MAGYAR BANKSZÖVETSÉG

# REPORT

## on Activities of the Hungarian Banking Association

## 1th Quarter 2015

**Budapest, June 2015**

# Contents

## *I. Executive Summary*

In Q1 2015, there have been no changes in the global economic processes of the previous year, as the global economy was determined primarily by the drastic fall of energy and raw material prices and a significant increase in USD exchange rates. The various countries and regions had diversified performance. The US economy continued to perform well, growth is driven by internal consumption and investments. In the European Union growth is likely to be recovering slowly primarily as a result of low oil prices, an aggressive monetary policy, improving credit markets and higher consumption, but the potential exit of Greece from the euro zone continues to be a risk. Japan seems to be recovering from a repeated recession and, owing to the weakening JPY, its export performance is also improving. The falling oil prices and the sanctions relating to the Russian-Ukrainian territorial dispute deepened the Russian economic crisis, while the deceleration of the Chinese economy could not be held back even with the measures introduced for growth stabilisation.

On a year-on-year basis, by the end of Q1, in a rather favourable external environment resulting from the slowly strengthening EU economy, the Hungarian GDP grew by 3.4%, primarily due to 11.6% industrial growth. On the consumption site, growth was also assisted by household consumption and improving net exports. Consumer prices fell on average by 1% since the same period of last year and there is still no sign of any inflationary pressure. As inflation continued to decrease, rates could be cut further: the CBH reduced the 2.1% base rate, which had not been changed since last July, to 1.95% in March (to 1.8% in April and to 1.65% in May). The balance indicators continued to be favourable; as a result of higher tax revenues and lower interest expenses, the central government deficit (HUF 536.7 billion) was HUF 164.5 billion lower than in the same period of the previous year. The external equilibrium is improving, as reflected in the data of the current account. The reducing external debt, which is the result of the HUF conversion of the retail currency mortgage loans, and the fiscal discipline still support the exchange rate of the forint against the EUR, but the actions taken by the Swiss Central Bank in January and the American interest rate increase expectations weakened the forint against the CHF and USD.

The aggregated balance sheet total of credit institutions continued to decrease moderately (-1.6%) in Q1. There was major restructuring within the asset portfolio; the liquid assets continued to increase, the accounted impairment declined, the loan portfolio shrank by 5% and the decrease in the corporate loan portfolio could not be stopped either by the banking sector's growing willingness to lend or by the Funding for Growth Scheme Plus. On the liability side the deposit balances decreased just over 2%. As a result of the settlement of the currency-based retail loans, the provisions dropped steeply by almost HUF 450 million (-61%). The credit institutions sector reported 21% higher (HUF 93 billion) profit before taxation for Q1 in comparison to 2014. Nonetheless, apart from the HUF 105 billion impairment and provision reversals increasing the income, the banking sector still did not produce any profit. It is positive though that, despite the additional labour and asset demand of the settlement process, the sector managed to cut its general expenses by 2.2% since the same period of the previous year. Contrary to that, the future income generating capacity may be influenced extremely adversely by the replenishment and advance payment obligations of the various protection funds (National Deposit Insurance Fund, Investor Protection Fund, Quaestor Victims Compensation Fund) triggered by the bankrupt brokerage firms.

In the first quarter of the year, the capacities of the sector were concentrated primarily on settlement, HUF conversion and the tasks relating to the implementation of the Fair Banking Act. While the 1 February settlement cut-off date of actual foreign currency and foreign currency-based loans and the 31 March final deadline for entering into the books of the settlement of foreign currency and foreign currency-based loans were approaching fast, there were still numerous open legal interpretation issues at the beginning of the year, which called for position statements from the Ministry of Justice, responsible for legislation, and the CBH, responsible for the related decrees. The

consultations also made it clear that the amendment of the acts regulating the settlement and HUF conversion process could not be avoided either, which in fact took place in *Act II of 2015*, promulgated at the end of February. The *58/2014. (XII.17.)* CBH Decree on information supply was also amended. The continuously changing and moving legislative environment had a detrimental impact on the preparation of the banks as well as on compliance with the rather tight deadlines, yet the banks tried to fulfil all their obligations towards consumers stemming from the new legislation. The banking and Banking Association experts actively took part in the preparations for the required legislative amendments and clarifications and attended meetings that facilitated interpretation. Apart from the consultations with the Ministry of Justice, the Ministry of National Economy and the Central Bank of Hungary, our Association also consulted with the Chamber of Bailiffs, representatives of the debt collectors (MAKISZ) and the Financial Arbitration Board; our members also satisfied the CBH requests for data and information relating to the settlement process. Despite the constructive co-operation that evolved in everyday work, the Banking Association reserves its constitutional concerns about the Act on Settlement *(Act XL* of *2014)* and therefore employed an external expert to draft a constitutional complaint, which was made available to our members for preparing their own submissions.

The other major task of the quarter related to the legislation on private bankruptcy. The Government approved the concept of legislation on the debt settlement of natural persons at the beginning of February, according to which debtors may apply for private bankruptcy protection whose assets and income available for repayment are not enough to make the repayment. The political parties supporting the regulation on private bankruptcy admitted that they intended it as a tool for resolving the problems of mortgage debtors who are still in trouble. The consultations on the legislative concept and the specific draft law were led by the Ministry of Justice and were attended by the working group of experts designated by the CBH, the Ministry of National Economy and the Board of the Banking Association since the middle of February. Following the approval by Parliament of the draft bill submitted in May, the Government will have to adopt six and the Minister of Justice must still prepare twelve implementation decrees in order to launch and ensure the operability of the system by 1 September 2015.

The organisational unit of the Central Bank of Hungary responsible for financial stability intends to apply further regulatory tools to make banks interested in developing a balance sheet structure which is healthier according to the CBH. Thus, following consultations with the European Central Bank, the CBH is likely to issue a decree on the introduction of the Mortgage Funding Adequacy Ratio (MFAR) in June. The CBH also proposed modifying the Foreign Exchange Funding Adequacy Ratio(FEFA) and the introduction of a new FX position/balance ratio.

The transfer of the banking portfolios secured by commercial real properties rated as bad to MARK Zrt. will be slightly behind the preliminary schedule. According to the current communication of the CBH, the first binding offer and transaction is likely to be made only in Q3 of the year.

The Hungarian Competition Authority submitted to the competent authorities its preliminary position in a procedure launched in 2012 in relation to a prohibited agreement, assumed in relation to BankAdat. Apart from proposing a legal amendment on the establishment of databases, the Banking Association employed an international advisor, experienced in EU competition law, to prepare a background study to help refuting the preliminary position. It is likely that the procedure, which has been pursued for three years, will be closed following the discussions at the beginning of June with the acceptance of the commitment of the parties concerned.

In terms of payments, preparations for the AML country assessment, the interpretation of the Hungarian tasks stemming from the SEPA End-Date Regulation, the closing general meeting of the Hungarian SEPA Association, the HUF joining the CLS, the increase in GIRO cycles, the protection

against bankcard fraud and surveys concerning the security of online payments and two free of charge cash withdrawals need to be mentioned, while in terms of accounting, the switch of the Hungarian banking system to IFRS, planned from 2017, will be the biggest challenge.

In communication, the organisation of the extremely successful “Money Week” programme series within the framework of the European “Money Week” deserves to be noted.

At the beginning of 2015, no new initiatives appeared in global regulations; the year will be dedicated to the finalisation of the previously decided regulations. In relation to capital adequacy, they improve the consistency and comparability of indicators, and will continue working on the leverage ratio to be finalised by not later than 2017. In 2015, the Financial Stability Board (FSB) will elaborate a standard for the total loss absorbing capacity and will review the results in the resolution of central counterparties and the plans for resolution. With G20 support, major steps were taken toward detecting the opacity of the OTC derivative markets, and now the main task is to make the related reports truly effective. While managing new risks and vulnerabilities, FSB places great emphasis on the collection of related data, detection and management of risks and improvement of market structures.

According to the plans, over the next two years the activities of the Basel Committee will be concentrated on the development of regulations: finding the right balance among the simplicity, comparability and risk sensitivity of the regulatory frameworks, monitoring and evaluation of the implementation of the Basel Accords (II, III) as well as improving the efficiency of supervision.

In the European Union, the experiences of the Single Supervisory Mechanism, the supervisory activities of the European Central Bank and the slightly tamed structural reform of the banking system since the preliminary concept are in the focus of attention. The first step towards the Capital Markets Union is the Green Paper of the Commission issued in February to be followed by the action plan elaborated on the basis of the opinions. The modification of the payments directive (PSD II) has reached the phase of trilateral negotiations. The approval in the near future will represent a breakthrough primarily in the regulation of third-party payment providers (TPPs).

Apart from the evaluation of the European banking system and the assessment of its risks, the European Banking Authority will continue preparing the single European rule book with provisions focusing primarily on the capital requirement and liquidity regulations (CRR/CRD4), as well as resolution and crisis management (BRRD, SRM). The European Banking Federation very intensively represented the views and interests of the banks of the continent both in EU and global consultations.

## *II. Macroeconomic outlook, operating environment of the banking sector*

In Q1 2015, there have been no major changes in the **global economic processes**. The global economy was determined primarily by the drastic fall in energy carrier and raw material prices, a significant increase in USD exchange rates, the deceleration of the Chinese economy, the mixed processes observed in the European economy and expectations relating to a change in orientation of the US monetary policy. The different orientation of the US monetary policy and the monetary policies of the other (advanced and emerging) countries contributed to the extensive volatility of the exchange rates of the various currencies. All in all, the various countries and regions had diversified performance.

The **US** economy continued to perform well with a healthy labour market; growth is driven by internal consumption and investments. On the contrary, there have been signs indicating the deceleration of exports which, according to certain views, was not so much due to the significant strengthening of the dollar as the weaker external market demand.

Owing to the rather aggressive monetary easement, **Japan** seems to be recovering from repeated recession, triggered by a badly scheduled tax increase. Although investments are still falling, due to an increase in wages there are already signs suggesting an increase in internal consumption and export performance is also rising due to the weaker JPY.

The economy of the **European Union** also showed improving performance, driven by positive and negative factors. It is a positive sign that growth is likely to have recovered primarily as a result of low oil prices, favourable conditions resulting from an aggressive monetary policy, improving credit markets and higher consumption. However, the fiscal situation of Greece and its potential exit from the euro zone entail significant risks and exert rather unfavourable impacts on the economic environment.

The economy of the emerging **BRIC countries** performed rather differently. The crisis of the **Russian economy,** which affects the Hungarian economy most, continued to deepen, primarily because of the falling oil prices and the US and EU sanctions introduced in response to the Russian-Ukrainian territorial dispute. The rouble exchange rate fell steeply, inflation suddenly rose and the currency reserves of the country were further depleted. Economic activity declined and the dried up financial channels, caused by the indebtedness of the private sector (primarily large companies) and sanctions, deepened the crisis even further. The government intended to mitigate the impacts of the closing of the market by opening towards China, but the results have been modest so far. **Brazil,** which had outstandingly good performance before, showed similar signs of a crisis: falling raw material prices, depreciating currencies, high inflation, indebtedness of the private economy, coupled with a strict monetary policy and corruption at state level carry the risk of a new wave of recession. The **Chinese** economy continued to decelerate even though the country's leaders introduced stronger measures to stabilise growth. As a result of further easement of monetary conditions, they intended to avoid the collapse of the real estate market by maintaining the same level of loan supply, yet this artificial loan supply entails severe macroeconomic balance risks and therefore the leaders are contemplating structural reforms. **India** has excellent performance, which is strengthened even more with major fiscal incentives introduced by the government.

