consider it indispensable that the relevant financial sector regulations are amended as soon as possible.

It is crucial that the during the drafting of the related laws, there should be a phase where the proposed amendments to the financial sector law, the tax, stamp duty and accounting laws and the proposed amendments to the Civil Code and other related laws can be reviewed together. A good example for this is the long-awaited new institution of lienholder's agent, the wider use of which depends not just on the provisions of the Civil Code but on the related tax, stamp duty and accounting regulations and their consistency with the financial sector law. Without this, the institution of lienholder's agent will not be practicable. The regulatory amendment proposals drafted thus far do not meet this requirement: they mostly focus on amendments ensuing from textual changes in the Civil Code, without solving the deeper issues.

Neither in the draft Civil Code, nor in its submission is there any provision as to how the notary lien register would operate after the entry into force of the Code. It is presumed that no new floating charge can be registered after March 15, 2014, whereas the management of pre-existing data will continue to remain with notaries and the Chamber of Notaries. It

would be important for the legislators to regulate these issues. We drew attention that the lack of regulation on the collateral register specified in Chapter XXV of the Code may thwart the coming into force of the Code. It is crucial that a proposal for regulation by an Act is made available as soon as possible.

In relation to the new Civil Code, we reviewed and commented on the following regulatory proposals:

- Civil Code White Paper,
- Proposed amendments to laws related to the Civil Code,
- Draft law on the transformation, merger and demerger of certain legal entities,
- Civil Code-related amendments to certain financial and economic laws.

Preparations for the new Civil Code – Seminar for banks' legal counsels

The coming into force of the new Civil Code on March 15, 2014 will entail major tasks for the Hungarian legal community, including legal counsels of banks. As a consequence of the new legislation, banks will have to review and redesign their contractual relationships. Preparations are hindered by the fact that the legislation enacting the Civil Code and the related laws are still missing.

In this situation, it was warranted for the Association to take a share in helping banks in their preparations. We organised seminars with presentations and consultations on contract law in May and on financial and credit transactions and collaterals in June. The seminars were held by Dr István Gárdos and Dr. Peter Gárdos, who both had been involved in the drafting of the legislation.

Most of the 187 persons who registered for the seminar attended all three events, with 70-80 participants in each event. The feedback was highly positive, participants expressed their thanks for the opportunity. The venue was provided by UniCredit Bank, with excellent organisation.

Prohibition of fiduciary collaterals – preparations for the new Civil Code

The new Civil Code, coming into force in March 2014, contains important changes with respect to collaterals. The new Code practically describes ("models") all collaterals through the legal institution of lien and prohibits a number of collaterals that have been used until now. In our opinion, the new rules will suitably protect creditor interests, but their implementation will require thorough preparations. This is made difficult by the fact that the law amendments required for putting the new Civil Code into effect have not yet been finalised and a number of issues are not regulated in the available proposals.

Review of the draft law on amendments to the Act on the MNB and other Acts

The Parliament has not yet adopted the new legislation on the MNB, necessitated by the proposed merger of PSZÁF with the MNB. The new law is expected to be passed during the autumn Parliamentary session. Since the draft law does not provide for amendments to the related laws, the Ministry for National Economy drafted amendments to those regulations that are needed for the merger. In our comments provided at the request of the Ministry for National Economy, we pointed out the inconsistencies arising from the hierarchy of the relevant pieces of legislation in relation to the MNB's extended decree powers. We proposed the retention of the current rules for supervisory disclosure and the keeping in force, for a temporary period, of the current PSZÁF decrees. In addition we provided amendment proposals for the Act on Stamp Duties, the Act on Taxation and the Act on Central Credit Bureau. We initiated an amendment to the Act on Taxation to give banks the right to electronically access the customer's tax certificates at the Tax Authority without the customer's contents, with a view to improving the quality credit appraisals.

Also, we proposed a statutory provision to ensure that in the case of a legal action being filed on the ground of voidness of the contract, the other party may, without filing a countersuit, submit a counterclaim for the application of the legal consequences of voidness. The purpose of this provision is that if the contract is declared void, the court can rule on the elimination of the causes of voidness, as is the case with the Supreme Court's verdict regarding the exchange rate spread to be applied.

I addition to the above, we reviewed and commented on the following draft regulations:

- Government Decree on Expropriation,
- PSZÁF draft decree on administrative service fees,
- Amendments to the Act on Judicial Foreclosure

Report to the Board on the legislation on the integration of co-operative credit institutions

The report presented the main form, content and legal issues related to the recently enacted legislation (Act CXXXV of 2013).

The draft law was submitted to Parliament under urgency on June 25, 2013. It was passed by Parliament two days later and took effect on the day following its promulgation, on July 13, 2010. The law puts co-operative credit institutions under state control. It establishes the Integration Organisation of Co-Operative Credit Institutions, with members including Takarékbank, co-operative credit institutions and the Hungarian development Bank (MFB). The institution protection funds of co-operative credit institutions will be dissolved and the Integration Organisation of Co-Operative Credit Institutions will take over their assets as their legal successor. The MFB will contribute HUF 1 billion to the Integration Organisation on foundation and provide an additional contribution under the special provisions of the legislation within 150 days after foundation. Members of the Integration Organisation shall pay an annual membership fee of 0.1% of their risk weighted exposures.

The Board heard a briefing from Representatives from the National Association of Savings Co-Operatives (OTSZ) and the National Interest-Representation Association of Savings Co-Operatives (TÉSZ), who pointed out that the new legislation violated certain provisions of

the Fundamental Law, the affected stakeholders had been completely left out of the drafting process, and the relevant government communications had painted a much more negative picture of the co-operative credit institutions sector, protected by institution protection funds, than what the reality was. They presented the measures they have taken since the Government Commissioner's announcement of the draft law. The Board took note and approved of the information provided.

Changes affecting the accounting framework

In June, the Ministry for National Economy launched a consultation on possibilities for the application of the IFRS reporting standards in Hungary.

In addition to the banking sector, which has raised the issue several times, the supervisory authorities of the financial sector and several other organisations, especially Hungarian companies with stock exchange or foreign business or ownership relations, have indicated to the Ministry the need to widen the application of IFRS in Hungary. Under the current Hungarian accounting law, the IFRS currently is only mandatory for certain companies and only allowed to be used for consolidated reports. In the coming period, the Ministry will look into the possibilities for introducing the IFRS for solo reports. Here, the Ministry counts on the assistance and experience of reporting entities as well as of users of financial reports.

