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HUNGARIAN BANKING ASSOCIATION

REPORT

on Activities of the Hungarian Banking Association 4th Quarter 2014

Budapest, February 2015

Contents

I. Executive Summary

Contrary to expectations, global economic activity weakened in the fourth quarter of 2014. The fourth quarter saw increasing geopolitical tensions, volatile financial markets, low inflation effects caused by low energy and raw material prices and weak demand in global markets. Of the developed countries, only the U.S. saw an acceleration of growth. Europe is faced with a deflation pressure and the threat of slowdown, also due to the slowdown of the German economy. Monetary conditions remained basically unchanged. With the U.S. economy picking up, the Fed ended its asset purchase programme at the end of October 2014. At the same time, the European Central Bank and the Bank of Japan announced significant liquidity-boosting measures. As a result of monetary and growth effects, the U.S. dollar started to appreciate against both the euro (and the Swiss franc, pegged to it) and the Japanese yen.

As for the Hungarian economy, the external environment was not supportive, with a slow EU economy, uncertainties in the euro area and geopolitical tensions caused by the Russia-Ukraine conflict. This is expected to be reflected in the growth figures for Q4. Analysts estimate the Q4 growth rate at 2.8%-3% and the annual GDP growth rate at 3.2%-3.4%. In terms of annual growth, Hungary is expected to continue to be one of the fastest in Europe. A slowdown in exports, caused by external market conditions was offset by increasing internal demand (investments, consumption). The average inflation rate in 2014 was a negative 0.2 percent, core inflation also fell substantially (to 0.8%). Due to the low inflation rate, the MNB kept its base rate unchanged (2.1%). Hungary's economic indicators continue to be good. The preliminary deficit of the central subsystem of general government is reported at HUF 872 billion for the year, HUF 325.8 billion lower than the adjusted forecast. This better-than-expected deficit was primarily due to a major decrease in interest expenses. The debt-to-GDP ratio decreased only slightly in 2014. External equilibrium continued to improve, as reflected in the current account. As was the case in 2013, the external financing capacity of the economy remained around 8% of GDP in 2014. With the combined effect of improving macroeconomic fundaments on the one hand and international developments on the other, the forint is not expected to strengthen in 2015.

According to MNB statistics, the stock of corporate loans grew significantly in Q3, based on transactional data. Disbursements exceeded repayments by HUF 97 billion. The increase in corporate loans was almost fully attributable to the growth in forint loans. The transaction-based annual growth rate of corporate loans fell to -2 per cent, mainly due to the strong base effect of the high volume of loan disbursements made during the first stage of the Funding for Growth Scheme. The stock of retail loans decreased as repayments exceeded disbursements by HUF 26 billion.

Banks' activities in Q4 were focused on tasks related to the four-law package which put their relations with customers on radically new bases:

1. The Uniformity Act (Act XXXVIII of 2014) presumed the unfairness of the application of an exchange rate spread and the unilateral raising of interest rates, charges or fees. Banks could file lawsuits to disprove the law's presumption of unfairness of their General Terms and Conditions for FX loans, with a very short deadline of August 25, 2014. Most banks availed of this option. However, all litigations were concluded, even at the appellate level, as early as late November, with banks losing the cases (except for one). Despite banks' requests, only a few of the judges availed themselves of the option to request a constitutional review. Complementing the judges' constitutional review motions, the Association sent an amicus curiae letter to the Constitutional Court, presenting the banking sector's arguments in detail, and compiled a background document to substantiate the constitutional complaints to be filed by banks. In its ruling No. 34/2014.(XI.14.), the Constitutional Court wholly rejected the judges' initiatives. Although a number of motions lodged by

judges and financial institutions are still waiting for ruling by the Constitutional Court. Banks had the opportunity to file lawsuits in respect of HUF and foreign currency loans until January 12, 2015.

2. The Settlement Act (Act XL of 2014) provides rules for the settlement of FX loans based on the Uniformity Act. It follows from the interrelation between these two Acts that the Association also considers the Settlement Act as unconstitutional and warranted to undergo preliminary constitutional review. To achieve this, we wrote a letter to the President of the Republic, requesting him no to sign the Act, with a view to ensuring legal certainty and predictable application of the law. The President of the Republic did not avail himself of this option and the Act took effect on October 15, 2015. (The Association's experts are currently working on substantiating the constitutional complaint, which should be lodged by banks by April 14, at the latest). The most important among the constitutional objections in terms of consequences is the provision that overpayments should be recognised as prepayments.
The Settlement Act has mandated the MNB to set the detailed rules for FX loan settlements by decree. The MNB developed a rather particular regulation structure for this issue. In a so-called main decree, it regulated the general cases of settlement and methodology, while special cases and the case of lack of data in the case of liquidation and winding up are regulated in two other separate decrees. Rules for consumer information and stringent consumer protection provisions are provided by a third decree. Specialists from banks and the Association were involved in drafting the detailed rules. During the related constructive consultations, the participants sought to ensure that – under the given circumstances and within the given legal framework - the regulation can be implemented with the least difficulties and according to rules ensuring a fair settlement. However, in our view, due to the settlement method chosen, it was not possible to develop a settlement that is easy to understand for the customer.
It is important to note that the settlement of FX loans will cause the banking sector a loss of HF 900-1000 billion. The related provisioning and impairment caused banks a total pre-tax loss of 328 billion in the period between January and November 2014.

3. *Act LXXVII of 2014 on the settlement of issues related to the currency conversion of certain consumer loan contracts* (the HUF Conversion Act) provides new contractual terms and conditions for contracts involved in the FX loan settlement process. The Act facilitates the conversion of loans into HUF at the market exchange rates applicable on the dates fixed in the Act (thereby avoiding further losses for the banking sector). Furthermore, it regulates the conditions for the conversion of foreign-currency denominated and foreign currency mortgage loans, the relevant procedures and the conditions under which the consumer may ask for retaining the original currency of the contract. The Act also provides rules regarding the payment of the new repayment amounts, the applicable interest rates and the rules for review.

4. *Act LXXVIII of 2014 amending Act CLXII of 2009 on consumer loans and certain related Acts* (the Fair Banking Act) provides new rules regarding consumer information, the making of amendments to the contract, the free-of-charge termination of the contract by the consumer and the shift to the new contractual terms and conditions, in respect of contracts concluded after the entry into force of the Act and, with some limitations, contracts concluded after May 1, 2004. The Fair Banking Act also sets out the rules for unilateral amendments to consumer loan contracts and provides for the rules for changing the interest rates, interest premiums for fixed interest rate and benchmark rate loans. The Fair Banking Act amends and complements the Settlement Act in several points and repeals the redundant provisions of the Credit Institutions Act.

The Ministry of Justice conducted intensive consultations with the Association during the drafting of the latter two Acts. Specialists involved in the consultations submitted proposals to make the Acts clear, intelligible and implementable for both banks and consumers. The rather particular evolution of the legislative process (the legislators correcting the problems detected in the next draft law by

including provisions amending the adopted Acts) was a major burden on the consultations. The constantly changing and shaping rules and the extremely short deadlines made the preparation of banks' operating and IT systems extremely difficult.
As another important development in Q4, negotiations on the proposed "bad bank" began between the MNB and the Association's high-level working group. The negotiations are aimed to agree on the details regarding the bad loan portfolios and the operation of the proposed asset management agency.

In global regulation, the development of measures to fix the regulatory shortcomings that caused the financial crisis was basically completed. Strengthened international standards are in place, and with the bank resolution framework and the proposal on a minimum standard for the Total Loss Absorbing Capacity for global systemically important banks, the framework for addressing the too-big-to-fail issue can be considered as complete. In the near future, the Financial Stability Board will focus on risks outside the core of the financial system (shadow banking, implementation issues related to derivatives).

The Basel Committee on Banking Supervision reported to the G20 leaders on progress in the implementation of the Basel III standards. The BCBS launched consultations on revised guidelines on corporate governance at banks and on a revised standardised approach for measuring operational risk capital. It finalised the Net Stable Funding Ratio for long-term liquidity, updated the methodology for assessing and identifying global systemically important banks, and developed criteria for identifying simple, transparent and comparable securitisations.

Following the EP elections, the new EU bodies commenced operation and set out the priorities for the new parliamentary cycle. A new objective in the financial area is the creation of a Capital Market Union. Improving long-term financing is priority for promoting growth. Despite the sector's endeavours, the banking structural reform, aimed at the separation of trading activities is still on the agenda.

The banking union started operation on November 4. Following the publication of the results of the comprehensive assessment (AQR), the European Central Bank assumed the supervisory tasks of the 120 institutions qualified as significant in the former monetary union. Another important development related to the banking union was the adoption of the direct bank recapitalisation instrument (fiscal backstop) and the development of detailed rules on contributions by banks to the national resolution funds and to the Single Resolution Fund.

II. Macroeconomic outlook, operating environment

Contrary to expectations, global economic activity weakened in the fourth quarter of 2014. The fourth quarter saw increasing geopolitical tensions, volatile financial markets and low inflation effects caused by low energy and raw material prices and weak demand in global markets. Of the developed countries, only the U.S. saw an acceleration of growth after a temporary slowdown at the beginning of the year. Europe is faced with a deflation pressure and the threat of slowdown, also due to the slowdown of the German economy. Major monetary easing measures are being taken in Japan and China to stimulate the economy, with no apparent results. Other emerging markets, in particular Brazil and Russia, experienced a major slowdown, the latter may even sink into recession in the coming years.

Monetary conditions remained basically unchanged. With the U.S. economy picking up, the Fed ended its asset purchase programme at the end of October 2014. A at the same time, the European Central Bank and the Bank of Japan announced significant liquidity-boosting measures. As a result of monetary and growth effects, the U.S. dollar started to appreciate against both the euro (and the Swiss franc, pegged to it) and the Japanese yen.

As for the Hungarian economy, the external environment was not supportive, with a slow EU economy, uncertainties in the euro area and geopolitical tensions caused by the Russia-Ukraine conflict. This is expected to be reflected in the growth figures for Q4. Analysts estimate the Q4 growth rate at 2.8%-3% and the annual GDP growth rate at 3.2%-3.4%. In terms of annual growth, Hungary is expected to continue to be one of the fastest in Europe. A slowdown in exports, caused by external market conditions was offset by increasing internal demand. Here, investments played a major role, coupled with an accelerated year-end drawdown of development funds from the 2014 budget. Internal demand is boosted by a growing internal consumption, as also reflected in the better-than-expected growth in retail sales (5.8% and 5.2% in October and November, respectively) and the rise in imports.

