REPORT

on Activities of the Hungarian Banking Association

3rd Quarter 2015

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I. Executive Summary

In Q3 of 2015 ***global economic processes*** were overall similar to the previous quarter. The world economy showed opposing cycles and differing trends; some regions saw improvement, while others saw an economic downturn. The diversity of the world economy was mostly due to low raw material and oil prices, falling asset prices and a massive sale of assets in Chinese financial markets for the second time this year, the finale of the Greek debt crisis, as well as the possibility that the USA will decide to change direction in its monetary policy. The US economy continues its robust growth, the EU's economy is also growing, though at a slower pace, Japan has not yet been able to move its economy towards growth, recession in Brazil and Russia has deepened, while China continues its shift towards a new economic structure, bearing the consequences it has on economic growth in the meantime.

The ***Hungarian economy****'s* surrounding environment was mostly supportive, due to the further strengthening economy of the European Union, however, the Greek crisis, slowing Chinese economic growth and the Russian recession continued to negatively influence macroeconomic performance. GDP growth is expected to continue slowing down during the second half of the year, with an approximately 3% GDP growth for the whole year, which is aided by industrial growth on the production side, and continues to primarily be aided by net export on the consumption side. Household consumption also strengthened. This was made possible by improving employment, and an increase in real wage. Inflation was once again negative at the end of the quarter (0.4%) but, core inflation stayed stable at 1.3%, therefore deflation risks are unlikely. The balance indicators of the Hungarian economy continue be favorable; approaching the end of the year, it seems more and more likely that the 2.4%, GDP proportionate government deficit, which was aimed for, will be kept to. Current account surplus is lastingly high, net external debt decreased to 30% of the GDP, and it will likely decrease further.

Until the end of August the balance sheet total of ***credit institutions*** decreased moderately (by nominally 1.2%). This was largely due to a decrease in liquid assets, and in smaller part, to a slight strengthening of the forint compared to other currencies. Within the asset portfolio, as a result of the self-financing measures taken by the central bank, the portfolio of long-term government securities continued to increase (+4%), while short-term HUF deposit portfolio placed in the domestic interbank market decreased significantly. The total gross loan portfolio shrank by a little over 1% nominally; there was a significant decrease in loans granted to government organizations. Reverse of impairment loss continued to increase (2.4% nominally), as a result, the decrease in net loan portfolio remained moderate. On the liability side, deposit balances grew by 1.6%, which is mainly due to the accounts and short-term deposit portfolio of the corporate sector. As a result of the above effects, compared to June, the net loan-to-deposit ratio of the credit institutions sector grew by almost 7 percentage points by the end of August and exceeded 104%. The credit institutions sector performed much weaker from July to August (HUF 19 billion profit) than earlier during the year (HUF 155 billion total in H1 of 2015, profit before taxes), which is explained by the lack of other income, and the significant depreciation of investment portfolio. As a result of these effects the sector's annualized average return on assets, before taxation (ROA) was +0.81%, and its return on equity (ROE) was 8.4%, which signals a downturn compared to H1 (0.92% and 9.8%).

In the third quarter, the ***Banking Association's work and the relevant work done by banking professionals*** mainly dealt with creating regulation for retail loans remained in FX, tasks concerning the private insolvency law – which came into effect in the beginning of September – and related decrees, as well as the implementation of the Mortgage Credit Directive. The settlement of loans

disbursed in HUF and FX and the notification of the clients concerned, also took place during the third quarter.

At the beginning of the summer, the Banking Association - prompted by the threat of the introduction of additional capital requirements – initiated the ***HUF conversion of retail loans remained in FX*** (mainly car and consumer loans). A criterion set by the government was that the HUF conversion of the loans of the clients concerned should be done with similar conditions to the HUF conversion in February, while the Banking Association promoted conversion at the market exchange rate, in light of the relevant decision of the Curia. A compromise solution was established, according to which the conversion will be implemented at market exchange rate. However, creditors must relieve debtors from a sum of their debt – this sum is equal to the difference between the settlement calculated according to the current exchange rate and the one based on the HUF conversion rate in February. The government agreed to compensate lenders for half of their losses; later on they will be able to get a refund on their corporate and sector-specific taxes. A further government requirement was that loan conditions may not be changed in any way that would be disadvantageous to the client as a result of the conversion. During the consultations we were also able to find a satisfactory solution for managing FX loans with fixed HUF installments. The NBH provided the foreign currency needed for HUF conversion (from its foreign reserves) through a tender, announced on 19 August 2015.
Act CXLV of 2015 on resolving issues concerning the HUF conversion of receivables from certain consumer loan agreements was promulgated on 2 October and entered into force on 5 October. According to the Act, HUF conversion must be completed over a very short period of time, with 1 December 2015 as its deadline.

