# REPORT

## on Activities of the Hungarian Banking Association

## 1st Quarter 2014

**Budapest, April 2014**

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# I. Executive summary

The gradual pick up of the global economy continued in the first quarter of 2014. Growth was felt in both Europe and the U.S. The favourable changes in the international economy were also reflected in Hungary's economic performance, the country's vulnerability decreased. The government continued to keep the budget deficit low in 2013. With an improving external equilibrium, external debt decreased somewhat. With good economic indicators, Hungary has a favourable growth outlook in the short-term. However, analysts agree that the rapid improvement in economic equilibrium might entail growth sacrifices in the medium-term, although taking into account economic actors' balance sheet adjustment, some analysts say that a 2.5-2.6 percent growth projected for this year might be sustainable in the long-term. Hungary's GDP grew at a better-than-expected rate of 1.2% in 2013. Inflation fell to an all-time low by the end of 2013 and remained at a low 0.1% in the first quarter of 2014, as well. The central bank continued its rate cutting cycle, reducing the base rate to 2.6% by March 2014.

The performance of and outlook for the banking sector did not improve, despite the relatively favourable macroeconomic conditions. While the sector's capitalisation is strong (with a capital adequacy ratio of 17.9%), its profitability continues to be low (in our estimate, the sector's loss exceeded HUF 100 billion in 2013). The sector continued to see a decreasing stock of loans and a deteriorating portfolio quality. The fiscal burdens imposed on the sector, unprecedented by international comparison, are not expected to be eased: the government, re-elected in April, has announced the continuation of the bank tax.

The MNB's Funding for Growth Scheme was only able to stop the decrease in corporate loans temporarily in Q3 2013, and that only in the case of HUF loans. The volume of new loans under the scheme is moderate for the time being. According to MNB statistics, the total value of new contracts concluded in Stage II of the scheme as of the end of February 2014 was HUF 50.2 billion. Borrowing under the scheme is expected to grow from the second half of 2014. The MNB has announced the improvement of the eligibility criteria from the middle of the year. In conclusion of the municipal debt consolidation, at the beginning of the year, the state, based on the 2014 Budget Act, assumed municipalities' and their micro-regional associations' debts to financial institutions outstanding as of December 31, 2013: debts of 509 municipalities were taken over by the state to a total value of HUF 456.1 billion.

In the case of municipalities where bankruptcy procedures were in process as of December 31, 2013, the debts will be consolidated within 60 days from the closure of the bankruptcy procedure, under a separate process.

A major development in retail lending in Q1 was the Constitutional Court ruling on the government's submission on FX loan contracts. In its ruling in March, the Constitutional Court pronounced that it has no jurisdiction to directly examine the compliance of contracts or contractual provisions with the Fundamental Law and to, based on this, annul the contract or contractual provision in question. It further said that for the state to amend the contents of a contract, the same conditions must be present as those required for a judicial amendment of the contract. A legislative amendment to the contract must take into account the interests of all parties and seek to strike a balance by taking into account the equitable interests of both parties.

One of the biggest challenges for the sector in 2014 will be the full application of the Civil Code taking effect on March 15. The new Civil Code prohibits the transfer of ownership, other right, or claim for the purpose of security for a pecuniary claim. This prohibition prevents banks from the well-proven practice of requiring the debtor to take out insurance on the real estate provided as collateral and to assign the potential indemnity to the bank, thereby ensuring that the indemnity is spent on the damaged real estate. As a solution, we drafted jointly with the Association of Hungarian Insurance Companies a standard lienee statement form, in which the insured notifies the insurance company of the fact that its creditor bank has a lien on the insurance claim.
A major issue in preparing for the application of the new Civil Code was the delay in the issue of the decree providing detailed rules for the collateral register. Due to this, we initiated the postponement of the entry into force of the Civil Code provisions prohibiting fiduciary collaterals in view of the fact that the institutional system for lien replacing them is inoperable due to the absence of a collateral register. Our effort failed and the collateral register has formally operated since March 15, 2014 with manual data receipt and processing.
The new Civil Code also raises issues in relation to day-to-day payments, for example, the use of payment account balances as security. We requested the competent Ministry to solve the related issues.

Another important task at the beginning of the year was the clarification of the regulatory details of the monthly two free cash withdrawals option, the creation of the operational conditions at banks and the drafting of the legislation on the customer statements register. In cooperation with BISZ, we started preparations for the creation of the register and its upload with data and initiated the regulatory amendments required for the operation of the register.

The MNB’s resolutions finding 35 credit institutions in breach of the regulations in respect of certain fee increases came unexpectedly for banks, since the sector gives special attention to compliance with the laws and supervisory expectations. Of the seven breaches listed in the MNB’s resolutions, the Association contested two on a general basis, since these contradicted previous rulings of the MNB. We wrote several letters to the competent Deputy Governor of the MNB regarding the fines and fee refunds to customers, requesting the suspension and amendment of the resolutions and amendment of the deadline for refunds.

In global regulation, a major task for 2014 is the completion of the regulatory reform, which has four main elements: building resilience of financial institutions, ending too-big-to-fail, transforming shadow banking to transparent and resilient market-based financing and making derivatives markets safer. In January, as a final step of the Basel III package, the Basel Committee published its revised documents on leverage ratio and liquidity.

Partly due to the approaching European parliamentary elections, European legislation was in full gear and a number of long-discussed directives and regulations were adopted in Q1. To only mention the most important ones: agreements were reached on the Bank Recovery and Resolution Directive, the Single Resolution Mechanism, the Deposit Guarantee Scheme Directive, the Payment Accounts Directive and the Regulation on European Account Preservation Order. The European Central Bank continued preparations for the Single Supervisory Mechanism and the European Banking Authority worked on regulatory and implementing technical standards, which will be part of the Single European Rulebook.

## II. Macroeconomic outlook, operating environment

The gradual pick up of the global economy seen in the second half of 2013 continued in the first quarter of 2014. Although jerkily, the European and U.S. economies started to gain speed, even though some unexpected data caused some turmoil every now and then. The Fed continued to cut back on its liquidity support. Based on the current developments, it may fully stop its bond purchases by the second half of the year, although it will certainly keep its interest rates at the current record-low level until the second half of 2015. The slow growth of the emerging economies (in particular, of the Chinese economy) and the escalation of geopolitical conflicts (in particular, Ukraine and the Middle East) were the biggest threats in the first quarter.

**Hungary's** performance continued to improve in terms of vulnerability indices in the first quarter of 2014. Although due to the election year, expenditures grew, this did not jeopardise the objective of keeping the budget deficit low. External equilibrium continued to be good, resulting in the further drop of external debt. With good economic indicators, Hungary has a favourable growth outlook in the short-term. However, analysts agree that the rapid improvement in economic equilibrium might entail growth sacrifices in the medium-term, although taking into account economic actors' balance sheet adjustment, some analysts say that a 2.5-2.6 percent growth projected for this year might be sustainable in the long-term.

The Hungarian economy saw a surprising growth in the second half of 2013. It grew by 2.7 percent in Q4 year on year, resulting in a **GDP** growth of 1.2% on an annual basis in 2013. With growing external demand and increased government spending, this favourable trend continued in the first quarter of 2014. The good macroeconomic data were primarily attributable to the good performance of the car and construction industries (the latter starting from a low base). Consumption also grew in 2013, with increasing exports and a rise in domestic demand and in investments. As a negative factor though, while exports were significantly high, domestic industrial sales fell somewhat in the first two months of 2014. The **current account** balance, showing a surplus since 2009, was nearly 3% of GDP in 2013.

After several years of decline, the investment volume index grew by 7.2% in Hungary in 2013. According to data of the Central Statistical Office, this outstanding growth rate was characteristic of most sectors of the economy and primarily came from investments in machinery and equipment (+8.5%), construction (+5.9%), manufacturing (+4.9%) and transport and storage (+15.6%). A decline was recorded in real estate transactions and financial and insurance activities (-11.4% and -3.6%, respectively).
Due to one-time effects (primarily, the government's utility cost cutting measures), **inflation** dropped to all-time low by the end of 2013 and remained at a low 0.1% in the first quarter of 2014. The **unemployment rate** fell from 10.7% in 2012 to 8.3% in Q1 2014.

Good inflation data encouraged the MNB to continue its rate-cutting cycle, reducing the base rate to 2.6% by March 2014. However, there is not much space for any further rate cuts, if the MNB wants to continue to maintain positive real interest rates. According to analysts, the base rate will hit the bottom in the band between 2.25 and 2.5 percent. In the wake of the decreasing base rate, the HUF interbank benchmark rates and banks' HUF deposit and lending rates decreased further. International financial market developments (in particular, the devaluation of emerging market currencies) and the continuous interest rate cuts did not leave the exchange rate of the forint untouched, which fell by 3%, from the below HUF 300/EUR levels at year-end to HUF 310/EUR as of the end of Q1.

The **banking sector** continued to be characterised by a duality. Banks' capitalisation is strong, with a capital adequacy ratio of 17.9%. Liquidity at the sector level is good, although with large differences at the individual banks' level. The stock of loans continues to exceed that of deposits. The banking system is able to meet the account and cash turnover needs, that is, it is capable of fulfilling its fundamental short-term economic functions. At the same time, the bad portfolio quality and the continuing low profitability due to government measures, the low creditworthy loan demand and the constant regulatory stress hinders banks in fulfilling their role of stimulating real economic growth.

Deleveraging continued. In addition to the reduction of forex assets, the flow of loans into more liquid assets continued, as well. The stock of **corporate loans** (both HUF and foreign currency) kept falling in the first half of the year. The stock of HUF loans saw a one-time rise in the first quarter of 2013, as a result of the MNB's Funding for Growth Scheme, then fell in the fourth quarter, however, rising overall on an annual basis. The volume of foreign currency loans decreased significantly. The total stock of corporate loans fell by 3.3%. The share of SME loans in total corporate loans rose substantially, from 43% to 57%. The stock of **retail loans** declined throughout 2013. The proportion of **past due loans** was 23.2% in 2012 and 23.4% in 2013, in other words, the deterioration of the portfolio quality, although at a slower pace, continued in 2013.