Q4 was characterised by negative inflation indicators. Core inflation fell substantially (to 0.8%) and there is no inflation pressure in the economy. The average inflation rate in 2014 was a negative 0.2 percent. With downward risks due to low energy prices and slow external demand, inflation is expected to continue to remain well below the MNB's mid-term target (3$\pm$ 0.5%) in 2015. At the same time, an upward risk is that a potential increase in risk premiums due to the geopolitical tensions might adversely affect interest rates. Due to the low inflation rate, the MNB kept its base rate unchanged (2.1%).

Hungary's economic indicators continued to be good. The preliminary deficit of the central subsystem of general government is reported at HUF 872 billion for the year, HUF 325.8 billion lower than the HUF 1,151.5 billion projected. The 2013 deficit was 932.8 billion. This better-than-expected deficit was largely due to a major decrease in interest expenses. Although the debt-to-GDP ratio decreased only slightly in 2014, with accelerated economic growth and with continued disciplined fiscal policy, a more substantial reduction of this ratio could be possible in the coming period.
External equilibrium is clearly improving, as reflected in the current account. As was the case in 2013, the external financing capacity of the economy remained around 8% of GDP in 2014. The pace of economic growth, which is above the EU average growth rate, and fiscal discipline continued to support the forint exchange rate in Q4. However, the Swiss central bank's steps in mid-January 2015, and the U.K. and U.S. interest rate raises have weakened the forint. Thus, the improving

macroeconomic fundaments are not expected to be reflected in the exchange rate of the forint for some more time.

There was no significant change in banks' total assets in Q4 in the period until November. Although the forint strengthened by around 0.5%-1% relative to the most important currencies in banks' assets (CHF, EU) compared to September, total assets rose (by 0.8%). The net stock of loans fell despite the decrease in impairment, although the rate of decrease was less than 1%. The most important changes occurred in the structure of liquid assets. As a result of changes in the MNB toolkit, current account balances and deposits placed with the MNB rose significantly and there was a shift from short-term to long-term forint and foreign-currency government securities.
In liabilities, deposits grew by slightly more than 1% in the period until November, with corporate deposits playing a major role. Deposit from households and other financial institutions rose as well. The stock of bank issued securities grew at a pace above average (by 4.2%), mainly through international offerings. In addition to the HUF 620 billion worth of provisions made for losses from FX loan settlements as of the end of Q3, banks provisioned another HUF 80 billion by the end of November to cover expected net losses.
As a result of the above effects, the net debt-to-deposit ratio of the credit institutions sector fell from 107% in 2013 to 102% in 2014.
As for profitability, apart from provisions, all other profit items followed the Q1-Q3 trend in Q4 up to November. As a result of the above effects, the total loss of the sector in the period between January and November was close to HUF 328 billion. The annualised ROA and ROE were -1.1% and -11.8%, respectively.

III. Corporate lending

According to MNB statistics, the stock of corporate loans grew significantly in Q3, based on transactional data. Disbursements exceeded repayments by HUF 97 billion. The increase in corporate loans was almost fully attributable to the growth in forint loans. The transaction-based annual growth rate of corporate loans fell to -2 per cent, mainly due to the strong base effect of the high volume of loan disbursements made during the first stage of the Funding for Growth Scheme.

Funding for Growth Scheme Stage II

According to MNB statistics, credit institutions participating in Stage II of the Funding for Growth concluded HUF 584.2 billion worth of contracts as of December 31, 2014. Of this amount, credit institutions have so far disbursed HUF 472.3 billion to nearly 14,000 SMEs.
97% of the contracted HUF 584.2 billion are new loans. In new loans, 61% are investment loans, 27% working capital loans and 12% EU grant prefinancing loans. In Pillar II (redemption of forint and foreign currency loans), the share of loans disbursed for the redemption of investment loans is 76%, while 24% of the loans has been provided for the redemption of working capital loans. In Pillar I, the average loan amount was HUF 23 million for new investment loans, HUF 36 million for new working capital loans and HUF 36 million for EU loans.

EXIM Sub-Working Group

In the second half of the year, the Sub-Working Group set the goal of developing the conditions for the Exim Microcredit Programme (EXIM Card). Accordingly, the Sub-Working Group's activities were

primarily focused on the finalisation of the product concept, the framework agreement, the style guide, the sales aids and the flow charts. The Sub-Working Group held several consultations regarding the conversion of the facility with a maturity of less than two years into a revolving credit facility. As a result, the related refinancing agreement was amended based on banks' comments. Eximbank's specialists presented the International Competitiveness Loan Programme to be introduced next year, aimed to provide loans for purposes other than export. At the Sub-Working Group's meetings, representatives from EXIM provided regular updates on the latest developments related to refinancing (organisational/personnel changes, the establishment of a branch office network, future plans).

IV. Retail lending

According to the MNB's November Report on Trends in Lending: „In the third quarter of 2014 the household loan portfolio of credit institutions decreased further, as repayments exceeded disbursements by HUF 26 billion. The contraction of the loan portfolio reflects the continued shrinking of foreign currency loans, while the aggregate forint lending was characterised by recovery. The disbursements of forint loans exceeded repayments by HUF 61 billion, while the volume of new household loans during the quarter amounted to HUF 160 billion, which is 32 per cent higher on an annual basis. Based on the responses given by banks in the lending survey, the terms and conditions of consumer loans eased in Q3, while there was no substantial change in those of housing loans; moreover, in their responses looking two quarters ahead a narrow range of banks indicated tightening in housing loan conditions. Based on the survey the banks reported recovery primarily in demand for housing loans, and in the next half-year they expect additional growth in demand for both product types. In Q3, the interest rate spread of new housing loans decreased, but it is still considered high by regional standards".

Constitutional Court proceedings related to the Uniformity Act (Act XXXVIII of 2014)

In the litigations filed to rebut the presumption of unfairness of foreign-currency denominated loan contracts, most banks proposed that the judges avail of the option to request a constitutional review. Some of the judges did so. Complementing the constitutional review motions filed by the judges, the Association sent an amicus curiae letter to the Constitutional Court, presenting the banking sector's arguments in detail. This letter was published on the Constitutional Court's website together with the Justice Minister's opinion.

Banks planned to lodge constitutional complaints after their receipt of the appeal courts' negative decisions. We considered it important that constitutional complaints addressing issues not addressed by the judges' motions are also lodged with the Constitutional Court by one or more financial institutions. To achieve this, we complied a draft motion with the involvement of renowned constitutional lawyers. This draft motion was used by several member banks in drafting their individual constitutional complaints. The draft motion presented the involvement of banks based on **the violation of the fundamental right to fair procedure** and substantiated the unconstitutionality of certain provisions of the Act based on the **prohibition of retrospective legislation, procedural provisions violating the right to fair procedure, and in the case of the exchange rate spread, the violation of ownership rights.**

In its ruling No. 34/2014.(XI.14.), the Constitutional Court ruled on the motion lodged by a judge of the Budapest Municipal Court Economic Department, combining the case with two other cases. The Constitutional Court wholly rejected the judges' initiatives, with reasoning from three judges and

minority opinions from four judges. A number of motions lodged by judges and financial institutions are still waiting for ruling by the Constitutional Court.

Settlement Act: Letter to the President of the Republic, requests for rulings

The Association turned in a letter to the President of the Republic, requesting him not to sign the "*Act on rules for the settlement and other provisions provided by Act XXXVIII of 2014 on the settlement of certain questions related to the Supreme Court's uniformity ruling on financial institutions' consumer loan contracts*" (the Settlement Act).
The Settlement Act is closely related to Act XXXVIII of 2014 on the settlement of certain questions related to the Supreme Court's uniformity ruling on financial institutions' consumer loan contracts (the Uniformity Act). The Settlement Act regulates settlement issues that might arise in the case of a potential invalidity of the contractual provisions specified in the Uniformity Act, but in addition, it has also substantially amended the Uniformity Act, adopted two months earlier, although the litigations filed based on the latter have not been concluded yet. The Settlement Act is an implementing Act and its application is inconceivable without the Uniformity Act. In our letter to the President of the Republic we drew attention to the problems ensuing from the Settlement Act implementing the Uniformity Act, which – in our view – was unconstitutional and against which several motions were lodged with the Constitutional Court. We pointed out that the Settlement Act served the implementation of the presumably unconstitutional Uniformity Act, hence, it would make the situation even more difficult if it was promulgated before the Constitutional Court ruled on the constitutionality of the Act it implements. We also pointed out that there were several other constitutional queries concerning the Settlement Act (independent of the Uniformity Act), which also warranted a constitutional review. We provided detailed arguments in an annex to the letter and requested the President to avail himself of his constitutional powers and send the Act for review by the Constitutional Court. This did not happen and Act XL of 2014 took effect on October 15, 2014.

Following the promulgation of the Settlement Act, we submitted several clarification requests to the Ministry of Justice. Partly as a result of this, the Settlement Act was amended by another Act of the four-law package on consumer loans (*Act LXXVII of 2014 amending Act CLXII of 2009 on consumer loans and other related Acts*).

HUF Conversion Act and Fair Banking Act

The Ministry of Justice conducted intensive consultations with the Association during the drafting of these Acts. Specialists involved in the consultations submitted proposals to make the Acts clear, intelligible and implementable for both banks and consumers.

Act LXXVII of 2014 on the settlement of issues related to the currency conversion of certain consumer loan contracts (the HUF Conversion Act) provides new contractual terms and conditions for contracts involved in the FX loan settlement process. The law does not apply to credit cards, loan contracts related to payment accounts, subsidised loans and loan contacts concluded before May 1, 2004. The Act facilitates the conversion of loans into HUF at the market exchange rates applicable on the dates fixed in the Act (thereby avoiding further losses for the banking sector). Furthermore, it regulates the conditions for the conversion of foreign-currency denominated and foreign currency mortgage loans, the relevant procedures and the conditions under which the consumer may ask for retaining the original currency of the contract. The Act also provides rules regarding the payment of the new repayment amounts, the applicable interest rates and the rules for review.