Since the ***Private Insolvency Act*** – officially act CV of 2015 on the Debt Settlement of Natural Persons – has brought only a small number of proceedings, amending the legislation became justifiable. The modified Act extends the deadline for launching debt settlement proceedings prior to 30 September 2016 to 1 March 2016 as a one-off measure. This does not mean that the moratorium of execution will be extended. A comprehensive, detailed correction was not possible, however several of the Banking Association's short provisions – eliminating confusion in terms of coherence and important in terms of implementation – were added to the draft law, which was submitted to Parliament. We deem two provisions absolutely necessary in the future: the exemption of the obligations of natural person debtors towards third parties (e.g., surety, guarantee and pledge for SME loans) from the procedure, and the omission of the rules on interest capitalization. Concerning the decrees, which elaborate on debt settlement proceedings, the Banking Association's professional advice was mostly taken into consideration in connection with the wording of the *Implementation Decree on Repayment Subsidy* and the *Payments Implementation Decree.* The *Ministry of Justice Decree on the tasks of the main creditor* also provides that financial institutions report data on the applicants to the Central Credit Bureau through the local Family Insolvency Service, which will provide a valuable source of information for creditor banks.

During the quarter, consultations on the ***implementation of the Mortgage Credit Directive*** continued. The provisions of the directive that have not yet been filed will become part of Hungarian legislation through the "salad" law on the *legal harmonization oriented modifications to laws, which concern certain actors of the financial intermediation system*.

The ***National Bank of Hungary***, which also acts as a supervisory authority, further tightened the sector's regulatory conditions. In August it announced (without previous consultation) that from 1 April 2016, it will require a 100% fulfillment of the LCR, and will derecognize balance sheet and deposit coverage ratios as of 1 January 2016. The central bank also (basically) repealed its Decree on the transitional rules related to the introduction of the CRR, effective from the same date. Thus, it withdrew the temporary benefits which could be granted nationally. The Mortgage Funding

Adequacy Ratio will be in effect from October of 2016, and due to the lack of legal framework (which was promised), institutions will have severe problems preparing for its fulfillment. The Ministry for National Economy consulted with the Ministry of Justice, the National Bank of Hungary and the Hungarian Banking Association on how to fulfill the MFAR.

GIRO's transition to a 10-cycle system, and the NBH's proposal for secure internet payments were the most important events of Q3 with regards to ***clearing***.

In addition to having to prepare for the mandatory ***transition to IFRS*** in 2017 and in turn, the changes in ***data reporting***, having to satisfy updated data reporting criteria from 2016 also takes considerable effort on the part of institutions.

Concerning ***international regulation***, the Financial Stability Board continued its work on finalizing the reforms decided on during the financial crisis, and devised solutions for managing new phenomena. Thus, it launched a peer review on the implementation of its policy framework for Shadow Banking Entities, published its ninth progress report on OTC derivatives market reforms, and proposed reforming major interest rate benchmarks and finalizing the principles on regulating total loss absorbency capacity to be calculated for global systemically important banks' resolution. The FSB put together three reports before the G20 Finance Ministers and Central Bank Governors met in September: a report on the status of the data gaps initiative (announced in 2009) one on data reporting related to foreign currency exposure, and one on corporate funding structures and incentives.
Regarding the Q3 activity of the Basel Committee on Banking Supervision, the following two are likely the most important: publishing the consultative paper on the review of the Credit Valuation Adjustment Risk Framework and elaborating the criteria for simple, transparent and comparable securitization. Aside from these, the BCBS published a report on the impact and accountability of banking supervision and its progress report on the implementation of principles for effective supervisory colleges. It reviewed and updated the Guidelines for Corporate governance principles for banks and the Guidelines for identifying and dealing with weak banks.

A highly important event in financial regulation in the ***European Union*** was the introduction of the Capital Markets Union Action plan in late September. Early Action plan measures are: establishing new rules on securitization; new rules on Solvency II treatment of infrastructure projects; public consultations on venture capital regulation and the role of covered bonds, as well as the cumulative impact assessment of financial regulation. The package, which aims to create simple, transparent and standardized securitization, contains both the securitization regulation and amendments to the CRR.
Concerning the Single Supervisory Mechanism (SSM), the European Central Bank – which carries out the unified supervision of big, Eurozone banks – will turn its attention towards decreasing the amount of options and national discretions, unifying the Supervisory Review and Evaluation Process (SREP), and its homogenous implementation. In the long-term, the ECB – to satisfy its multi-purpose data needs – plans to introduce the new European Reporting Framework, a data collection reform for a broader scope of application. The Anacredit project, to be used for collecting individual credit data, will likely be an introductory element of the ERF.