In Q1 2015, the external environment of the **Hungarian economy** was rather supportive due the slow strengthening tendency in the economy of the European Union but the uncertainty around the euro zone and Russian-Ukrainian geopolitical tension continue to represent significant risks. In the first quarter the ***GDP*** growth was 3.4% on annual basis, while it increased by 0.6% in the quarter. (In general, similar good growth figures were achieved in the other countries of the region.) The GDP increase was the result of the ***industrial growth*** (+11.6%) on the production side, more specifically, the improving performance of vehicle manufacturing and the processing industry (primarily electronic consumer goods). On the consumption side, household consumption (supported by 4.1%

increase in average wages and negative quarterly inflation) and improving net exports (with rising foreign trade turnover) all contributed to the GDP growth, therefore the Q1 figures did not bring any positive surprise due to the drop in investments (-4.5% on annual basis) and negative impact on changes of inventories.
The ***unemployment ratio*** (8.3% → 7.8%), and the average quarterly ***employment*** ratio (60.6% → 62.4%) improved significantly compared to the same period of the previous year, but the figures have deteriorated compared to those measured in H2 of 2014.
The previous quarter was still characterised with negative ***inflation*** indicators. Since the same quarter of last year, consumer prices dropped on average by 1% and the economy still does not show any sign of any inflationary pressure. The inflation processes may be determined by dual impacts: on the one hand, there is a slight price pressure on the expenditure side resulting from moderation in food and fuel prices and, on the other hand, the gradually rising demand, which is still not significant due to the low wage dynamism of the competitive sector.
As inflation continued to decrease, the CBH saw a good opportunity to cut the rates further, and therefore reduced the 2.1% *base rate*, which had not been changed since last July, to 1.95% in March (1.8% in April).
Hungary's economic indicators continued to be favourable. The ***central government deficit*** (HUF 536.7 billion) was HUF 164.5 billion lower in Q1 2015 than in the same quarter of the previous year. Main reasons in the positive trends of the budget deficit: tax revenue increase driven by improved economic performance and relevant reduction in interest expenditures. The external equilibrium is improving, as reflected in the data of the current account. The favourable processes, especially the reducing external debt, which is the result of the HUF conversion of the retail currency mortgage loans, and the fiscal discipline still support the exchange rate of the forint against the EUR, but the actions taken by the Swiss Central Bank in the middle of January and the American interest rate increase expectations weakened the forint against those currencies.

The ***aggregated balance sheet total*** of credit institutions decreased slightly in Q1 (-1.6%). Since the beginning of the year, the HUF exchange rate moved in a different direction in comparison to certain currencies (CHF, EUR) important for the asset portfolio. The abolition of the kept exchange rate cap towards the EUR allowed the CHF to gain strength by more than 9%, while the EUR weakened against the HUF by 5%. As within the total asset portfolio the portion denominated in EUR is close to twice the volume of the assets kept in other currencies, these contrary exchange rate fluctuations more or less offset each other's impacts.
There was major restructuring within the ***asset portfolio.*** The share of liquid assets continued to increase (interbank deposits and government securities), primarily in short terms. The accounted impairment decreased and the loan portfolio shrank in total by 5%. What should be highlighted within the tendency is that the loans extended to domestic non-financial enterprises also shrank by almost 7% and even the HUF loans subsidised through FGS2 declined by 2.3%. As a result of the settlement and conversion of foreign currency denominated retail loans, the retail loan portfolio dropped by 9% with internal restructuring within the portfolio in favour of the HUF loans.
On the ***liability side*** the deposit balances decreased slightly in Q1, just over 2%. It was primarily the result of the decrease in retail and corporate deposits (-1.6%, -3.3%), while the overall reduction was slightly offset by a major, almost 23% increase in municipality deposits. There was major restructuring within the interbank deposits and loans to the advantage of the former, but it did not have any significant impact on the liabilities. As a result of the settlement of the currency-based retail loans, the provisions dropped steeply by almost HUF 450 billion (-61%).
As an overall result of the above effects, the net debt-to-deposit ratio of the credit institutions sector fell from 99% at the end of the year to 96% by the end of March.
In terms of ***profit,*** the credit institutions sector reported 21% higher (HUF 93 billion) profit before taxation for Q1 in comparison to Q1 of 2014. In total the settlement and HUF conversion took place with a neutral effect on profit, but caused major changes within the P&L items. The most important factor affecting the profit was the major drop in the accounted risk costs, in total HUF 105 billion

resulting from reversed impairment and provisions. This means that ***apart from the reversals increasing the income, the banking sector still did not produce any profit.*** In addition, the 19% decline in interest margin, resulting from the lower interest revenues and a similar rise in interest expenses should be mentioned. Despite the additional labour and asset demand of the settlement process, the credit institutions sector managed to cut its general expenses by 2.2% since the same period of the previous year.
As a result of the above effects, the return on assets of the sector, calculated before annualised taxation (ROA) was +1.2%, while its return on equity (ROE) amounted to +12.1%.

### *III. Corporate lending*

**Introduction of the Funding for Growth Scheme Plus (FGS+) and changes in the conditions of Phase Two of the Funding for Growth Scheme**

Based on the success of Phase One of the Funding for Growth Scheme, on 11 September 2013 the Monetary Council decided to continue the programme. On 2 September 2014 the Monetary Council decided to raise the HUF 500 billion, initially allocated for Phase Two of the scheme to HUF 1,000 billion, which may be increased up to HUF 2,000 billion. Then on 18 February 2015 the Council decided to launch FGS+ and allocated HUF 500 billion to the scheme. FGS+ was introduced on 16 March 2015. The purpose of the scheme is to improve the opportunities of small and medium-sized enterprises, previously not eligible under the FGS, to have access to loans.

Under FGS+ the Central Bank of Hungary provides refinancing loans with 0 percent interest for a tenor of maximum 10 years (for O/D facilities maximum 3 years) to credit institutions involved in the scheme. The credit institutions use these funds to lend to SMEs with a capped interest margin of 2.5%. p.a. As a supplementary feature of the new scheme, in relation to loan agreements concluded under FGS+, the CBH reimburses half of the loan losses related to clients who go into default within five years. However, the total reimbursement cannot be higher than 2.5 percent of the loan portfolio of the individual credit institutions relating to the scheme. The loans disbursed under FGS+ must be drawn between 16 March 2015 and 31 December 2016, with the following exceptions: after 30 December 2016, once loans provided for pre-financing EU grant receivables available on application annually have been repaid, the loans may be drawn again until 31 December 2018 or, in the case of factoring, until 4 December 2018. Only new loans can be granted under FGS+, it cannot be used to refinance existing loans. This scheme focuses on investment loans and therefore at least 70 percent of the loans granted to SMEs must be new investment loans and working capital loans cannot exceed 30 percent. Under the FGS+ scheme, the minimum loan amount is HUF 1 million, while the maximum amount is HUF 500 million.

The deadline for drawing down loans disbursed under the FGS+ scheme was also amended to the end of 2016. Similarly to other fees payable to third parties, the guarantee fee can be taken out from, or charged in addition to, the margin, kept at 2.5 % both under the FGS and FGS+ schemes. A new loan objective has been added to the FGS and FGS+ product information; residential property construction has also become eligible for financing.

According to CBH statistics, in Phase Two of the Funding for Growth Scheme credit institutions entered into contracts with 16,675 small and medium-sized enterprises for HUF 693.6 billion. Consequently, in Phase One and Phase Two of the Funding for Growth Scheme in total 22,000 enterprises had access to almost HUF 1,400 billion loans. More than 96% of the contracts concluded in Phase Two are for new loans. In loans, 63% are investment loans, 26% are working capital loans and 11% are EU grant receivable pre-financing loans. Within the transactions under Pillar One, the

average loan amount was HUF 22 million for new investment loans, HUF 58 million for new working capital loans and HUF 33 million for EU loans. The average tenor of the new investment loans was 6.8 years, for new working capital loans 2.4 years and for EU loans 1.5 years.
Agriculture, manufacturing industry and trade had a substantial share also in Phase Two of the FGS.

## *IV. Retail lending*

**Open issues and amendment in February of the Settlement Act and HUF Conversion Act**

While the 1 February settlement cut-off date of actual foreign currency and foreign currency-based loans and the 31 March final deadline for entering into the books of the settlement of foreign currency and foreign currency-based loans were approaching fast, there were still numerous open legal interpretation issues impeding preparations at the beginning of the year. As a result of Ministry of Justice consultations and internal consultations conducted last December on closely related settlement, HUF conversion and fair banking acts, our Association also requested position statements from the Ministry for the interpretation and implementation of the following issues:

- deadlines for the settlement of currency-based contracts and in the process relating to the HUF conversion of currency-based mortgage loans, 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),
- 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,
- the definition of fair interest rate, the date and process for the reinstatement of fair interest rates,
- 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, and interpretation of operational discounts in the fair banking regime,
- special issues related to contracts involved in the Exchange Rate Cap Scheme, and in the payment alleviation schemes of the banks,
- rules for settlement and information supply, if no unfair term has been applied or the consumer claim is zero,
- rules for contracts outside the scope of Act XL of 2014 (credit and credit cards assigned to payment accounts),
- coherence problem relating to the negative scope of Fhtv. (Consumer Loans Act) and transition provisions.

Even though the written response of the Ministry of Justice in the second week of January provided some guidance on the legislator's intentions in almost every topic, it failed to provide clear and practical guidance for the exact application of the provisions of the law in several cases.

In the second half of January the CBH also published its responses to major interpretation issues concerning CBH decrees on the subject and to methodology issues concerning the applicable reference rates, interest rate alteration and interest rate premium alteration indicators. The central bank regularly publishes its position statements about the raised issues on its website.

*Act II of 2015*, amending the Settlement Act and the Consumer Protection Act, as well as other acts was promulgated at the end of February 2015. The act made several required corrections in the acts referred to above and also introduced new rules on the application of reference interest rates, which cannot be very well interpreted in comparison to the previous rules. In response to our request submitted in March, the Ministry of Justice confirmed that our former, jointly developed interpretation should also be applied to the new rules.

At the beginning of February the *58/2014. (XII.17.)* CBH Decree on information supply was also amended. As a result of the amendment, the decree contained the required clarifications and new content elements for providing more detailed information to consumers.

In the course of preparation for the execution of settlement, further problems were also detected:

- There was some uncertainty in the interpretation of the law as to whether or not collection orders submitted against debtors pursuant to the Act on Payment Services had a priority over the offsetting of the consumer claims against the outstanding principal of the loan. (In response to the problem we received a response from the Ministry of Justice which was reassuring to clients, as well as to banks.)
- The modification of the Act on Consumer Loans and Act on Credit Institutions triggered by the fair banking regulations raised several problems concerning the alteration of the interest rate and fees and conditions of credit lines assigned to payment accounts, credit cards, loans with state interest subsidy, granted before 1 February 2015 and loan agreements concluded prior to 1 May 2004. The issue was submitted to the Ministry of National Economy in the second half of January.
- In relation to the special features of mortgage registration, we applied for guidance to the Ministry of Agriculture i.e., the authority responsible for property registration.

**Further consultations and data collection related to the execution of the settlement process**

*Consultations with the Chamber of Bailiffs and MAKISZ*

Attracting a great deal of interest from our members, in January we held consultations with the new management of the Chamber of Bailiffs and the Ministerial Commissioner supervising the chamber on issues pertaining to the interpretation of the law on the issues of enforcement of settlements and on the distribution of bailiff notices on settlement. Following the discussion, a small group of banking experts had a meeting with the IT experts of the chamber on the technical details of the enforcement notice format. The proposal was also discussed with the workout colleagues in writing.
Similarly, we held several rounds of discussions with the professional debt collection organisation, MAKISZ, on the interpretation and enforcement of the provisions on settlement applicable to debt collectors.