Act LXXVIII amending Act CLXII of 2009 *on consumer loans and certain related Acts* (the Fair Banking Act) provides new rules regarding consumer information, the making of amendments to the contract, the free-of-charge termination of the contract by the consumer and the shift to the new contractual terms and conditions, in respect of contracts concluded after the entry into force of the Act and, with some limitations, contracts concluded after May 1, 2004. The Fair Banking Act also sets out the rules for unilateral amendments to consumer loan contracts, so, the Credit Institutions Act now only contains a few remaining provisions applicable to unilateral contract amendments in respect of non-consumer loan contracts. Only the interest rate, the interest premium and the fees and charges can be changed unilaterally to the disadvantage of the consumer, subject to conditions set out in the contract.
No interest rate raise is allowed for fixed interest rate loans with maturities of less than three years. In the case of loans with interest rates pegged to benchmark rates, the benchmark rates change automatically, which is not considered as a unilateral contract amendment. However, the interest premiums shall remain unchanged throughout the entire loan period.
In the case of loans with maturities of more than three years, there will be two types of variable interest rate allowed: an interest rate pegged to a benchmark rate and a variable interest rate fixed for three-year periods. In the case of loans with interest rates pegged to benchmark rates, the interest rate will change in step with the change in the benchmark rate, while the interest premium shall remain unchanged over the entire loan period, or for interest periods of at least three years. In the case of variable interest rate loans with interest rates fixed for three-year periods, the creditor should apply an interest change indicator, to be approved by the MNB. The approved indicators will be displayed on the MNB's website. Only one type of interest change indicator, interest premium change indicator or benchmark interest rate may be applied in a contract. Interest-related changes must be notified in advance to the customer. In case of changes detrimental to the customer, the customer may terminate the contract free of charge. The Act also provides rules for the termination of contracts. Creditors are required to amend their General Terms and Conditions in accordance with the provisions of the Act by February 1, 2015. The Fair Banking Act amends and complements the Settlement Act in several points and repeals the redundant provisions of the Credit Institutions Act.

MNB decrees related to the Settlement Act

The MNB started the drafting of decrees related to the Settlement Act by holding a briefing for a wide range of banks on September 15. At the briefing, in addition to the principal prepayment method (Method I), the MNB presented an additional two, mathematically equivalent, formulae. To ensure efficiency, consultations on these proposals took place with a smaller group of experts from banks.
During the consultations it soon became obvious that the additional formulae suggested by the MNB (Methods II and III) were not suitable to handle loans with delinquencies, loans subject to the Exchange Rate Cap Scheme and loans where concessions have been granted to the debtor. Hence, the expert group started to develop the detailed calculation formulae based on Method I.

The MNB developed a rather particular regulation structure for the issue. In the so-called main decree, it regulated the general cases of settlement and methodology. This main decree was completed relatively soon and issued in early November (MNB Decree No. 42/2014.(XI.7.) Issues causing difficulties during the settlement are regulated in two further decrees. One addresses the above mentioned special cases (MNB Decree No. 54/2014.(XII.10.), the other provides estimate methods for lack of data in the case of liquidation and winding up (MNB Decree No. 55/2014.(XII.10.). Rules for consumer information and stringent consumer protection provisions are provided by a third decree (MNB Decree No. 58/2014.(XII.17.). The complexity of the issue is shown by the fact that the main decree had to be adjusted already on December 10 (MNB Decree No. 53/2014.(XII.10.).

During the drafting of the settlement methodology and the consumer information decree, specialists from the MNB and the Association held a series of constructive consultations. The participants sought to ensure that – under the given circumstances and within the given legal framework - the regulation can be implemented with the least difficulties and according to rules ensuring a fair settlement. However, in our view, due to the settlement method chosen, it was not possible to develop a settlement that is easy to understand for the customer.

Consultations and frequently asked questions regarding the four Acts setting a new regulatory framework for consumer loans

The complexity of the issues related to the implementation of the Settlement, HUF Conversion and Fair Banking Acts, the short time allowed for the review of the relevant draft laws before their submission to Parliament, the rather particular evolution of the legislative process (the legislators correcting the problems detected in the next draft law by including provisions amending the adopted Acts) and the extremely short parliamentary cycles, during which proposals amending previously agreed provisions were incorporated in a manner impossible to follow, the sector was faced with continuous legal interpretation issues during the legislative process in the autumn. The constantly changing and shaping rules and the extremely short deadlines made the preparation of banks' operating and IT systems extremely difficult.
We raised these issues at several levels during reviews of the relevant draft laws and decrees and communicated them to the Ministry of Justice as the drafter of the Acts and the Ministry for National Economy and the MNB as drafters of the implementation decrees.
With the adoption by Parliament of the HUF Conversion Act on November 25, the complete set of rules regulating the contracts in question became available, including the MNB draft decrees, which by then had been reviewed in detail. To clarify the interpretation issues, we held a consultation for all members on November 27. The meeting was attended by representatives from the Ministry of Justice and the Ministry for National Economy, who touched upon some of the issues collected ahead of the meeting. After the meeting, a number of new questions were raised by banks (bringing the total number of questions to more 140). The questions were sent to the Ministries' representatives attending the meeting. The questions, inter alia, addressed the following interpretation and implementation issues:

- the definition of fair interest rate, the date and process for the reinstatement of fair interest rates - also in the context of HUF conversion,
- the rules for settlement, if the unfair term has not been applied,
- special issues related to the application of the settlement rules: the handling of currency change in the settlement model, performance by third parties (insurance company, state), settlements with debt collectors, cash payments in the absence of suitable branches, the treatment of foreign addressees, the treatment of banks' own debtor rescue schemes,
- application of the new rules on interest, charges and fees, in particular: interest and interest premium periods, the starting date for benchmark interest rates, the classification of certain interest rates that can be changed based on the reasons list (fix/variable), the definition of originally calculable interest premium, interest rates applicable after HUF conversion, applicable fees based on the fair banking rules,
- the implementation of the settlement/HUF conversion, where several months elapse between the time the amendment becomes effective and the time the settlement occurs, (HUF and real foreign currency loans),
- implementation of the process in cases specified in Section 12 of the HUF Conversion Act,
- special issues related to contracts involved in the Exchange Rate Cap Scheme,
- the rules for contracts outside the scope of Act XL of 2014.

After collecting and consolidating the issues raised, we held a high-level consultation with the Ministry of Justice on certain key interpretation issues. We drew up a memo on the meeting and sent

it to the Ministry for review. On December 16, we approached the Ministry with the remaining questions and those raised in the meantime. The Ministry's answers to both documents were received in the second week of January 2015. At the same time, the interpretation of certain provisions of the Acts has not been concluded yet, a number of issues will require further consultations.

Review of the proposed decrees of the Ministry for National Economy on consumer information and on buffer account loans

The Act on Fair Banking and the Act on the conversion of FX loans into HUF have mandated the Ministry for National Economy to set out by decree the rules for consumer information and the rules for determining the maturities for buffer account loans. The Ministry gave the Association the opportunity to comment on the relevant draft decrees.
The draft-decree on consumer information provided detailed guidance as to the additional oral and written pieces of information to be provided by creditors to help the consumer make a decisions. These include

- the description of the detailed parameters of the chosen loan,
- information on how the benchmark interest rate mechanism works,
- information on what the customer should do in case of any payment difficulties,
- presentation of the impacts of interest rate changes on the repayment amount, in a table format.

In our response we requested guidance on how the oral information provided should be certified. We also proposed that the statistical justification of the incomes used in the table should be clarified. The final decrees gave satisfactory answers to both of these questions.

In our comments on the draft decree on determining the maturities for buffer account loans, we submitted that the conditions set out in the draft decree were insufficient for creditor to calculate the appropriate maturities and the low repayment amounts set out in the decree would result in unmanageably long maturities.
The final decree has failed to address either of these concerns, which means that the decree will have to be adjusted subsequently.

Review of the Code of Conduct on Retail Lending

The various laws and regulations adopted since 2010 have repeatedly overridden a number of provisions of the Code of Conduct on Retail Lending – in particular, those of Chapter III on unilateral contract amendments. The Fair Banking Act, enacted to protect consumers, regulates this issue on a completely new basis, by providing indicators instead of a reasons list for unilateral contract amendments. As a result, the most important provisions of the Code of Conduct will become inapplicable from February 2015 (the deadline for banks to put into effect their new General Terms and Conditions as revised in accordance with the Fair Banking Act). Therefore, these provisions needed to be repealed. Following consultations with the Ministry for National Economy and the MNB[1], it was agreed that in view of its consumer protection provisions, the Code, as updated by abolishing the provisions overridden by the legislation should remain in force until the end of 2015. The Association's Board's corresponding decision was notified to all member. The updated Code of Conduct was published on the MNB's website on January 27.

[1] The Code of Conduct was drafted in 2009 with the involvement of the Ministry of Finance and the financial supervisory authority.

V. Other important regulatory developments affecting banks

Other regulatory changes affecting the money and capital markets

A new financial omnibus legislation was adopted at the end of the year. This, inter alia, is aimed at the transposition into Hungarian law of the EU Deposit Guarantee Schemes Directive. Here, a change will be that the scope of deposits protected by the National Deposit Insurance Fund (OBA) will be extended to include deposits of smaller municipalities, and certain special deposits, such as income from the sale of flats, insurance indemnity and crime indemnity will be protected up to EUR 150,000 instead of EUR 100,000. This extension of the scope of insured deposits is not objectionable in itself, but the fact that these deposits are not included in the fee base, which means that these are not subject to fee, is objectionable. This is against the logic of insurance. In this way, another disproportionality has been built into the deposit insurance system represented: for example, in case the bank managing the municipality's account goes bankrupt, the compensation should be paid from the common deposit insurance fund of OBA, despite the fact that the bank did not pay a deposit insurance fee on the deposit.

The law package also contains a number of capital market-related provisions (central clearing, security deposits) and tweaking amendments related to the integration of cooperative credit institutions, bank resolution. It should be mentioned here that another omnibus legislation is expected in March 2015, the Ministry for National Economy has already requested comments on the proposal.

As far as we know, a review of experience of the application of the new Civil Code may take place in 2015, including the making of any corrections to the legislation, if necessary.

Other legal interpretation and amendment requests

The Ministry for National Economy drafted a *Government Decree on eligible costs incurred during the application of resolution tools.* The Association was given the opportunity to review the proposed decree. The decree may set out the eligible costs incurred during the application of resolution tools based on Sections 35 and 145 (1) of the Bank Resolution Act (*Act XXXVII of 2014 on the further development of the institutional framework strengthening the security of certain actors of the financial intermediary system*). We proposed that the decree should not contain restrictions that would only allow reasonable and warranted costs to be reclaimed. In this context we submitted detailed proposals. However, our proposals were not incorporated in the decree. (*Government Decree No. 363/2014. (XII.30.) on eligible costs incurred during the application of resolution tools*).

We requested a ruling from the Ministry of Justice on whether loan agreements concluded in accordance with the new Civil Code can be secured by framework mortgage agreements concluded in accordance with the Civil Code. In addition, we submitted a proposal to allow the institution of lien on deposits. Solutions to these issues are expected in 2015.