Based on the consultation, it is clear that shifting from Hungarian Accounting Standards to IFRS will, inter alia, require the following:

- education and training (there is a shortage of IFRS experts) ;
- the consequences of opting for IFRS or HAS should be tax neutral;
- consistency should be ensured in issues affecting other legal areas (e.g., company law);
- the scope of those entities for whom IFRS would be mandatory and those for whom it would be optional should be defined.

Technical work on the issue will commence in September.

Online securities account opening

An amendment to the Anti-Money Laundering Act, taking effect in July 2013, allows for the online opening of securities accounts and the purchase of securities without the customer having to appear at the bank in person. All the customer needs to do is send a scanned copy of his or her ID document to the investment firm (bank) and designate his payment account. The investment firm (bank) verifies the identity of the customer with the bank managing the payment account and if the verification is successful, the securities account can be opened without the customer having to appear at the bank in person. In preparation for the implementation of this new provision, it was clarified that the institution (bank) managing the payment account is entitled and required to answer the verification request, without prejudice to bank secrecy laws.

Inheritance by the state

In cases where there is no heir, or where there is one, but he or she refuses the inheritance, the state necessarily becomes the heir. In this case, the state is represented by Hungarian National Asset Management Inc. (MNV). In cases where the inheritance is a bank deposit or securities, MNV contacts the banks in question. In this process, MNV has experienced divergent procedures, sometimes even within the same bank. Therefore, MNV approached the Association, requesting us to ask our member banks to manage these processes in a uniform manner, preferably by each bank appointing a Budapest branch of its to handle these affairs. MNV also proposed wider cooperation with the Association (exchange of experience, exchange of publications, participation in each other's events, etc.), this proposal will be decided on by the Board.

ANNEX

INTERNATIONAL DEVELOPMENTS:
REGULATION, SUPERVISION – EUROPEAN BANKING FEDERATION

I. Global regulation

In April, the ***Financial Stability Board (FSB)*** reported to the G20 Finance Ministers and Central Bank Governors on ***progress on the financial reform programme.*** The report addresses the implementation of the Basel III capital and liquidity requirements aimed at increasing the resilience of banks and banking systems, the reform of the resolution regimes aimed at ending „too big to fail", and the implementation of OTC derivatives reforms. In relation to the regulatory reform, the FSB points out that while the fundamental goal is to reduce systemic risks from interconnectedness, it is equally important to maintain an integrated global financial system.

The report establishes that significant progress has been made in ***Basel III implementation***. Out of the twenty-four member jurisdictions of the FSB, eleven had issued final Basel III-based regulations by end-March 2013 and the remaining thirteen have also published their draft regulations. Banks' capital levels are rising at a faster pace than set out in the Basel III phase-in arrangements. Over a year to June 2012, the average Core Equity Tier1 (CET1) capital ratio of banks rose from 7.1% to 8.5%. The capital shortfalls of those banks that do not yet meet the fully phased-in 2019 CET1 requirements fell from EUR 450 billion to EUR 200 billion, 45% less than at the end of 2011. Banks in the EU have to do more than elsewhere to close the gap. To ensure a level playing field, the Basel Committee is now assessing the options to reduce the excessive variation in the calculation of risk-weighted assets (risk weights) under the IRB approach. The Basel Committee plans to finalise its work on leverage ratio by the end of 2013. Regulations on the Net Stable Funding Ratio, the trading book, securitisation and large exposures are expected to be finalised in 2014.

The report points out that while important measures have been taken in several FSB jurisdictions, the ***implementation of resolution regimes*** is still at an early stage and much work remains to be done. In many countries, resolution authorities lack important powers needed for resolution, such as powers to write down and convert liabilities of a failing financial institution to equity (bail-in), or to impose a temporary stay on the execution of financial contracts. Jurisdictions do not have the power to take control of the parent company or affiliates of a failing institution, such as central counterparties and other financial market infrastructures. Domestic authorities should be authorised to share confidential information and cooperate for resolution purposes with foreign authorities. Also, authorities should be authorised to impose a statutory resolution planning requirement.

In relation to the ***implementation of OTC reforms***, the FSB report establishes that although none of its member jurisdictions had fully adopted the rules set out in the G20 agreement by the end of 2012, considerable progress has been made with respect to comprehensive trade reporting, central clearing and trading on organised exchanges. The report also reviews the progress made in transforming shadow banking, reforming financial benchmark setting, implementation of the principles for eliminating mechanistic reliance on credit rating agency ratings and long-term investment finance. At its June meeting, the FSB also addressed issues related to the resolution of systemic insurance groups, accounting and auditing issues and compensation practices.

In addition to the report on monitoring the implementation of the Basel III regulatory reform, documents issued by the ***Basel Committee on Banking Supervision*** (BCBS) in the second quarter included a proposal for the leverage ratio framework and a study on regulatory proposals to reform the structure of the European banking sector.

The ***leverage ratio*** was introduced into the regulatory framework by the Basel III reform. It was designed to serve as a backstop to the risk-based capital measures by providing protection against model risk and measurement error. The Basel Committee aims to formulate a leverage ratio requirement that is robust and internationally consistent, regardless of the differences in national accounting standards. Banks should start disclosing their leverage ratio, calculated on a common basis, from the beginning of 2015. The consultative document sets out a methodology for the calculation of the leverage ratio and a set of public disclosure requirements. Final adjustments to the definition and calibration of the leverage ratio will be made by 2017, with a view to migrating to a Pillar 1 treatment on January 1, 2018. Comments on the consultative document are invited by September 20, 2013.