*Consultation on interpretation issues with the Financial Arbitration Board (FAB)*

At the meeting attended by the FAB, the open legal interpretation issues of the FAB procedure were discussed. The discussions focused on three main problems: (i) if there are several obligors in the contract who may initiate a FAB procedure, (ii) options of preparing the right settlement in cases disputed by the debtor, and (iii) the problem of managing heirs in case the debtor dies. We managed to reach a position shared by FAB and CBH representatives on the first two issues. (We agreed that

the party specified as the main debtor of the transaction may proceed at the FAB and, if it becomes necessary during the proceedings, may subsequently request the respective bank to prepare a repeated settlement or may compare the settlement to the calculation made by the application developed by the CBH.) In relation to managing heirs replacing deceased debtors, it was concluded that the effective laws and regulations did not provide clear guidance, especially when there are several heirs. Consequently, in order to urgently develop a standard procedure applicable to separate cases, we also contacted the consumer protection division of the CBH in January. The CBH responded that it would develop its recommendations on the issue but as far as we are aware, no progress has been made.

*Supply of test data for the development of the CBH system and cooperation in controlling the banks' settlement systems*

At the end of December the CBH indicated a need for actual input data used by the banks for settlement as assistance in the control of settlements by the CBH and to promote the development of the CBH application supporting the future FAB proceedings. The Banking Association and experts of the banks had two consultations with the CBH units responsible for consumer protection and the settlement methodology in the first half of January. It was agreed that the banks intending to take part in the CBH development process would make available to CBH experts the data required for development and testing in the framework of bilateral cooperation. The Central Bank moved forward the thematic examinations of all banks involved in the settlement for the applicant banks, which created a framework for the action. At those banks the CBH reviewed by the middle of March whether or not their applications developed for settlement complied with the statutory requirements and then communicated its experience.

*CBH request for data relating to actions in the public interest*

In relation to HUF and actual foreign currency agreements, Act XXXVIII of 2014 did not include an assumption that the General Contracting Terms and Conditions issued after 26 November 2010 and the amendments thereof contained unfair terms and conditions. Simultaneously, it authorised the CBH to launch legal actions in the public interest until 30 April 2015 in order to conclude the unfairness of the conditions. In order to enforce that right, the CBH distributed a resolution at the end of 2014 requesting the credit institutions involved in the settlement to supply detailed data and documents within the framework of an extraordinary data supply. The requested information showed significant overlaps with the document supply obligation, already fulfilled in relation to the lawsuits of the banks and therefore the Banking Association proposed a meeting for the beginning of January to review the documentation requested by the CBH and to reduce the scope of previously submitted documents. The meeting successfully reduced the number of the documents to be submitted. The CBH later informed the credit institutions concerned about it.

**Managing buffer account loans in the settlement process**

The HUF Conversion Act had to be able to manage the issue of repayments of the buffer account loans, which increased due to the mandatory conversion. The act stated that the clients could not have any additional payment obligation either due to the conversion of the buffer account loan or the beginning of the repayments of the aggregated buffer account loan, registered in HUF. The act set as requirement for both loan components that repayments must begin only after the original accumulation period and the rate of increasing the repayments was also limited (15-15%).

As the act raised problems, upon the initiative of our members, the Banking Association applied to responsible authorities for position statements and submitted proposals to amend the law on several occasions, including the following:

- The repayment increase had to be allowed in relation to combined loans because, due to the nature of the product, the repayment ratio paid to the bank is extremely low at the beginning of the tenor and therefore the accumulated client debt was reduced only very slightly.
- In relation to the accumulation loan, the debtors had to be given the right to voluntarily increase the repayment or make a lump sum final repayment if they had sufficient income.
- We also made material corrective proposals for establishing the tenor of the loan.

The Ministry of National Economy, competent in the issue, accepted the majority of our proposals.

**Impact of the settlement process on debtor records - tasks related to KHR**

The Settlement Act and the HUF Conversion Act made major changes in the key factors of the loans concerned (maturity, principal debt, repayment, currency). In terms of the KHR system, used for recording the loans, the way to change the components of the system and to report the changes was a key issue. The Banking Association collected and classified the questions of its member banks, and organised several rounds of written consultations with the experts of BISZ managing the KHR. Thus, most issues and problems were resolved reassuringly, without any need for a legal regulation:

- The creditors submitted a report modifying the old loan to the KHR for each loan the conditions of which changed significantly, even though many considered these products new loans.
- The law permitted debtors of loans converted into HUF by the law to reconvert it into a foreign currency. Many recommended that the creditor should report the converted loan as a HUF loan only when the grace period of re-conversion has expired (to avoid dual recording). The solution turned out to be the fair monitoring of the actual situation i.e., any change in the currency had to be reported into the KHR immediately.
- It was also clarified that the major changes (principal debt, repayment) had to be reported into the system by the fifth day of the subsequent month, just as under the previous rules.
- The way KHR should treat amounts charged unlawfully under the law and therefore reimbursed to the client in the course of settlement as soon as they incurred turned out to be the most sensitive issue. According to the decision this retrospective calculation method does not change the data entered into the KHR system earlier (the retrospective settlement was made only in order to make a fair calculation for the client).
- If as a result of the reimbursed amount, the client's default registered in KHR disappeared, it has to be considered an entry, settled by the client and to be deleted within one year.

**Draft constitutional complaint related to the Settlement Act**

The Banking Association employed an external expert to draft a submission on the constitutional problems of the Settlement Act (Act XL of 2014 on the 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 draft constitutional complaint presented and objected to

- the subsequent re-classification by the legislator of any consumer overpayment falling within the scope of the Act as prepayment for contracts concluded or even terminated prior to the entry into force of the Act,

- the amendment with a retrospective effect of the rules pertaining to the statutory limitation period,
- and to the provision of the Act disregarding the power of the substantive law without any due constitutional reason. (The Act contained a provision with retrospective effect for legal disputes, previously assessed and effectively closed in a lawsuit.)
- The submitted complaint objects to the fact that no legal remedy can be sought while litigation and that only out of court procedures are available in relation to settlement.
- The submission also disputes the consistency between the provisions of Act XXXVIII of 2014, amended by the Settlement Act and previously not assessed in Constitutional Court decisions and the Fundamental Law.
- The submission also presents in detail the conditions of submission of the constitutional complaint, involvement of the financial institutions, and that there is no legal remedy against the provisions deemed to be contrary to the Fundamental Law.

The purpose of the completed draft is to enable any member bank intending to submit a constitutional complaint to use it in its own submission.

## *V. Other important regulatory developments affecting the banking sector*

**Consultation on the draft bill on private bankruptcy with the Ministry of Justice, the Ministry of National Economy and the CBH**

Following prior consultations with the Ministry of National Economy and the CBH, on February 11, 2015 the Government approved the concept of an act on the debt settlement of natural persons. According to the approved concept, such debtors are eligible for private bankruptcy protection whose assets and income available for repayment are not enough to make the repayment (without any specified amount). (The debtor must have at least HUF 2 million and no more than HUF 60 million debt, which cannot exceed twice the debtor's assets.)

Following the Government's decision, on 19 February the Deputy State Secretary of the Ministry of Justice, competent in the issue, organised a meeting for executive officers, attended by the CBH, the Ministry of National Economy and the Banking Association, where the Banking Association was invited to take part in drafting the act with a working group of experts. During the regular meetings attended by the working group of experts appointed by the Board of the Banking Association, numerous proposals of the banking sector were approved in the concept and in the text of the legislation. The Government approved the draft with an obligation to conduct subsequent consultations on 6 May 2015 i.e., consultations on the text of the legislation continued until it was submitted to Parliament.

The act defines two types of proceedings: out of court debt settlement and in-court debt settlement. The debtor first must request an out of court debt settlement procedure if a main creditor has a mortgage on debtor's residential property or a financial lease agreement was concluded for the residential property. In the case of out of court debt settlement, the debt settlement agreement is prepared under the coordination of the main creditor. The main creditor must perform the out of court debt settlement tasks if the debts are owed only to the main creditor and the main creditor's affiliated companies, as defined in the accounting regulations. When an out of court debt settlement procedure fails, the Family Bankruptcy Protection Service forwards the debtor's application for debt settlement to the court, competent according to the debtor's address.

The in-court debt settlement procedure will not take place in the form of a lawsuit. The performance of the tasks of the court will be assisted by the ***Judicial Office, Family Bankruptcy Protection Service***, which will prepare the court decision, supervise the debtor's fund and asset management, prepared the bankruptcy agreement and, whenever any asset is sold, distribute the proceeds from the sale among the creditors. The costs of the proceedings must be paid by the debtors and the creditors.
In the course of the in-court debt settlement procedure, an agreement will be prepared between the debtor and the creditors to be approved by the court. The agreement may also include the separation of the mortgaged pledged asset, in the course of which the debtor will pay only the interests on the loan for the real property which is the debtor's place of residence and repay any other debt accumulated towards other creditors on a pro rata basis for a temporary period for two years. The family receiver prepares a debt repayment plan which may also establish the rules of sale of the individual assets and the distribution of the proceeds among the creditors by taking into account the assets and proceeds that can be left at the debtor. The debt repayment plan is approved by the court. If the five-year debt repayment period was successful, a final settlement is prepared and the debtor is relieved from the payment of further debts with the exception of the mortgage loan.

The system will be introduced gradually. In the first phase those debtors may apply for bankruptcy protection in the autumn of 2015 whose loan agreement was terminated in spring 2015 or whose property is expected to be subject to a forced sale. Those who are not eligible for the first phase may apply for bankruptcy protection from 1 September 2016.

The draft legislation does not violate the soundness of mortgage lending and does not limit the enforceability of the mortgage. Within the framework of in-court debt settlement, no decision can be made on the separation or sale of the mortgaged asset without the main creditor's consent, while in the case of an out of court debt settlement procedure the main creditor decides on every important issue.

Following the approval of the act by Parliament, the Government will have to adopt six and the Minister of Justice must prepare twelve implementation decrees in order to launch and ensure the operability of the system by 1 September 2015.

**Exhaustion due to OBA and Beva brokerage bankruptcies, the Quaestor act**

The resources of OBA and Beva were absorbed in the new wave of compensation payments in the recent period and then, at the beginning of April, a new act approved with record speed with retroactive effect imposed an obligation on universal banks and the other Beva member investment service providers to settle the losses caused by the Questor group.

OBA was exhausted with compensation made in relation to the effective laws and regulations: following the bankruptcies of savings cooperatives and the closing of Széchenyi Bank last year, four small banks emerging from the savings cooperatives and operating within the DRB Bank group (DRB South Dunántúl Regional Bank, South Dunántúl Savings Bank, North Hungary Regional Bank and Buda Regional Bank) were liquidated as a result of the failure of their owner, the brokerage firm, Buda-Cash. On that basis OBA paid out HUF 103 billion compensation to depositors of the respective banks. Beva must provide compensation to Buda-Cash clients in an amount which is still unknown but will definitely reach several tens of billions HUF. The Buda-Cash bankruptcy drained the funds of both OBA and Beva, even (potentially) forcing them to take a rather large loan compared to their assets accumulated earlier. The closing of Hungária Értékpapír brokerage firm made the situation of Beva even worse.

Pursuant to Act XXXIX of 2015 the compensation for damages caused by the default of the Quaestor group is provided primarily from the debt management fund that secures the compensation of the agreed parties of Quaestor, into which the required funds must be contributed by the investment service providers (primarily universal banks). Prior to the disclosure of the draft bill, the BEVA Board decided, based on a majority vote, to compensate the holders of HUF 150 billion fictitious bonds issued by Quaestor Hrurira Kft. up to the limit specified by law. Then the Quaestor act stated that the losses of subscribers of Quaestor bonds (irrespective of the fictitious status or existence of the bonds) must be compensated for up to HUF 30 million (i.e., the same agreed party may receive no more than HUF 30 million from Beva and the Quaestor Victims Compensation Fund). The Quaestor Fund also assumed the issuer risk under the title of compensation as it also provides compensation for the inability of the issuer of the bond to make the payment undertaken in the bond. The act authorises the Fund to take a loan or issue bonds under state guarantee in order to conduct a smooth compensation process. Beva members are obliged to contribute annual advances on a pro rata basis of their Beva membership fees, effective in 2014, in order to fund the compensation. The Compensation Fund enforces the receivables assigned to it by the Quaestor bond holders in exchange for compensation provided to them and uses the proceeds for the prepayment/reception prior to maturity of the loan/bond issued for compensation. If the Compensation Fund cannot collect enough receivables to fund the advance repayment, the BEVA members will be able to deduct any of their receivables not collected for the above reason from their tax liability pursuant to a separate act to be adopted later.