VI. Developments related to supervision

Consultation on the proposed „bad bank"

The idea of setting up a "bad bank" was mentioned for the first time by the MNB in its May 2014 Financial Stability Report, as part of its measures to help banks clean up their corporate loan portfolios. Soon after that, the MNB also announced its plan to set up an asset management agency (to be fully owned by the MNB) for this purpose.
Top MNB officials, in their interviews and publications, explained that the purpose of the asset manager would be to help banks reduce their non-performing commercial real estate loan portfolios, thus ridding the banking system of its bad loans. They emphasised that non-performing commercial real estate loans are the primary assets that are weakening healthy lending and consequently, hindering effective monetary policy. To achieve the objective, the MNB regards the asset management agency as a monetary policy tool that might improve credit channel efficiency and monetary transmission. By improving monetary transmission, this monetary policy tool will also help in meeting the inflation target.
In late summer, the MNB's competent Deputy Governor initiated consultations with the Association on details of the bad loans portfolio and the operation of the asset management agency. At its extraordinary meeting of September 19, 2014, the Association's Board agreed to set up a high-level working group on the issue.
The asset management agency, MARK Zrt., was set up with some delay, in early November, and the consultations between the Association and MARK's leaders and specialists began.

As a result of several months of preparatory project work, the MNB and MARK Zrt. presented to the Association the following proposals regarding the tasks and operation of MARK Zrt.:

- The claims/assets will be purchased by MARK on a market basis, under solutions to be developed by the MNB and MARK based on the principle of business decisions between equal parties.
- The scope of claims/assets suitable for take-over by MARK in the form of claim assignment or asset purchase will be specified. It is expected that only Hungarian real estate or loans secured by Hungarian real estate will be purchased by MARK.
- The take-over may be done in two ways (through an accelerated process or under a normal schedule). The details of these procedures are to be developed.
- If the real estate loan is part of a bigger services package granted by the bank group in question, the claim assignment will not affect the other products (e.g., guarantees) and services (e.g., account management) in the package. The relevant details are to be clarified.
- In developing the programme, the requirements set out by EU institutions should be taken into account.

It was agreed that a joint expert group made up of representatives from MNB, MARK and the Association will be established. The expert group commenced operation in the second week of January 2015.

MNB consumer booklets

The MNB continues the publication of its consumer protection booklets as scheduled. The booklets are reviewed by the Association before publication. In those cases, where regulatory changes are expected, we propose that the booklets are only published electronically to avoid outdated publications being in circulation. In the fourth quarter, we reviewed the booklets on consumer loans, the monthly two free cash withdrawals option, the question of what to do in case of termination of the loan contract, pre-investment information, risks in the use of bank cards/credit cards and choosing bank accounts.

New MNB reporting requirements (deposit and account products)

Under its Decree No. 51/2014. (XII. 9.), the MNB collects data on deposit and account products. This data collection is aimed to support the MNB's analyses of payment services and related price monitoring. In addition, a part of these data are used for the MNB's website calculators helping customers to choose between banks' deposit and account products.
The relevant reporting requirements will change from 2015, with more data to be reported. The MNB held a consultation in mid-December on the changes taking effect on January 1, 2015. With the short notice, preparations for these changes were a major challenge for banks.

MNB recommendation on internal defence lines

The MNB is updating the recommendation previously issued by Hungarian Financial Supervisory Authority (PSZÁF). Together with the Compliance Working Group, we requested a meeting on the draft recommendation with the MNB to obtain clarifications on some key questions, such as what the expectations are regarding the place of this function in the organisational structure and whether the integration of this function with other functions (such as the data protection officer's function) is allowed or not. The main problem is that while in the case of investment services, this function is regulated by an Act, in the case of financial services it is not so. Hence, the MNB recommendation is especially important. However, even in this case, it would be desirable for the compliance requirements and for the conflict of interest and organisational rules to be regulated by an Act.

Independent appraisers' application award committee under the bank resolution legislation

The Bank Resolution Act (Act XXXVII of 2014) requires the MNB to, as an element of the resolution process, provide for the independent, true and fair appraisal of the institution's assets and liabilities by a person specified by legislation, meeting the relevant professional and conflict of interest criteria. The MNB keeps a register of independent appraisers. It invites applications for registration and the applications are appraised and the registration decided on by a committee established for this purpose.
The MNB established the committee in October, with seven members (the maximum number of members specified in the Act). The Hungarian Banking Association and the Association of Investment Fund and Asset Management Companies have been allocated one seat each on the committee. At its kick-off meeting on November 11, the committee adopted its rules of procedure, elected the Head of MNB's Resolution and Reorganisation Department as Chair, and decided on the applications received in October from nine individuals and 25 legal entities. Since none of the applications had fully complied with the conditions set out in the competition invitation, a rectification procedure was conducted in December. The committee is expected to decide on the registration in January.

VII. Payments

Reduction of the Financial Transaction Levy on bank card payments

The banking community has long advocated for the reduction of the Financial Transaction Levy on bank card payments, since it adversely affects this modern payment method. Unexpectedly, and without any prior consultation, a proposal was tabled to Parliament, providing that the levy base shall be the total value of payments made with the same bank card in the year in question (probably resulting in a decrease of the total levy payable). Pursuant to the new regulation, the FTL on bank card transactions will be a flat annual HUF 800, or HUF 500 for contactless cards. Following the publication of the legislation on the Parliament's website, we took up the matter with the Ministry for National Economy and were given the opportunity to submit our tweaking proposals. The Cards,

Tax and Payments Working Groups proposed amendments to the legislation in relation to the following:

- the interpretation of the term „same bank card" (e.g, new bank cards issued to replace expired cards or stolen cards, or new, contactless bank cards issued to replace the old, non-contactless cards should be treated identically for the purpose of FTL).
- the lower FTL rate shall apply even if just one transaction has been carried out with a contactless card,
- if a bank card has not been used at all, it should be exempt from FTL.

Our proposals were only partially accepted, but the Ministry promised to issue rulings to clarify those questions which are not adequately clear in the legislation.

New QR Code services of the Hungarian Post Office – Consultation on a new payment method for postal payment vouchers (yellow cheques)

At the meeting of the Payments Working Group, participants indicated that the Post Office planned to amend its General Terms and Conditions with an extremely short notice in a matter largely affecting banks (QR code payments). According to the Hungarian Post Office's plans, customers would be able to pay their "white and yellow cheques" by downloading the Post Office's application to their mobile phones and make the payment remotely with their bank cards by using the QR codes printed on the cheques.

At members' request, the Association organised a consultation for members' specialists with the Hungarian Post Office. At the consultation, the Hungarian Post Office informed the following:

- The Post Office is required by law to introduce this modern e-payment method. The legislators have provided for a very short implementation time.
- There would be no inconvenience for banks, since no QR code payments would yet be possible at the time of entry into force of the amended General Terms and Conditions (thus far, only one print shop has applied for a licence to print QR codes - the licensing is in process).
- The issue of new QR coded cheques will only be mandatory from 2015 and the old cheques can be used until the end of 2015,
- A meaningful change is only expected from the bank card payment of yellow cheques, however, this is only expected to be introduced in Q1 2015.

Specialists from member banks indicated the following:

- a number of important documents required for preparations are still missing (process description, test procedure),
- the refund of cheque/bank card payments made to wrong bank accounts is unsettled,
- billers are not informed about the changes (banks proposed to the Hungarian Post Office the preparation of a common information material).

After clarifying a number of important details, the consultation was concluded by banks taking note of the starting date set by the Hungarian Post Office for QR code payments and of the fact that this will not generate immediate tasks for banks. Representatives from the Post Office promised to provide the missing documentation and to ensure further consultation opportunities, if necessary.

Association request for the extension of the CLS project deadline

At the MNB's request, the Association is involved in the CLS programme. This programme is aimed to connect the forint as a foreign currency to the Continuous Linked Settlement System operated by CLS Bank. The Association's Board reviewed the issues related to the implementation of the legislation adopted in the wake of the Supreme Court's uniformity ruling on FX loans. The Board established that the exchange rate and interest compensation to be provided to customers and the conversion of

FX loans into HUF would have a fundamental impact on the FX positions and transactions of most member banks during the next period, overriding their business plans. To ensure the successful implementation of these two interrelated tasks, the Associations Board initiated with the MNB that the timetable for the CLS programme be aligned with the timetable set for the implementation of the FX loan-related tasks, since banks can only develop accurate business plans once the FX loans are settled. The Association requested the extension of the deadline for the start of CLS settlements by six months, from the second half of 2015 to the beginning of 2016.

The MNB Financial Stability Board (FSB) addressed the request on October 28, 2014. In view of the proposed time requirement for the project and of the fact that the process of the MNB joining the system is separate from the process for individual banks to join the system, the FSB decided that the end date for the forint to be connected to the CLS system shall be November 30, 2015. Since the original date was April 2015, this means that banks will have a nearly nine months longer time to prepare themselves.

Association request to postpone the IG1-IG2 project

After its acquisition by the MNB, GIRO has adopted a new strategy, in line the MNB's objectives. An important element of the new strategy is the migration of the items from its overnight processing platform IG1 to its daytime processing platform IG2. Although the process of direct debit would have remained unchanged in the bank-to-customer space, the changes in the inter-bank space would have required significant developments. The banking community indicated to GIRO at several forums that due to the huge tasks related to the FX loan settlement process and the HUF conversion of FX loans, banks were unable to commit the resources required for the development projects entailed by the changes in the direct debit process. Since these indications were not taken into account, the Association's Board turned to the MNB's top management, requesting them to take into account the aspects of banks. Following the sending of this letter, GIRO informed us that the project of migration of direct debits into the IG2 system has been postponed.

Cafeteria support for home loan repayments: new ISO purpose code in InterGiro2

It was raised in the Payments Working Group that a special purpose code should be created to be used by employers for home loan repayments under the cafeteria system. This would substantially help banks in meeting their cafeteria reporting obligations. The new purpose code will have to be approved by the International Organisation for Standardisation (ISO).
The Working Group requested the Association to take action with the ISO for the introduction and use of this special purpose code for reporting purposes. In response to the Association's request, the ISO 20022 standard registration body has added the HREC (Housing Related Contribution) purpose code to its code list, effective November 28. In the future, this purpose code will designate the home loan repayment support granted by employers under the cafeteria system. GIRO informed that from January 8, 2015, banks can send payments with the new HREC purpose code through the InterGIRO2 platform.
The HREC purpose code has the same meaning as the CAL group transfer purpose code (group transfer of home loan repayments under the cafeteria system). The HREC purpose code can be used in non-group transfer orders in the InterGIRO2 system and the relevant inter-bank messages cleared by GIRO.
Purpose codes are used in the ISO 20022 standard to notify the beneficiary on the purpose of the payment. In other words, they contain information to be forwarded to the beneficiary. At the same time, the payer's bank can also use this information, for example, to collect the total amount of housing contribution granted by the employers under the cafeteria system, on which it is required to provide a certificate to the employer for tax purposes.

New HUF 10,000 banknote

Consultations between banks and the central bank and among banks intensified ahead of the date of putting into circulation of the new HUF 10,000 banknote in December 2014.
The main issued addressed during these consultation included the following:

- banks' involvement in the frontloading process,
- the purchase – under appropriate terms and conditions – of the software required for the identification and processing of the new banknotes,
- technical, reporting and timing issues related to the conversion of the banknote processing machines,
- sharing the experience of the ATM tests.