II. Macroeconomic outlook, the banking sector's operating criteria

In Q3 of 2015 ***global economic processes*** were overall similar to the previous quarter. The world economy showed opposing cycles and differing trends; some regions saw improvement, while others saw an economic downturn. The diversity of the world economy was mostly due to low raw material and oil prices, falling asset prices and a massive sale of assets in Chinese financial markets for the second time this year, the finale of the Greek debt crisis, as well as the possibility that the USA will decide to change direction in its monetary policy.
The US economy continues its robust growth, the EU's economy is also growing, though at a slower pace, Japan has not yet been able to move its economy towards growth, recession in Brazil and Russia has deepened, while China continues its shift towards a new economic structure, bearing the consequences it has on economic growth in the meantime.

The ***USA***'s economy continues to be supported by the favorable development of internal factors. The employee market is promising and together with low raw material prices, they provide a basis for domestic consumption. By contrast, industrial performance is moderate, especially in terms of export, which has been continuously decreasing for the past half year due to the strengthening of the dollar and sluggish external demand.
The ***European Union***'s economy is growing slowly. Despite the monetary easing measures announced by the ECB, the weakening of the Euro, and oil prices which are considerably lower than last year, European economic outlook is only improving gradually: the new events of the Greek debt crisis and concerns in connection with China's growth have unsettled market actors. This is also visible through relatively low productive investment. The fact that Germany (the engine of the EU) needs to face new challenges, such as the escalating political and financial burden of the refugee crisis, and the VW scandal – the latter of which weakens its key sector – presents further problems. The primary driving force of growth is export and domestic consumption (incentivized by the weakening Euro and low energy prices), the strengthening of which is due to better employment ratio, lower raw material prices and the positive influence low interest has on real income.
Despite government measures and monetary easing, the ***Japanese economy*** still cannot produce lasting growth values. High corporate profit and improving employment could provide a basis for economic recovery, but the global economic environment (disadvantageous to the country) and the slow implementation of structural changes hinders this possibility.
The ***Chinese economy*** is on a prolonged path of adjustment, which will be followed by a surge of adjustment processes in financial and capital markets. The government wishes to shift from achieving economic growth by financing infrastructure development through debt and state investment to a sustainable development based on domestic demand. This process will require a longer period of time and demands obvious sacrifices; development rate will stabilize at a lower level. The influence of this adjustment process on capital markets greatly increases world economic volatility.
Recession in ***Russia*** deepened further. The country cannot mitigate its dependency on oil and gas export, therefore low oil prices, together with economic sanctions deepened the recession. By August the downtrend somewhat decreased – if this lasts, a slow recovery may start. To mitigate the effects of economic and financial recession, the government turned to fiscal easing, and thus it will slowly use up its reserves (which it accumulated from the income on oil in the previous years).

The ***Hungarian economy's*** surrounding environment was mostly supportive, due to the further strengthening economy of the European Union, however, the Greek crisis, slowing Chinese economic growth and the Russian recession continued to significantly influence macroeconomic performance.

Based on the detailed ***GDP*** data of Q2 and the monthly statistics which followed, a continued deceleration in growth pace for Q3 – and for the entire second half of the year as well – can be expected.
On the production side, GDP growth was aided by ***industrial growth*** (+6.2% in August on a year to year basis). This shows a significant decrease since Q2 (+11%), which does not come as a surprise, as German industrial production decreased by 1.2%.
On the consumption side, ***net export*** remains the primary driving force. The cumulative foreign trade balance exceeded last year's by 30% in the first 8 months of the year, therefore a significant surplus is to be expected, despite the moderate setback in August. However, the VW scandal may pose a risk for export.
Household consumption also strengthened (thanks to improving employment, and a 2.7% increase in real wage). Even though retail sale growth came to a halt as compared to previous periods of the year, there is still a 5% increase predicted for the entire year.
By August, compared to this same period of last year, there was an increase in the number of persons ***employed,*** approximately 135 000, which gives the highest number (4.2 million persons) since the regime change in Hungary. Compared to last August, this year's ***unemployment rate*** decreased by one percentage point, to 6.7%. The improvement in employment was due (fifty-fifty) to increased public employment and employment opportunities provided by the private sector.
Inflation reached into the negatives by the end of the quarter (September data shows -0.4% on a year-to-year basis). However, core inflation stayed stable at 1.3%, therefore deflation risks are unlikely.
The ***balance indicators*** of the Hungarian ***economy*** continued to move in a favorable direction. The central government deficit (HUF 954.6 billion) was almost HUF 110 billion more at the end of September, than at the same time in 2014. This is primarily due to the fact that the budget was complemented by HUF 407 billion less from the European Union, due partly to the items put under investigation by the European Commission. However, the Commission ended the suspension of EU funds in the meantime, the positive effects of which will be visible in terms of budget deficit later. The main reasons for the positive developments concerning government deficit continue to be increasing tax revenues, and decreasing interest expenditure, due to better economic performance. Approaching the end of the year – taking into account the extra expenditures due to the migration crisis – it seems more and more likely that the 2.4%, GDP proportionate government deficit, which was aimed for, will be kept to.
External balance also continued to improve. Current account surplus is lastingly high, external financing capacity is 10% of the quarter's GDP. Net external debt decreased to 30% of the GDP, and a further decrease is probable.