The Bank for International Settlements issued a paper on the rationale and features of the proposals adopted to separate specific investment and commercial banking activities. This paper analyses the implications of such initiatives for: (i) financial stability and systemic risk; (ii) banks' business models; and (iii) the international activities of global banks. It concludes that structural measures can reduce systemic risk in several ways. First, it can shield the institutions carrying out the protected activities from losses incurred elsewhere. Second, it can prevent any subsidies that support the protected activities (e.g., central bank lending facilities and deposit guarantee schemes) from lowering the cost of risk-taking and encouraging moral hazard in other business lines. Third, it can reduce the complexity and size of banking organisations, making them easier to manage, more transparent to outside stakeholders and easier to resolve. At the same time, structural regulation has some risks. One risk is that banks may respond to the reforms by shifting activities beyond the perimeter of consolidated regulation. A second risk is that it may create disincentives to global banking by seeking to protect depositors within the home country jurisdiction. Also, ring-fencing may constrain the allocation of capital and liquidity within a globally operating banking group. As a result, structural regulation may contribute to a fragmentation of banking markets along national lines.

IMF staff also ***analysed the potential impacts of structural reforms***[1]. Their Discussion Note points out that the nations proposing structural banking reform are global financial centres and systemically important economies. By enhancing financial stability in these countries, such policies can have positive impacts on the global economy and the financial system. To assess these impacts, there is a need for a global cost-benefit exercise encompassing the extra-territorial implications of structural measures. According to the authors, a targeted approach - with structural measures tailored to the specific risk profiles of individual banks at a global group level - would promote global financial stability more effectively than an across-the-board approach. However, in the absence of sufficient supervisory capacity to implement the targeted approach, across-the-board measures could be appropriate, provided their global benefits exceed their costs.

II. European Union

II.1 Reforming the structure of the European banking sector

As presented in our previous reports, structural reforms are on the agenda of the European Union, as well. Following the report of the Liikanen High-Level Expert Group (HLEG), the European Parliament's ***Committee on Economic and Monetary Affairs*** (***ECON)***, issued an own initiative report on reforming the structure of the European Banking Sector at the beginning of the year[2]. The EBF gave the following main comments on the report:

- The EBF questions the conclusion of the report that a fundamental reform of the banking sector is essential and complementary to the other proposals. The proposals being discussed all aim to solve the same problem as that addressed by the report, while the combined effect of the reform measures is no yet felt.
- The report proposes determining the costs of bank failures that occurred during the crisis. According to the EBF, the costs for the real economy of the EU-wide implementation of the proposed structural reform and the regulatory package now being discussed should also be assessed.
- It is true that economic growth should be stimulated by lending to the economy. The mandatory separation of trading activities would adversely affect corporate lending.
- In most of its elements, the ECON's proposal goes beyond the proposal made by the HLEG: it proposes the full separation of banks' retail and trading activities without a size threshold. At the same time, it is positive that the proposal regards market making as a customer-oriented business, not to be separated.
- The separation of trading activities in the proposed manner would have far-reaching consequences. The proposal fails to consider the fact that banks' business models played no role in the bank failures. The Liikanen report at least tried to preserve the benefits of universal banking by allowing the ring-fenced activities to be managed within the same holding company. The activities the report proposes to be ring-

[1] José Vinals, Ceyla Pazarbasioglu, Jay Surti, Aditya Narain, Michael Erbenova and Julian Chow: Creating a Safer Financial System: Will the Volcker, Vickers, and Liikanen Structural Measures Help? IMF Staff Disscussion Note, May 2013

[2] See our Q1 2013 report

fenced (lending, deposit taking, payment transactions) are too narrow and ignore the fact that customer-oriented banking services are crucial for the real economy.

In the wake of the Liikanen report, the ***European Commission, too, considers that the reforming the structure of the banking sector is crucial***. It will make a proposal after the summer break. It is unclear yet whether it will be a Directive or a Regulation. In explaining the reasons, the Commission's representatives cited the regulatory measures already implemented or being planned by member states, affecting the structure of their banking sectors, and the need to safeguard the Single Market.
The Commission's proposal starts out from the Liikanen report's proposal for mandatory separation, however, its baseline scenario is that there will be no mandatory structural reform. The Commission will conduct a thorough impact assessment, considering the consequences of the proposal, the appropriate size of the separation threshold and the scope of activities to be separated. It will attempt to strike a fragile balance which can ensure the implementation of the set objectives (ending "too big to fail", eliminating intra-group/intra-bank subsidies), while not damaging banking services that are crucial for economic actors. Accordingly, the Commission will try to draw the right boundary between market making and hedging and ordinary trading activities. The Commission will study the interaction between structural reforms and the other regulatory elements, their impact on the competitiveness of European banks and on funding the economy, the risks of regulatory arbitrage and increase in shadow banking activities, and how the proposal would contribute to preventing future bank crises and how it would impact on deposit protection and taxpayers. It will also assess the risks of not having an EU-level regulation.
In May, the Commission issued a consultative paper with 11 questions, addressing the problem drivers of the reform, the possible policy options, the scope of banks potentially subject to separation (de minimis exemptions), supervisory discretion for separation, activities to be separated and the strength of separation (intra-group or full ownership separation). The annex to the paper, assuming two stylised scenarios, was aimed at assessing the practical impact of the proposed structural reform on large systemically important European bank groups.

The EBF supports the Commission's approach to structural reforms and shares the concern of the Commission over the different national proposals. The EBF points out that the definition of high-risk trading activities must be based on methods that measure the real level of risk in the trading book and not on accounting categories. The EBF favours a targeted approach, where it is left to the supervisor how to target high risk activities, with separation being a last resort tool. The EBF is concerned that an EU proposal for structural reform would add another layer of reform, thereby making it even more difficult for cross-border banks to operate.

The ***ECON's final report, published at the end of June,*** providing a principle approach to the separation of activities, is more favourable from a banking point of view than that contained in the draft report, and it takes account the EBF's comments in several points. According to this final report, the proposed structural reform would only be complementary to the other regulatory measures. Compared to the draft report, the scope of fundamental banking activities (deposit-taking, lending and payment services) has been extended to include other customer-oriented banking services and these shall be ring-fenced from non-fundamental

and risky activities. The final report takes better account of the Bank Recovery and Resolution Directive. At the same time, the ECON report continues to support the proposal to have an EU-level regulation for mandatory separation, citing the objective of ending “too big to fail” and preventing the fragmentation of the single market.

II.2 CRR/CRDIV adoption

Following the legal and linguistic reviews (checking of the translations) of the text adopted on April 16, the European Parliament and the ECOFIN readopted the capital requirement and liquidity framework. The final CRR/CRDIV texts were published in the European Union’s Official Journal on June 27.