The Association helped the smooth introduction of the new banknotes by representing the banking community's position vis-á-vis the central bank, organising the work of the Cash Working Group and coordinating the information flow between banks.

Central customer statements register related to the monthly two free cash withdrawals option

The uploading of customer statements into BISZ Zrt.'s „KPKNY" system took place on December 1, 2014. The new rule for application by the customer for the monthly two free cash withdrawals option also took effect on December 1. According to this, the customer does not have to withdraw the statement he provided to the old bank, because the statement provided at the new bank overrides the old statement provided at the old bank. The customer may request information on whether he has provided any statement and if so, at which bank, free of charge. A minor amendment to the Act on Payment Services is needed to allow for this information to be provided also electronically, if so requested by the customer. We drafted the relevant amendment proposal jointly with BISZ and sent it to the Ministry for National Economy.

Bank cards

Competition for a Hungarian term for "contactless bank cards"

In keeping with the development of this innovative and popular technology, the Association invited a competition to find simple, intelligible and technically proper terms in two categories: one for the cards and one for the payment method. The competition was well-received, with 3,000 proposals submitted under 1,270 bids. The award ceremony, combined with a press conference, was held on November 4, 2014. The jury included representatives from the MNB, the two large card associations and the Hungarian Banking Association. Observance of the linguistic aspects and rules and the aspects of colloquial and professional use were ensured by an expert from the Hungarian Academy of Sciences and an economic journalist. The winner for the term for the card was "érintőkártya" (touch card), the winner for the method was the term "érintés" (touch). At the award ceremony, the jury member representing the MNB, Lajos Bartha gave a presentation on contactless cards, followed by a presentation by Dr. Erzsébet Nagy Heltai from the Hungarian Academy of Sciences about interesting linguistic solutions in the bids.

Q3 Statistics

The MNB published in Q3 payments statistics on December 31, 2014. Figures reveal that the use of electronic payment methods continued to increase. The MNB considered that the although the number of equipment enabling card payments increased at a slower pace than in previous years, the

contactless technology continued to become increasingly wide-spread, with the development of POS networks focusing mainly on this technology. Accordingly, although the total number of payment cards fell slightly, the share of contactless cards rose.

ECB-MNB recommendation for the security of internet payments

At the MNB's request, the Association informed members both orally in the working groups and in writing on future expectations regarding interment payments. The European System of Central Banks (ESCB) and the European Banking Authority (EBA) agreed a set of security requirements for internet payments. The SecurePay Forum, established by the ESCB and the EBA in 2011, developed 14 recommendations for internet payments, including criteria for assessing their implementation. Payment service providers in member states should comply with the recommendations effective February 1, 2015. The EBA published its final guidance based on these recommendations in October 2014.
The MNB will inspect Hungarian payment service providers' compliance in 2015. It will send them a self-assessment questionnaire in February 2015, with a response deadline of six to eight weeks, and simultaneously, will conduct on-site inspections to inspect compliance.

Review of the EBA Guidelines on national provisional lists of the most representative services linked to a payment account and subject to a fee

The EU Payment Accounts Directive, adopted in 2014, mandates the EBA to issue guidelines to help national authorities in identifying the most representative and most costly banking services related to payment accounts. The objective is to prepare a common European list of 15-20 banking services, with standardised terminology and contents. All banks should use this list. The lists will be comparable both nationally and across member states, making bank switching easier.
In its comments on the EBA's relevant consultation paper, the Association's Bank Accounts working group

- agreed with the option that national authorities should not be required to substantiate their recommendations with supportive data,
- considered that the two selection criteria – also specified by the Directive – were insufficient. Instead, the Working Group proposed that national authorities should be allowed to define additional selection criteria (although this would make the creation of a standardised list more difficult). The Working Group pointed out that the overdraft mentioned in the proposal is not a standard optional product associated with the payment account, since the use of overdraft is subject to separate regulations.

We sent our comments to the European Banking Federation and the EBF incorporated them in its response to the consultation paper.

Presentation by the Secretary General of the European Payments Council (EPC) at the Association

On its series of visits to member states ahead of the 50th and, in this form the last, plenary meeting of the EPC, the EPC Secretary *Etienne Goosse* paid a visit to the Hungarian Banking Association to provide first-hand information on the proposed new structure of the EPC. In addition to the SEPA Working Committee, the meeting was attended by banks involved in SEPA payment schemes (primarily, the SEPA Credit Transfer Scheme) and representatives from the MNB and the Hungarian State Treasury.

The Secretary General said that the need to renew the EPC's organisation was prompted by several factors. The current monolithic structure was created in 2002, when the EPC was the only custodian of the SEPA project. By now, the situation has changed fundamentally. The EPC's mission has been

essentially accomplished. The SEPA Credit Transfer and SEPA Direct Debit Schemes have been gradually introduced since 2008, and with regulatory intervention, the migration of eurozone payment service providers to SEPA was completed by August 2014. Another reason for the change is the appearance of new stakeholders and the fact that a new governing body, led by the ECB, and a related new structure bringing together stakeholders has been established to further catalyse the SEPA process. The Secretary General admitted that there has been some uncertainty among members in recent years, seven members quit the EPC. The number of regulations affecting payments has increased and technological development requires innovations, whose incorporation in SEPA is a must (and advisable).

The Secretary General presented the proposed mission statement for the New EPC, the organisational structure that can best support this mission, and the financing calculations. The New EPC's mission is to contribute to safe, reliable, efficient, convenient and economically balanced and sustainable payments, which meet the needs of payment service users and support the goals of competitiveness and innovation in an integrated European economy. The EPC seeks to accomplish these objectives by managing the pan-European payment schemes, developing positions on issues related to European payments and conducting ongoing dialogue with stakeholders under a comprehensive strategy.
To achieve these goals, the current monolithic organisation will be replaced with a modular governance structure. There will be two modules: Module1, with a separate managing body, the Scheme Management Board (SMB), to manage tasks related to the already operating SEPA payment schemes, and Module2 to manage tasks related to regulation. Above the two modules would be a new General Assembly and a new EPC Board, supported by a Secretariat.
The financing of the new organisation would mirror the new organisational structure, with separate membership fees for the New EPC for Module1 and for Module2. EPC members would automatically become members of the New EPC. Membership in Module1 would be mandatory for all SEPA Scheme Participants, with a mandatory membership fee, while membership in Module 2 would be optional.
Based on the 2014 budget as an upper limit and the 2014 membership numbers, the 2015 membership fees for the above three categories are estimated as follows: the New EPC membership fee would be EUR 10,000; the annual Scheme membership fee for Scheme Participants would be EUR 230 for each Scheme, and the membership fee for Module2 would be EUR 25,000. A combined membership fee category would be created for the two voluntary memberships: those with membership in both the new EPC and Module2 would pay a combined membership fee of EUR 30,000.

Etienne Goosse finished his presentation by saying that the final decisions would be adopted by the EPC General Assembly on December 11, 2014. Until then, every stakeholder could consider how they wanted to be involved in the future. He expressed hope that the Hungarian banking community would continue to represent itself in the New EPC.

Main decisions of the EPC plenary meeting of December 11, 2014 - interrelation with the ERPB[2] work plan

[2] Euro Retail Payments Board: a body established by the European Central Bank to promote SEPA dialogue between stakeholders on the demand and supply sides and to identify and address strategic issues and manage their implementation. It is made up of representaives from the the demand side (consumers, SMEs, large companies) and the suppy side (banks, payment service providers and e-money issuers). Furthermore, representatives from euro area and non-euro area central banks participate in the ERPB meetings a rotational basis as active participants, and the European Commission attends the meetings as an observer.

The EPC plenary meeting adopted the Charter of the New EPC. The French version of the Statutes is the governing version, but it was emphasised that it is the same as the English version presented to the plenary meeting.
Pursuant to the Charter, the New EPC governance and work structure is modular and financed accordingly. The role of the plenary meeting will be taken over by the General Assembly. EPC plenary members – including the Hungarian Banking Association - will automatically become members of the General Assembly. The General Assembly will elect the Board.

The payment schemes operating under Module1 (SCT, SDD, SDD-B2B) form an independent unit with an own managing body, the SMB. Scheme Participants automatically become Module1 members.

Module2 will be managed by the Board. It was agreed that the former working groups (the *Cash Expert Working Group*, the *Payment Security Support Group* and an *Expert Group* supporting the Card Stakeholder Group's activities) will be revived. In addition, two new working groups will be established to mirror the ERPB working groups: the Working Group on Person-to-Person Mobile Payments and the Working Group on Mobile- and Card-Based Contactless Proximity Payments.

The Charter allows members may acquire seats together in the two management bodies by forming coalitions to reach the required payment volumes (the seats are allocated based on payment volumes). The Association acquired a seat in the SMB in coalition with *Italy, San Marino and Croatia* and a seat on the Board in coalition with the *Czech Republic and Slovakia*. The coalitions appoint their representatives on a rotational basis, in accordance with coalition procedures to be drawn up in accordance with the relevant provision of the Charter.
The plenary meeting adopted the new Rulebooks. The new Rulebooks will take effect on November 22, 2015 and are now available on the EPC's website.

VIII. Taxation, accounting

Special tax on investment funds

The 2015 tax law package passed by Parliament includes a new special tax on investment funds and investment fund distributors. However, the legislation fails to provide clear guidance on a number of issues related to the application of the law. In consultation with the Association of Hungarian Investment Fund and Asset Management Companies (BAMOSZ), we requested a ruling from the Ministry for National Economy and submitted proposals to make the wording of the legislation more specific, in particular in respect of the definition of the tax base and the tax status of investment funds. The new tax, applicable from January 1, 2015, affects the calculation of the net asset values of investment funds. This also requires clear guidance.

Tax adjustments related to the Settlement Act

The promulgated tax law package has left a number of issues open. We compiled the open questions and sent them to the Ministry for National Economy. We requested the Ministry to confirm that under the new Section 29/ZS of the Corporate Tax Act, incorporated into the legislation in connection with the Settlement Act, the special credit institution tax has the same status as the special financial institution tax, since this public burden is a supplementary tax to the special financial institution tax, and therefore, of the same character. The objective in its introduction was to replace the special financial institution tax, payable by profitable banks on total assets, with a tax payable on pre-tax

profit. In calculating the special financial institution tax liability, the special credit institution tax is taken into account up to 30% of pre-tax profit, in a way that this tax burden is capped in the special financial institution tax liability payable on 2009 adjusted total assets. This is sufficient proof that these two taxes are the same and the special credit institution tax can be taken into account for the purpose of Section 29/ZS of the Corporate Tax Act regardless of the fact that the legislation does not specifically mention this tax type. Official confirmation from the authorities is important for banks to be able to properly meet their tax obligations.