## III. Corporate lending

The total stock of corporate loans fell by 3.3% in 2013. Overdrafts continued to make up an increasingly important part of SME loans last year, with businesses borrowing to meet their daily expenses. Investment loans had a minimal share in corporate lending in 2013.
The volume of new loans under the Funding for Growth Scheme was moderate as of the end of 2013. It is expected to grow from the second quarter of 2014.
As a positive development, the MNB's rate-cutting cycle is increasingly reflected in the pricing of corporate loans: the average interest rate on loans with a minimum maturity of five years fell to 4.9% by February 2014. The interest rates for euro-denominated loans remained unchanged and so did the premiums. Another positive development is that the ratio of non-performing corporate loans decreased from 17.3% in Q3 to 16.4% at the end of 2013.

### *Funding for Growth Scheme Stage II*

With the success of Stage I of the Scheme, on September 11, 2013 the Monetary Council decided to continue the programme. Stage II of the Scheme lasts from October 1, 2013 to the end of 2014. The allocation for Stage II is HUF 500 billion, which may be increased by the Monetary Council up to HUF 2,000 billion. In Stage II, the MNB continues to make available refinancing with zero percent interest and a maximum maturity of 10 years. Financing banks can relend the central bank funds to SMEs in the form of loan or financial leasing facilities at a maximum interest margin of 2.5%. Banks can also use the facility to refinance financial enterprises.
90% of the total scheme allocation is for new loans under Pillar I, 10% is for replacement loans under Pillar II. As opposed to Stage I, allocations under Stage II are awarded on a first-come-first-served basis. The combined lower limit for SME loans (the total amount of loans taken in Stage I and Stage II) is HUF 3 million, the upper limit is HUF 10 million.
To achieve the goals under the first pillar of the scheme, the scope of use of SME loans has been reduced: in the case of investment loans, only projects closely related to the applicant's business activities can be financed under the scheme and the maturity for working capital

loans has been reduced to one year. The second pillar of the scheme is aimed to reduce foreign currency-based loans in the SME loan portfolio and to mitigate businesses' financing costs related to HUF loans or financial leasing aimed to prefinance EU grants. Under the third pillar of the scheme, the MNB introduced FX swap and currency interest rate swap (CIRS) tenders with eight different maturities to add new euro liquidity.
The total value of contracts concluded in Stage II as of the end of February was more than HUF 50.2 billion, with 98% of the loans taken under Pillar I. In new loans, 55% were investment loans, 39% working capital loans and 6% EU grant prefinancing loans. The average maturity for new investment loans was nearly 7 years, that for new working capital loans 11 months and that for EU grant prefinancing loans 1.3 years. In the case of new investment loans, the average maturity was a year shorter than in Stage I.

The MNB announced the following changes to be expected from mid-2014: the maximum maturity for working capital loans will be increased from one year to three years, the product range will be widened (factoring, commercial property refinancing) and the final drawdown date for investment loans will be extended by a year.

***Municipal lending***

The government recast the laws regulating the day-to-day operations of municipalities and the provisions required for the performance of their tasks. In addition, the framework for their financing was also changed. As a major step, the government sought to consolidate those debts required by municipalities to ensure their day-to-day operations and the implementation of development projects previously not funded by the state. To achieve this, the state provided a one-time non-refundable aid to county municipalities to a total value of HUF 189 billion in 2011. This was followed by the consolidation of municipalities with less than 5,000 inhabitants, affecting 1,720 municipalities and 10 micro-regional associations of municipalities, to a total value of HUF 85 billion. In mid-2013, the government partly assumed (at a rate of 40 to 70 percent) the debts of municipalities with more than 5,000 inhabitants. This consolidation affected 279 municipalities to a total value of HUF 614.4 billion.

In continuation of the programme, under Act CCXXX of 2013 on the 2014 Central Budget, the government assumes municipalities' and their micro-regional associations' debts to financial institutions outstanding as of December 31, 2013, arising from loans, debt securities, drafts, financial leasing or a minimum 365-day deferred payment or instalment payment terms granted by contract, as specified in Section 3 (1) a)-d) and f) of Act CXCIV of 2011 on Hungary's Economic Stability.

The consolidation extends to the full debt (capital, delinquent capital) outstanding as at December 31, 2013 and the related charges (interest, late interest, commitment fee, handling fee) as at February 28, 2014. Pursuant to the 2014 Budget Act, the state may carry out the assumption of certain debt elements by granting a one-time support for minor debts not exceeding HUF 200 million, or CHF 815,000, or EUR 660,000. In this way, the technique for the assumption of minor loan debts can be simplified. This year, the state assumed the debts of 509 municipalities to a total value of HUF 456.07 billion. The debt consolidation affected 281 municipalities with more than 5,000 inhabitants, 214 municipalities with less than 5,000 inhabitants and 14 micro-regional associations of municipalities. Municipalities with less than 5,000 inhabitants were relieved of HUF 6.5 billion of debt, those with more than 5,000

inhabitants were freed of HUF 447.3 billion of debt. Micro-regional associations of municipalities were consolidated to a total value of HUF 2.2 billion.

In the case of municipalities where bankruptcy procedures were in process as of December 31, 2013, the debts will be consolidated within 60 days from the closure of the bankruptcy procedure, under a separate process.

The Association was actively involved in the review of legislation related to the debt consolidation process, providing proposals to improve the legislation. Banks, by making special efforts, duly met their, fairly tight, statutory data provision obligation in all phases of the debt consolidation process.

## IV. Retail lending

### *Constitutional Court ruling on the interpretation of the Fundamental Law in relation to foreign currency-based loan contracts*

In its motion of November 28, 2013, the government asked the Constitutional Court to interpret the Fundamental Law in two questions. First: "*whether or not it can be derived from Paragraph (2) of Article M) of the Fundamental Law that a contractual provision applied en masse in a manner causing consumers a unilateral and material disadvantage, in particular, by assigning the exchange rate risk solely to the customer and giving the creditor a relatively free and wide discretion to raise the interest rates, and the contractual provision on the application of a spread and the relevant court decision confirming it, and the statutory provision serving as a ground for such provision and court decision are contrary to the Fundamental Law*.

Second: the government asked the Constitutional Court to interpret "*Article II and Paragraph (1) of Article B) of the Fundamental Law in terms of under what constitutional conditions other than those provided by the Constitution may existing contracts be amended by law*."

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

In its ruling No. X/1769/2013, published in March, the Constitutional Court ruled as follows:
Paragraph (2) of Article M) of the Fundamental Law provides for the obligation of the state to ensure fair competition and, with a view to consumer protection, to develop and maintain legislation that protects consumer interests, creates an institutional system to act against excessive market power and protects consumers' rights**. Failure to meet the legislative, institution management and law applier's obligations provided by the Fundamental Law may ultimately serve as a ground for the Constitutional Court to establish the breach of the Fundamental Law on the ground of the state's failure to fulfil its obligations. However, Paragraph (2) of Article M) of the Fundamental Law does not provide for a constitutional ground to establish the illegality of court decisions.**
**The Constitutional Court has no jurisdiction to directly examine the compliance of contracts or contractual provisions with the Fundamental Law** and to, based on this, annul the contract or contractual provision in question**.**
The ruling concerning the second question relates to the question of **under what constitutional conditions other than those provided by the Constitution may existing contracts be amended by law**. Pursuant to the operative part of the ruling, legislation may,

exceptionally, based on the clausula rebus sic stantibus principle, amend the contents of a contract entered into before the effective date of such legislation. For the state to amend the contents of a contract, **the same conditions must be present as those required for a judicial amendment of the contract**.
The Constitutional Court has ruled several times on the question of how contracts can be amended by legislation. The first important ruling was Constitutional Court Resolution No. 32/1991 (VI 6) on home loans with preferential interest rates. In this, the Constitutional Court declared that the following conditions should be collectively present:

- in the case of a long-term legal relationship,
- a material change in the circumstances has occurred after signing the contract,
- the contract is detrimental to any of the parties' material interests,
- the change in the circumstances was not foreseeable and goes beyond the risk of a normal change, and
- the change in the circumstances must be of a societal scale and must affect a large number of contracts.

**A legislative amendment to the contract must take into account the interests of all parties and seek to strike a balance under the changed circumstances.**

***Asset insurance related to home loans, drafting of a standard lienee statement (Cooperation with the Association of Hungarian Insurance companies)***

The new Civil Code taking effect on March 15, 2014 prohibits **the transfer of ownership, other right, or claim for the purpose of security for a pecuniary claim**. This prohibition prevents banks from the well-proven practice of requiring the debtor/lienee to take out insurance on the real estate provided as collateral and to assign the potential indemnity to the bank, thereby ensuring that the indemnity is spent on the damaged real estate. This is an important goal for both creditors and debtors and we will need to find some other tool to achieve this goal. Since the new Civil Code considers lien as the ultimate universal collateral, the solution is to be found in the lien laws. Since pursuant to both the old and the new Civil Code, the value replacing the pledge replaces the pledge, the lien on the insurance claim is the collateral in this case. Of course, the insurance company should also be informed of any lien established on the insurance claim. For this purpose, we drafted jointly with the Association of Hungarian Insurance Companies a form to be used after the new Civil Code enters into force. In this, the insured party notifies the insurance company of the fact that its creditor bank has a lien on the insurance claim.

## V. Other major regulatory developments affecting banks

***Issues related to new laws related to the new Civil Code***

We reviewed a number of laws related to the entry into force of the new Civil Code. The most important of these were as follows:

- Ministry of Administration and Justice draft decree on detailed rules for the collateral register,
- Government draft decree on certain rules for fiduciaries,
- Government decrees implementing the new Civil Code (list of liquidators, government decrees on certain issues related to the share book, out-of-court enforcement of lien,

pawn office activities, rate of commission for long-term intermediation under intermediation contracts, new land use rights, Act on Judicial Foreclosures).
- Ministry of Administration and Ministry for National Economy draft decrees related to the entry into force of the new Civil Code,
- Draft amendment to the decree on electronic company registration and company registry.

We provided several comments on the proposed detailed rules for the collateral register and held discussions with the drafters of the legislation. Previously, we initiated that the entry into force of the Civil Code provisions prohibiting fiduciary collaterals is postponed in view of the fact that the institutional system for lien replacing them is inoperable due to the absence of a collateral register. In March, a few days before the entry into force of the Decree, we had a discussion with the responsible head of department of the Ministry of Administration and Justice, who informed us that the decree will be phased in gradually in several steps, allowing time for the development of the collateral register. During the transitional period, the collateral statements will be free of charge. The biggest problem was that the decree providing detailed rules for the operation of the collateral register was published right before the entry into force of the new Civil Code, not allowing sufficient time for the development and implementation of the system. The adverse economic consequences are not foreseeable at this point.