In its press release issued following the adoption of the CRD/CRDIV, the European Banking Federation, while welcoming the certainty the new capital and liquidity requirements bring to banks, expressed its disappointment that the European Commission and Parliament have not succeeded in bringing forward a true Single Rulebook for banks, since the agreed regulation has left a surprising degree of flexibility to member states to vary the different national capital buffers. This will not simplify the working of the Single Supervisory Mechanism, under which the European Central Bank must oversee all banks according to their respective national rules. At the same time, the EBF pointed out that European banks were pleased to see the agreement on a more workable liquidity regime that now consists of a wider range of assets than merely sovereign bonds and is appreciative of the accommodation made for capital requirements for lending to small and medium-sized enterprises. While the EBF agrees with the need to provide long-term incentives for banks’ remuneration appetites, it regrets the Commission’s insistence on restrictions that are in isolation from other industries and in excess of the internationally agreed standards. Notwithstanding, the EBF pointed out that with the adoption of the CRR/CRDIV, Europe has taken a significant step towards greater financial stability, which European banks have already anticipated by moving to significantly improved capital levels. In the spirit of a global level playing field, the EBF will urge for all G20 signatories to Basel III to implement without delay the internationally agreed capital rules.

On July 16, 2013, the European Commission published a Frequently Asked Questions document to promote implementation and public understanding of CRR/CRDIV.

II.3 Bank Recovery and Resolution Directive (BRRD)

II.3.1 ECON position on the BRRD

According to the ECON’s position adopted in May, Recovery and Resolution Plans (RRPs) should be prepared at the group level, except where the affiliated entity is systemically important. RRPs should be tested based on institution specific scenarios. The EBA will not prepare guides for these scenarios. Supervisors will have the power to require a bank to change its legal or operating structure and to issue or restructure liabilities. At the same

time, banks will have the right to appeal and seek revision of the supervisor's decisions, including those requiring strategic and structural changes.
The European Parliament will set a hard threshold for early intervention: the minimum own funds requirement + 1.5%. A special manager may be appointed in the resolution phase.
Banks will be required to have sufficient own funds and bail-inable funds, as expressed as percentage of their total liabilities. The EBA shall set the minimum requirement for own funds and eligible liabilities (MREL[3]) in a Regulatory Technical Standard. In the case of insolvency, depositor claims will be given preferred treatment (priority) over other unsecured creditors. (Secured deposits will continue to be protected). As opposed to the originally planned date of January 1, 2018, the bail-in requirement will enter into force on July 1, 2016.
The target level for national resolution funds to be reached in ten years would be increased to 1.5%. Bank taxes could be used to replace the resolution fund. Resolution funds may borrow from each other. Deposit Guarantee Schemes will not be involved in the resolution.

II.3.2 EBF letters

The EBF wrote a letter to the EP Rapporteur on BRRD, drawing attention to some key aspects. The letter advocates for a single approach and harmonised bail-in instruments at the EU level. National resolution authorities should not be given discretion to exclude certain liabilities from the scope of eligible bail-in instruments. Many EBF members are of the view that harmonised bail-in instruments would make it unnecessary to set up ex-ante funded resolution funds. However, should the EU decide to require the establishment of resolution funds, member states should be allowed to make maximum use of the synergies with Deposit Guarantee Schemes. The use of resolution funds should be restricted in an unambiguous and clear manner. Potential impacts should be carefully assessed, not only for banks, but for the entire European real economy. Filling up the resolution funds will require at least fifteen years, the assumption of liabilities should be given priority over payments into the fund. The EBF gives great emphasis to ensuring efficient operation of the resolution colleges and to increasing the EBA's mediation role, while it understands the concerns raised regarding the budget implications of mandatory mediation.

Ahead of the ECOFIN's June 21 meeting, the EBF wrote a letter to once again draw attention to potential problems certain amendments made to facilitate the adoption of the BRRD may cause. The EBF reiterated the need for harmonised bail-in instruments at the EU level and its objection to giving national authorities discretion regarding eligible liabilities. Such flexibility would harm the transparency of cross-border resolution. Investors would not be able to foresee the impacts of the bail-in and would assume a worst case scenario. This would further increase banks' funding costs, which are already high due to the financial regulatory package. Regarding the minimum requirement for own funds and eligible instruments (MREL), the EBF pointed out that these should be set by institution during the resolution planning process and based on the risks. The EBF supports the proposal that the EBA should, by 2016, review the need to set harmonised MRELs by taking account of the various business models.

[3] Minimum Requirement for Own Funds and Eligible Liabilities

II.3.3 Compromise in the Council

Member states reached a compromise on liabilities eligible for in bail-in. Under the agreement reached, deposits from natural persons and micro, small and medium-sized enterprises and liabilities to the European Investment Bank would have preference over the claims of ordinary unsecured, non-preferred creditors and depositors from large corporations. The deposit guarantee scheme, which would always step in for covered deposits, would have a higher ranking than eligible deposits. Certain types of liabilities would be permanently excluded from bail-in. These would include covered deposits, secured liabilities, including covered bonds, liabilities to employees of failing institutions, such as fixed salary and pension benefits, commercial claims relating to goods and services critical for the daily functioning of the institution, liabilities arising from a participation in payment systems, which have a remaining maturity of less than seven days, and inter-bank liabilities with an original maturity of less than seven days. To ensure flexibility, national resolution authorities would also have the power to exclude, or partially exclude, liabilities on a discretionary basis for the following reasons:

- if they cannot be bailed in within a reasonable time;
- to ensure the continuity of critical functions;
- to avoid contagion;
- to avoid value destruction that would raise losses borne by other creditors.

National resolution funds would have to reach a target level of at least 0.8% of covered deposits of all banks in the country within ten years. Member states would be free to choose whether to merge or keep separate their funds for resolution and deposit guarantee schemes. In both cases, the combined target level would be the same (1.3%). National resolution authorities would set minimum requirements for own funds and eligible liabilities (MREL) for each institution, based on its size, risk and business model. A review in 2016 would enable the Commission, based on recommendations by the European Banking Authority, to introduce a harmonised MREL applicable to all banks.