In Q3, by the end of August, the ***balance sheet total of credit institutions*** decreased moderately in nominal terms (-1,2%). The Hungarian Forint, compared to other currencies – weighted to FX portfolio – weakened by an average of approximately 0.9%, providing explanation for a quarter of nominal change, which was mostly due to a decrease in liquid assets.
Within the ***asset portfolio***, the structural change of liquid assets stayed significant, and credit portfolio stopped decreasing. Within this, due likely to the self-financing actions of the Central Bank, the share of long-term government securities continued to grow (+4%). Short-term deposit portfolio placed in the domestic interbank market (mainly in HUF) decreased significantly. The decrease of the stock of EUR on foreign nostro accounts in Q3 equaled their increase in the last quarter, while short-term interbank deposits placed at foreign credit institutions grew by a similar amount (HUF -175 vs +172 billion).
The total gross ***loan portfolio*** decreased by somewhat more than 1% in nominal terms, half of which is due to changing exchange rates. There was a significant decrease in loans granted to governmental bodies (-22.6%). This decrease – due to small volumes – was only partially reversed by the increase in loan portfolio granted to private entrepreneurs and foreigners (+2.9% and + 3.1%). The reverse of

impairment loss continued to grow (by 2.4% nominally), exceeding the improvement of last quarter as well. As a result, the decrease in net loan portfolio remained. Primarily, the requirement analysis of the domestic corporate sector improved (depreciation decreased by almost 4% here), which meant that the net loan portfolio of the affected segment could grow slightly.
On the ***liability side***, deposit balances grew by 1.6%. This is due to the fact that domestic and European corporate sector account and short-term deposit portfolio increased by approximately HUF 300 billion (+5.4%). Interbank liabilities decreased considerably, domestic interbank deposits decreased by almost 30%, while liabilities from credit institutions outside of Europe decreased by HUF 200 billion (-16%). As an overall result of the above effects, compared to June, the net loan-to-deposit ratio of the credit institutions sector grew by almost 7 percentage points by the end of August and exceeded 104%.
In terms of ***profit***, the credit institutions sector reported a much weaker performance in July through August than before (HUF 19 billion July-August as opposed to HUF 155 billion total in H1 of 2015, before taxes). Net income of business activities came in on a pro-rata basis, the weaker performance of this period was due to the lack of other income, and the significant increase in the depreciation of investment portfolio. As a result of these effects the sector's annualized average return on assets, before taxation (ROA) was +0.81%, and its return on equity (ROE) was 8.4%, which signals a downturn compared to H1 (0.92% and 9.8%).

III. Corporate Lending

According to the NBH's report on trends in lending: "Outstanding lending to non-financial corporations by credit institutions contracted significantly in the second quarter, but overall developments in corporate lending during the period under review were characterized by two distinct trends depending on corporate size categories. Although lending to the SME sector expanded on the whole, there was a substantial decline in outstanding loans to large corporations, and the transaction-based annual growth rate of outstanding borrowing by non-financial corporations dropped to -3.4 per cent. The decline in outstanding borrowing was attributable to a few largevolume corporate transactions. These included transactions to replace bank finance with direct financing provided by the parent company. At the same time, lending to SMEs expanded by around 1.8 per cent in annual terms in the period under review, with the FGS continuing to play a substantial role in this regard. The aggregated volume of contracts concluded within the FGS in 2015 Q2 was 15.6 per cent higher on a year-on-year basis. Credit conditions generally eased during the quarter, accompanied by a drop in financing costs. Banks participating in the lending survey also reported growth in demand, which may strengthen further in the next half year, supported by the drawdown of EU funds." However, overall, the dynamics of corporate lending are still significantly below the level that would support sustainable growth.

Use of the Funding for Growth Scheme budget in its second phase

On 16 March 2015, the NBH started the Funding for Growth Scheme Plus with an allocation of HUF 500 billion. The aim of this scheme is to improve the loan opportunities of micro, small and medium enterprises, which were not able to participate in the Funding for Growth Scheme. The central bank provides loans for credit institutions up until the amount of the FGS+ allocation with 0% refinancing, and as with the FGS, these can be used for SME lending, with a maximum interest rate of 2.5%.
The NBH reimburses half of the lending loss with respect to transactions, which will become non-performing within 5 years. However, all reimbursements are limited in terms of portfolio: they must not be more than 2.5% of the existing loan portfolio granted with the scheme in any credit institution's case. The FGS+ only allows granting new loans, it does not provide the opportunity to redeem existing loans. In order that as many smaller, riskier enterprises as possible are granted