It is also important to clarify how the differences to be calculated retrospectively up to 2004 affect 2009 total assets, which are the tax base for the special financial institution tax. It is unclear whether this effect should be calculated from 2004, or only from the starting year for which the relevant tax self-revisions can be filed, i.e., from 2008. In our view, banks would do the right thing by taking the "original" 2009 total assets for the purpose of determining the 2015 special financial institution tax liability until the 2009 total assets are recalculated in accordance with Section 29/ZS of the Corporate Tax Act (the filing of the tax returns on the corporate tax top-up liability for 2015). However, after that (provided that the definition of the tax base remains unchanged in the legislation), the future special financial institution tax liability should be calculated based on the adjusted total assets.

Request to the MNB to make provisions deductible in the calculation of the FX Funding Adequacy Ratio

In the fourth quarter of 2014 we requested the MNB to amend its decree regulating the maturity mismatch of foreign currency positions of credit institutions (FX Funding Adequacy Ratio regulation), in view of the adverse impacts of the FX loan settlement process on FX positions. In November, the MNB sent us the proposed amendment to the decree. This sought to solve the temporary effect of FX loan settlement losses through central bank swap transactions. After consultations with members, we indicated to the MNB that FX swap transactions were not a solution for all banks, since not all banks had swaps in their books. Instead, we requested that provisions on losses from FX loan settlements should be made deductible, since that would be a more manageable solution for the temporary state (until the actual settlement takes place). Pursuant to the current FX Funding Adequacy Ratio regulation, impairment is deductible from the stock of FX loans, while the regulation is silent on the deductibility of provisions. The provisions to be made on FX loan settlement losses are temporary and in terms of economic substance are of the same character as impairment. In other words, they cover future realised losses - in this case: differences from the settlement of FX loans. Therefore, we consider it warranted to apply the same methodology, that is, to allow the provisions, or at least those made in foreign currency, to be deductible. The temporary state also warrants the application of special rules for a special settlement situation.

Amendments to the Government Decree on book-keeping, NPL reporting

The standardisation of the frameworks for credit institutions' reporting in the EU – focused on systemically important institutions – prompted the MNB to introduce a reporting requirement on non-performing and restructured loans, with the same level of detail as that provided by the EU methodology. The imposition of this new reporting requirement would have required an amendment to the relevant government decree (Government Decree No. 250/200 on book-keeping rules for credit institutions). This could not be carried out due to the complexity of the legal framework and the time requirement of the related system developments. We conducted several consultations on the issue in Q4 with the Ministry for National Economy and the MNB. Finally, the MNB accepted our arguments. Thus, Annex 7 to the Government Decree was left unchanged. Instead, the relevant reporting requirements taking effect on January 1, 2015 were changed.

The book-keeping rules related to portfolio quality remained unchanged, with some minor adjustments. As a positive development, the regulators accepted our arguments, and as a result, the

refundable tax overpayments can be deducted from the losses from FX loan settlements to be reported as provisions at year-end.

Government Resolution on transition to IFRS

The Government Resolution providing for a schedule for transition to IFRS was issued at the end of the year. This provides for the continuation of the preparatory works, including the preparation of studies and analyses on a number of issues in the first half of 2015 with a view to developing the rules and setting the deadline for transition to IFRS. The aspects set out in the preparatory stage will be developed in detail by five working groups. The Association has been allocated seats in the Financial Institutions Working Group (the only sector-specific working group). The Accounting, Tax and Fiscal Working Groups (the latter also responsible for education and training) and the Statistics Working Group are made up of experts from the regulatory and supervisory authorities and from auditing firms. The work will commence in mid-January. We are seeking involvement in activities of the functional working groups, since transition to IFRS will be a comprehensive change, which will require thorough preparation.

IX. Other Association developments

European Money Week

The European Money Week is a programme launched by the European Banking Federation to promote financial literacy at national and European level. Participants in the programme will concentrate some actions on financial education during that week, with a view to boosting public awareness and interest. The European Money Week will be held annually, in the second week of March. The first EMW will be held between March 9 and 15, 2015. The Association's Board supported the Association's participation in the programme. Éva Hegedűs, member of the Board, has undertaken the management of the project and representation of the Association in the programme. The Association has officially announced to the EBF its participation in the 2015 programme. 23 countries have now registered for the 2015 programme. A key objective in the programme is to establish cooperation between organisations and institutions working to promote financial literacy. According to plans, the Hungarian Money Week programme will start with an international conference, followed by thematic classes at schools and associated events. The MNB's Pénziránytű Alapítvány (Financial Compass Foundation) will act as a co-organiser of the project, cooperating partners will include the Ministry for Human Resources, the Ministry for National Economy and the State Audit Office.

Board decision regarding the standardisation of training

An objective of the Association's Education and Training Working Group is to formulate and set up a set of requirements that could serve as a basis for the basic training of branch staff and new recruits. The Working Group decided to develop a proposal for standard curricula under two pilot projects (one for the training of new branch recruits and one for training on investment services). The Chair of the Working Group presented the proposed topics at the December board meeting. Members of the Board had different opinions on the timeliness of the project. In view of current tasks related to the implementation of the Settlement, HUF Conversion and Fair Banking Acts, the Board requested the Secretary-General to submit, at a later stage, a proposals for the continuation of the work.

Actions of the Physical Security Working Group related to security risks in the FX loans settlement process

At its meeting in November, the Physical Security Working Group reviewed potential risks related to the FX loans settlement process, in particular, risks entailed by an increased customer traffic and by potential mass cash disbursements at branches, and physical security risks outside the branches. The Working Group reviewed the tools available for banks to manage these risks and agreed that regarding the further management of risks, consultations should be conducted with the Police. To assess how big these problems might be, the Working Group decided to draft a questionnaire to collect data on the expected increase in customer traffic and cash disbursements and on planned security measures. The Working Group requested the Association's staff to assist in sending out and collecting the questionnaires.

Anti-Money Laundering Working Group

The former head of the Anti-Money Laundering Working Group, Zsombor Brommer, who continues his career in London, was awarded with the Association's Commemorative Certificate. His successor, is Ildikó Józsa, Director, MKB Bank. The Working Group monitored non-natural persons' compliance with the requirement to submit their beneficial owner statements by end-2014, in the absence of which banks had to block certain transactions. Compliance with this requirement was made difficult by the fact that the first working day in 2015 was January 5, and the blocking of bank card transactions would have caused major difficulties to corporate card-holding customers being on vacation for the holiday season. Banks drew customers' attention several times through several channels to compliance with the regulation.
In our response to the EBF's question ahead of the promulgation of the Fourth Anti-Money Laundering Directive, we supported the proposal that there should be no differentiation between the treatment of domestic and foreign political public actors. The Working Group is monitoring the updated EU and international sanctions list and their application on an ongoing basis. Russian and Ukrainian exposures are a daily challenge for banks.

Central Credit Bureau Working Group

At its meeting in the autumn, the Working Group reviewed the developments since its meeting six months ago:

- Central Credit Bureau data reflect a decreasing willingness to lend in both the retail and corporate segments,
- consumers' willingness to consent to inquiries on their positive credit histories remains low,
- the share of electronic information provision in the case of consumer inquiries has improved,
- the accuracy of data reported to the system, in particular those on outstanding principal amounts and on repayments, which are to be provided during monthly data maintenance and are key pieces of information, has significantly improved.

The heads of BISZ, the company managing the Central Credit Bureau briefed participants on the main IT development projects related to the system and on the new feature supporting market research. It became clear for all participants that tasks related to the Settlement Act and HUF Conversion Act will be the most important ones in the coming period. However, the questions raised could not be answered due to the absence of relevant regulation.

E-Working Group workshops

Mobile Wallet (MobilTárca) is a smartphone application that is capable of collecting one's plastic cards in a virtual form in one place. Mobile Wallet dematerialises the bank cards, loyalty cards, passes, coupons and tickets, in other words, all plastic and hard-copy cards that are required for the initiation of transactions or for authentication and kept in one's wallet. A new era in the use of these instruments is the NFC (Near Field Communication) technology, enabling the user to pay or authenticate his loyalty cards or tickets by one touch. The Association organised a kick-off workshop on the issue for interested members in July, in cooperation with Mobiltárca Egyesület (Mobile Wallet Association). This was followed by another event on mobile payments and mobile wallets on October 30, where we provided a professional overview, reviewed current market developments and gave an update on the results of the recently concluded mobile payments pilot. We also announced an incubation programme aimed to make available the necessary information for potential card issuers to

- decide on their joining of the MobilTárca ecosystem,
- reduce the pre-integration phase.

Data Protection Working Group

At its meeting in Q4, the Data Protection Working Group heard a presentation by Kornél Bódis, member of the Board of the Association of Hungarian Debt Collectors (MAKISZ), followed by a detailed consultation. The consultation addressed the ideas and principles for a potential debt collection Act. We also reviewed data protection issues related to the FATCA regulation and the customer statements register related to the monthly two free cash withdrawals option.

Communications

The settlement of FX loans was the main topic in our communications in Q4. We continued our regular communications, informing the media and the public on current developments and issues of interest. The Association's leaders and officials gave a number of interviews on the key issues. At a press club event on November 11, we summarised the most important points to know regarding FX loan settlement process and the HUF conversion process and the MNB's related FX transactions. At a press meeting held jointly with the MNB Consumer Protection Directorate on December 16, we briefed journalists on actions to be taken by customers and on the settlement procedure and its timetable.

In Q4 we issued two press releases. In a press release issued jointly with the Ministry for National Industry and the MNB on November 12, we drew our corporate customers' attention to the fact that no transaction can be initiated in 2015 without beneficial owner statements. In a press release on December 11, we confirmed the warning previously published by the Police on its website (police.hu) on a bank card phishing fraud on a social media website.

We had fewer appearances in the media in Q4 due to the long December holiday season. We had appearances in the online media in 114 instances, followed by the print media, in 84 instances and the electronic media, in 71 instances. In total, we had nearly 270 appearances and mentions in the Hungarian media in Q4.

A highlight in the fourth quarter was the launch of the Association's new publication „Gazdaság és Pénzügy/Economy and Finance", co-sponsored by the Budapest Stock Exchange, KELER, the Confederation of Hungarian Employers and Industrialists (MGYOSZ) and the National Association of Entrepreneurs and Employers (VOSZ). The involvement of co-sponsors ensures that the publication will be able to cover a wide range of diverse and synergetic topics of economy and finance.