We requested several rulings from the responsible Ministry regarding the interpretation of the new regulation. The main issue included the following:
- Act CCLII of 2013 amending certain acts in relation to the entry into force of the new Civil Code amended the Bankruptcy Act in a way that, in our opinion, due to a technical error, is inconsistent with the lien regulations in the Civil Code and seriously disadvantages lien holding creditors in the lien priority. We requested the Ministry to correct the legislation.
- We requested the interpretation of the prohibition of fiduciary collaterals in terms of scope and asked for a ruling on how the changes in the rules for vehicle registration will affect liens established on vehicles. We proposed to facilitate inquiries by the subject of the lien in the collateral register. We also proposed that the designation of the creditor as the beneficiary in life insurance contracts should not be considered as a fiduciary transaction.

The new Civil Code affects day-to-day payments. The Association's Payments Working Group addressed two key recurrent issues:
- What should the bank do if it does not want to apply two different laws to the same payment services contract? New contracts related to framework contracts existing before the entry into force of the new Civil Code (for example, a new overdraft agreement related to a payment account contract concluded in 2013) are governed by the old Civil Code, while an overdraft agreement related to a framework contract concluded after March 15, 2014 is governed by the new Civil Code. Although the parties may agree to apply the new Civil Code to their old contracts, a bank obviously cannot start individual negotiations with thousands of customers, while a unilateral contract amendment is not possible.
- The use of payment account balances as security is common banking practice. This is now made impossible by the new Civil Code regulation on savings deposits. Under the new Civil Code, security is considered as a type of lien, no lien can be established on

savings deposits, and payment accounts are subject to the same rules as those applicable to savings deposits.

While in the case of the first question, a solution based on the interpretation of the law is possible, the second issue can only be solved by amending the legislation. The Association submitted a proposal for a regulatory amendment accordingly.

***Regulatory changes affecting co-operative credit institutions***

In 2013, Parliament enacted a legislation reregulating co-operative credit institutions and creating a mandatory integration of co-operative credit institutions. This has hurt interests, but the legitimacy of the purpose, namely, to institutionally ensure the long-term prudent operation and the required regulatory capital of co-operative credit institutions with a view to financial stability is indisputable.

Since even with the new regulation it cannot be ruled out that – as has happened several times before – a major part of the loss caused by the bankruptcy of a savings co-operative is directly borne by banks through the National Deposit Insurance Fund, we initiated regulatory amendments and other measures with the Ministry for National Economy and the MNB. We requested that the National Deposit Insurance Fund should be split in two and each of the two credit institution sectors should bear its own risk related to deposits becoming unavailable. We also requested a compensation for previously sustained losses through a Resolution Fund to be set up. The MNB did not support our proposals, the Ministry for National Economy has not responded yet.

## VI. Developments related to the supervisory authority

***MNB answer to our questions related to banks' liquidity***

In the last quarter of 2013, we collected banks' comments in two rounds regarding the interpretation of the various provisions of the CRR and sent them to the MNB Liquidity Working Group.

The MNB Liquidity Working Group sent us its position on the various interpretation issues in the second half of February 2014. The Working Group pointed out that the final regulation making the general requirements more specific is to be adopted by the European Commission by June 30, 2014, therefore, national-level requirements can only be specified after that date.

***BUBOR: debate between the MNB and the Hungarian Forex Association over the responsibility of delegates – MNB initiative for the renegotiation of the financing of the rate-setting work at a later date***

To implement the reform of benchmark rates (BUBOR, BIRS, HUFONIA), set under the sponsorship of the Hungarian Forex Association, negotiations on a cooperation agreement were launched between the Hungarian Forex Association, the Hungarian Banking Association and the authorities involved. The draft agreement was almost completed by October 2013, but two issues required further negotiations.

After the merger of the supervisory function into the MNB, the previous supervisory proposal for the composition of the Hungarian Forex Association's Rate-Setting Committee, namely, for the supervisor to delegate to the Committee an independent expert (not belonging to either of the affected institutions) and the proposed responsibility rules for this expert came under

debate. As a solution, the Hungarian Forex Association and the MNB proposed that the MNB should appoint two of its staff members to the Committee, that is, there will be no independent public member on the Committee. On behalf of the Association, we had no objection to this proposal. The MNB also wanted to open up a discussion on sharing the financing of the rate-setting process: it wanted to include a provision in the draft agreement to provide for the renegotiation of this issue at a later date. According to the relevant principle decision of the Association's Board, apart from participating in the Committee, the Association will not provide any financial contribution to the management of the rate-setting process. At our request, the final text of the draft agreement clarifies that the Association will not be affected by any future negotiations on cost sharing, such negotiations will only be between the Hungarian Forex Association and the MNB.
The draft of the cooperation agreement was finalised by expert teams of the parties, approvals by the parties' leading bodies are in process.

***Banks fined for fee increases– Letters to the competent Deputy Governor of MNB***

On March 13, 2014, the MNB found 35 credit institutions in breach of the regulations in respect of certain fee increases. All 35 financial institutions must pay a fine and 33 of them must also refund the relevant fees to their customers by the end of April. The central bank announced the fines at a press conference before the affected banks have received the relevant resolutions. The MNB said that in determining the fines it had taken into account the effect of the infringement on consumers, its frequency, the number of illegal fees and transactions and the range of customers affected.
This en masse penalty came unexpectedly for banks, since the sector gives special attention to compliance with the laws and supervisory expectations. Of the seven breaches listed in the MNB's resolutions, the Association contested two on a general basis, since these contradicted previous rulings of the MNB. In our interpretation, the infringements mentioned under points 6 and 7 of the statements published by the MNB ("*previously free, 0 forint transactions were made payable*, *which also means the introduction of a new fee*" and ***"****changed the method of fee calculation****"***) are unjustified. We wrote several letters to the competent Deputy Governor of the MNB, requesting the suspension of the resolutions and amendment of the deadline for refunds.

***MNB decree on rules for gradual application of the CRR***

In April, the MNB Governor issued a Decree on capital requirements, unrealised profit and loss valuated at fair value, related deductions and acquired rights related to capital instruments. The decree provides for the gradual application of certain provisions of the CRR (in most cases by using the alleviations offered by the CRR), thus allowing banks more time to adapt. The MNB consulted with the Association on the proposed decree and took several of our comments into account.

***Reporting***

The implementation of the new EU capital requirements framework is a major challenge for the European banking community, including for banks in Hungary. Implementation is hindered by the fact that the drafting of the related regulatory and implementing technical standards has come to a standstill. It is unknown at this point what changes are yet to be expected, therefore, it is uncertain whether the implementation process, requiring major IT development projects, can be completed by the set deadline.

The Hungarian supervisory authority has set the deadlines for the new reports in accordance with the relevant EU regulations. At the same time, in February, the MNB, under an extremely short notice, imposed an extraordinary reporting requirement on several banks, based on the EU Capital Requirements Directive taking effect on January 1, 2014, with a set of national templates (CAX templates). We challenged the conditions and the deadline for this reporting requirement and requested that the MNB take into account the regulatory circumstances affecting EU-level reporting and the related preparations, since several of our members have difficulties in meeting the reporting requirement due to the many uncertain circumstances. We also requested the MNB to publish those requirements where the decision is a national discretion and to amend the deadlines by taking into account the EU deadlines. In its response, the MNB said that although it cannot offer a general solution for all banks to meet the reporting requirement provided by its relevant resolution, individual banks may approach it with an appropriate application, giving the reasons for the request, and the MNB will decide on each application based on the reasons presented.

We also approached the MNB in connection with another extraordinary reporting requirement in Q1: given the extremely short time allowed for preparations, we requested the extension of the reporting deadline for 2013 Financial Transaction Levy payment reports. (The 2013 reports require substantially more data than those specified in 2013 for these reports). We cited that the areas involved were busy with last year closes during that period, the methodology for data collection was ambiguous and IT developments were also necessary. In view of all this, the MNB extended the reporting deadline by one month.

## VII. Payments

### *Developments related to bank cards*

*Monthly two free cash withdrawals: drafting of legislation on customer statements register*

Pursuant to an amendment to the Act on Payments, consumers may apply for the monthly two free cash withdrawals option, not to exceed HUF 150,000 in total, by providing a statement. The option is available in respect of one account only. To check that a consumer only exercises this right at one bank, the law provides for the establishment of a central register. The central customer statements register will be operated by BISZ Zrt. The testing of the system will start in September and the system will go live in December. An important change in the application process is the following: currently, if there are several statements from a customer, the earlier statement is governing. From December, a new statement will override the old one, that is, the customer will not have to withdraw the previous statement, since it will be automatically cancelled upon submission of the new statement.

In cooperation with BISZ, we began the preparations for setting up and uploading the new system and initiated regulatory amendments needed for the operation of the system.

As for the monthly two free cash withdrawals, now defined as a consumer right, we managed to clarify the issue of limits and ATM settings. Namely, on the one hand, these limit serve the interests of card holders by limiting the withdrawal amount in the case of unauthorised withdrawals, while on the other hand, undoubtedly, they may prevent the customer from

exercising the HUF 150,000 cash withdrawal option. After entry into force of the legislative amendment providing for the monthly two free cash withdrawals option, banks in each case have set their limits in a way that ensures that the customers can avail of the HUF 150,000 cash withdrawal option, unless otherwise requested by the customer.

*Regulated IC fees*

Under an amendment to the Payment Services Act (Act LXXXV of 2009), the regulation of interchange fees for domestic bank card transactions took effect on January 1, 2014. This caps the interbank interchange fees for debit and credit cards at 0.2 and 0.3 percent, respectively. This regulation is unprecedented in Europe in terms of both extent and introduction date, since the European Parliament has not adopted the relevant Directive (envisaging similar rates) as yet and proposes an implementation period of at least one year.
The subjects of the Hungarian regulation (the Payment Services Act) are payment service providers, but it is the card associations, doing the settlements, that can technically implement the application of IC fees. Accordingly, the Association approached the two major card associations, to ascertain the implementation and application of the provisions of the legislation. Also, based on the decision of the Cards Working Group, we requested a ruling from the Ministry for National Economy on the IC fees for prepaid bank cards, not separately specified in the legislation. (According to MNB statistics, there were 4,033 prepaid cards in use in Hungary as of the end of 2012).