financing with the FGS+, the lower and upper limit of available loans are both smaller than those in the FGS: the smallest available loan is HUF 1 million, while the maximum amount is HUF 500 million.
On 22 September 2015 the Monetary Council decided that credit institutions may use its entire HUF 500 billion credit limit allocated for FGS+ in lending done in the second phase of FGS.
According to the statistics of the NBH, the credit institutions which participate in the second phase of the Funding for Growth Scheme reported data on the submission of contract amounting to HUF 1,014.1 billion, with relevance to 35,783 transactions and 21,875 enterprises. The second phase of the program was used by HUF 42 billion more in the first 9 months of this year than at the same time last year. 96% of the contracts signed during the second phase are loans. New investment loans constitute 58%, new current asset loans are 30%, while loans to pre-finance EU subsidies amount to 12%. In Pillar II, loans taken out to redeem existing investment loans are 68%, while loans taken out to redeem existing current asset loans are 32%; nearly 76% of loans were taken out in pillar II to redeem HUF loans, while 24% to redeem FX loans. Within transactions created in pillar I, new investment loans amount to HUF 22 million on average, new current asset loans to HUF 57 million, while EU loans to HUF 30 million.
By enterprise we can establish that 76% of loans taken out by micro enterprises are new investment loans, while in small enterprises this number is 50%, and with medium enterprises it is around 43%. In terms of sectorial distribution, the agricultural, commerce and manufacturing sector took out the most loans out of all; nearly three quarters of loans belong to these three sectors.

IV. Retail lending

The NBH's Trends in Lending report (based on ***data collected up until June*** states the following: "In 2015 Q2, the household loan transactions of the credit institutions sector resulted in a decrease of some HUF 58 billion in the outstanding stock. Outstanding forint loans decreased by HUF 24 billion, while total foreign currency loans fell by HUF 34 billion, and thus the annual rate of the portfolio contraction increased to 14 per cent from 13.5 per cent in the previous quarter. The volume of gross new loans extended to households by the entire sector of credit institutions totalled HUF 159 billion, representing an increase of 9 per cent in year-on-year terms. Based on banks' responses to the lending survey, conditions on housing loans remained broadly unchanged in Q2, while those on consumer loans eased. Easing was primarily recorded in the reduction of the spreads of interest rates over cost of funds. However, the banks indicated that in the next half year no major easing of credit terms and conditions is expected, either for housing or consumer loans. Furthermore, according to the survey, banks reported a marked increase in demand for housing loans and a slight increase in demand for consumer loans, while they anticipate a similar trend for the coming period as well. The APR on new household loans continued to fall in Q2, accompanied by a decline in the interest rate spread on newly extended mortgage loans."

Mortgage Credit Directive (MCD) – consultations with the Ministry for National Economy (MNE) continue

The MNE – to continue consultations – asked the Banking Association to join in the debate on the concept of the local implementation of the EU Mortgage Credit Directive (MCD). Through the involvement of banking professionals, we managed to achieve the following during these consultations (partly as a result of previous consultations):

- If the bank obligates and elderly client to start life insurance next to real estate collateral, it is not considered negative bundling.
- The client may ask to finalize the contract at any time during the 7-day credit offer period, which is obligatory for banks.

- The calculation system for early prepayment will become simpler. Early prepayment possibilities, which result in great, unfair expenses for banks will cease to exist.

However, the following topics have not been agreed on:

- regulating the involvement of bank employees who have direct contact with clients, but do not participate in making decisions on loans;
- the method of calculating business insurance on the real estate that serves as loan collateral into the APR
- granting pre-contract information to clients electronically, which is less expensive;
- Splitting the expenses of the demanding professional training prescribed by the directive with the state.

At the time this report was compiled, the legislative text of the draft was still being consulted on.

HUF Conversion of Receivables from Certain Consumer Loan Agreements

As the NBH intended to introduce an additional capital requirement under the systemic risk buffer for banks managing retail loans still denominated in foreign currencies, the Banking Association conveyed the unanimous position of the banks involved in the issue and proposed to the government and the NBH the HUF conversion of the respective loan portfolio instead of modifying the rules on the capital requirement. The government discussed the issue at its meeting on 1 July 2015. Then negotiations began between the Banking Association and the ministries concerned, as well as the Central Bank.

The conversion of the loans still denominated in foreign currencies of the respective customers, also including debtors of terminated loans, into HUF under terms and conditions, similar to those applied during the HUF conversion of the foreign currency mortgage loan debtors in February was a basic condition of the negotiations, set by the government. As it is a fundamental thesis of all Curia decisions on foreign currency loans that the exchange rate risk included in the contract must be borne by the debtor in exchange for a favorable interest rate, the Banking Association consistently argued that the HUF conversion must take place at the market interest rate. According to the compromise, also included in the promulgated act, the HUF conversion takes place at market interest rate, but creditors must deduct an amount equal to the difference between the exchange rates applied to the current HUF conversion and the HUF conversion in February from their receivables from customers. According to another important condition set by the government, the HUF conversion losses should be borne only by the government and the banking sector without the involvement of the debtors. The government agreed to contribute covering the gross capital loss resulting from the cancellation and the consequential loss interests as creditors could later reclaim the respective amount from their corporation tax and sectorial taxes but the respective institutions must cover the total loss stemming from the Fair Value Adjustment (FVA) of the loans in compliance with the IFRS rules. During the discussions we managed to agree that the losses can be deducted from the tax types stated above in any order. Similarly to the HUF conversion of foreign currency mortgage loans, the government also demanded on this occasion that the conversion could not be associated with any modification in the terms and conditions of the loans, detrimental to the customers, i.e. the creditors cannot increase the cost of funding/reference rate increment due to the conversion.