According to our opinion the Quaestor act violates the Fundamental Law for various reasons. Example: the act has retroactive force, by requiring mandatory advance contribution it claims assets owned by the parties concerned without any consideration. In addition, the annual advance payment contribution obligation also applies to the legal successor, which violates the freedom of enterprise. In view of the above and based on a Board decision, the Hungarian Banking Association employed a law office to draft a constitutional complaint against the Quaestor act and made available the text of the drafted complaint to its members to be used in complaints submitted to the Constitutional Court in their own names.

**The "spring omnibus" legislation - amendment of the Financial Institutions Act and the Capital Market Act**

The spring legislative package on the amendment of several acts dedicated to financial subjects was submitted to Parliament under No. T/4393 "on the amendment of certain acts in order to promote the development of the financial intermediary system". Our Association had already reviewed the draft bill during the prior technical discussions in the phase of the administrative consultations.

Several provisions of the draft bill added subsequently relates to the Quaestor scandal with the aim of preventing the occurrence of similar situations in future. The draft intends to prevent the issue of fictitious dematerialised securities by giving a right and option to investors to verify whether or not the securities included in the statement received from the service provider keeping the securities account actually exist, and were effectively generated in KELER. These provisions again impose new burden on companies operating according to the law even though their objective i.e., to restore trust in investments services, is understandable and worthy of support. Raising the amount of compensation for Beva to the same amount as compensation available from OBA intends to achieve the same objective. However, we deem it unreasonable and a measure that erode the difference between savings and an investment. Another new provision of the draft also aims at the shared management of the two funds that have similar, yet not identical purposes, according to which the two funds (more specifically OBA, Beva, the Resolution Fund and the Quaestor Compensation Fund) will have the same working organisation from 2016. The draft bill also provides for how the

compensation of Quaestor bond holders imposed mainly on the banks through the Quaestor act as a non-recoverable item can be deducted from tax.

We managed to persuade the legislator to include in the draft modifications, important to the banks, which rationalise the new information supply rules on deposit insurance. The draft which is likely to be approved at the end of May will also reconsider the central settlement system.

**Review of the effect of the new Civil Code and other related laws**

In January 2015 the Ministry of National Economy involved the professional interest groups of the financial sector and proposed a discussion and review of the experiences and problems of the entry into force of the new Civil Code and related laws and regulations. In that context, regular expert discussions were held with the involvement of the Ministry of National Economy, CBH and the Ministry of Justice. Several draft bills were prepared to resolve the problems identified during the consultations. In February 2015 the Minister of Justice submitted a *draft bill under No. T/3117.*, amending Act on the Consumer Loan Agreements of Financial Institutions and other private law related acts, which triggered amendments in the Settlement Act. In addition, the Financial Institutions Act and Act CLXXVII of 2013 on Transitional and Authorising Provisions related to the entry into force of Act V of 2013 on the Civil Code (Hungarian abbreviation: Ptk.) were also amended. (The act providing for the amendments was promulgated under *Act II of 2015.*) The rest of the proposals were integrated into *draft bill T/4393 on the amendment of certain acts in order to promote the development of the financial intermediary system,* which is being discussed by Parliament.

**Regulations on negative interest**

The falling reference interest rates of the central bank and their turning into a negative figure have a detrimental impact on the financial systems, where no negative interest can be specified due to legislative restrictions. As the falling interest rates and their turning into a negative figure seem a longer term tendency and in order to protect the interests of Hungarian banks, we successfully proposed to the Government to allow for the establishment and enforcement of an interest rate with a negative prefix on corporate deposits by making the relevant modifications in the respective laws. The option also applies to the previously signed deposit agreements.
Consequently, the *new Article 280 of the Financial Institutions Act* states that, contrary to the provisions of the Civil Code, 0% interest rate or interest rate with a negative prefix can also be applied to the deposit amount in deposit agreements concluded with non-natural person clients. If an interest rate with a negative prefix is applied, the amount to be repaid reduces on as pro rata basis reflecting the interest rate with a negative prefix. The new *Article 52/A of Act V of 2013 on the Implementation of the Civil Code* also contains a similar provision.

**Summary for the Ministry of Justice on fraudulent bankruptcy. Commission Recommendation on a new approach to business failure and insolvency**

Based on a request from the Ministry of Justice with the help of the work-out committee, in February the Association prepared a summary on the issues of fraudulent bankruptcy and on the inadequacies of the regulations that allow for such fraudulent events. In our opinion progress could be achieved by re-regulating the bankruptcy procedure, strengthening the transparency of the proceedings, giving priority to the satisfaction of claims of secured creditors and by reconsidering the role of creditors in a bankruptcy procedure. At present the creditors do not have any relevant influence on the

bankruptcy procedure, they are passive parties to the proceedings who can vote only on the proposed bankruptcy agreement.

Similarly, based on a request from Ministry of Justice, the Association also made remarks on the Commission Recommendation on a new approach to business failure and insolvency *[(2014.3.12.) C (2014) 1500]*. The Ministry of Justice developed a regulatory concept for the implementation of the recommendation. We proposed integrating certain elements of the recommendation into the bankruptcy act and that the state should also apply incentives to promote the reorganisation. The debtors initiating bankruptcy must make a lot of preparations for the proceedings; it should not be possible to escape into the payment moratorium provided by the bankruptcy proceedings without any preparations or a true chance for a bankruptcy agreement. In addition to the above the Association also recommended regulations on the minimum recovery of the claims in the various creditor categories and extending the appeal options.

## *VI. Events relating to the Central Bank of Hungary and other authorities*

**A series of consultations with MARK on the transfer of bad portfolios**

MARK Zrt. and the Banking Association established a joint expert group (with the involvement of a few member banks), which began its work in the second week of January, 2015. The group will work on details of transactions and properties accepted in the portfolios to be transferred in relation to the reduction of the banks' not soundly performing commercial real property loan portfolios and of the implementation and documentation of the transfer.

The working group set itself a task to review the following topics:

- Definition issues: definition of portfolio components, potentially used in the various transfer methods (accelerated and normal) to be applied by MARK.
- Pricing and valuation mechanism of portfolios, portfolio elements and real properties.
- Legal issues and documentation.
- Operational implementation and transaction issues.

According to the targets of the CBH, which founded the asset management company, MARK must make its first binding offer for a banking portfolio in H1 2015, and therefore the joint working group prepared a schedule for elaborating the details accordingly. As given the role of the state played by the CBH, the pricing and valuation methods defining the transfer prices constitute the most sensitive issue (they were likely to generate a dispute in consultations with the European Central Bank and the European Commission), the working group began to review the portfolio definition and operative implementation issues. Both parties reserved the right to conduct a subsequent review on the agreements reached during the consultations on pricing and valuation principles and other issues according to requirements set by foreign institutions later.

The individuals representing the banks in the consultations also indicated that, apart from the agreement reached on the topics in the series of consultations, the CBH's capital buffer regulatory concept concerning the portfolios in question should also be revealed before individual banks can make decisions on the sale of transactions and real properties, because responsible decisions can only be made having considered all these circumstance. With reference to its independence, MARK Zrt. did not add that issue to the topics of the consultations, and therefore the Banking Association directly approached the CBH Vice Governor responsible for macro prudential issues in March. We have not yet received an answer to our request.

The working group discussions on the portfolio definition and the technical issues of the due diligence process were successfully concluded in February and March and negotiations began on the technical issues of the process of purchasing receivables.

A consultation was also held to present the details of the portfolio definition, where the Banking Association was not present with its consulting delegation, but experts of institutions interested in the topic were there. The banks' remarks made at the meetings and submitted subsequently were integrated into the portfolio definition documentation of MARK Zrt.

At present the negotiations are pending. The feedback from MARK suggests that the consultations with EU institutions may have been extended and the received remarks may be integrated into the documentation. Another sign pointing in the same direction is that according to the current communication of the CBH, the first binding offer and transaction is likely to be made later than previously planned, only in Q3 of the year.

**Introduction of a Mortgage Funding Adequacy Ratio (MFAR)**

Following the HUF conversion of retail currency mortgage loans the CBH concluded that the maturity mismatch between the long-term HUF loans and short-term HUF funds could also entail a risk. In order to mitigate that risk it developed a regulatory concept introducing a new Mortgage Funding Adequacy Ratio, and promoted consultations about it with the Banking Association and its member banks in the middle of February.

According to the original concept of the CBH, the numerator of the MFAR ratio would have contained the long-term HUF funds that are used for financing and re-financing mortgage loans, while the denominator would have included the retail HUF mortgage loan portfolio. According to the regulatory concept only the securities instruments and no long-term deposits would have been taken into account among the liabilities. Following a very short consultation period and a discussion with the ECB, the intention was to promulgate the CBH decree in March 2015 with a date of entry into force in April 2016.

According to the views of the Banking Association, the fast implementation would cause a problem because the introduction of MFAR would simultaneously require:

- a review of long-term conformity to EU regulations,
- consultations with market actors on short and medium-term macro prudential risks and the alternative options of their management,
- an analysis of the impact of accelerated long-term fund-raising on loan and deposit interests and on the profitability of the banks, and
- a survey of the issue opportunities of the Hungarian banking sector and the absorbing capacity of the market.

During the consultation series dedicated to the presented regulatory concept, the Banking Association made the following main proposals:

- two-phased implementation from October 2016,
- inclusion of securities and deposits with 1-year original tenor in the numerator of the ratio and eligibility of securities, not only denominated in HUF, but also in foreign currency prior to April 2015,
- mortgage bonds eligible as collateral at the ECB and CBH should also be eligible if they are held by group members,
- the long-term portfolio of mortgage loans not overdue, or overdue for not more than 90 days, and only retail mortgage loans should be taken into account at net value, reduced by impairment, in the denominator of the ratio.

In the end the CBH took on board the proposed modifications with the exception of those related to long-term deposits, funds denominated in foreign currency and the disregarding of non-performing loans. The competent CBH executive officer verbally agreed with the deadline.
The decree is being negotiated with the European Central Bank and expected to be issued in June.

**Proposal for the modification of the FEAA (Foreign Exchange Funding Adequacy) ratio and the introduction of a new FX position balance ratio**

At the end of March the CBH proposed consultation on the modification of the FEAA ratio (foreign exchange funding adequacy ratio) and the introduction of a new FX position/balance ratio. As the competent executive director explained, the central bank management intended to review and correct the macro-prudential regulations of the past. Their intention is to complete that work at an accelerated pace in the first half of the year, also including the introduction of fast solutions to the problems of the balance sheet structure of banks and maturity mismatch. The adaptation process expected by the Central Bank includes the elimination of short-term foreign currency funds and swapping them for long-term funds, as well as the sustainability of the status resulting from the elimination of swap portfolios. The modified FEAA ratio would not contain the long-term SWAP portfolios, and compared to the scheduled on May 2014, the introduction of 100% of the ratio would be moved forward to this year. The new ratio would limit the on-balance sheet open positions in proportion to the balance sheet total. The target date of entry into force is *1 October 2015* for both consultations.

Following the consultation, the Banking Association prepared a letter objecting to the fact that the amendment in the former schedule developed for the FEAA ratio was detrimental to the banks complying with the law and that it would be unreasonably stricter than the NSFR rules to be implemented later. As the two regulations should be approximated, in its letter the Banking Association also requested the recalibration of other FEAA items.