***Consultations on proposed amendments to the MNB decree on banknotes***

The MNB indicated its intention to revise its decrees regulating cash circulation. The planned changes were reviewed at a consultation with the MNB and subsequently within the Association's Cash Working Group. The objective of further increasing automatic processing is supported by banks. However, we expressed our concerns over the excessive administrative tasks related to the maintenance of cash processing machines deployed at banks and the dependence on the machine suppliers. We took note of the obligation for banks to exchange the banknotes withdrawn from circulation for valid ones of the same denomination. However, banks cannot be expected to accept deposits made with withdrawn banknotes or to exchange denominations free of charge (these transactions are normally subject to a fee). The most concerns were related to the planned regulation on disaster recovery plans:

- The emergency measures for branch tills cannot be dissociated from the disaster recovery plans (which have already had to be submitted to the Supervisory Authority).
- The emergency measures for a potential breakdown of the CIT company's services also raise interpretation questions. In case of a breakdown of the CIT company's services, the bank branch would not have enough cash for the branch staff to fill up the ATM. If in this case the central bank arranged for the supply of cash, banks' tills would be able to serve all customers (including those of other banks through the POS terminals).

The public consultation on the proposed decrees is in process, we are going to submit written comments on the proposals.

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

The Board issued its Recommendation No. 1/2012 on retail basic payment accounts in 2012, in line with the relevant EU Recommendation. Due to regulatory and other changes, the Recommendation had to be revised, in particular with regard to the law capping of the fees for BPAs. It was also timely to review the services related to BPAs, since the legislation authorising monthly two free cash withdrawals, including from ATMs owned by other banks, has made the provision of monthly one free cash withdrawal from the bank's own ATM or branch pointless. Accordingly, instead of the previous 1%, we set the maximum fee for a BPA at 1.1% of the annualised minimum wage at all times (or exceptionally, in the case of preferential fees for frequent use of the account, at 1.5%). This fee increase is only theoretical, since with fee discounts subject to certain conditions that can be easily met, the actual fees payable is in fact much lower.

Based on data from member banks, 60,400 basic payment accounts were opened in 2013, including 1,600 by non-Hungarian EU citizens, considerably more than in 2012. (In 2012, there were 21,520 BPAs opened, including 660 by non-Hungarian EU citizens.)

Under the simplified bank account switching procedure introduced under the Association's self-regulation (Recommendation No. 6/2009), 4,300 costumers initiated switching in 2013, out of which 2,700 cases were successfully completed, roughly the same number as last year.

***SEPA[1] developments***

The Association's SEPA Committee and its working groups (provided with strengthened mandates) commenced operations in January 2014.

*The SEPA Payment Schemes Working Group*

- addressed issues related to the issue and registration of the Creditor Identifier (CI) under the SEPA Direct Debit (SDD) Scheme. The SEPA Direct Debit Scheme can also be used by domestic businesses as creditors. For this purpose, they need a Creditor Identifier (CI). The issue of CIs is not a precondition for adherence to the SDD Scheme and they can be determined and provided by any payment service provider. In Hungary, CIs are based on the multiple collections system. The CI is determined by the bank managing the business's account and reported by the bank to GIRO. GIRO registers and publishes the CI;
- developed, by working together with the Payments Working Group, an answer to the EPC's questionnaire on recall under the SEPA Credit Transfer Scheme in the case of fraud;
- made preparations for the creation of an IBAN Only Register. (The objective is that after 2016 it should suffice for the payer to provide the beneficiary's IBAN without giving the BIC, which would be automatically assigned from the proposed register.)

The *XML Account Statements Working group,* provided with strengthened mandates and a widened range of members, started the last phase of the design of XML account statements and the preparation of the publishable version.

The SEPA National Adherence Support Organisation (*NASO)* also commenced operations. In the recent period, we received inquiries and information requests from several key market players on the SEPA adherence process in general and specifically, on the process for adherence to the SEPA Credit Transfer Scheme, due in 2014. We answered all inquiries by providing the inquirers with information on the relevant procedural and documentation requirements.

[1] Single Euro Payment Area

*Continuous Linked Settlement (CLS)*

At the request of the MNB, the Association is actively involved in the *CLS programme*, planned to be concluded in April 2015. This programme is aimed to connect the *forint* as a foreign exchange currency to the Continuous Linked Settlement System operated by CLS Bank, to eliminate Hungarian Banks' foreign exchange settlement risks. The CLS system manages FX transactions in 17 currencies, based on the *payment-versus-payment* (PvP) principle. Concurrently with the forint, other currencies such as the Russian rouble and the Chinese remnimbi will also join to the system. The system settles the transactions finally and irrevocably. To achieve this, CLS Bank opens accounts in the real-time gross settlement systems of the central banks issuing the currencies involved and in turn, central banks have multi-currency accounts with CLS Bank. FX transactions submitted for a given day are settled by multilateral netting.
In preparation for joining the system, we participated in the organisation of two forums in the first quarter and a workshop in April, providing a regular information channel and mobilising treasury and back office managers and officers at our member banks.

## VIII. Taxation, accounting

*Taxation issues*

From 2014, Long-Term Investment Accounts (TBSZ) as specified in Section 67/B of the Act on Personal Income Tax (Act CXVII of 1995) can be transferred between credit institutions and investment firms without interruption.
At the beginning of the year, we held several consultations with banks' tax and business specialists on issues related to the **transfer of Long-Term Investment Accounts.** Specialists from the Association of Securities Dealers were also involved in the consultations. During the consultations, a Transfer Form containing essential information for tax purposes was drafted, as an alternative solution to eliminate taxation risks arising from uncertainties due to missing data during the transfer of the accounts. In addition, we requested a ruling from the Ministry for National Economy regarding the responsibilities and tasks of the parties involved (the transferor, the recipient and the customer) and a number of accounting technical issues.

Another key task was related to the procedure related to **employer's repayment support,** in particular, the role of banks in the process. Under the Act on Personal Income Tax**,** from 2014 employers may grant their employees a loan repayment support exempt from tax. Due to the many details and the complexity of the related procedural rules, this support is regulated by an Economic Ministry Decree. We conducted several consultations on the contents of the Decree with tax and business specialists from member banks as well as with the responsible officer at the Ministry. Taking into account the different loan administration systems of banks, it was important to find a solution that involves the least possible costs and administration for banks and to ensure that the tasks and responsibilities are clearly defined for each of the three parties involved (the employer, the employee and the banks).
The Economy Ministry Decree was published in early April and it may also be applied to all repayments made since the beginning of the year.

In addition to the above, we requested rulings from the Ministry regarding the record and documentation requirements related to the determination of **arm's length price** to be applied

between the bank and its financial leasing subsidiary in the context of the MNB Funding for Growth Scheme.

***Accounting issues***

In 2013, the Ministry for National Economy launched negotiations on its proposal for requiring certain companies to prepare their solo reports exclusively according to the IFRS. Representatives from the affected institutions and professional associations held a meeting on the issue in early March 2014. The MNB had not said anything previously on its plans regarding the IFRS transition of the most affected sector, the financial sector. At the meeting, the representative from the MNB informed participants that according to its plans, banks should switch to IFRS at the solo level from January 1, 2017. The MNB does not support the optional use of IFRS before that date (previously, the Association had presented a proposal for the optional use of IFRS based on a survey among members). The MNB does not rule out that when IFRS is introduced on a mandatory basis for the entire financial sector in 2017, individual banks may be granted an exemption in certain cases and on a case-by-case basis. Representatives from the banking sector indicated that there would be no point in an optional use before 2017, if, due to supervisory regulations, they would continue to have to file their national-level reports according to Hungarian accounting standards.
The MNB's representative said that there is no final schedule or decision on the government's side. He said that consultations are in process and more discussions will be needed in order to reach a compromise solution acceptable for all those affected. The decision on the introduction of IFRS is expected to be published in the second half of 2014, probably in the form of a Government Resolution. Until then, consultations will resume at the level of working groups: the *Related Areas Working Group* will assess ways to align the related areas and regulations and the *Training Working Group* will address the issues and possible solutions for IFRS specialist training.

## IX. Bank Security

***Explosion at a bank branch***

Around a quarter past four in the morning on January 13, 2014, a motorcyclist placed a bomb outside CIB Bank's 13th district branch at Lehel út 70-72. The device went off a few minutes later, making the branch inoperable. The explosion also damaged two nearby bank branches (Budapest Bank and FHB). Two other bank branches were also affected, but without any major damages. Fortunately, there were no personal injuries, no static damages in the building, and no significant damages in the surrounding residential buildings and indoor parking lot.
The Human and Physical Security Working Group, complemented with representatives from the Police met on the day of the incident to review the circumstances and the protective measures to be taken. The perpetrator has not been found to date.

***New FX debtor demonstrations slowing customer service***

Citing its letter sent to the Association in February, the GYŐZ (Win) movement, linked to VÉSZ (Interest Representation Organisation of Enterprises), timing its action to immediately after the elections, announced through the media a new type of demonstration, slowing customer service. Demonstrators appear at bank branches and, pretending to manage their

banking affairs, keep asking questions from the bank clerks, thus trying to paralyse the operation of the branch.

## X. Association developments

***Standardising banking training – Questionnaire on organised training courses and qualifications accepted by banks***

The Association's Education and Training Working Group was set up in 2013. A key task for the working group is to formulate and set up standard training requirements that can serve as a basis for the basic training of branch employees and new recruits. To achieve this, in February 2014 a questionnaire was developed under the sponsorship of Budapest Bank to assess current practices and expectations regarding standardisation. The questionnaire was answered by a great number of members by mid-March. The evaluation of the answers is done by the International Training Centre for Bankers, which will present a report to the Working Group at its meeting in April. At this meeting, a decision is expected to be made regarding the subjects to be standardised and the principles for and main directions of standardisation.

***Communications***

The Association received intense attention from the media in the first quarter of 2014. We had appearances in the online media in 414 instances, followed by the print media, in 300 instances and the electronic media, in 170 instances. In total, we had 880 appearances and mentions in the Hungarian media in Q1. Public and media attention was focused on the following:

- Tasks related to the monthly two free cash withdrawals option (the preparation and receipt of the related customer statements, customer information, the preparation of ATMs and the handling of the limits).
- Within the framework of a press breakfast, we provided economic and financial journalists with comments and points to be taken into account when evaluating the banking sector's 2013 results, presenting the situation of the banking sector from a different perspective and offering arguments that can fundamentally influence the perception of the sector.
- Issues related to FX lending, including the extended Exchange Rate Cap Scheme, and the positions of the various professional organisations continued to be key topics.
- In March, as an astonishing move, the MNB's supervisory unit imposed a resolution imposing fines on 35 credit institutions. The Association reacted promptly by making public its and its affected members' first opinion.
- The Financial Transaction Levy and its impacts on banking costs generated regular attention and inquiries.