The management of foreign currency loans with fixed HUF repayments was another important issue of the consultations because a large portfolio, collected on separate accounts, has been accumulated in relation to these loans which would have significantly increased the repayments and the tenor of the loans when they fell due later. According to the agreed solution, such contracts can be converted into loans with equal repayments (annuity loans) on condition that the repayments may rise by no more than 15 or 25 percent reflecting the extension in the tenor, also allowed under the original contract.

Based on the further negative experience related to the legal interpretation of foreign exchange risk, the Banking Association presented an important request, namely that the exact text of information on interest rate risk should be included in the act that was also approved by the legislator.
Similarly to foreign currency mortgage loans, the NBH supplied the foreign exchange amount required for HUF conversion for its foreign exchange reserves, only in the form of unconditional instruments on this occasion. The central bank issued a tender on 19 August 2015, the exchange rate of which must be applied to HUF conversion. The common government and central bank requirement of considering the same exchange rate applicable also to the calculation of repayments to be made between the promulgation of the act and the cut-off date of HUF conversion was revealed only after the tender. The central bank supplied the additional volume of foreign exchange required for it through further tenders.
The completion of the HUF conversion in a short time was another requirement of the government. The steps of execution were already known to the institutions also providing mortgage loans, which could shorten the time required for preparations, and therefore the HUF conversion deadline of 1 December 2015 was set with the agreement of the parties concerned.
Act CXLV of 2015 on resolving issues concerning the HUF conversion of receivables from certain consumer loan agreements was promulgated on 2 October and entered into force on 5 October. The CBH will issue a recommendation with further details of the annexes of the act concerning the information. In order to provide guidance in frequent questions, it plans to publish the "Frequently Asked Questions" and responses on its website.

Introduction of the Family Home Building Allowance scheme

The Family Home Building Allowance (FHBA) scheme was launched on 1 July 2015. The government expected an active involvement from banks in the execution of the scheme both in terms of the administration of state subsidies and in the supply of the loans related to the subsidy.
Compared to the previous products with interest subsidy which generated only moderate interest, this non-repayable subsidy scheme gave a clear impetus to the stagnating housing market. The subsidy varies between HUF 500,000 and HUF 3,250,000, depending on the number of children, the size of the home and the degree of energy efficiency. It is an important positive aspect that the amount of subsidy is included in the own funds of the potential loan and that the purchase of a used home and home extension are also included among the objectives eligible for the subsidy. Similarly to former successful schemes, the subsidy is available not only for existing, but also for children "promised" to be born in future.
The subsidy regulations were not sufficiently discussed with the banks prior to their introduction, and therefore during the initial period of the FHBA the inaccuracies and deficiencies of the respective government decree occurred regularly. The banks reported them to MNE in charge of the regulations through the Banking Association and also directly. The ministry responded to the suggestions fast and made numerous modifications in the regulations, making implementation feasible.

Retail Committee (RC) of the European Banking Federation (EBF)

The EU authorities intend to take further definite steps towards a single European retail market of banking services (a Green paper is being drafted on the topic). The authorities deem it acceptable that cross-border services make up only 1-2 % of the total retail banking services, although the expanding digital technology, the increasingly consistent consumer friendly regulatory frameworks and huge price differences between the Member States could provide a sufficient basis for the fast expansion of the single market. According to the views of the sector, the authorities apply a wrong approach because:

- the retail banking services traditional require a national framework due to the language and habits,

- the forced EU consumer protection rules themselves are not enough to achieve the objective because the taxation and civil law framework is at least equally important to any banking service provider and that framework is governed by the national legislation.

The EBF working committee hopes that following the consumption protection dumping of the last few years the EU authorities will stop producing regulations and wait to see the relevant impact of the existing ones.

According to the RC, in relation to the practical issues of the directive that are currently being transposed into the national legislation:

- in the case of the Mortgage Credit Directive (MCD) the appropriate interpretation of loan advice, lending in non-EU currencies and the errors of the centrally provided APR calculator generated the largest number of problems;
- in the case of the Payment Account Directive (PAD) the EU plans for the transferability of bank accounts have caused a problem because the development trends point much rather towards e-mail address or mobile phone number-based transfers than bank account number-based ones.