With this compromise in the Council, it will perhaps be possible to ensure that the requirements for fundraising by banks are more or less the same in all member states and that potential investors and creditors do not move between countries due to the divergent treatment of their monies for the purpose of bail-in. To ensure a level playing field, member states should consistently apply the special exemptions from bail-in, in accordance with the criteria determined by the EBA.

After the European Parliament and the Council giving their positions, the trilogue commenced in July and is hoped to be concluded in the autumn. The positions of the Parliament and the Council differ in a number of points. Just to mention some of them: the appointment of a special manager, the joint management and target levels of resolution funds and deposit guarantee schemes, mandatory EBA mediation in the resolution colleges, or the date of introduction of the bail-in requirement.

II.4 Banking union

II.4.1 Single Supervisory Mechanism (SSM[4]) - operational framework

Despite expectations, the trilogue on the proposed SSM was not concluded in May. The decision on the SSM is expected to be postponed to September, with Germany expressing some reservations over the not fully appropriate separation of the ECB's monetary and supervisory powers.

An Administrative Review Board will be established within the ECB. The Supervisory Board shall take into account the decisions of the Review Board, and in the case of conflicting opinions, make a proposal for the Governing Council.
As for licensing, national supervisory authorities will make a preliminary decision. The ECB may approve the decision or contest it within ten working days. The supervision of smaller banks[5] will be exercised by National Competent Authorities (NCAs). However, even in this case, the ultimate supervisory responsibility will remain with the ECB: it may withdraw the supervision from the national authority at any time, require regular reporting from the NCA, and issue decrees, guides or general instructions to be followed by the NCA in its decisions. This arrangement practically means a two-tier supervision.
The ECB shall respect national discretions: it shall take into account prudential differences allowed by law and divergences in the transposition of the relevant Directives in the various member states. At the same time, it is unclear whether it will be the ECB to decide in those cases, where the NCAs have discretion.

A High-Level Group, led by Mario Draghi and made up of representatives from eight member states was set up to prepare the establishment of the managing bodies of the SSM and draft the most important legal documents (such as a framework regulation and the regulation on supervisory fees) and the Memorandum of Understanding to be signed with opt-in and non-euro-area countries. (The drafting of a Single Rulebook is the responsibility of the European Banking Authority!). The setting up of Joint Supervisory Teams, made up of representatives from NCAs and the ECB also commenced. Before migration to the SSM, all banks subject to direct ECB supervision will undergo a comprehensive balance sheet review (including assets, capital, debts and provisions) in order to ensure that accumulated (hidden) losses do not encumber the new system. The ECB is scheduled to begin supervision on June 1, 2014.

II.4.2 European Commission Proposal for a Single Resolution Mechanism (SRM[6])

Following the adoption of the Directive harmonising member states' bank resolution frameworks and practices, the next step towards a banking union will be the establishment of a Single Resolution Mechanism (a single resolution authority and a single resolution Fund). The Commission' relevant proposal was published with some delay, in early July.

Pursuant to the Commission's proposal:

[4] Single Supervisory Mechanism

[5] Banks with less than EUR 30 billion in total assets and a total assets/GDP ratio of less than 20%.

[6] Single Resolution Mechanism

- The ECB, as the supervisor, would signal when a bank in the euro area or established in a member state participating in the banking union was in severe financial difficulties and needed to be resolved.
- A Single Resolution Board, consisting of representatives from the ECB, the European Commission and the relevant national authorities (those where the bank has its headquarters as well as branches and/or subsidiaries), would prepare the resolution of a bank. It would have broad powers to analyse and define the approach for resolving a bank: which tools to use, and how the European Resolution Fund should be involved. National resolution authorities would be closely involved in this work.
- On the basis of the Single Resolution Board's recommendation, or on its own initiative, the Commission would decide whether and when to place a bank into resolution and would set out a framework for the use of resolution tools and the fund. For legal reasons, the final say could not be with the Board.
- Under the supervision of the Single Resolution Board, national resolution authorities would be in charge of the execution of the resolution plan.
- The Single Resolution Board would oversee the resolution. It would monitor the execution at national level by the national resolution authorities and, should a national resolution authority not comply with its decision, it could directly address executive orders to the troubled banks.
- A Single Bank Resolution Fund would be set up under the control of the Single Resolution Board to ensure the availability of medium-term funding support while the bank was restructured. It would be funded by contributions from the banking sector, replacing the national resolution funds of the euro area member states and of member states participating in the banking union, as set up by the draft Bank Recovery and Resolution Directive.

The Commission's role would be limited to the decision to trigger the resolution of a bank and the decision on the resolution framework, thereby ensuring its consistency with the Single Market and with EU rules on state aid, and safeguarding the independence and accountability of the overall mechanism.

Legally, the proposal assigns the function of a resolution authority to the Commission. Initial analyses did not find this solution to be appropriate, since the Commission is the joint body of all member states, while the banking union will only extend to a part of the member states. At the same time, what is in favour of the proposed solution is that, according to most analysts, it will not require an amendment to the EU Treaty.

The SRM will apply to all banks of the banking union. The powers and operations of the single resolution authority and the resolution process will be aligned with the BRRD, by also taking into account the outcome of the remaining discussions. The single resolution fund, funded by banks, is proposed to be fiscally backed by the European Stability Mechanism, which has the power to directly recapitalise banks. At the same time, the resolution authority may not adopt decisions affecting member states' budgets.

The SRM will be established by an EU Regulation. The Commission would like to have the Regulation passed by the EU Parliament and Council before the EU Parliamentary elections

in the spring of 2014. According to plans, the SRM would start shortly after the introduction of the Single Supervisory Mechanism, on January 1, 2015. This would ensure that, if the Commission's proposal is endorsed, there is no contradiction (or if so, only for a short period) between central supervision of banks in the banking union and national resolution.

In its press release, the EBF welcomed the announcement on the Single Resolution Mechanism. It pointed out that, if implemented correctly, the Single Resolution Mechanism (SRM) would provide a common framework for the treatment of failing banks within the banking union. It would further alleviate contentious home-host issues in the recovery and resolution process and also speed up cross-border resolutions. However, the EBF noted that not all EBF members believe that a Single Resolution Fund is feasible, at least not in the short term, since significant preconditions need to be fulfilled. Most importantly, these include an equal footing for all participating member states in terms of the legacy assets of the financial crisis.