At the beginning of April the CBH organised further consultations, in the course of which it recognised the positive role of the SWAPs in the liquidity management activities of the banks. Then it made a proposal for a compromise involving the possible dismissal of the modification of the FEAA regulation and the introduction of the new ratio, if the bank sector took voluntary actions and undertook further commitments, as and when necessary to reduce its short-term FX liabilities because the main objective of the central bank is to reduce the banks' on-balance sheet short-term FX liabilities across the system.

**Reporting**

The implementation of the legal regulations on foreign exchange rates, unfair interest, fee increases and HUF conversion, as well as the fulfilment of the applicable extraordinary, as well as statutory data supply obligations required separate IT development at the credit institutions. At the beginning of 2015, a survey was conducted among the members of the Association to conclude whether or not reporting the currency mortgage loans to be converted into HUF at a fixed exchange rate according to the CBH guidelines was a problem for them or not. Following the data supply requirements would have captured a status, different from the settlement process and real positions in the reports and would also have generated additional capital requirements. The problem was reported to the CBH. The CBH responded to our remarks and modified the instructions quickly.

In Q1 our Association was also requested to review the draft CBH recommendations on the management of risks related to encumbered assets and disclosure of information concerning encumbered and non-encumbered assets, in relation to which we submitted several proposals for modification/clarification. Among others, we indicated the problem that credit institutions where the relevant bodies (Board of Directors, Supervisory Board) already approved the 2014 annual report were unable to comply with the requirements of the CBH recommendation for 2014. Pursuant to the Financial Institutions Act, the auditor must check the contents and correctness in terms of value of the disclosed information and data, which can no longer be done for a closed period. That is why we requested the postponing the entry into force of the recommendation, which the CBH accepted and now expects the disclosure of information first for 2015 instead of 2014.

**Preliminary views of the Economic Competition Council on BankAdat (BankData system)**

The Hungarian Competition Authority launched a procedure in 2012 in relation to a prohibited agreement, assumed in relation to BankAdat. The Competition Council shared its preliminary views on the case with the stakeholders at the beginning of February. Accordingly, the Parties concerned i.e., the Banking Association, the Bankers' Training Institute and the banks involved in the data exchange, operated BankAdat in a manner restricting competition by sharing with each other information constituting business secret that could not be obtained from any other source. According to the preliminary position, the Competition Council is likely to conclude an infringement and impose a fine in its decision to be adopted in the case.
The Association held consultations with the legal representatives of the member banks on the measures required in relation to the preliminary position of the Competition Council, based on which the following decisions were made:

- we need to dispute and refuge in merits the statements of the Competition Council,
- in order to be successful in those endeavours, an international advisor, competent in the EU competition law must be employed to prepare a background study,
- a commitment of public interest must be made to the Competition Council for the further development of BankAdat.

**Consultations about the data required by NAV (Tax Authority)**

The NAV request for data for enforcement and control purposes occurred as a problem for the Payments Working Group of the Banking Association, because the data request of the Authority did not comply with the payment categories used by the banks. This prevented fast, automatic and cheap data supply. In order to manage the problem, the Banking Association wrote a letter to the NAV President with a specific proposal for the adjustment and content clarification of the payment terms used by NAV. NAV proposed a consultation to discuss the raised issues. At the meeting attended by banking experts and competent officers of NAV, the data request of the Authority was analysed and discussed in detail, as a result of which the parties found a mutual solution for most issues. They agreed on

- the accounts that need to be reported as payment accounts,
- the format in which NAV can request data about loan accounts,
- the method to be used in the data request for handling the private accounts of individual entrepreneurs, and
- the categories to be used for savings and securities investments.

The working group will decide on the need for any further consultations based on the memo to be prepared by NAV.

## *VII. Payments*

**Preparations for the AML country assessment (Moneyval) - summary of country risks**

The fifth round of the assessment of Moneyval, the international organisation assessing the efficiency of anti-money laundering measures will start next year, but preparations must commence this year. In that framework the Ministry of National Economy organised a two-day conference, to which a few banking colleagues were also invited. The information learned at the conference was also shared with the other members of the Anti-Money Laundering and Terrorist Financing Working Group. At the meeting of the working group the competent CBH officers presented the information. Upon their request the Association made a proposal for the report on the Hungarian AML risks. In the context of AML threats the following were highlighted:

- generally high tax rates and a great deal of tax avoidance attempts,
- anti-banking atmosphere, high degree of cash usage,
- Ukrainian situation: transfer of Ukrainian savings,
- funds received through offshore companies,
- opening (towards the East) to countries less committed to combating money laundering,
- resident government bond (offshore sales companies),
- Stability Savings Account, and in general capital repatriation schemes.

Within the framework of vulnerability, the rapidly changing legislative environment and the difficulties in suspending suspicious transactions were also mentioned.

**Interpretation of the Hungarian tasks arising from the EU SEPA End-Date Regulation, consultation with authorities**

The 260/2012/EU Regulation, also known as the End-Date Regulation (EDR), sets numerous requirements for credit transfers and direct debits in EUR for banks and other payment service providers (PSP) of Member States not part of the Euro zone by 31 October 2016. In view of the complex changes and projects relating to payments and the payment system in progress, demanding a great deal of resources of the member banks and the available deadline of 18 months, the issues relating to the switch to SEPA payment methods need to be analysed and preparations must be started now. In terms of the End-Date Regulation, the Payments Working Group first discussed the issues of interpretation of requirements for *SEPA collections*, and the migration to the SEPA direct debit model first. The working group analysed the cases when banks and PSPs will be obliged to switch to the SEPA direct debit model. The consultations with the CBH on the topic were closed with the following conclusions:

- if a bank (PSP) does not provide direct debit (and/or credit transfers) as a service, they will not be obliged to offer those services after 31 October 2016 either,
- if a bank (PSP) provides direct debit (and/or credit transfer) service in EUR, they can only do that in the SEPA format after the End-Date,
- after the End-Date any direct debit denominated in EUR based on a letter of authorisation may only be executed according to the SEPA standard in the business sector,
- although EUR transfers made as regulatory transfers and transfer orders contain some collection features, they are special transactions that are not governed by the End-Date, because they are not executed with the model defined in the End-Date Regulation.

Considering that in addition to collection, other problems were also identified in the interpretation of the End-Date Regulation and compliance with its requirements, the Banking Association will set up a

*Migration working group* within the SEPA working group to support a consistent and efficient switch to the new method.

**Voluntary dissolution of the Hungarian SEPA Association (HSA) - final Members' Meeting**

The Liquidator called the final Members' Meeting of HSA for 12 March 2015.
The HSA Members' Meeting decided to terminate the Association through voluntary dissolution based on a resolution adopted on 9 September 2013. In line with that decision the HSA submitted the required documents and statements to the Metropolitan Court (MC) requesting a court resolution on the launch of the voluntary dissolution process and its disclosure. Following a supplementation procedure, the MC issued its decision on 19 September 2014 (which entered into force on 28 October 2014) recognising the launch of the voluntary dissolution process of the HSA and ordered its disclosure (29 January 2015) in the national register. According to the decision, the creditors had 40 days to submit their claims. The deadline expired on 10 March 2015. No creditor claims were reported in that period.

Within the period of the closing Member's Meeting, the Liquidator presented the status of the voluntary dissolution process and the conditions of its conclusion. The members unanimously approved the final report, the opening and closing balance sheet of the voluntary dissolution process, the tax declaration, the report, the balance sheet, the profit and loss account for the last business year, prepared according to the Accounting Act. The Members' Meeting decided on the distribution of Assets presented by the Liquidator. Each member must provide a written order for the payment to the Liquidator. In that order the member may request the assets due to them to be transferred directly to the Hungarian Banking Association pursuant to the support contract between the HBA and the member, or into any other bank account specified by the member.
The Liquidator submitted the "*Application for the deletion of the Association from the Register"* to the Metropolitan Court on 14 April 2015. The process will be closed when the Liquidator sends a copy of the effective resolution on deletion to each member and makes the payments to the members within five working days from the date of receipt of that resolution.

**HUF connection to CLS**[1]

The connection of the Hungarian forint to the continuously linked settlement mechanism, which is a programme controlled by the CBH, reached a major milestone in the first quarter. The top management of CLS Bank held its Board meeting in Budapest in February. The event lasted for several days involving major discussions between representatives of the CBH and CLS. The Central Bank believed that the choice of CLS of Budapest as the venue of its meeting expressed its commitment to the success of the project and gave an opportunity for the parties to review in person the tasks to be completed before the system goes live. In that context joint tests were conducted on the IT systems of the CBH and CLS Bank and the tests of the daily processes to be used in future were completed by March. The first phase of the market test process was also completed with the involvement of three Hungarian and three foreign banks. As a result of the tests the parties concerned gained assurance of the secure operation of the basic functions. Following the status review of the individual projects conducted with support from the Banking Association, further test phases will be arranged among the parties concerned, with the involvement of a larger number of actors, in the subsequent months. On the basis of the results of the tests completed so far, the CBH assessed the current degree of preparations and concluded that they were in line with the November 2015 deadline, established by taking into account the previous request for postponement of the banking system and that the system could go live as planned.

[1] Continuously Linked Settlement

**GIRO: Increase in the number of IG2 cycles**

GIRO Zrt. organised several rounds of consultations with several banks, discussing its plans to increase the number of settlement cycles. In explanation for its plans to increase the 5 settlement cycles to 10, it argued that

- more balanced liquidity management can be offered to clients,
- the availability period will be longer as a result of earlier opening and later closing,
- the unavailability of one cycle will not impose any threat to the 4-hour execution deadline,
- with the earlier opening (first cycle) the transfer items submitted on the previous evening will reach the beneficiaries sooner, and
- it will take us a step closer to the rapidly spreading prompt payments.

The earlier opening and handling of continuous incoming credits will represent additional work for the banks.

In general, the banks support the GIRO project and accept the tasks for the testing period at the beginning of the summer of 2015, as well as the start date of 1 September 2015. The GIRO involved the Consultation Board, a body of the payment experts of the leading banks, intensively in the decision-making process.

**Preparations and implementation of the survey on the security of online payments**

With an input from the Banking Association, the CBH began preparations for a questionnaire-based survey in Q4 2014 with an intention to conclude the adequacy of the security of online payment services offered by payment service providers in terms of the recommendations of the Secure Pay Forum and the related EBA[2] guidelines issued accordingly. The Central Bank made available the questionnaire with 200 questions relating to the 14 recommendations for the Banking Association and, with its mediation, to the members concerned at the beginning of February and set a deadline for responses for 31 March.
During the available period, the IT Security working group proposed consultations with experts of the two CBH organisational units preparing the questionnaire, the Directorate of Financial Infrastructures and the Directorate of Methodology, Information Technology Supervision Department in order to facilitate consistent interpretation of the contents of the questionnaire in the banking system. Following the efficient consultations, the parties concerned submitted the questionnaires by the deadline. After the evaluation, the CBH may conclude the degree of conformity of the banking system and other Hungarian payment service providers, according to the EBA guidelines. The CBH will report the results to EBA and will also organise a meeting to inform the Board of the Banking Association.

During the consultation, the CBH representatives mentioned that the Secure Pay Forum and EBA were working on further recommendations on payment services. Thus, in future guidelines are expected about the services of TPP[3]s and the security of mobile payments, which the payment service providers must also comply with.

**Latest news on bank cards, fraud events and threats**

[2] European Banking Authority: European Banking Authority
[3] Third Party Service Provider

On 10 March 2015 the European Parliament approved a proposal for the regulation of the bank card interchange fees, according to which maximum 0.2% interbank commission can be charged on debit card transactions and maximum 0.3% commission may be charged on credit card transactions. The European Council also gave a green light to the proposal, which is likely to enter into force in the EU Member States in May. The same fees were introduced in Hungary more than a year ago, yet the positive impact expected by those who were in favour of the regulation has not yet been observed in the dissemination of the POS terminals.