V. Other important regulatory developments affecting banks

Developments concerning the Private Insolvency Act

- *Review of the modification of the Private Insolvency Act*

The modified act CV of 2015 on the Debt Settlement of Natural Persons (Debt Settlement Act) extends the deadline for launching debt settlement proceedings prior to 30 September 2016 to 1 March 2016 as a one-off measure. This extended deadline does not affect the deadlines of judicial execution and sales outside execution regulated in the temporary provisions of the Debt Settlement Act, i.e. the moratorium of execution will not be extended. In addition, in the case debt settlement by court the modification clarifies the provisions of the act and states, for mortgage loans with a longer tenor than the debt settlement period, that the tenor for the repayment of the mortgage loan will not be shortened and that the mortgage loan must be paid until the end of the original tenor irrespective of any decision of exemption pertaining to other loans. The private insolvency working group reviewed the draft modification in several rounds. On this occasion, no complex or more detailed modification proposals could be submitted, the institution presenting the draft law insisted that only minor modifications could be made. As a result of our proposal, still several short provisions eliminating confusion in terms of coherence and important for application were inserted into the draft to be submitted to Parliament under No. T/6631. The most important proposals were as follows:

- other obligors may only be natural persons,
- creditors that have receivables certified with an accounting document are also classified as other creditors,
- the definition of the main creditor will be more accurate in terms of a financial enterprise,
- the deadline to satisfy the claim of the beneficiary of a collateral deposit is calculated from the disclosure of the announcement of the Family Insolvency Service (FIS) on the website,
- several provisions will be modified in order to facilitate the exchange of a residential property encumbered with a mortgage for a smaller property in the debt settlement procedure.

We proposed further modifications in the act to the MJ involving the exemption of the obligations of natural person debtors towards third parties (e.g., surety, guarantee and pledge for SME loans) from

the procedure and the omission of the rules on interest capitalization. At the same time, we are also working on the provisions of the act that require further clarification.

- *Draft decree of the Minister of Justice on cooperation between the parties and the payment to creditors from the payment account used for repayments (Payments Implementation Decree).*

In September we conducted several rounds of review on the draft decree and also held consultations with the competent officers of the Ministry of Justice. The last draft returned to us contained most of our remarks, therefore we only made a few formal and wording remarks to that text. We managed to achieve our goal that the account managing financial institution should not be a signatory in the cooperation agreement specified in the decree; responsibilities should be clarified; and that the account managing institution should not have any obligation to control whether or not the debtor complies with the provisions of the cooperation agreement. The right of disposal over the debtor's payment account is clearly regulated and sufficiently flexible. According to the decree, the debtor must have one debt repayment account into which the amounts required for debt repayment are transferred regularly and the right of disposal over which is exercised by the family receiver. The account and the funds in it constitute the property of the debtor. Another purpose of the transfer of the right of disposal is to enable the receiver to distribute the funds among the creditors in compliance with the decision on debt settlement. The family receiver is responsible for ensuring that the payment orders submitted for the debt repayment account comply with the laws and regulations and the contract with the account manager.
In addition, the debtor must also have a subsistence account to which their income and revenues are credited and from which the everyday expenses are paid.
The decree also states that no transfer order or collection order of authorities and no other transfer orders may be executed against the debt repayment account or subsistence account. During the execution of the payment orders the account managing institution must check only the provisions of the law and the framework agreement on payments. The decree was not yet promulgated when our report was written.

- *Amendment of Government Decree No. 256/2011. (XII.6.) on the repayment subsidy for enabling natural persons involved in debt settlement to retain their homes and on home construction subsidy (Implementation Decree on Repayment Subsidy).*

The repayment subsidy is introduced based on the principle that the debtor should receive subsidy to be able to fulfil a payment obligation to restore their solvency, specifically to be made in relation to a real property constituting their home and satisfying equitable housing requirements (serving as collateral) in order to be able to retain the residential property and that it should not have been sold under constraint. When a debt settlement procedure is launched, the respective loans are generally classified as non-performing loans and without the state subsidy there is no reasonable chance for the debtor to restore their solvency; or to reach an agreement between the main creditor and the debtor.
The subsidized individual is eligible for the repayment subsidy as long as the agreement is effective, also including the deferred payment and the subsequent repayment period, but for no more than 5 years. The decree makes the supply of repayment subsidy conditional to a real property, the size of which does not exceed the housing demand and other conditions detailed in the decree. If the subsidized individual fails to fulfil any payment obligation stated in the agreement for more than 60 days, they are no longer eligible for the repayment subsidy for the first day of the subsequent month. The monthly amount of repayment subsidy equals 1/12 of 3.8% of the principal debt outstanding on the date of the conclusion of the agreement p.a., or not more than HUF 25,000.
A joint proposal was prepared for the draft decree and the modification of Government Decree No. 256/2011. (XII. 6.) on home construction subsidy. The Association made remarks for the draft of the

government decrees in several rounds. We proposed for consideration that the tasks relating to the repayment subsidy should be performed by the Family Insolvency Service and not by the main creditor. We proposed producing an application and contract template in order to make the procedure efficient. We submitted several proposals clarifying the text and of technical nature to the draft, a large amount of which has been integrated into the legal regulation. The Government Decree No. 274/2015. (IX.21.) on repayment subsidy for enabling natural persons involved in debt settlement to retain their homes entered into force on 1 October 2015.