X. ANNEX

INTERNATIONAL DEVELOPMENTS, REGULATION, SUPERVISION

I Global regulation

The G20 Summit setting the main directions for global regulation was held in November in Brisbane, Australia. The meeting primarily addressed the issues of economic growth and climate change. The communiqué on the meeting addressed, inter alia, the issues of raising private infrastructure investment, increasing the participation rate of women in the economy, fighting corruption, tax evasion and money laundering, an Energy Efficiency Action Plan, the Principles for Energy Collaboration, contributions to the Green Climate Fund and progress in financial regulatory reforms.

I.1 Financial Stability Board (FSB[3])

I.1.1 FSB Chair's letter to the G20 leaders

The Financial Stability Board's Chair's letter to the G20 leaders ahead of the Brisbane summit reported on progress in financial reforms, highlighting the following main points:

1. The job of agreeing on measures to fix the fault lines that caused the financial crisis is substantially complete. Strengthened international standards are building more resilient financial institutions and more robust markets.
2. The endorsement of proposals to end Too Big To Fail in the banking sector will be a watershed. Once implemented, these agreements will play important roles in enabling global systemically important banks (G-SIBs) to be resolved without using public funds and without disruption to the wider financial system.
3. In the next phase of financial reform, the FSB will focus on addressing new and constantly evolving risks and vulnerabilities**.** Many of these risks arise from outside the core of the financial system. The FSB asks for the ongoing support of the G20 in addressing these new risks and, where appropriate, in developing common responses to promote global financial stability.
4. The FSB seeks the support of G20 leaders to promote a system based on mutual trust and co-operation**.** Building trust relies on consistent implementation of agreed common standards, with the recognition that each jurisdiction will need to take account of its own circumstances while implementing internationally agreed minimum standards.

I.1.2 Report on shadow banking

The FSB report on shadow banking reviews the FSB's two-pronged strategy to address the regulatory shortcomings that contributed to the global financial crisis and to build safer and more sustainable sources of financing for the real economy. To achieve this, the FSB will establish a system-wide monitoring framework to track developments in the shadow banking system with a view to identifying the build-up of systemic risks and initiating corrective actions where necessary. The FSB proposes actions in five areas to reduce excessive build-up of leverage and maturity and liquidity mismatch in the system. The report also includes a roadmap for strengthened oversight and regulation of shadow banking in 2015.

I.1.3 FSB consultative document on Total Loss-Absorbing Capacity for global systemic bank (TLAC[4])

[3] Financial Stability Board: the highest international body for financial standards

The FSB report to the 2013 St Petersburg G20 Summit had identified the need to develop a proposal for a minimum standard for the loss absorbing capacity of G-SIBs by end-2014, with a view to ending too-big-to-fail. (Other key elements to ensure effective resolution include the implementation of appropriate legislative reforms, structural changes to ensure resolvability, enhanced cross-border information sharing and the prevention of large-scale early termination of financial contracts in resolution). The FSB's consultative document proposes to set a new minimum requirement for total loss-absorbing capacity (TLAC) for global systemically important banks. The minimum Pillar 1 TLAC requirement is a requirement for loss absorbing capacity on both a going concern and gone concern basis, incorporating existing Basel III minimum capital requirements and excluding Basel III capital buffers. The proposal specifies in detail the instruments and maturities eligible for recognition in the TLAC and those liabilities excluded from the TLAC. The FSB proposes that a single specific minimum Pillar 1 TLAC requirement be set within the range of 16%–20% of RWAs and at least twice the Basel III Tier 1 leverage ratio requirement. The final calibration of the common Pillar 1 Minimum TLAC requirement will take into account the results of the consultation and the Quantitative Impact Study and market survey to be carried out in early 2015. Authorities may determine an additional Pillar 2 TLAC requirement for individual firms based on the individual G-SIB's recovery and resolution plans, its systemic footprint, business model, risk profile and organisational structure. The calibration and composition of firm-specific TLAC requirements should be determined in consultation with the Crisis Management Groups involved and subject to review in the Resolvability Assessment Process. In addition to protecting taxpayers' funds, the proposal aims to ensure a level playing field internationally by reducing G-SIBs' funding cost advantage.
Comments on the consultative document were invited by February 2, 2015.
The European Banking Federation supports the endeavour to develop a global loss absorbing capacity standard, however, it considers that the proposed 16%-20% minimum requirement is too high.

I.1.4 Other documents published ahead of the G20 Summit

Other documents published ahead of the G20 Summit included the following:

- FSB consultative document on cross-border resolution actions
- FSB report to the G20 on progress in reforming resolution regimes and resolution plans for global systemically important financial institutions (G-SIFIs)
- BCBS[5] report to G20 leaders on reducing excessive variability in bank's regulatory capital ratios
- International Association of Insurance Supervisors report on basic capital requirements for global systemically important insurers
- OTC Derivatives Regulatory Group report to the G20 on cross-border implementation issues

I.2 Basel Committee on Banking Supervision

I.2.1 Report to G20 leaders on progress in the implementation of the Basel III standards

In its fifth progress report, the BCBS established that by end-2013, all 27 Committee members had implemented the Basel risk-based capital regulations. The adoption of Basel III regulations for liquidity and leverage ratios and for global systemically important banks (G-SIBs) and domestic systemically important banks (D-SIBs) is currently underway. As of September 2014, 23 members had issued final or draft rules on their G-SIB or D-SIB framework, 26 had issued final or draft rules on the

[4] Total Loss Absorbing Capacity, basically corresponding to the Minimum Requirement for Own Funds and Eligible Liabilities (MREL) set for all banks in the BRRD.
[5] Basel Committee on Banking Supervision

Liquidity Coverage Ratio (LCR), and 23 had issued final or draft rules on the leverage ratio. Banks also continue to make progress towards meeting the fully phased-in Basel III capital requirements by the 2019 deadline. The average Common Equity Tier 1 (CET1) capital ratio of large internationally active banks rose from 9.5% to 10.2%. The report establishes that despite these good numbers, a number of banks still need to improve their capital and liquidity positions to meet the Basel III minimum requirements.

I.2.2 Operational risk

In early October, the Basel Committee published a consultative document on a revised standardised approach for measuring operational risk capital. Once finalised, this standardised approach will replace the current non-model-based approaches (the Basic Indicator Approach, the Standardised Approach and the Alternative Standardised Approach). The new approach will also address weaknesses identified in the current approaches. The proposal would be based on a statistically superior measure of operational risk, the Business Indicator (BI). The BI comprises the three macro-components of a bank's income statement: the interest component, the services component, and the financial component, and therefore is able to capture the operational risk inherent in a bank's mix of business activities. The proposal disregards the business line, since analyses carried out in the past couple of years showed that it did not prove to be a significant risk indicator. At the same time, the size of a bank was a dominant factor in operational risk exposure, therefore, the proposal introduces a new risk-based coefficient to the approach. (Comments on the proposal were invited by January 6).
Concurrently with this proposal, the Basel Committee published another consultative document, reviewing banks' implementation of the 2011 Principles for the Sound Management of Operational Risk. The review covered 60 systemically important banks (SIBs) in 20 jurisdictions. It was carried out in the form of a questionnaire against which banks self-assessed their compliance with the Principles. The results reveal that progress in the implementation of the 11 Principles set out in the guidelines varies significantly across banks, and overall, more work is needed to achieve full implementation. Four principles that have been identified as among the least thoroughly implemented are: operational risk identification and assessment, change management, operational risk appetite and tolerance, and disclosure. At the same time, most banks comply with the three lines of defence, including (i) business line management, (ii) an independent corporate operational risk management function, and (iii) an independent review.

I.2.3 Revised principles for corporate governance for banks

On October 10, the Basel Committee published for consultation a set of revised guidelines on corporate governance at banks. Focused on risk awareness, the guidelines include 13 principles as follows: the board's overall responsibilities, board qualifications and composition, the board's own structure and practices, senior management, governance of group structures, risk management, risk identification, monitoring and controlling, risk communication, compliance, internal audit, compensation, disclosure and transparency, and the role of supervisors. Comments on the revised guidelines were invited by January 9.

In its comments, the European Banking Federation (EBF) pointed out, inter alia, that it is important that the revised principles take different corporate governance systems duly into account and the principles of proportionality and relevance are given greater emphasis.

I.2.4 Final standard for the Net Stable Funding Ratio (NSFR)

On October 31, the Basel Committee published the final standard for the Net Stable Funding Ratio, as endorsed by the Group of Central Bank Governors and Heads of Supervision (GHOS). The NSFR is an

important component of the Basel III framework. It requires banks to maintain a stable funding profile in relation to their on- and off-balance sheet activities, thus reducing the likelihood that disruptions to a bank's regular sources of funding will erode its liquidity position in a way that could increase the risk of its failure and potentially lead to broader systemic stress. The NSFR will have to be applied from January 1, 2018.

The final NSFR basically retains the structure of the January 2014 consultative proposal. The key changes introduced in the final standard cover the required stable funding for:

- short-term exposures to banks and other financial institutions;
- derivatives exposures; and
- assets posted as initial margin for derivative contracts

The final standard recognises that, under strict conditions, certain asset and liability items are interdependent and can therefore be viewed as neutral in terms of the NSFR. In January 2014 the Committee issued a revised standard that was recalibrated to focus on the riskier types of funding profile employed by banks, while improving alignment with the Liquidity Coverage Ratio (LCR) and reducing cliff effects in the measurement of available and required stable funding. The standard sets the minimum requirements and defines the available stable funding and the required stable funding for assets and off-balance sheet exposures. The minimum requirement (available amount of stable funding/required amount of stable funding ≥ 100%) must be met on an ongoing basis and reported at least quarterly. The NSFR should be applied on a consolidated basis, in accordance with the Basel II framework. However, bank should actively monitor and control liquidity risk exposures and funding needs at the level of individual legal entities, foreign branches and subsidiaries, as well.

The Basel Committee also launched a consultation on disclosure requirements for the NSFR, comments are invited by March 16, 2015.

I.2.5 Updated list of global systemically important banks (G-SIBs)

In November, the FSB published the 2014 list of global systemically important banks (G-SIBs), as updated based on end-2013 data. (http://www.financialstabilityboard.org/wp-content/uploads/r_141106b.pdf). In conjunction with this, the BCBS updated the July 2013 methodology for assessing and identifying global systemically important banks, including the calculation of the indicators. The methodology describes how the higher loss absorbency requirement (HLA) should be calculated based on the 12 indicators. The HLA will be phased in between January 1, 2016 and January 1, 2019. By January 1, 2016, banks will only need to meet 25% of the HLA requirement, the full HLA requirement will have to be met by January 1, 2019.
(With Agricultural Bank of China added to the list, the number G-SIBs rose from 29 to 30).