The Association issued two press releases on current issues in Q1: one on the ATM cash withdrawal limit and one on payment fraud attempts.

**ANNEX**

## INTERNATIONAL DEVELOPMENTS:
## *REGULATION, SUPERVISION – EUROPEAN BANKING FEDERATION*

## I. Global regulation

### *I.1 Financial Stability Board (FSB)*

Ahead of the G-20 Ministers' and Governors' meeting of February 22-23 in Sydney and at their meeting in late March, the FSB outlined its main objectives for 2014.
First, the FSB wants to complete the remaining core elements of the regulatory reform. The programme has four elements:

- Building resilience of financial institutions
- Ending too-big-to-fail
- Transforming shadow banking to transparent and resilient market-based financing
- Making derivatives markets safer

**Second, once the regulatory reform is completed,** the G20 will look to how, collectively, members will regulate and supervise the global system in a way to build mutual confidence and trust and thereby fully realise the benefits of an open and integrated system. Commitment of, and support from, the G20 countries is needed in four areas:

- Global standards to address global systemically important institutions (supervision, resolution);
- Outcomes-based approaches to resolving cross-border issues (deferring to each other's market regulatory regimes where they achieve equivalent outcomes);
- Peer reviews and impact assessments to ensure consistent implementation when the standards are right and refinement of standards when they are wrong; and
- Enhanced co-operation to avoid domestic measures that fragment the global system.

Out of the FSB activities in the first quarter, the following should be highlighted:

- Publication of a consultative document on methodologies for identifying non-bank non-insurer global systemically important financial institutions.
- Publication of a consultative document on approaches to aggregate OTC derivatives data.
- Commencement of the review of foreign exchange benchmarks.

### *I.2 Basel Committee on Banking Supervision (BCBS)*

#### *I.2.1 Basel III*

In January 2014, the Basel Committee published its revised documents on leverage ratio and liquidity.

*I.2.1.1 Leverage ratio*

The Basel III leverage ratio framework is complementary to the risk-based capital framework. The Basel III leverage ratio is defined as the "Tier 1 capital" (the numerator) divided by the "exposure measure" (the denominator) and is expressed as a percentage. The minimum leverage ratio is 3%. The Basel Committee monitors banks' leverage ratio data on a semi-annual basis in order to assess whether the design and calibration of a minimum Tier 1 leverage ratio of 3% is appropriate over a full credit cycle and for different types of business models. The technical modifications to the June 2013 proposals relate to:

- Securities financing transactions. Securities financing transactions include transactions such as repos and reverse repos. The final standard now allows limited netting with the same counterparty to reduce the leverage ratio's exposure measure, where specific conditions are met. .
- Off balance sheet items. Instead of using a uniform 100% credit conversion factor (CCF), which converts an off-balance sheet exposure to an on-balance sheet equivalent, the leverage ratio will use the same CCFs that are used in the Basel framework's Standardised Approach for credit risk under the risk-based requirements, subject to a floor of 10%.
- Cash variation margin. Cash variation margin associated with derivative exposures may be used to reduce the leverage ratio's exposure measure, provided specific conditions are met.
- Central clearing. To avoid double-counting of exposures, a clearing member's trade exposures to central counterparties may be excluded, where certain conditions are met.
- Written credit derivatives. The effective notional amounts included in the exposure measure may be capped at the level of the maximum potential loss.

Implementation of the leverage ratio requirements has begun with bank-level reporting to national supervisors of the leverage ratio and its components and proceeded with public disclosure starting January 1, 2015. The Basel Committee will review and finalise the requirements by 2017 with a view to migrating to a Pillar 1 treatment on January 1, 2018. The Committee will also monitor accounting standards and practices to address any differences in national accounting frameworks that are material to the definition and calculation of the leverage ratio.

*I.2.1.2 Liquidity Coverage Ratio (LCR[2])*

In January 2013, the Basel Committee's oversight body, the Group of Governors and Heads of Supervision (GHOS), agreed the final form of Basel III's Liquidity Coverage Ratio (LCR). At that time, the GHOS asked the Committee to develop the details for the short-term liquidity framework. The Committee completed this work and in January 2014 issued three documents:
- *Final requirements for LCR-related disclosures,* to improve the transparency of regulatory liquidity requirements and enhance market discipline. In line with the Basel III agreement, national authorities will give effect to these disclosure requirements, and banks will be required to comply with them, from the date of the first reporting period after January 1, 2015.
- *Guidance for supervisors on market-based indicators of liquidity.* This document is aimed to assist supervisors in the evaluation of the liquidity profile of assets held by banks and to help promote greater consistency in High Quality Liquid Assets (HQLA) classifications across jurisdictions. The guidance does not change the definition of HQLA within the LCR; rather, it helps supervisors assess whether assets are adequately liquid for LCR purposes.

[2] Liquidity Coverage Ratio

- Finally, the Committee modified the LCR's definition of HQLA, including *a restricted version of Committed Liquidity Facilities (RCLF)*, to provide greater use of facilities provided by central banks. The use of CLFs within the LCR has until now been limited to those jurisdictions with insufficient HQLA to meet the needs of the banking system. The Committee has agreed that, subject to a range of conditions and limitations, a restricted version of a CLF (an RCLF) may be used by all jurisdictions. The decision to make use of RCLFs is a matter of national discretion. The restrictions agreed by the Committee are intended to limit the use of RCLFs in normal times, and therefore maintain the principle that banks should self-insure against liquidity shocks and that central banks should remain the lenders of last resort. These restrictions may, however, be relaxed during times of stress, when HQLA might otherwise be in short supply.

*I.2.1.3 Net Stable Funding Ratio (NSFR)*

The GHOS also revised its proposal for the Net Stable Finding Ratio. The proposal was submitted for public consultation with comments invited by April 11, 2011. The NSFR limits over-reliance on short-term wholesale funding, encourages better assessment of funding risk across all on and off-balance sheet items, and promotes funding stability. The revisions to the NSFR are aimed at reducing cliff effects within the measurement of funding stability, improving the alignment of the NSFR with the Liquidity Coverage Ratio (LCR) and altering the calibration of the NSFR to focus greater attention on short term, potential volatile funding sources. The Chairman of the Basel Committee said the NSFR will help to identify less stable funding structures and - without unduly hampering banks in their traditional role of maturity transformation - encourage them to develop more robust funding profiles.

*I.2.2 Results of the Basel III monitoring exercise*

Since April 2012, the Basel Committee has published semi-annual reviews of the implications of the Basel III standards for banks. The results of the fifth review have been published recently. A total of 227 banks participated in the current study, comprising 102 large internationally active banks ("Group 1 banks", defined as internationally active banks that have Tier 1 capital of more than EUR 3 billion) and 125 Group 2 banks (representative of all other banks). The results of the monitoring exercise assume that the final Basel III package has been fully implemented, based on data as of June 30, 2013. That is, they do not take account of the transitional arrangements set out in the Basel III framework or assumptions about banks' behavioural responses. For that reason, the results of the study are not comparable to industry estimates.
Data as of June 30, 2013 show that shortfalls in the risk-based capital of large internationally active banks generally continue to shrink. At the Common Equity Tier 1 (CET1) target level of 7.0%, the aggregate shortfall for Group 1 banks is EUR 57.5 billion, compared to EUR 115.0 billion on December 31, 2012. However, the aggregate shortfall of CET1 capital with respect to the 4.5% minimum has increased to EUR 3 billion, which is EUR 1.1 billion higher than previously. (As a point of reference, the sum of after-tax profits prior to distributions across the same sample of Group 1 banks for the year ending June 30, 2013 was EUR 456 billion).
Under the same assumptions, the capital shortfall for Group 2 banks included in the sample is estimated at EUR 12.4 billion for the CET1 minimum of 4.5% and EUR 27.7 billion for a CET1 target level of 7.0%. This represents an increase compared to the previous period of EUR 1.0 billion and EUR 2.1 billion, respectively. (The sum of Group 2 bank after-tax profits in the year ending June 30, 2013 was EUR 26 billion).

The average CET1 capital adequacy ratios under the Basel III framework across the same sample of banks are 9.5% for Group 1 banks and 9.1% for Group 2 banks.
The Basel III Liquidity Coverage Ratio (LCR) came into effect on January 1, 2015. The minimum requirement to be phased-in gradually from January 1, 2015 to reach 100% in 2019. The weighted average LCR for the Group 1 bank sample was 114% on June 30, 2013, down from 119% six months earlier. For Group 2 banks, the average LCR has increased from 126% to 132%. For banks in the sample, 72% reported an LCR that met or exceeded a 100% minimum requirement, while 91% reported an LCR at or above a 60% minimum requirement applicable in 2015. The report did not include long-term liquidity indicators, to avoid confusion with the revised NSFR.

Figures published by the EBA painted a somewhat worse picture: the 43 Group 1 banks had a capital adequacy ratio of 9.1%, with only 58.5% of them reaching a 100% LCR.

*I.2.3 Other BCBS documents published in the first quarter*

In addition to the above, the Basel Committee published the following documents in the first quarter:

- Risk management guidelines related to anti-money laundering and terrorist financing,
- Revised good practice principles for supervisory colleges,
- A sound capital planning process: fundamental elements,
- Standardised approach for measuring counterparty credit risk exposures,
- Guidance on external audits of banks.

## II. European regulation

### *II.1 Single Supervisory Mechanism (SSM)*

*II.1.1 European Central Bank (ECB) quarterly report on progress in the operational implementation of the Single Supervisory Mechanism*

The EU Regulation on the Single Supervisory Mechanism (Regulation 1024/2013/EC) requires the ECB to report on a quarterly basis to the European Parliament, the Council and the Commission on progress in implementing the SSM. The ECB's first report covers not only the three months up to February 3, 2014, but the entire period since the adoption of the decision on the SSM ( June 29, 2012). Accordingly, it contains many pieces of information that have been provided in our previous quarterly reports.

Important initial steps in the implementation process included the appointment of the Supervisory Board's Chair (Daniele Nouy), Vice-Chair (Sabine Lautenschläger, member of the ECB Executive Board) and the additional four members representing the ECB on the Board. The Supervisory Board (SB) held its first meeting on January 30, 2014. The SB is supported by a Steering Committee (SC). The Steering Committee was appointed in February. The Steering Committee is made up of a maximum ten members, including the Chair, the Vice-Chair, one ECB representative, and representatives from national competent authorities (NCAs) appointed based on a fair balance and rotation. To perform its new supervisory function, the ECB will have a total headcount of around 770 full-time equivalents (FTEs), to be selected by an application process. First, the managers will be selected, who will then

participate in the selection panels for the staff. The ECB will establish a Code of Conduct for the ECB staff and management involved in banking supervision.