II.5 Commission Green Paper on long-term financing

The European Commission issued a Green Paper on long-term financing, aiming to start a broad debate on how to foster the supply of long-term financing to stimulate the economy and how to improve and diversify the system of financial intermediation for long-term investment in Europe. In the Green Paper, the Commission asked thirty questions. Answers were invited by June 25. The paper reviewed the role of potential actors (commercial banks, national and multilateral development banks and institutional investors), the means to involve more funding sources (savings incentives, taxation, accounting principles, disclosure requirements). The Green Paper also addressed the ways to promote access by SMEs to bank and non-bank sources of finance.

In its response to the Green Paper, the EBF supported the further development of a market-based financing structure in addition to bank-based financing. However, it noted that the financial market is not always as effective as the Green Paper implies. A number of regulatory proposals are hampering a proper engagement of the financial sector in the real economy. Given the divergence between what is justified for economic reasons, and what is proposed at the political level, the European Banking Federation supports the Commission's decision to launch a debate on the issue. Some parts of the new regulatory framework (such as the Net Stable Funding Ratio or the proposed Financial Transaction Tax) would directly handicap banks' ability to provide longer term finance. European banks should be given scope to use capital markets to a greater extent in managing their business, while maintaining their central role in relationship-based financing.

II.6 ECON public consultation on the coherence of EU financial legislation

In May, the EU Parliament's Committee on Economic and Monetary Affairs held a public consultation on enhancing coherence of EU financial services legislation. The reason for the consultation was that the various regulatory measures adopted in the wake of the financial crisis had been introduced independently of each other (silo approach), which raises the issue whether these regulations are consistent with each other. The consultation was aimed

to identify any inconsistencies, including overlaps, divergences between the details of otherwise largely similar regulations, scheduling problems, divergences between EU and national regulations and inconsistencies between sector regulations. Another objective was to examine whether the regulations give the same degree of consideration to all business models.
In its response, the EBF focused on those inconsistencies and overlaps that it considered as unintended.

II.7 New legislation on Credit Rating Agencies (CRA3)

The new legislation on Credit Rating Agencies was published in the EU Official Journal at the end of May and took effect on June 20. In July, the European Securities Market Authority (ESMA) published the relevant draft Regulatory Technical Standards. These include disclosure requirements on structured financial instruments, the European Rating Platform, and the periodic reporting on fees charged by CRAs.

II.8 European Systemic Risk Board (ESRB) recommendations on intermediate objectives and instruments of macro-prudential policy

In view of the fact that member states have by now set up (or are in the process of setting up) their macro-prudential authorities, the ESRB issued a set of recommendations on intermediate objectives and instruments of macro-prudential policy in April. Pursuant to these, macro-prudential authorities should define and pursue intermediate objectives of macro-prudential policy. These should include the following:

- to mitigate and prevent excessive credit growth and leverage;
- to mitigate and prevent excessive maturity mismatch and market illiquidity;
- to limit direct and indirect exposure concentrations;
- to limit the systemic impact of misaligned incentives with a view to reducing moral hazard;
- to strengthen the resilience of financial infrastructures;

Authorities should select instruments that can be used to pursue these objectives. The recommendations include an indicative list of these instruments (e.g., counter-cyclical capital buffer, sectoral capital requirements, LTV, LTI, liquidity ratios, margin and haircut requirements, increased disclosure, etc.). Authorities should define a policy strategy for achieving financial stability through the application of intermediate objectives and instruments. Authorities should periodically assess the appropriateness and efficiency of intermediate objectives and instruments, including the appropriateness of the legal framework. The ESRB recommends that the European Commission should establish a set of coherent macro-prudential instruments and allow EU institutions and member states to apply these instruments whenever needed, while preserving the single market.

II.9 Survey on the European System for Financial Supervision (ESFS)

In May, the European Commission and the European Parliament commissioned a survey on the European System of Financial Supervision, including the three European Supervisory Authorities and the European Systemic Risk Board. The survey, inter alia, addressed the Authorities' mandates, resources, independence and accountability, cooperation and communications, consumer protection, the evolution of the European supervisory framework and macro-level issues. The survey also reviewed the efficiency and performance of the ESFS, soliciting proposals to improve the current structure.

II.10 ECB report on card fraud

The European Central Bank issued its second report on card fraud.

The report analyses the developments in fraud related to card payment schemes in the Single Euro Payment Area (SEPA). The report reveals that the total damage caused by fraud using cards issued in SEPA worldwide was EUR 1.16 billion in 2011, the lowest level since 2007. (7.6 % lower than in 2007). Card frauds have shown a decreasing trend in terms of both number and volume since 2007. Fraud in Card-Not-Present (CNP) transactions (mainly, online transactions) made up 56% of all fraud transactions. CNP transactions accounted for 68% of all credit card fraud transactions and 48% of all debit card fraud transactions. In ATMs, debit card fraud made up 34%, credit card fraud accounted for 7% of all ATM fraud transactions. (The use of ATMs is not typical in the case of credit cards, hence the significantly lower rate of fraud in this case). Fraud rates significantly vary in some EU member states.

Fraud over the Internet is rising year-by-year, in terms of both number and value.

The ratio of fraud over the Internet grew from 47% in 2007 to 56% in 2011. In terms of number of incidents, it rose from 45% in 2007 to 60% in 2011. With this trend, the ratio of fraud over the Internet is likely to have exceeded 60% in 2013.

Due to this trend, the European Forum for the Security of Retail Payments recommended the introduction of stringent customer identification requirements for payments over the Internet, effective February 2015. The use of 3D Secure (confirmation of online transactions by SMS) has been introduced by several banks in Hungary, as well.

A Hungarian proposal is the strengthening and coordination of actions by banks, authorities and the Police to combat the ever-increasing trend of fraud over the Internet. To achieve this, consultations between these organisations have commenced.