In the field of bank cards and electronic channels the review and prevention of fraud events is in the focus of attention. At the end of January 2015 the Association organised an extensive technical consultation and discussion with the involvement of the CBH, the National Investigation Bureau and the card companies. The primary objective was to summarise the typical fraud events of the recent past and to point out potential new threats by concluding the lessons and providing an international overview. According to the CBH, there has been a moderate increase both in the number of fraud events and in the amount involved in them over the last year. The dominance of online fraud is clearly obvious, especially in relation to cross-border transactions. However, Hungary continues to perform well in the security of electronic payments and is among the countries at the top of Europe.
Last year the National Investigation Bureau contributed to more secure bank card services with several arrests. The Europe-wide phenomenon of "ATM jackpotting" (the ATM is opened with its own key, and a software is inserted into the machine, based on which the ATM releases the full content of its cassettes) has also occurred in Hungary. The proposals for prevention and intensive care have so far effectively prevented its dissemination. Owing to regular technical consultations with Europol, we have also been informed of the international fraud events, based on which we have a chance of prevention.

The suspension of the activities of DRB Bank requires more attention also in terms of bank cards, because the bank did not only operate its own bank cards, but was also engaged in bank card activities as a sponsor bank. The Banking Association offered communication support in the case to the competent organisational unit of the CBH in order to assist in providing more transparent and fast technical information and facilitate smooth continuation of bank card settlement processes.

With the help of the honorary tickets of the Vienna Innovation Forum, in March we contributed to the activities of bank card experts with an international overview within the framework of successful professional cooperation that has been conducted for years.

**Involvement in the CBH survey conducted on the monthly two free cash withdrawals**

The CBH requested the Banking Association to conduct a survey to conclude how the calendar month as period of preference is taken into account in the monthly two free cash withdrawals. The Central Bank received consumer complaints indicating that certain banks consider the booking and processing day, subsequent to the current month, indicative.
Our survey revealed that each credit institution complied with the statutory requirements, yet in some cases the actual chronological order of transactions can be established only subsequently, in the following month, especially when they involve cash withdrawals from third party ATMs at the end of the month. Consequently, the banks did not charge any fee for the cash withdrawals in the particular months and applied their charges lawfully to the transactions only subsequently, in the following months. Other banks charged the applicable fee to each item and exempted the transactions "eligible" for no charge only in the subsequent month. Even though it may have caused misunderstanding in the interpretation of the account statement, the clients did not lose any money.
The CBH accepted the results of our survey.

**Experience relating to the introduction of the new HUF 10 thousand banknotes**

The Cash Working Group of the Banking Association invited the new management of CBH Cash Logistics to its meeting in order to jointly assess the initial experiences of the introduction of the new HUF 10 thousand banknotes. The responsible director of the Central Bank thanked for the active contribution of the banks to the distribution of the new bank notes, and expressed his satisfaction with the fact that within a relatively short period almost 35% of the HUF 10 thousand banknotes in circulation were new banknotes. The CBH continues to assist the increased distribution of the new banknotes with favourable tariffs, yet stressed that over a certain degree they were not interested in the accelerated withdrawal of the old banknotes. The CBH raised it as a problem that the share of HUF 20 thousand forint notes in the circulation was rather high and instead recommended the banks to distribute HUF 10 thousand banknotes in higher proportions. The banking experts did not support the proposal because the right to monthly two cash withdrawals radically increased the cash demand, and it is more efficient to satisfy that higher demand with banknotes with higher nominal values from the ATMs.

**Consultation with KLIK on the compensation of teachers**

Several people raised a point at the meeting of the Payments Working Group that a large number of teachers have submitted requests for data supply about bank charges previously applied to their bank accounts. The large amount of requests was triggered by a legal regulation which ordered, following a Curia decision, in which the state lost, compensation of teachers for their additional expenses incurred in relation to the mandatory transfer of their wages into bank accounts. The state assigned Klebelsberg Intézményfenntartó Központ [Klebelsberg Institution Maintenance Centre] (KLIK) to make the payments, but partly the regional organisations of KLIK and partly the schools requested various data from banks through the teachers, causing a great deal of additional work. The Banking Association contacted KLIK and obtained the internal regulations on compensation, and also received some examples requesting data which KLIK had previously been discussed with the banks. The documentation shared with the member banks proved to be really helpful in the banks' data supply.

## *VIII. Accounting, taxation*

**Preparations for the transition to IFRS**

Pursuant to a Government Resolution issued at the end of last year on the transition to IFRS, the Ministry of National Economy had to review the impacts of implementation by 31 March 2015 and make proposals for legislative changes, the impacts on budget revenues and the required translation and training tasks by 31 May 2015. In order to achieve the objective, operational preparations began for the transition to IFRS in five expert working groups in January 2015 (Accounting, Taxation, Statistics, Budget, Training and Translation and Financial Institutions).

The Financial Institutions Working Group, to which the Banking Association is also a party, discussed the conditions of transition of not only the credit institutions but also other financial and capital market operators on several occasions. The first version of the summary report prepared for the Government was completed by the beginning of March. This report confirmed the previous discussions and indicated that credit institutions were obliged to switch to IFRS from 2017. The Banking Association requests competition neutral regulations for the transition because it is

important that implementation should be postponed in a sufficiently defined scope and not according to individual assessment. The application of IFRS would be optional for money and capital market operators other than credit institutions (including financial enterprises, insurance companies and investment service providers) also from 2017. As a prerequisite of the choice, the CBH intends to gain assurance about the preparations of the particular institution and requires an auditor's statement in that regard. As the regulations on international audit do not contain such a responsibility, such discussions are still in progress on the scope and contents of the auditor's statement.

Our Association prepared a proposal for the net sales revenues, which are the basis of the local business tax, for the IFRS Taxation Working Group, especially focusing on the criteria of tax neutral transition. We also organised consultation to present the differences in the profit and loss account, currently prepared according to HAS and as would be prepared under the IFRS. We formed a request that regulators should not prepare a new IFRS-based profit and loss structure to define the base of the local business tax and apply the FINREP report from the single rulebook of the European Banking Authority instead, because it was based on a methodology, consistent and regulated at Community level, where the data content was also regularly controlled by the Central Bank. (There is no standard structure of a profit and loss account under IFRS.)

**Accounting and taxation issues relating to the settlement of foreign currency loans**

Several consultations were held on the problems of implementation of the Act on the Settlement of Currency Loans concerning its Hungarian and international (IFRS) accounting issues by banking experts, with the involvement of external accounting experts and auditors in 2014. At the beginning of 2015 the Government Decree on Accounting was modified based on a proposal of the Association, resolving the uncertainty that occurred in relation to the management of suspended interest and other revenue type claims accumulated on the off-balance sheet contingency accounts in relation to currency loan debtors not making repayments. The legal regulation now states that the suspended items included in the records in relation to currency loans must be reported as extraordinary items and not as interest income during the settlement as would have been the case under the General Accounting Settlement Rules. Consequently, the interest income resulting from ordinary lending will not be mixed up with any interest correction occurring due to the special FX loan settlement.

The retrospective force of the Settlement Act, the almost HUF 1,000 billion consequential loss and the possible refund of various types of taxes generated a lot of issues and therefore we requested a position statement from the Ministry of National Economy. Our Association pointed out that the effective Act on Corporation Tax did not specify the special tax applied to credit institutions in relation to the settlement going back to 2004. The Association requested confirmation that the correction of that tax was also permitted. In profitable years the credit institutions fulfilled their special tax payment obligation based on their total assets in 2009 *in the form of the special tax of credit institutions* (30% of the profit before taxation, in the same amount) and *not under the title of special tax of financial organisations*. The Association also recommended amending the provisions of the Act on Corporation Tax accordingly in order to have clear provisions and mitigate the considerable risk that may occur at the parties applying the law. Unfortunately, the issue of special tax of credit institutions has not been resolved assuringly.

**Issues concerning the extension of long-term investment accounts**

The Taxation Working Group held consultations also on the extension of the tax exempt long-term investment accounts, launched in 2010 and maturing first on 31 December 2015. The relevant

modifications of Act CXVII of 1995 on Personal Income Tax (PIT Act) do not provide clear guidance for all technical issues of extension. The issues need to be clarified also in order to enable credit institutions to provide information to clients in time and to make the required system developments. As an example, it is not clear how to proceed when the maturity of a savings instrument (deposit, securities) kept on an LTIA exceeds the tenor of the maturing LTIA. How can savings be transferred from an LTIA into a new LTIA, open for yet another 5 years and what should happen if the client intends to extend only part of the savings? When and how should interest tax and health contribution be paid? The Association has already received some guidance to some of the above issues, but we are still waiting for a more detailed written response from the Ministry in order to formulate more consistent market proceedings.

## *IX. Banking Association developments*

**Preparations for General Meeting (modification of the Charter and regulation of membership fees)**

The Charter must be modified in relation to the entry of the new Civil Code. The new draft has already been prepared for the General Meeting. The most important news is the establishment of a Supervisory Board at the Banking Association, the five members of which will be elected from experts working in Legal, Accounting and Taxation Working Groups.
According to another new provision of the Charter, in future financial enterprises pursuing activities partially identical with those of banks (e.g., payment institutions, card companies), and other institutions may join the activities of no more than two working groups and working committees with consultation rights, subject to the consent of the particular working committee or working group as associate members, without a member status, in exchange for the payment of the membership fee applicable to associate members. Consequently, the new membership fee category has also been added to the regulation on membership fee payment.

**Money Week – Hungarian involvement in the European Money Week programme series**

The "Money Week" programme series, aimed at providing financial education to primary and secondary school students began on 9 March 2015 with presentations and student flash mobs. The audience included representatives of professional institutions, teachers, students and financial experts. In the programme organised by the Hungarian Banking Association and professionally supported by the Financial Compass Foundation, with which Hungary joined a European initiative taking place simultaneously 24 countries, approximately 90,000 students were able to learn about every day financial problems and fundamental issues concerning the family budget in lessons managed by their head teachers. The subject material approved under the professional supervision and published with the support of the Ministry of Human Resources and Education Research and Development Institute was developed and tested in pilot lessons for several months by our expert-teacher team. 200 financial experts from the banking sector, and under the coordination of Hungarian Economic Association, from the Central Bank of Hungary joined the programme voluntarily. The programme series also includes contests and competitions which help introduce reasonable opportunities, family budget and careful money handling to students.
Besides the initiative, extensive, cross-trade and institution cooperation has evolved. This is how the Hungarian "Money Week" reached a large number of students even in a European comparison, because 660 primary and secondary schools, 1,000 teachers and 90,000 students joined the thematic week. Approximately 15% of the schools attend the special lessons in the first year, with which one-third of the 315,000 students reached in Europe were Hungarians.

**Working Groups, not mentioned before**

*Agricultural Working Group*

At the first meeting of the Agricultural Working Group held this year representatives of the Ministry of Agriculture reported on the extension of data collection covering the total loan portfolio of individual farmers from 2015. At the second meeting the representatives of the Ministry of Agriculture presented the conditions of the direct farmer support system in the 2015-2020 period, and the Public Warehousing Association gave a presentation on the current situation of the public warehouse market. The electronic interface of the *Single Application* for agricultural support and the legal regulations pertaining to its submission have changed significantly in 2015 and therefore, at the third meeting, the representatives of the Agricultural and Rural Development Agency presented the changes and the test mode-based version of the system accepting the Single Applications. The meetings were followed by detailed consultations and a thorough discussion of the professional recommendations.
After the working meetings the Association also held several consultations in writing with the respective, primarily administrative organisations. Most of the questions proposed by our members were satisfactorily answered.