The SSM Regulation provides that the ECB should establish an Administrative Board of Review charged with carrying out internal administrative reviews of the decisions taken by the ECB when conducting its supervisory tasks. This internal body, to be composed of five individuals with sufficient experience in the fields of banking and other financial services, will review supervisory decisions at the request of the bank concerned. Also, the ECB will set up a Mediation Panel with a view to ensuring the separation between monetary policy and supervisory tasks.

Within the SSM, the operational supervision of institutions will be carried out by Joint Supervisory Teams (JSTs). The processes and procedures of supervision are detailed in the Supervisory Manual. Issues covered in the manual include the risk assessment system, the supervisory review and evaluation process, on-site inspections, supervisory processes and procedures and language policy. (For communication between the ECB and supervised entities, as a general rule, the supervised entities may address the ECB in any one of the official languages of the EU and the ECB will respond in English and the language of the supervised entity).

The progress report addresses in detail the organisation of the comprehensive assessment process, the supervisory data reporting framework, the supervisory fee framework, the IT infrastructures, information management, the communications framework and the ECB's accountability.

*II.1.2 SSM Framework Regulation – Procedural rules for the Supervisory Board*

The draft of the ECB Regulation establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities was published in early February. This addresses the methodology for assessing significance, cooperation between the ECB and NCAs in the supervision of significant and less significant supervised entities and general principles for supervisory procedures within the SSM. The Framework Regulation also regulates cooperation with non-euro area member states, the language regime, procedures relating to micro and macro-prudential tasks, and administrative penalties. The ECB held a public hearing on the proposed Framework Regulation on February 9. The final version of the Framework Regulation will be published on May 4.
The European Banking Federation (EBF) reviewed the Framework Regulation and commented on the various provisions of the proposed Regulation in detail.

On March 31, the Chair of the Supervisory Board published the rules of procedure for the Supervisory Board and the Steering Committee. This latter will be made up of five NCAs, selected based on an annual rotation of the countries within each size group.

*II.1.3 ECB Note on the Comprehensive Assessment*[3]

The Asset Quality Review (AQR) will be managed by a Comprehensive Assessment Steering Committee (CASC) and a Central Project Management Office (CPMO). Each participating

[3] ECB Note on the Comprehensive Assessment, February 2014

NCA will set up a national steering committee and a central project management office mirroring the ECB structures. The national steering committees will be responsible for the timely delivery of key outputs to the ECB. National project management offices will control, coordinate and promote the execution of the comprehensive assessment, outlining detailed project plans, tracking whether milestones have been reached and reporting the project status to both national steering committees and the ECB. With respect to the selection of portfolios, data for all banks were submitted to the ECB by late December. The selection of the most risky portfolios for inclusion in the AQR and subject to the minimum criteria that selected portfolios must account for at least 50% of a bank's risk-weighted assets was completed in mid-February. The methodology for the AQR was published in the first quarter. The selected credit files were collected by mid-March. The ECB will publish detailed results of the comprehensive assessment and any recommendations relating to individual banks before assuming its supervisory tasks in November 2014.

In early February, the ECB named the 128 banks involved in the comprehensive assessment. These include four banks (one Maltese and three Slovakian-based) that are subsidiaries of groups that by definition are involved in the assessment. Banks directly supervised by the ECB include an additional two Maltese, three Estonian, three Finnish, three Latvian, three Slovenian, four Greek, four Portuguese, four Cypriot, five Irish, six Austrian, six Belgian, six Luxembourgian, seven Dutch, 13 French, 15 Italian, 16 Spanish and 24 German-based banks.

### *II.2 Single Resolution (SRM)*

#### *II.2.1 Debates around the SRM, efforts to reach compromise*

In relation to the compromise reached in the ECOFIN[4] in December, the European Parliament rejected the proposal that certain parts of the SRM should be regulated by intergovernmental agreements (IGAs) rather than by the SRM Regulation. In the Parliament's opinion, Article 114 of the EU Treaty provides sufficient legal ground for the Regulation to contain the elements of the IGAs. The Parliament also disagreed to the proposal for the IGAs to only be signed after the Regulation has been adopted. It also rejected that the use of the Single Resolution Fund should be conditional and in line with the principles set out by the IGAs. The Parliament also objected to the 10-year transitional period. In the light of all this, the Presidency sought to reduce the content of IGAs to the minimum, in line with the previous agreement. The Presidency seeks proposals as to how to address the Parliament' expectation regarding a backstop, key to the credibility of the system, should be addressed.

There were fierce debates regarding the roles and decision powers of the Council, the Commission and the Single Resolution Board in the resolution process: the Presidency and the Parliament sought to simplify and reduce the decision-making process. The positions of the Parliament and the Council also differed on whether the decisions should be made at the plenary or the executive session of the SRB and on the voting regime. There were also divergent views on the role of national resolution authorities in the acceptance of resolution plans and tools and in setting the level of MREL[5]. Not surprisingly, the Council would give more powers, the Parliament would give less powers to the national authorities. The Parliament's and the Council's views also differed on who will determine whether an institution is failing or likely to fail, the regulation of the computation of the contributions to and fill-up of the Single Resolution Fund (SRF) and the consistency of such regulation with

[4] Economic and Financial Affairs Council: the Council of EU finance ministers
[5] Minimum requirements for own funds and eligible liabilities

the BRRD. The Presidency sought compromise on all these issues, but it needed a new mandate from the Council.

In its press release of February 18, the Council reiterated its commitment to reaching an agreement, inter alia, on the framing of the role of the plenary session of the single resolution board, the review of the thresholds for the involvement of the plenary, and of voting modalities, a better framing of the Council's role in order to limit its discretion and the grounds on which it can raise objections to the SRB's decisions, the simplification and shortening of the decision-making process, a more framed oversight of the SRB over national resolution authorities and a central role for the European Central Bank in determining whether a banking institution is failing or likely to fail. It also agreed that that bail-in and not bail-out is the main guiding principle for bank resolution. The Council considered that more negotiations were needed regarding the mutualisation of national contributions to the SRM, the capacity of the SRF to borrow in the markets and the method for calculating individual contributions to the SRF. The press release confirmed that despite the differences, the aim was to enable the SRM Regulation to be adopted at its first reading.

*II.2.2 EBF position*

In its letter to the European Parliament, the EBF drew attention to the following points:

- The Single Resolution Mechanism is a major building block of the banking union. Only an agreement on the SRM can ensure the long-term stability of the eurozone.
- Members of the EBF support the "apply-to-all" principle as proposed by the Parliament: all SSM banks should fall within the scope of the SRB, regardless of whether directly or indirectly supervised by the ECB. A two-tier system should be avoided.
- If – as is the case with the SSM – a two-tier system were adopted (where banks not directly supervised by the ECB would fall within the scope of the National Resolution Authorities), even then the SRB should be the ultimate decision-making body just as the ECB is in supervisory matters.
- Bail-in should be the main source for resolution. There should be minimum national discretion in the application of bail-in.
- All banks should contribute to the SRF, regardless of legal form or membership of any protection fund (deposit or institution).
- In determining the contributions to the SRM, the principles of proportionality and fairness should be applied.
- Legacy assets should not be included in the SRM.

*II.2.3 European Parliament and Council compromise*

At the end of March, the European Parliament and the Council reached agreement on previously debated issues and it seems that member states will also accept the compromise as follows:

- The Single Resolution Mechanism will be governed by two texts: an SRM regulation covering the main aspects of the mechanism and an intergovernmental agreement related to some specific aspects of the Single Resolution Fund.
- The ECB, as the supervisor, will decide whether a bank needs to be resolved. (The Single Resolution Board may ask that the ECB takes such a decision).
- Resolution decisions will be made by the 8-member executive session of the SRB.

- The Single Resolution Fund would reach the target level over a period of 8 years instead of the previously planned 10 years and the mutualisation of the national compartments will be accelerated. (40% of the fund is to be mutualised in the first year, 20% in the second year, the rest equally over a further six years. National compartments will cease by the eighth year). The SRF target level will be EUR 55 billion.
- Access by the SRB to the national funds would be provided for by intergovernmental agreements to ensure that the required funds are available already at the start of the system.
- Upon entry into force of the Regulation, the SRB and participating member states should take joint steps to create appropriate methods and modalities facilitating borrowing by the SRF from the start of application of the Regulation.
- The Council will only be involved if so requested by the Commission. The Commission's decision will be subject to approval or objection by the Council (silence procedure) when there is no public interest in resolving the bank or where the resolution amount exceeds five percent of the Resolution Fund.
- The SRB plenary session will decide where the resolution amount exceeds EUR 5 billion.
- The SRB's powers in respect of national resolution authorities responsible for non-significant institution will be strengthened. The SRB may issue warnings to a national resolution authority where the Board considers that a decision that a national resolution authority intends to adopt does not comply with the SRM or with the Board's general instructions.

Analysts say that despite the compromise reached, the question of a fiscal backstop is not adequately clear in terms of the nature and timeline of the credit line (although it has been envisaged that the relevant details will be developed before the entry into force of the Regulation).

The European Parliament adopted the text of the compromise on April 15.

***II.3 Council position at first reading of the Deposit Guarantee Scheme Directive***

The Council published its proposals for the Deposit guarantee Scheme Directive on February 14. According to the proposal:

- Payout arrangements will be further simplified and harmonised.
- Depositors will no longer have to submit an application for repayment if their deposits become unavailable
- The time limit for paying out depositors in the event of deposits becoming unavailable will be reduced from the current 20 working days to seven working days by 2024.
- Depositors will have to be provided with proper information about the protection of their deposits,
- E-money will not be subject to deposit protection.
- The protection of deposits of municipalities with budgets below EUR 500,000 will be a national discretion.
- ex-ante financing arrangements will be introduced, with a minimum target level of 0.8% of covered deposits to be reached within a period of 10 years. DGSs may borrow from each other on a voluntary basis.
- Institutions' contributions to the DGSs should be proportionate to the volume of deposits insured and the riskiness of the institution. DGSs should apply a risk-based

methodology, to be approved by the supervisory authority. The European Banking Authority will prepare a guide for the calculation method.
- Deposit Guarantee Schemes will be subject to continuous supervision and will have to carry out stress tests on a regular basis.