III. European Banking Authority (EBA)

In the EBA's ***annual report*** on its second year of operation, the EBA Chair highlighted the following priorities in the EBAs operations in 2012: strengthening the capital position of European banks, working towards the realisation of the Single Rulebook, and the establishment of a Single Supervisory Mechanism. Priorities in 2013 include the development of the Single Rulebook in depth (regulatory and implementing technical

standards and EBA guides), preparation for a new crisis management regime, assessment of the impact of regulation on the economy and growth and the drafting of a supervisory manual for the SSM and involvement in colleges of supervisors, especially those of credit institutions operating in both the SSM and non-SSM countries.

III.1 Joint Committee of the European Supervisory Authorities call for action on cross-sectoral risks

In April, the Joint Committee of the European Supervisory Authorities published its first report on risks and vulnerabilities in the European Union's financial system. The Committee highlighted the following risks:

- weak macroeconomic outlook, and consequently, the deterioration of financial institutions' asset quality and profitability,
- low interest rate environment,
- further fragmentation of the single market,
- increased reliance on collateral in financial transactions,
- lack of confidence in financial institutions' balance sheet valuations and risk disclosures, and
- loss of confidence in financial market benchmarks.

The Joint Committee points out the need for concerted action by policy makers and member states to restore the trust and confidence in the financial sector that has been eroded during the financial crisis. The Joint Committee urges the EU political leaders to press ahead with the establishment of the banking union, including the Single Supervisory Mechanism, and bank resolution schemes. It reaffirms that the ESAs remain committed to promoting supervisory convergence, inter alia, through a strong role in supervisory colleges and through the development of both the EU-wide Single Rulebook and Supervisory Handbooks.

III.2 EBA proposal for supervisors to conduct asset quality reviews; adjustment of the timeline for the EU-wide stress testing exercise

Instead of stress testing, the EBA recommends supervisors to conduct asset quality reviews in the second half of 2013. Accordingly, the EBA adjusted the timeline of the next EU-wide stress test so to conduct the exercise in 2014 once the asset quality review is completed. The EBA recommendations aim at contributing to a uniform approach in the methodology of the reviews through a set of good practices and to a consistent communication on the outcomes of national exercises. Meanwhile, a balance sheet assessment of the Single Supervisory Mechanism will be conducted under the aegis of the European Central Bank (including assets, capital, debts and provisions), aligned in methodologies and timeline with the balance sheet assessment. These reviews can serve as a point of reference for future stress tests. (The EBA took account of the proposals made by the EBF's Stress Testing Working Group and will forward them to the national authorities).

III.3 Final draft Regulatory Technical Standards (RTS) on own funds

Following the adoption of CRR/CRDIV, the EBA published its final draft Regulatory Technical Standards on own funds. These RTS, not yet adopted by the European Commission, were, uncommonly, issued in advance, to help banks prepare for implementation. The RTS include provisions regarding technical aspects in relation to Common Equity Tier 1, Additional Tier 1, deductions from Common Equity Tier 1 and from own funds in general, as well as transitional provisions on grandfathering. (In respect of write-downs, the standards provide for the cancellation of coupon payments during a write-down period).

III.4 Good practices for responsible mortgage lending and for the treatment of borrowers in mortgage payment difficulties

In June, the European Banking Authority published two Opinions on good practices for responsible mortgage lending and for the treatment of borrowers in mortgage payment difficulties. Both Opinions are addressed to competent authorities and aim at promoting common practices, with a view of enhancing consumer protection and contributing to the stability, integrity and effectiveness of the financial system. The Opinion on responsible mortgage lending addresses the following aspects:

- Verification of information provided by the mortgage applicant;
- Reasonable debt service coverage;
- Appropriate loan-to-value ratios; and
- Lending and supervisory processes.

The Opinion on the treatment of borrowers in mortgage payment difficulties sets out good practices on the following aspects:

- General principles;
- Policies and procedures;
- Provision of information and assistance to the borrower; and
- Resolution process.

The two Opinions complement, and provide suggestions on how to give effect to, the related provisions expected to be set out in the pending EU Directive on Credit Agreements Relating to Residential Property (Mortgage Credit Directive). In drafting the two Opinions, the EBA took into account the findings of a survey conducted by the EBA on national supervisory practices and the Principles for Sound Residential Mortgage Underwriting Practices identified by the Financial Stability Board (FSB).

III.5 EBA-ESMA joint principles for benchmark setting

In June, the EBA and ESMA published their final report on principles for benchmark setting processes in the EU. The principles are aligned with the global principles developed by IOSCO. Compared to the initial version, the final principles are now complemented with continuity and liquidity requirements. In addition to a general framework for benchmark

setting, the principles provide requirements for benchmark administrators, benchmark providers, benchmark calculation agents and benchmark users. ESMA and EBA plan to conduct a review of the application of the principles after eighteen months.

III.6 EBA consultations launched in the second quarter on issues related to prudential regulation

- Consultation on draft Regulatory Technical Standards (RTS) on the determination of the overall exposure to a client or group of connected clients in respect of transactions with underlying assets (CP/2013/07)
- Consultation on draft Regulatory Technical Standards on the assessment of recovery plans (CP/2013/08)
- Consultation on draft RTS specifying the range of scenarios to be used in recovery plans (CP/2013/09)
- Consultation on draft Implementing Technical Standards (ITS) on institution-specific prudential requirements (CP/2013/10)
- Consultation on draft Regulatory Technical Standards on criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile (CP/2013/11)
- Consultation on draft Regulatory and Implementing Technical Standards (RTS and ITS) on passport notifications aimed at specifying the information to be notified to the competent authorities (CP/2013/12 and 13)
- Consultation Paper on draft Regulatory Technical Standards on securitisation retention rules (CP/2013/14)
- Consultation on draft Regulatory Technical Standards on the definition of market (CP/2013/15)
- Consultation on draft Regulatory Technical Standards (RTS) on non-delta risk of options (CP/2013/16)
- Consultation on Regulatory Technical Standards on own funds – Part 3 (CP/2013/17)
- Consultation on draft Implementing Technical Standards on additional liquidity monitoring metrics (CP/2013/18)
- Consultation on draft Technical Regulatory Standards on additional liquidity outflows corresponding to collateral needs (CP/2013/19)
- Consultation on draft Guidelines on capital measures for foreign currency lending (CP/2013/20)

IV. European Banking Federation – International Banking Federation (IBFed)

In addition to lobbying on major legislative proposals (BRRD, banking union, structural reform of the banking sector) and participation in EBA consultations, the EBF's Banking Supervision Committee's activities in the second quarter included the following:

IV.1 Reporting requirements

Letter to the EBA on reporting timelines

The EBF welcomed that the European Banking Authority, in meeting the EBF's request made in January, published the revised COREP and FINREP reporting requirements in March. The geographical breakdown of assets and off-balance sheet items (domestic, non-domestic, and location of the customer) has been reinstated into the FINREP package (these were not included in the August 2012 version). The geographical breakdown of liabilities will also be subject to reporting. Since banks did not consider these items in their preparations for the new reporting requirements, reporting according to the FINREP templates from the first quarter of 2014 would pose them serious difficulties. January 1, 2015 would be a more appropriate date, although even that date would be a challenge for some banks. The letter also mentions that a breakdown of assets by location of the customer will be a problem in the case of forbearance and non-performing exposures (CP 2013/06).