I.2.6 Criteria for identifying simple, transparent and comparable securitisations (STC criteria)

In December, the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) published a consultative document on *criteria for identifying simple, transparent and comparable securitisations.* The document aims to assist the financial industry in developing securitisation structures and help market players to evaluate the risks of a securitisation transaction.
The criteria on **simplicity (S)** refer to the homogeneity of the underlying assets with simple characteristics and a transaction structure that is not overly complex.
The criteria on **transparency** are aimed to provide investors with sufficient information on the underlying assets, the structure of the transaction and the parties involved in the transaction,

thereby promoting a more comprehensive and thorough understanding of the risks involved. The manner in which the information is presented should not hinder transparency, but instead should support investors in their assessment.
The criteria promoting **comparability** (C) are aimed to assist investors in their understanding of the investment and enable more straightforward comparison between securitisation products within an asset class. Importantly, they should appropriately take into account differences across jurisdictions.
The BCBS and IOSCO identified 14 STC criteria which, if satisfied, could indicate that a securitisation is STC. The criteria indicate the risk in the underlying assets (asset risk), the transparency of the securitisation structure (structural risk) and the governance of the parties involved (fiduciary and service risk).

The crisis revealed that securitisation products became too complex and investors had insufficient information to assess the underlying risks. The STC criteria are aimed at remedying this.
Comments on the consultative documents are invited by February 13, 2015.

In parallel with the BCBS consultation, the European Banking Authority is conducting a consultation on simple, standardised and transparent securitisations.

II European regulation

II.1 The new European Commission's work programme

The new European Commission's work programme for 2015 sets out 10 priorities, with 23 new initiatives. The key priorities are as follows:

- A new boost for jobs, growth and investment
- A connected digital single market
- A resilient energy union with a forward-looking climate change policy
- A deeper and fairer internal market with a strengthened industrial base
- A deeper and fairer Economic and Monetary Union
- A reasonable and balanced free trade agreement with the U.S.
- An area of justice and fundamental rights based on mutual trust
- Towards new policy on migration
- A stronger global actor,
- A union of democratic change.

Of the 23 initiatives, only two (the one on the capital markets union and the one on the resolution of non-banking entities) affect the financial industry. The Commission is committed to better regulation, building on its Regulatory Fitness Programme. In this context, the Commission has identified a series of proposals and existing pieces of legislation, which will be reviewed and amended. The work programme also identifies 80 existing proposals, which the Commission proposes to withdraw or amend, including the proposal on the review of the investor compensation schemes directive.

II.2 Banking union: Start of the Single Supervisory Mechanism (SSM[6])

Since November 2013, the ECB has submitted quarterly reports to the European Parliament, the European Council and the European Commission on the operational implementation of the SSM. The fourth quarterly report covers the period between August 4 and November 3, 2014. According to the report, the ECB is ready to fully assume the supervisory tasks conferred to it by the SSM regulation.

[6] Single Supervisory Mechanism

The results of the comprehensive assessment (AQR[7]), including bank-level outcomes were finalised and published on October 26, 2014. Based on end-2013 data of the 130 participating banks, the comprehensive assessment identified a capital shortfall of EUR 24.6 billion across 25 participating banks. With capital raises carried out in 2014, the capital shortfall has been reduced to EUR 9.5 billion across 13 banks. Banks with capital shortfalls must submit capital plans within two weeks from the public disclosure of the results. These are then evaluated by the Joint Supervisory Teams (JST) responsible for their supervision.

The SSM governance is fully operational: in the period under review, the Supervisory Board and the Steering Committee held several meetings and the Administrative Board of Review also commenced operation.

As of the beginning of November, 900 staff were recruited out of the total of 1,000 positions budgeted for.

The Joint Supervisory Teams (JSTs) are operational and ready to start the day-to-day supervision of significant banks.

The ECB Regulation on supervisory fees was approved by the ECB's Governing Council and published on October 30, 2014.

The "Guide to Banking Supervision" was published in all 16 official euro area languages.

In accordance with the preliminary announcements, on November 4 the European Central Bank assumed the supervisory tasks of the 120 institutions/groups qualified as significant as per the list published in advance.

Following the ECB's assumption of the supervisory function, the SSM's Chair Daniel Nouy emphasised that in performing its day-to-day supervisory operations, the ECB will build on experience of the AQR and take into account all prudential elements in the Supervisory Review and Evaluation Process (SREP). Going forward, the SSM's priorities will include the review of internal models and the application of microprudential instruments.

II.3 Detailed rules on contributions of banks to the national resolution funds and to the Single Resolution Fund

In October, the European Commission adopted a delegated act and a draft proposal for a Council implementing act to calculate the contributions of banks to the national resolution funds and to the Single Resolution Fund (SRF), respectively. The establishment of resolution funds financed by the banking sector is a solution to avoid taxpayers having to pay for failed banks. The resolution funds' target level of at least 1% of the covered deposits will have to be reached by December 31, 2024.

The delegated act supplementing the Bank Recovery and Resolution Directive (BRRD) determines how much individual credit institutions will have to pay each year to their respective resolution funds according to the bank's size and risk profile. The fixed part of the contribution is based on the institution's liabilities (excluding own funds and guaranteed deposits), so the larger the bank, the higher the fixed part of the contribution. This fixed part is adjusted based on the risk posed by the institution. For this purpose, the legislation provides risk indicators against which the risk level of the institution will be assessed. The delegated act applies the principle of proportionality by providing for a special lump-sum regime for small banks, reflecting the fact that small institutions have a lower

[7] Asset Quality Review

risk profile and are less likely to use resolution funds. (Accordingly, banks representing 1% of the total assets would only pay 0.3% of the total amount of contributions in the euro area).

In parallel with this, the European Commission drafted a proposal for a Council implementing act to specify the methodology for the calculation of contributions to the Single Resolution Fund in the same manner as described above. The national resolution funds will be merged into the Single Resolution Fund over a transitional period of eight years.
On December 9, the Council reached a political agreement on the Commission's proposal. This is another important step regarding the banking union.

Another news in this context is that the Commission put forward a proposal for the Chair, Vice Chairs and four members of the Single Resolution Board (SRB). The proposal was endorsed by the European Parliament. The term of office of the Chair is three years, renewable once for a period of five years. The term of office of the Vice-Chair and members of the SRB is five years, non-renewable. The Single Resolution Board commenced operation on January 1, 2015.

II.4 ESM[8]: direct recapitalisation instrument

On December 8, the European Stability Mechanism's Board of Governors (made up of the euro area finance ministers) adopted the ESM direct recapitalisation instrument for euro area financial institutions. The new instrument allows the ESM to recapitalise failing euro area banks as a last resort measure. The ESM can recapitalise banks directly only if private investors have been bailed-in, in accordance with the BRRD. In addition, the national resolution funds (from 2016 onwards, the Single Resolution Fund) must also contribute. With a view to preserving the ESM's creditworthiness and lending capacity for other purposes, the total amount of ESM resources available for the new instrument is limited to EUR 60 billion. The direct recapitalisation instrument is another key element of the banking union. It contributes to breaking the link between governments and banks ("the vicious circle").

II.5 CRR/CRD IV developments

In October, the European Commission published the final version of the delegated regulation supplementing the CRR with regard to the Liquidity Coverage Ratio (LCR). The regulation is based on the LCR disclosure standards released by the BCBS in January 2014, but it also takes into account European specifics and has to be applied by all banks at the individual level as well. It allows a wider scope of covered bonds and asset-based securities to be recognised in the LCR and also addresses the treatment of intra-group liquidity.
In December, the European Commission adopted a decision on supervisory and regulatory arrangements the EU considers as equivalent for the purpose of credit risk weighting. The decision establishes a list of third countries recognised as equivalent. (Previously, these decisions were made by the individual member states).

The European Banking Authority published a number of consultation papers with regard to the CRR/CRD IV and the BRRD in the context of the development of the Single Rulebook.

II.6 EBF position on Banking Structural Reform (BSR)

The European Banking Federation is of the view that the TLAC regulation, doubling G-SIBs' loss absorbency capacity, properly addresses the "too-big-to-fail" (TBTF) issue, so, the BSR proposals should be re-assessed accordingly. The European Commission's proposal for a Capital Markets

[8] European Stability Mechanism

Union, aimed at establishing a liquid and efficient EU capital market, also points to the need to reconsider the structural reform concept.

In December, the EBF wrote a letter to the Commission's First Vice-President, requesting the withdrawal of the Banking Structural Reform proposal. (The apropos was the new Commission's review of the 2015 work plan). The letter points out that the BSR proposal, which is intended to improve the banking sector's stability, in fact jeopardises the EU's plans for job creation and growth and its measures to establish a Capital Markets Union and to strengthen long-term financing. The letter provides the following arguments against the BSR:

- The series of regulatory measures already adopted (the CRR/CRD IV, the BRRD, the TLAC requirement) have strengthened the financial system and have effectively addressed the TBTF issue.
- Universal banks play an important role as liquidity providers and market makers. The BSR would adversely affect these operations.
- The mandatory separation of activities would adversely affect competition in the capital markets (services would be concentrated in the hands of a few large players, the role of non-EU institution would increase, liquidity would decrease).
- Access by SMEs to financial services would deteriorate.

The letter failed to achieve its goals, the Commission did not withdraw the BSR proposal. The EBF expressed its disappointment in a press release. The communication, with the telling title "EC misses to support capital markets and growth" reiterated the EBF's main arguments against the BSR. The EBF emphasises that the maintenance of the BSR proposal goes against the objective of easing the regulatory burdens, whereas the already adopted new regulations and measures make it unlikely that banks will have to call on government support again.

II.7 Long-term financing of the European Economy

Following its Green Paper of March 2013, in March 2014 the European Commission issued a communication on the long-term financing of the European economy. This communication was commented on by stakeholders, including the European Banking Federation. On December 9, the European Council published its conclusions on the issue. The European Commission identified the following areas as key to promoting growth:

1. Mobilising private sources of long-term financing
2. Making better use of public funding
3. Developing European capital markets
4. Improving SME's access to finance,
5. Attracting private finance to infrastructure delivering the Europe 2020 strategy
6. Enhancing the wider framework for sustainable finance

The EBF of course supports the objectives of sustainable economic growth. In its comments, the EBF highlights the constraints set by the liquidity ratios on lending and the adverse impact of EU savings accounts on competition. The EBF supports the strengthening of national promotional banks, the diversification of the investor base, the development of EU project bonds and the proposed measures to revive the European securitisation markets. At the same time, the EBF points out that the financial transaction tax and its negative impact on market liquidity does not help the development of the EU capital markets and the creation of a Capital Market Union. The EBF is of the view that there is no need for a detailed EU regulation on corporate governance issues, however, it agrees that financial reporting should reflect the economic substance of economic transactions and must avoid introducing artificial volatility. Then EBF also emphasises that SME's access to finance should be an absolute priority in the debate on long-term financing.