*Data Protection Working Group*

At its March meeting, the Data Protection Working Group discussed the following topics: data processing based on lawful interest, processing of the personal data of other "non-client" parties concerned, lessons of the 2014 "Optimusz" NAIH[4] Resolution. The working group also made proposals for the clarification of the provisions of the Financial Institutions Act concerning data protection. At the April meeting the working group reviewed the resolutions of the NAIH audits focusing on receivables management. In addition, the working group listened to a presentation on the problems of record keeping at the data protection authority and the internal data protection records of the banks from the point of data processors.

*E-working group (workshops, incubation programme)*

On 13 January 2015 the Electronic Channels Working Group launched an incubation programme with seven banks and in cooperation with the Mobile Wallet Association within the framework of which technical presentations were given to interested banking experts, preparing them for mobile payments and the NFC (Near Field Communication) technology. The Mobile Wallet (MobilTárca) is a smartphone application that is capable of collecting one's plastic cards in a virtual form in one place, thus dematerialising the bank loyalty and admission cards, coupons and tickets in the wallet. The incubation programme is aimed at making available the necessary information for potential card issuers to enable them to decide on their future Mobile Wallet developments. Three banks are taking part in Phase 2 of the Mobile Payment Incubation Programme with specifications and technical work tailored to each of them.

*Human and Physical Safety Working Group*

[4] Hungarian National Authority for Data Protection and Freedom of Information

The mandate of the former leader, György Fialka, of the Human and Physical Safety Working Group expired in February 2015. As he will continue his career outside the banking sector, only new candidates were eligible for the position. At its February meeting the working group elected Gergő Rajzó, head of the Physical Security Department of Budapest Bank for the position of the working group leader.

**Communication statistics and recent news**

The major banking communication topic of the first quarter was regular information supply and reporting on the preparation of the banks for the settlement process of consumer loans. Our Association continued the previous efficient practice of summarising the information at press club events and with the help of interviews. The sector level information, important also in terms of information supply to clients, was summarised at a press conference shared with the CBH consumer protection managers on 19 March, thus assisting the clarification of the issues of HUF conversion and supporting the transparency of the process of distributing settlement letters and information supplied to clients.

The "Money Week" programme series launched on 9 March, which also attracted extensive press coverage, was emphasised in the HBA communication. The communication focusing on the topic on 4 February promoted the forthcoming event in a press statement, stressing its importance and relevance. The Association organised a public opening event, open to the press and arranged for numerous articles, as well as issued another press statement about the launch of the Money Week programme series on 9 March. It was a pleasure to report on the interest which exceeded all previous expectations and the active participation of the educational institutions that were in the focus of the programme.

The Code of Conduct updated by the Hungarian Banking Association also attracted public interest, which was communicated in a press statement prepared jointly with the Central Bank of Hungary and published with the support of the Board of the Hungarian Banking Association. (The Code of Conduct on the principles of fair conduct by financial organisations engaged in retail lending entered into force on 1st January 2010 for the purpose of strengthening the confidence between retail borrowers and creditors. Parliament and the Government regulated numerous provisions of the Code of Conduct in the legal regulations in 2014, which called for the review of the Code of Conduct. As a result of the process and the consultations between the Central Bank of Hungary (CBH) and the Hungarian Banking Association, the updated Code of Conduct entered into force on 1 February 2015 containing provisions not regulated in the law.)

According to our statistics, during the first three months of the year, we had appearances in the online media in 600 instances, followed by the print media, in 340 instances and the electronic media, in 290 instances. In total, the Hungarian Banking Association had more than 1,250 appearances and mentions in the Hungarian media during the quarter.

***ANNEX***

***INTERNATIONAL DEVELOPMENTS: REGULATION, SUPERVISION***

*I. Global regulation*

## I.1 Financial Stability Board (FSB[5])

### I.1.1 FSB Chair's letter on 2015 priorities

In a letter preparing for the meeting of G20 Finance Ministers and Central Bank Governors in Turkey, the Financial Stability Board Chair indicated the following priorities:

- Full, consistent and immediate implementation of the approved reforms;
- Finalisation of the reform actions, still outstanding after the crisis;
- Managing new risks and vulnerabilities.

The FSB will prepare an annual report, first in 2015, on the implementation and impact of the reforms, covering not only the good practices and inadequacies, but also unintentional impacts and the difficulties faced during the implementation. The Ministers and Central Bank Governors committed themselves to the elimination of differences in implementation, while in the case of any unintentional consequences, the regulations must be modified. The FSB pays special attention to the slow and uneven implementation of the reforms concerning OTC derivatives and the cross-border aspects.

The closing of the reforms affects three areas: measures relating to the capital adequacy framework of banks, and the TBTF banks (too big to fail), as well as finalisation of the rules boosting the security of derivative markets. In relation to capital adequacy, they improve the consistency and comparability of indicators, and will continue working on the leverage ratio to be finalised by not later than 2017. In 2015 the FSB will develop a standard on total loss absorbing capacity (TLAC[6]), while the FSB Member States will introduce measures for the temporary suspension of the closing of financial contracts with institutions subject to resolution. The FSB will also review progress in the resolution of central counterparties and the plans for resolution. With G20 support, major steps were taken toward detecting the opacity of the OTC derivative markets, and now the main task is to make the related reports truly effective.

While managing new risks and vulnerabilities, FSB places great emphasis on the collection of related data, detection and management of risks and improvement of market structures.

### I.1.2 FSB and IOSCO[7] valuation methodology for the identification of systematically important global institutions (not banks, not insurers)

At the beginning of March FSB and IOSCO published the second consultation document for the evaluation methodology of the identification of systematically important global institutions (not banks, not insurers) (NBNI G-SIFIs[8]). The purpose of the document is to identify the NBNI financial institutions, the crisis or operational fault of which imposes a threat to the stability of the whole system based on their size, complexity or their interconnectedness with the financial system. Due to the diversity of NBNI institutions and the limited accessibility of data pertaining to their activities, the judgement of the supervision is more important in the course of identification than any methodology pertaining to banks or insurers. The NBNI G-SIFIs identification is based on a detailed analysis prepared by the national supervisory authority, supplemented by the supervisory information exchange and coordination with FSB mediation.

The consultation document discusses separately the sector specific methods applicable to the identification of (1) financial companies, (2) service providers on the securities market (brokers), (3)

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

[6] Total Loss Absorbing Capacity, the contents of the concept is more or less the same that of the MREL, set as a requirement for all banks in the EU BRRD Directive. (Minimum Requirement for own funds and Eligible Liabilities)

[7] International Organization of Securities Commissions: the international organisation of securities supervisions

[8] Non-Bank Non-Insurer Global Systemically Important Financial Institutions

investment funds, and (4) asset managers. The draft does not contain any regulatory proposal, the elaboration of which will be a task following the development and approval of the identification methodology.

### *I.2 Basel Committee on Banking Supervision (BCBS[9])*

#### I.2.1 Basel Committee work programme for 2015 and 2016

The activities of the Committee will concentrate on the following four topics in the next two years:

- Policy development;
- Finding the right balance among the simplicity, comparability and risk sensitivity of regulatory frameworks;
- Monitoring and evaluation of the Basel Accords (II, III);
- Improving the efficiency of supervision.

In addition to the proposals prepared earlier/in the progress of consultations, the Committee will also assess the correlation, coherence and calibration of the rules adopted after the crisis; it will review the regulations on sovereign risk management; and will also review the role of the stress tests in the regulation based on national developments. The Committee will focus on stress tests, valuation practices and Pillar 2 in the spirit of supervisory efficiency.

#### 1.2.2 Reviewed Pillar 3 disclosure requirements

At the end of January the Committee published the reviewed version of the Pillar 3 disclosure requirements, based on which market operators can compare better information on risk weighted assets disclosed by the banks. The revision was aimed to improve the transparency of the internal models used for defining the minimum regulatory capital requirements. The reviewed disclosure requirements will be effective from the end of 2016. The Committee made the following changes in the consultation document issued in June 2014:

- it defined more exactly the quarterly, semi-annually and annually disclosure obligations,
- it reduced the requirements on credit risk exposures and credit risk mitigation techniques,
- it clarified and reduced the disclosure requirements of securitisation.

#### I.2.3 Monitoring the implementation of the Basel III Accord

The Committee presented the results of the impact study of the implementation of the Basel III rules for the seventh occasion in March. The study covered 224 banks, including 98 large (Group 1) banks with more than EUR 3 billion tier 1 capital. The calculations made on the 2014 June data suggested complex implementation of the rules (without any transition measures). According to results, all large international (Group 1) banks had at least 4.5% minimum capital. The aggregated capital shortage to the 7% target level was only EUR 3.9 billion compared to EUR 15.1 billion at the end of 2013 and EUR 485.6 billion at the end of 2011. (As a point of reference, the profits of Group 1 banks for H1 2014 were EUR 210.0 billion). In Group 2 two banks did not comply with the 4.5% minimum requirement, while in total EUR 1.8 billion tier 1 capital was missing for the 7% indicator. The average CET1 capital adequacy ratio was 10.8% for Group 1 banks and 11.8% for Group 2 banks.
The requirement for the liquidity coverage ratio (LCR[10]) has been effective from 1 January 2015, 100% must be achieved from 2019. For Group 1 banks, the ratio was 121% at the end of June 2014 (2 percentage points higher than six months before), while the average LCR of Group 2 banks grew from 132% to 140%. 80 percent of the banks involved in the sample exceeded the 100% target, and 96%

[9] Basel Committee on Banking Supervision
[10] Liquidity Coverage Ratio

surpassed the 60% minimum level. The net stable funding ratio (NSFR[11]) was 110% for Group 1 banks and 114% for Group 2 banks. (Among the banks reporting NSFR 92% exceeded 90% of the indicator, while 80% were able to achieve the 100% level.)

### I.2.4 Other BCBS documents

Apart from the above, the Committee also published a second report on the use of aggregated data supply on risks. The risk data supply pertains to global systematically important banks (G-SIBs[12]) and must be fully complied with from 2016. Of the 31 banks concerned in 2014 instead of the former 10, 14 banks indicated that they would not be able to fully comply with the data supply obligation by the set deadline.

The Committee published consultation documents on the accounting of expected credit loss (ECL[13]) to substitute the supervisory guide introduced in June 2006. Having recognised the differences in ECL accounting of the various jurisdictions, the draft guide intends to support consistent application of ECL accounting and, in line with IFRS and other accounting standards, lays down 11 principles for the accounting of credit losses.

Similarly, the Joint Forum of global financial regulatory authorities (Joint Forum) issued a report on cross-sector credit risk management (affecting banks, investment service providers and insurers).

In cooperation with IOSCO, the Committee also reviewed the application of custody (margin) requirements of derivative transactions settled with non-central counterparties.

## *II European regulation*

### II.1 Single Supervisory Mechanism (SSM[14]) – European Central Bank

### II.1.2 ECB annual report on supervisory activities - 2015 priorities

The supervisory priorities of ECB for this year focus primarily on the results of the asset quality review concerning credit risks. The joint supervisory teams (JSTs[15]) check whether or not banks take into account the quantifiable results of the review, consistently implement the corrective measures and eliminate the outstanding inadequacies. The JSTs also closely monitor portfolios that have been left out from valuation. In terms of the corporate segment, they examine with special attention loans involving a large amount of leverage. Similarly, great emphasis is placed on the efficiency, reliability and foundation of credit risk management functions. They try to eliminate identified methodology weaknesses, wrong classification of non-performing exposures and erroneous provisioning models, thus promoting harmonisation of accounting practices and an equal playing field in competition.
The review of business models and profitability incentives, as well as aggressive yield hunting strategies is also a priority task. Institutional level corporate governance - composition, professional expertise, diversity, tasks of the board of directors and corporate culture - as well as management information systems are also in the focus of attention of the JSTs. The risk appetite and business practice quality review system are still being developed.