### *II.4 Single European Rulebook*

#### *II.4.1 Leverage ratio, LCR*

Basel III detailed liquidity and leverage ratio requirements were published in January. They will be incorporated into EU legislation by delegated acts to be adopted by the European Commission as parts of the Single Rulebook. The Commission held a public hearing in the subject on March 10. The delegated acts are planned to be adopted before June 2014. EU banks should meet the 100% LCR requirement from 2018.
The EBF and the EBIC[6] were actively involved in the consultations on the LCR. They drew attention to potential negative impacts and made proposals for the extension of the scope of eligible instruments. They also drew attention to deviations from the Basel standards. In relation to the delegated act on leverage ratio, the EBF pointed out that there was no urgent need for legislation. There are still a number of open issues regarding the Basel III leverage ratio. It would be detrimental to international regulatory consistency if the relevant requirements were adopted before these issues are clarified.

#### *II.4.2 Nine Regulatory Technical Standards adopted*

CRR/CRD IV mandate the European Banking Authority to develop implementing and regulatory technical standards on more than 100 issues, as parts of the Single European Rulebook. The Technical standards are developed by the EBA and adopted by the European Commission. The Commission adopted the following technical standards in March:

- Regulatory Technical Standards on credit valuation adjustment risk for the determination of a *proxy* spread.
- Regulatory Technical Standards specifying the requirements for investor, sponsor, original lenders and originator institutions relating to exposures to transferred credit risk.
- Regulatory Technical Standards related to classes of instruments that can be used for variable remuneration, reflecting institutions' credit quality.
- Regulatory Technical Standards on assessing the *materiality* of extensions and changes to the Internal Rating Based approach (IRB approach) for credit risk and the Advanced Measurement Approach (AMA) for operational risk.
- Regulatory Technical Standards **on information exchange between home and host competent authorities.**
- Regulatory Technical Standards on the definition of market.
- Regulatory Technical Standards on non-delta risk of options in the standardised market risk approach.
- Regulatory Technical Standards further defining material exposures and thresholds for internal approaches to specific risk in the trading book.
- Regulatory Technical Standards **on close correspondence between the fair value of an institution's covered bonds and the fair value of its assets.**

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

The European Parliament and the Council have one month to decide on whether to accept or reject an RTS adopted by the Commission. (This deadline may be extended by and additional two months). Then, the RTS is published in the EU Official Journal and takes effect in all member states on the twentieth day after publication.

### *II.5 Structural reform*

On January 29, the European Commission published its proposal for structural measures to improve the resilience of EU credit institutions, concluding the Liikanen High-Level Expert Group's work launched in 2012. The key elements of the final proposal are as follows:

- The Regulation will apply to global systemically important banks that in three consecutive years exceed EUR 30 billion in total assets and EUR 70 billion or 10 per cent of the bank's total assets. According to 2006-2011 data, 29 banks are currently affected, but the number of banks may change as new data become available.
- The Regulation will also apply to foreign banks' branches operating in the EU, except if equivalent measures are in place in the home country (such as the Volcker Rule in the USA). At the same time, the Regulation will not apply to EU banks' subsidiaries operating in non-EU countries where equivalent measures are in place in the jurisdiction in question.
- Member states may be granted a derogation from the separation of trading activities (but not from the prohibition of proprietary trading!) if equivalent measures were already in place as of January 29, 2014).
- The proposal prohibits banks from proprietary trading and from owning, sponsoring, or having exposure to hedge funds. Supervisory authorities will be granted wide discretion regarding separation.
- A core credit institution (CCI) may not hold capital instruments or voting rights in the trading entity (supervisors may exempt co-operatives and savings banks from this rule). The core credit institution and the trading entity must meet the CRR/CRD IV requirements on an individual basis and be funded on an individual basis. Transactions between the two entities will be subject to the large exposure rules, including a large exposure limit of 200% of own funds.

The proprietary trading ban would apply as of January 1, 2017 and the effective separation of other trading activities would apply as of July 1, 2018.

Ahead of the publication of the proposal the EBF President wrote a letter to European Commission President Barroso. In this, he pointed out the following: while banks' broadly support the regulatory measures taken in the wake of the crisis, they do not see the need for a structural reform, that is, for the separation of trading activities. Such separation would harm the universal banking model, which has proven itself during the financial crisis. Furthermore, it would not promote sustainable growth and would entail higher costs for customers and society as a whole. If decision-makers believe that banks' activities should be further restricted, then this should be achieved through the calibration and fine-tuning of the new measures already in place. These measures have already caused significant structural changes in the case of certain banks and at the industry level as a whole.

### *II.6 ECON report on enhancing the coherence of EU financial services legislation*

The European Parliament's Economic and Monetary Affairs Committee (ECON) held a public consultation on enhancing the coherence of the EU financial system. The report on the results of this consultation was published in February. The main conclusions of the report are as follows:

- The next Parliament is requested to review the overlaps in existing legislation and those areas where potential distortions are introduced by different or missing regulation of like activities.
- In impact assessments better consideration should be given to interactions between new proposals and existing legislation.
- As a starting point, the Commission should assume in its proposals that the European Supervisory Authorities (ESAs) are given 12 months from entry into force for the preparation of RTS.
- An assessment on possible models for a code on financial services should be commissioned.
- The Commission should explain its reasons where it departed from ESA advice.

### *II.7 EU Payment Accounts Directive*

After intensive trilogue negotiations between the European Parliament, the Commission and the Council, the European Parliament adopted the (Payment Accounts Directive (PAD). After previous EU initiatives and recommendations, the PAD sets a stricter legal framework for member states to meaningfully act in protection of consumers with payment accounts.
The Directive is aimed to promote the social inclusion of those who have no banking relationships yet by giving them access to a basic payment account. Another objective of the Directive is to promote competition by simplifying bank switching and creating a more transparent fee structure, thereby making *it easier for consumers to compare fees and change bank accounts.* The Directive targets the single market: an EU citizen may in principle open a payment account in any member state and, with the help of the fee tables, may choose between the various bank accounts across the EU.
During the review of the draft Decree, industry associations (including the Hungarian banking Association) sought to ensure that the legislation build as much as possible on existing bank self-regulations and avoid unrealistic customer demands. This endeavour was basically successful, although the final legislation contains some exaggerated provisions in some points (for example, the use of an EU level bank card attached to the payment account). The only new tasks Hungarian banks will have in connection with the Directive is the requirement to compile, at least once a year, of a fee table for payment accounts.
The PAD will be formally adopted by the Council in July 2014 and then submitted to the European Parliament for approval. It is expected to be promulgated in September 2014 and member states will have two years to transpose it into national legislation.

### *II.8 Drafting of the EU Regulation on European Account Preservation Order (EAPO)*

In 2006, the European Commission issued a Green Paper on improving the efficiency of the enforcement of judgments in the European Union and launched a consultation on cross border debt collection. In 2007, the European Parliament adopted a resolution welcoming the initiative and inviting the Commission to identify the yet unresolved issues, in particular, by conducting an impact assessments. In 2010, the Commission launched an impact study and conducted hearings for market players on the enforcement of judgments through the attachment of bank accounts, including SMEs, consumers, banks, courts, bailiffs, bailiff agencies and law offices. The EBF played an active role in these consultations to ensure that

the impacts on banks of the proposal are adequately taken into account (the extra costs and responsibility to be borne by banks, data protection, data transfer issues, etc.)

In 2011, the European Commission set up an expert group. The EBF also participated in the group. The expert group's report served as a basis of the EU draft Regulation on European Account Preservation Order (EAPO). This would be a separate procedure, complementing existing national foreclosure systems, which would allow the creditor to request, in certain cases, the attachment of the debtor's bank account before a judgment is taken. The reason why a common procedure is needed is that national regulations on the attachment of funds in bank accounts vary, it is difficult to find out which bank the debtor has an account with and cross-border foreclosure procedures are costly. Pursuant to the proposed Regulation, if the claimant lacks sufficient information on the defendant's bank account, the competent authority may obtain this information through inquiries from banks or through a central register. The Regulation would only apply to creditors domiciled in an EU member state and to those accounts of the debtor which are managed by a bank based in the EU.

The EBF examined the proposal from the point of view of the fact that banks would be involved in the process not as creditors, but as contributors approached by third parties, which imposes additional financial and operational burdens on banks, and in some cases, additional financial liabilities. The EBF's consideration is that banks will not be able to recover their increased costs, or this may depend on the national legislation in question. Another important issue is that the Regulation will apply to cash (bank account money). The EBF managed to ensure that the Regulation only applies to cash and does not apply to financial assets. Pursuant to the proposed Regulation, member states may require banks to provide the defendants' bank account numbers. The EBF also proposed the further amendment of the deadlines to ensure that the short deadlines do not impose an unsolvable burden on banks.
The European Parliament adopted the draft Regulation with amendments at its first reading on April 15, 2014. The amendments related to the obtaining of bank account information and to some additional data protection provisions. The liability of banks and the reimbursement of their costs will be referred to national legislation. The Council of Justice and Home Affairs may adopt the draft Regulation at its meeting in June 2014.

### *II.9 European Data protection framework*

On January 25, 2012, the European Commission issued a data protection reform package. This included a draft EU Regulation to replace Directive 95/46/EC and a draft Directive on protecting personal data in the area of law enforcement and related judicial activities.

The main elements of the data reform package can be summarised as follows:

- right to data deletion (right to be forgotten)
- international data transfer between providers
- explicit consent from the individual for processing his data
- the user should be notified on data security breaches
- a basic principle of the regulation will be that personal data cannot be used
- a "one-stop shop" mechanism (for example, one can turn to the Hungarian data protection authority with a complaint against a Belgian-based service provider).