Technical notes to the COREP and FINREP templates

Despite long preparations, the EBA's reporting packages have not proved appropriate, with a number of inconsistencies, technical errors, confusing mistakes and wrong references.

Additional letter to the EBA on ITS for reporting requirements

Following the promulgation of the CRR/CRDIV, the EBF wrote an additional letter to the EBA on issues related to the ITS for reporting requirements:

1. Geographical breakdown
   The various FINREP templates require a breakdown of assets, liabilities and off-balance sheet items by country, whereas these data of the customer are normally registered in the risk management systems, not in the accounting systems. The EBA should take this into account in setting the implementation date for the new reporting requirements. The COREP, FINREP as well as BIS statistics provide geographical breakdown requirements, however, each in a different way.
2. In some cases, a breakdown by instrument and the sector classification of the counterparty is required. Banks do not process these data in this way.
3. The value added by some new templates in the FINREP package is questionable.
4. The industry has not received appropriate information on the possible IT solutions.
5. The new reporting frameworks require the collection of data that are currently not maintained in banks' systems. Therefore, it is crucial that banks are allowed to leave legacy/current transactions out of the reports.

In its response, the EBA said that there would be more changes to the templates and it would also reconsider the reporting frequencies. The final ITS would contain explanations and reasons for the application of the various templates. The ITS would also contain transitional provisions to reduce banks' reporting burdens.

FINREP complementary reports

In relation to the complementary reporting requirements on restructured and non-performing exposures, the EBF stressed the importance of consistent global application and the need for expert consultations. The definition of these exposures should be consistent with the IFRS. A preparatory period of 18 months will be required for introducing reports.

In relation to the ITS for ***encumbered assets***, the EBF welcomed the proposal to develop a common European reporting framework. The EBF is of the view that the proposed templates are too complex and detailed, and hence, should be simplified. The levels of application (individual or group-level) should be aligned with those of the liquidity reports. The earliest introduction date of the reporting requirements could be January 1, 2015.

IV.2 Meeting with representatives from the ECB

At this meeting, representatives from the ECB presented the data to be reported through national central banks to the ECB from January 1, 2015. Due to the extensive reporting requirements under the Basel III package, the head of the EBF's Working Group on Reporting proposed that the ECB should postpone the introduction of its reporting requirements. The ECB said this was not possible, since these data were only those that are absolutely necessary for it to fulfil its duties. In relation to the ESRB proposal for exploiting the synergies between supervisory reports and Pillar 3 disclosure requirements, the EBF explained that the reason for banks' opposition to the standardisation of risk reports was the concern that, rather than trying to understand the actual contents of the supervisory data, investors would only look at how the risk data impact on the balance sheet.

IV.3 Letter on country-by-country reporting (CRR/CRDIV)

Pursuant to CRDIV Article 86 (a), banks should disclose annually the following information: name, nature of activities and geographical location, number of employees, profit or loss before tax, tax on profit or loss, public subsidies received. Here, the problem is that the EU Bank Accounting Directive does not have a line for “turnover”. The EBF wrote a letter to the EU Rapporteur on CRR/CRDIV to replace turnover with other data. Alternative data could be: interest receivable, net profit or loss on financial operations, or the total of net interest income, net fee income, net trading income and other income. The EBF also proposed that this disclosure requirement should only apply to those subsidiaries which are included in the consolidated financial statements of the group. The EBF also stressed that the principle of materiality should apply to any public disclosure requirement.
The EBF also suggested the consideration of an Implementation Guide to be issued by the SBA.

IV.4 EBF response to the consultation on the materiality of extensions and changes of internal approaches for the measurement of credit risk, operational risk and market risk.

Institutions are required to obtain supervisory approval for any material extension of or change in their internal approaches for the measurement of credit risk, operational risk and market risk. In its response to the relevant consultation, the EBF proposed the reduction of

the scope of changes requiring ex-ante supervisory approval, the simplification of the approval process, and a deadline (one month) for supervisory approval. The EBF also pointed out that qualitative assessment should continue to have greater priority than the quantitative criteria. The threshold for materiality should be related to the impact on the institutions' overall risk-weighted assets rather than to one risk category (credit risk, operational risk, market risk).

IV.5 Comments on the BCBS document on supervisory framework for measuring and controlling large exposures

In their joint comments, ***the IBFed and the IIF*** pointed out the industry's concerns that the proposed approaches for measuring exposures are not consistent with established sound risk management practices and not reflective of the worst case scenarios that the Large Exposures regime aims to capture. The main concerns included

- the required use of non-model standardised methods for calculating exposures,
- the risk-shifting approach to capturing credit risk mitigation (CRM),
- the economic interdependence criteria for connected counterparties, and
- the look-through approach (LTA) for funds and securitisation vehicles.

They also pointed out that the proposed approaches substantially overestimated the potential losses that would occur from a single large counterparty default.

In its response to the BCBS document, the ***EBF*** recommended applying the same exposure for the Large Exposure Regime (LER) as for Pillar 1 purposes everywhere, including for off-balance sheet items. The EBF is of the view that the Basel Committee's preference for simple methods of calculating exposures is not justified and would lead to a divergence between the capital and large exposure regimes. The EBF also emphasised its position that the free flow of capital and liquidity must be guaranteed within a banking group, since any restriction would have an adverse effect on the group's capital and liquidity management.