[11] Net Stable Funding Ratio
[12] Global Systemically Important Banks
[13] expected credit loss
[14] Single Supervisory Mechanism
[15] Joint Supervisory Teams

Capital adequacy and liquidity continue to be key points, in relation to which the supervisory review and evaluation process is fundamental (SREP[16]). Improving the convergence and coherence of supervisory practices is an issue occurring in the validation (authentication) of the internal models of the banks. In the CRR/CRD IV transition process the ECB will scrutinise national discretions, trying to reduce differences between the SSM countries in terms of capital quality. In terms of operational risks the review of appropriateness of corporate governance frameworks and identification and mitigation of major losses are key aspects of single supervision.
In relation to indirectly supervised, less significant institutions, the complex target for 2015 is to finalise the structure and organisation of the supervisory methodology in cooperation with the competent national authorities. Better coordination of supervisory methodologies is also required horizontally. Elaboration of high capacity information exchange systems and cooperation channels and, primarily, the development of the SSM team culture are key tasks.

The annual report, published in March as a quasi summary of quarterly reports, presents in detail the SSM organisation and its foundation, the practical implementation of the concept; it also covers the absorption of the budget resources allocated for such purposes. The appendix also contains a list of legal regulations on the general framework system of banking supervision, approved by the ECB.

### II.1.2 Roundtable discussion with CEOs of the supervised large banks

At the meeting held at the end of March with the involvement of the European Banking Federation, the ECB considered it important to reveal the areas where SSM performed worse than the previous supervisory system, in order to improve the situation. The meeting concluded that the continued regulatory uncertainty made capital planning of the banks a lot more difficult. This uncertainty is also the main factor why the price of EU banks according to book value is lower than experienced in other jurisdictions. The ECB is determined to break down national discretions and targets at defining capital by focusing on consistent supervision. In terms of the internal rating based models, the SSM is currently working on the criteria and concept of the review. In relation to the additional capital required in the course of SREP, it is disputed whether such capital must be provided before or after filling the capital buffers.

### II.1.3 Draft ECB regulation on the supervisory reporting obligation of financial information

The reporting obligation equally applies to significant groups applying International Accounting Standards; significant groups applying national accounting standards, less significant institutions using international or national standards, and branch offices and subsidiaries of third country groups and groups not subject to SSM. The regulation defines the format, frequency, reference date and deadline of the reports, to be submitted on individual and consolidated basis, according to the categories indicated above. The competent national authorities must check the quality and reliability of the reported data and forward the controlled data to ECB. (17 March)

### II.1.4 Modification of Anacredit[17] project

The ECB intends to build a central analytical credit register[18] also in relation to its supervisory role. Taking on board the critical remarks received from several sources, the project, also aiming at the collection of individual credit information has been modified; from the originally planned two phases

[16] Supervisory Review and Evaluation Process
[17] See our report for Q2 2014
[18] Analytical Credit Dataset (AnaCredit)

for three phases. In phase 1, only statistical information must be supplied, and even in phase 2 only consolidated data of significant institutions are requested. The data on household loans are collected in phase 3 but, depending on the need for information on mortgage loans, Member States can activate the function even sooner. As a result of the modification, the implementation of phase 1 is postponed from December 2016 to December 2017.

### *II.2 Structural reform*

Parliamentary rapporteur Gunnar Hökmark published a report/modification proposals on the structural reform of the banking system on 7 January 2015. In the reasoning attached to the proposals the rapporteur recognised the advantages of the universal banking system. He argued that:
1.) Specialised banks are more exposed to systemic shocks and decreasing asset prices than diversified banks.
2.) The European banking model has developed for centuries, adapting to the structure of the European economy. No reduction in the role of universal banks would entail fast development of other financing channels and would lead to slow development of new institutions and lending, as well as a decline in investments.
3.) The regulatory environment has changed significantly, numerous new legal regulations entered into force since the crisis (CRR/CRD4, SSM, SRM, BRRD, DGSD, capital market regulations and directives) which fully restructured the financial markets.
Lending and financing assume more tier 1 capital, more bail-inable capital, stricter risk management, more effective supervision, as well as more prudent control of banks by the investors. At present too little investment and removal of financial mediation from regulated institutions may introduce new systemic risks.
The Committee proposal intends to close the single rule book by managing the systemic risk which remains even despite the new rules. The rapporteur agrees with the approach, yet believes that risk-based regulations are required that cannot lead to the removal of transactions from the regulated and supervised sector. It is important that the solution must be in line with the Bank Recovery and Resolution Directive (BRRD[19]), pursuant to which the separation of the trading activity is only one way to resolution besides capital increase and reduced activity. The size of bail-inable capital/obligations is fundamental in assessing the risk of trading activity. Nevertheless, there is no evidence indicating that the trading activity would be more risky than lending, in fact the situation is rather on the contrary. Consequently, a risk-based approach could be much more efficient in managing systemic risks than a structural approach.

According to the critics, the modifications proposed by the rapporteur in the spirit outlined above, could soften the original proposal and may render the structural reform ineffective. By allowing national discretions, the modifications undermine the single rulebook and by using risk-weighted assets as a basis the number of institutions concerned will be reduced. The proposed individual decision-making results a micro-prudential approach, instead of the desirable macro-prudential one. The proposed modifications would significantly alleviate the intra-group large risk limits.

At the same time, according to the European Banking Federation getting away from automatic separation and applying a broader range of tools was a step in the right direction.

### *II.3 European Commission's Green Paper on the Capital Markets Union (CMU[20])*

[19] Bank Recovery and Resolution Directive
[20] Capital Market Union

The purpose of the Green Paper published by the European Commission on the Capital Markets Union in February is to elaborate an action plan based on the versatile views and opinions collected during the consultation process. The action plan contains the building blocks which will make the Capital Markets Union fully operable by 2019.
The key priority of the new Commission that took office in H2 2014 is to facilitate growth and employment, where CMU could be one of the drivers. Compared to the rest of the world, at present the European economy is too heavily dependent on bank loans, while the capital markets have a relatively small role in its financing. Although the Treaty of Rome expressed the principle of free movement of capital 50 years ago, no major progress has been achieved in the integration of the European capital markets and the financial crisis only added to its fragmentation. According to the Commission's intentions CMU:

- unlock more investment for all companies, especially SMEs, and for infrastructure projects;
- attract more investment into the EU from the rest of the world; and
- make the financial system more stable by opening up a wider range of funding sources.

The implementation of the Capital Markets Union will be a long-term project, requiring sustained effort over many years that should not stop us introducing short-term measures. Consequently, in the next few months, the Commission will:

- develop proposals to encourage high quality securitisation and free up bank balance sheets to lend;
- review the Prospectus Directive to make it easier for firms, particularly smaller ones, to raise funding and reach investors cross border;
- start work on improving the availability of credit information on SMEs so that it is easier for investors to invest in them;
- work with the industry to put into place a pan European private placement regime to encourage direct investment into smaller businesses; and
- support the take up of new European long term investment funds to channel investment in infrastructure and other long term projects.

The Commission has already taken important steps towards a European single rulebook (MIFID 2, EMIR, the Market Abuse Regulation and Directive, Alternative Investment Fund Managers Directive, etc.), although it also understands that the degree of development of the capital markets is rather different in the 28 member states. It expressly encouraged the member states to contribute to the success of the consultations that will continue until the middle of May by presenting their national specificities.

### *II.4 Revised Directive on Payment Services (PSD II)*

The legislation drafting process has reached its final phase of "trilateral negotiations" (trialogue). The European Commission, Parliament and Council finalised the draft and are likely to produce the final version of the Directive by the end of the Latvian presidency.
The clearly most important element of the draft is the inclusion of a third party payment provider (TPP) in the directive:

- using the services of TPPs (making payments and account information supply) would be a fundamental right of each banking payment account holder. The bank could not refuse its account managed clients to give instructions to it through a TPP. Naturally, the TPPs must also comply with strict requirements: they cannot keep any funds of the client, only store the most important client data, could communicate with the client's bank and also with the clients only by using the strict and secure standard defined by the European Banking Authority (EBA), and the TPP would have the right to manage the secret client ID provided by the account managing bank to the client. The European banking sector criticised heavily

especially the latter element of the draft. Disclosing client IDs to a third party would bring a disproportionate risk into the process.

- The banks are also against the provision of the draft prohibiting a contract between the account managing bank and a TPP. According to the draft the relationship between the parties would be governed by the communication standard to be developed by EBA but, according to the banks, account managing banks should still be allowed to enter into a contract with the TPP also on components that support their client's security.
- If a particular order of the client is executed erroneously or late, or fails due to any error attributable to the TPP, then the account manager must indemnify the client but, when requested, the TPP would immediately reimburse the amount with an obligation to prove that no error occurred within its scope of interest. (This is an important change compared to the initial drafts, where the burden of proof lay on the account managing bank.)
- The TPP would have the right to issue a payment instrument with remote access. The banking sector is against that right, and especially the solution that TPP would issue a "bank card" for an account kept by the bank.

### *II.5 European Banking Authority (EBA)*

Based on the authorisation granted in CRD, EBA issued final guidelines on ***common procedures and methodologies for the supervisory review and evaluation process (SREP)*** at the end of 2014. These guidelines constitute the key component of the European Single Rulebook and are aimed at improving the operation of the internal market through effective, deep and standard quality oversight activities. It is a very important step towards establishing a consistent supervisory structure on the single European market through a common framework of supervisory evaluation. The guidelines contain four main blocks: (i) business model analysis; (ii) assessment of internal governance; (iii) assessment of risks to capital and adequacy of capital; and (iv) assessment of risks to liquidity and adequacy of liquidity resources. As a summary of evaluations, a common scoring system will be defined in order to consistently determine the required amount of additional capital and/or liquidity requirement. By recognising the principle of proportionality and the importance of supervisory assessment, the guidelines provide a flexible, yet clearly defined framework for all European supervisions. The EU Member States and SSM must apply the guidelines from 1 January 2016, adjusting their legislative framework and supervisory practices to them.

In March EBA updated its semi-annual ***Risk Dashboard*** publication, which identified the key risk factors on the basis of the September 2014 figures of 55 EU banks. The key findings of the survey are as follows:

- The positive trend of increasing capital adequacy ratios continued in the reviewed quarter, primarily owing to the generated (and not distributed) profit and capital increases.
- The quality of credit portfolios stabilised, even if only at a low level. There are great differences between certain banks and countries.
- The profitability of the banking sector continues to be volatile and low compared to the previous years.
- The loan to deposit ratio decreased and reached a historic low. There are great differences between the countries in that respect too.

### *II.6 European Banking Federation*

In the course of the quarter the European Banking Federation submitted its views to the competent regulatory authorities in the following consultative documents:

- FSB consultation on total loss-absorbing capacity
- BCBS consultation on capital floors
- BCBS consultation on securitisation

- BCBS consultation on Net Stable Funding Ratio disclosure standards
- BCBS consultation on the revisions to the standardised approach for credit risk
- BCBS consultation on corporate governance principles for banks
- ECB regulation on money markets statistics reporting
- ECON report on bank structural reform
- EBA consultation on IRB requirements
- EBA consultation on simple, standard and transparent securitisation
- EBA consultation on methods for calculating contributions to Deposit Guarantee Schemes
- EBA consultation on supervisory reporting on LCR
- EBA consultation on resolution colleges
- EBA consultation on valuation under recovery/resolution
- EBA consultation on rate of conversion of debt to equity in bail-in
- EBA consultation on the contractual recognition of bail-in
- EBA consultation on treatment of shareholders in bail-in or the write down and conversion of capital instruments
- EBA consultation on criteria for determining the MREL[21]
- EBA consultation on the materiality threshold of credit obligation past due EBA consultation on product oversight and governance (POG) arrangement for retail banking products

[21] Minimum Requirement for own funds and Eligible Liabilities