The draft Regulation was reviewed and commented on by the various Committees of the European Parliament and numerous advocacy organisations. However, no agreement was

reached on the "one-stop shop" mechanism. In December 2013, the European data protection authority published a document on strategic issues (a common data protection framework, assessment of the Safe Harbour mechanism, initiatives supporting economic growth and digital development, in particular, competition laws, information security and cloud services, agreements with third countries, financial sector reform, tax fraud and bank secrecy, VAT data exchange).
At the informal meeting of Justice Ministers in January 2014 in Athens, the Greek Minister of Justice chairing the meeting said that the main task for the Greek Presidency was to accelerate the data protection reform. He said that the Regulation should without question extend to third-country data transfers and it was also clear that EU citizens expected a wider and more efficient protection of their personal data. However, not much progress was made at the meeting. Participants are still divided over key issues such as whether the legislation should be in the form of a Directive or a Regulation, how the "one-stop shop" mechanism should be implemented in practice and what should be the practice and mechanism for third-country data transfers.
A new compromise text was drafted under the Greek Presidency, including on profiling, the use of alias, the relationships of data processors and scientific and historical data. The Greek Presidency aims come to at least a partial general agreement with a view to starting the trilogue in June 2014. However, with the approaching EP elections there is little chance for this.
According to the EBF, the data protection regulation affects the banking sector's interests in two respects: the legal framework should provide adequate legal assurance so that banks do not have to bear additional risks. Banks have to meet the anti-fraud, anti-money laundering and anti-terrorist financing regulations, while ensuring the protection of personal data. To this end, the legal framework should provide sufficiently clear and detailed guidance, however, a regulation leading to excessive burdens should be avoided. The EBF has serious concerns regarding the European Commission's further legislative powers, in particular in view of the limited involvement of stakeholders in the process.
On March 12, 2014, the European Parliament issued a legislative position on the proposal for a Regulation of the European Parliament and of the Council on the protection of individuals with regard to the processing of personal data and the free movement of such data (General Data Protection Regulation - COM(2012)0011 – C7-0025/2012 – 2012/0011(COD)).

### *II.10 Draft legislation on antitrust damage actions*

The European Commission published a White Paper on antitrust damage action in 2008. This was followed by a draft directive, which was then rejected by the European Commission and the Parliament. Also in 2008, a Green Paper on consumer collective redress was issued. The Green Paper included four possible models: cooperation between member states, mix of policy instruments, and a non-binding or binding EU measure, including alternative dispute resolution mechanisms. Further consultations on the issue were held in 2009 and 2011. In its closing report, while welcoming the efforts for a European collective redress mechanism, the European Parliament's Legal Committee (JURI) emphasised the need for an EU-level legislation in line with the principle of subsidiarity. National regulations vary and the divergent scopes and procedural systems may weaken consumer rights. According to a study published by ECON in the summer of 2012, a horizontal regulation of collective redress is particularly important where the domiciles of the party causing the damage and the aggrieved party are different. In the case of antitrust damage, common EU legislation on collective redress would be beneficial and provide equal treatment for the parties on both sides

(consumers and SMEs on the one side and the defendants – large corporations – on the other side).

In the EBF's view, an EU-level collective redress regulation may entail further legal risks for banks, because consumer groups or consumer organisations may collectively sue banks for consumer-right or anti-trust damages. The EBF does not see the need for an EU-level regulation. An EU-level collective redress mechanism should be confined to cases where there are no other redress tools available. It should be avoided that national regulations are weakened by an EU-level legislation. The EBF is of the opinion that there is no need for a collective redress mechanism, decisions of the national competition authorities should not have an unconditional effect, they should be treated as a rebuttable presumption. The limitation period should not be more than three years and the decisions of national authorities should include an assessment of the damage. Businesses participating in the leniency programme should only be responsible vis-á-vis their own customers, cartel damages should not be presumed.
In June 2013, the European Commission published a proposal for a Directive of the European Parliament and of the Council on certain rules governing actions for damages under national law for infringements of the competition law provisions of the member states and of the European Union. The proposal does not contain any collective redress provision. According to the rule for joint and several liability, the immunity recipient would only be liable if the injured parties are unable to obtain full compensation from the other infringers. Members states should ensure that where national courts rule in cases which are already the subject of a final infringement decision by a national competition authority or by a review court, they cannot take decisions running counter to such a decision. The European Parliament adopted the draft Directive with amendments on April 17, 2014.

### *II.11 Other EU regulatory decisions*

Agreement was reached at the trilogue on customer information requirements related to Packaged Retail and Insurance-based Investment Products (PRIIPs), including minimum information to be provided to small investors. Based on the agreement regarding the document for basic customer information, the European Securities and Markets Authority will draft a technical standard.

Agreement was also reached between the European Parliament and the Council on the legislation on Central Securities Depositories (CSD). Pursuant to the proposed regulation, all existing securities traded in regulated markets should be recorded in CSDs. The settlement period and deadlines will be harmonised and common rules will be introduced to mitigate the risks related to CDS transactions and services. An EU-level CSD legislation and passport will reduce the barriers to market entry.

## III. European Banking Authority

### *III.1 Key features of the 2014 EU-wide stress test*

On January 31, the European Banking Authority announced **the key components of the 2014 EU-wide stress test. The stress test will be conducted in close cooperation with the European Central Bank, the European systemic risk Board and the national supervisory**

**authorities.** The scenarios will cover the period of 2014–2016 based on data as of December 31, 2013. The tests will be conducted for a baseline and an adverse macro-economic scenario. The scenarios are developed by the EBA jointly with the ESRB and may be complemented by the national authorities.

The EU-wide stress test will be conducted on a **sample of 124 EU banks** which cover at least 50% of each national banking sector, and will be run at the highest level of consolidation. A key objective of the EBA is to ensure consistency and comparability of the outcomes across banks. Banks will have to meet the Common Equity Tier 1 capital requirement set by the EBA throughout the time horizon of the exercise. In terms of **capital thresholds,** 8% Common Equity Tier 1 (CET1) will be the capital hurdle rate set for the baseline scenario and 5.5% CET1 for the adverse scenario. The competent authorities may set higher hurdle rates. Should a bank's capital drop below the expected and calculated level, supervisory measures will be taken. The test will be conducted on the assumption of a static balance sheet, with zero growth and no workout of default assets. Banks will be required to stress test the following common set of risks: credit risk, market risk, sovereign risk, securitisation and cost of funding. The calculations will extend to both trading and banking book assets (including off-balance sheet exposures). In determining the capital, the CRR transitional arrangements will be taken into account.

The EBA will be responsible for the methodology and the collection, consistency and disclosure of the results. The quality assurance process will be managed by the national authorities and for SSM countries also by the ECB. The methodology and advance data collection for computing benchmarks are expected in April 2014. Banks' individual results will be released at the end of October.

Already in 2013, the European Banking Federation gave special emphasis to the stress testing exercise and was able to influence the contents of the test at several points. Representatives of the EBF met with the EBA's experts several times, and in early April the EBF wrote a letter to the EBA about contradictions in the test. According to the EBF, the assumption of static balance sheets is wrong because it does not take into account the effects of write-offs and portfolio cleansing. The use of 2013 RWAs as a lower limit and the application of the Basel I floor are unwarranted. The use of December 31, 2013 as a reference date, when CRR/CRD IV were not yet applicable, is also a concern. The EBF proposes that for simplicity's sake, as an alternative solution, a haircut is used for developing-country banks' non-EU subsidiaries. It also urges for a more flexible segmentation and a symmetric treatment of insurers. The EBF also draws attention to the potential double-counting of the same negative effect in certain cases during the AQR and the stress test.

### *III.2 Joint Committee[7] report on risks and vulnerabilities in the EU financial system*

The Joint Committee of the European Supervisory Authorities assesses risks and vulnerabilities in the European banking sector on a semi-annual basis. The assessments are focused on changes during the current period, without addressing the risk characteristics of the individual member states. The report published in early April establishes that although near-term risks to the EU financial system from the euro-area sovereign debt crisis have abated and several indicators are pointing to improving confidence in the EU economy, the economic outlook remains fragile in a number of Member States, also due to weak private and public balance sheets. The main risks identified by market players included the search-for-

[7] Joint Committee of the European Supervisory Authorities (ESAs)

yield behaviour, concerns about a sudden increase in global bond yields and credit spreads, and potential vulnerabilities stemming from renewed tensions in global emerging market economies (political uncertainties, economic slowdown, exchange rate volatility). The report reviews in detail risks affecting the banking sector (asset quality, profitability, funding conditions), the insurance sector (declining premium growth) and financial markets (decreasing price for risk. It also highlights risks from deteriorating conduct of business, risks from financial market infrastructures and trading venues, and operational risks from IT infrastructures.

### *III.3 Consumer trends report 2014*

Key consumer trends and issues identified by the EBA for 2014 include household borrowings (including the appropriate level of regulation of mortgage lending), bank accounts, traditional and non-traditional payment methods, crowdfunding, misselling, comparison websites and financial literacy.

### *III.4 EBA technical standard published in the first quarter*

- Final draft Regulatory Technical Standards on own funds requirements for investment firms
- Draft Implementing Technical Standards on the mapping of the credit assessments to risk weights of External Credit Assessment Institution (ECAIs)
- Final draft Regulatory Technical Standards related to classes of instruments that can be used for variable remuneration
- Draft Regulatory Technical Standards on the margin periods for risk used for the treatment of clearing members' exposures to clients. (Consultation)
- **Draft Regulatory Technical Standards on the conditions according to which competent authorities (CAs) may grant institutions permission to use relevant data covering shorter time series (data waiver permission). (Consultation)**
- Final draft **Regulatory Technical Standards** on own funds (Part IV)
- Final draft **Regulatory Technical Standards** on additional liquidity outflows
- Final draft Regulatory Technical Standards on liquidity requirements
- Final draft Regulatory Technical Standards (RTS) on prudent valuation

## IV. European Banking Federation

In the first quarter, the European Banking Federation was actively involved in the review of global and EU-level regulatory proposals and the development of their contents and expressed its views on the most important issues in press releases. It issued a press release on its reservations regarding the structural reform. It criticised the U.S. regulations on foreign banks and the reduction of interchange fees. At the same time, it welcomed the Fourth Anti-Money Laundering Directive and the agreement on the SRM. The EBF received the agreement on the Bank Accounts Directive cautiously, while supporting the Commission’s plans for long-term financing.
In addition to those mentioned in the previous sections, the EBF reviewed the following documents in the first quarter:

- Basel Committee: Fundamental review of the trading book,
- EBA: Discussion paper on the methodology for the assessment of liquidity and funding risk under the supervisory review process (SREP),
- EBA: Draft RTS, ITS and guidelines on the methodology for the identification of global systemically important financial institutions,
- EBA: Draft RTS on own funds (Part IV),
- EBA: Draft ITS on disclosure for the leverage ratio
- EBA: Final draft RTS for own funds,
- EBA: Final draft ITS on disclosure of encumbered and unencumbered assets,
- EBA: Consultation on harmonised definitions and templates for funding plans of credit institutions,
- Basel Committee: Second consultation on revisions to the securitisation framework,
- FDIC[8]: Consultation on the Single Point of Entry strategy[9].

[8] Federal Deposit Insurance Corporation: the U.S. deposit insurance agency
[9] The U.S. resolution framework