- *Issues concerning the Central Credit Information System (CCIS)*

Pursuant to the Decree of the Minister of Justice No. 16/2015. (VIII.28.) on maintaining contact among the parties of the out-of-court debt settlement procedures of natural persons and on the tasks of the main creditor, each financial institution must supply data on the parties applying for the procedure to the CCIS through the regionally competent Family Insolvency Service. The central organization of FIS published information and a completion guide for the temporary method of data supply, which we reviewed. The temporary system will be used until the online interface designed on the FIS website is introduced.

Long-term effects of the Debt Settlement Act affecting the CCIS:

- The Family Insolvency Service as reference data provider reports each relevant event/change concerning the bankruptcy process to the CCIS, which will extend and also improve the CCIS database.
- It is at least equally important that BISZ should immediately transfer all such changes received from FIS to the respective creditors who can then receive authentic information about the status of their clients and the phases of the private insolvency.
- In the course of the mandatory query for loan applications, the credit report will be specifically extended with private insolvency information, and therefore the potential creditor can immediately prevent a potential loan loss.
- The negative CCIS database will also be extended by natural persons (surety, specially interpreted co-debtor, pledgor) who do not have a loan but are not eligible for loans either as they are involved in a private insolvency procedure.

Thus, the CCIS will be a source of more relevant information supply for banks involved in lending than the official FIS database established pursuant to the Private Insolvency Act.

Review of the draft decree of the Minister of Justice on the fees of court bailiffs

The decree on the fees of court bailiff intends to reduce the unreasonably high bailiff fees charged earlier by making the fees more favorable to parties requesting judicial enforcement. In our remarks submitted to the Ministry of Justice, we recommended maximizing the cost of enforcement at 50% of the collected amount in the sale of real properties and vehicles similarly to the expenses of a liquidation procedure. We also proposed maximizing the working fee of bailiffs in the case of any judicial enforcement procedure applied on payment accounts in relation to wages. We also recommended reducing the eligible out of pocket expenses. We made a request to prevent the bailiff from charging any collection commission on debt amounts cancelled for the debtor by the party requesting judicial enforcement. Similarly, we also requested a review of the flat rate chamber costs.

Pledge summary of the working group established for the review of the Civil Code

Under the leadership of the minister of state of the Ministry of Justice, responsible for legislation in the field of private law, a working group was formed from experts of MNE, NBH, the Hungarian

National Chamber of Notaries Public and the Banking Association to review certain provisions of the Civil Code, including the provisions on pledge. The working group had several meetings, the Banking Association also expressed its opinion on the most important issues, considering each disputed item given by the intention that the main purpose of the collateral system is to promote secure lending. We propose easing the fiduciary ban in relation to regulated financial institutions and agreed with the attempts that the law should regulate the foundation and establishment of a pledge as a legal act again. We recommended a more accurate definition of the subject of a collateral deposit; our association agreed with the re-regulation of the framework mortgage and floating charge. We urged restoring an individual pledge and making the collateral register an authentic public register.

Electronic communication with courts

The Ministry of Justice requested a review of the amendments of Act III of 1952 on Civil Proceedings. The draft intends to regulate the method of electronic communication with courts. Pursuant to a former legal regulation, business associations and parties proceeding with legal representatives are obliged to apply electronic communication from 1 January 2016. According to the draft, business associations may maintain contact with courts by using a secure delivery service with password-based identification of their legal representatives (attorney at law, legal counsel, legal representative), i.e. by using the Customer Port and related storage space.
Our Association submitted various remarks to the draft because, in our opinion, the planned solution does not resolve the problem of communication and identification of non-natural persons. That problem could be resolved with a company port or official port, but it is not detailed sufficiently in the draft. In addition, in terms of secret protection (bank, insurance, security secret), industrial right protection and in other aspects the solution in which the documents of all lawsuits in progress or closed in the county would be accessible in the repository attached to the Customer Port is an extreme security risk. In our opinion the secure conditions of switching to electronic communication could not be put in place by 1 January 2016.

VI. Developments relating to the National Bank of Hungary

Consultation in connection with the (MFAR)

In July, following the publication in June of its Decree stipulating the application of the MFAR (Mortgage Financing Adequacy Ratio), the central bank decided on the forint resources that could be taken into account, indicating that in its view, due to the constraints in the Hungarian legal environment, it is not possible to issue securities compliant with Article 129 of the CRR, thus the requirement provided for in the Decree can exclusively be met with mortgage bonds.
The NBH invited the experts of the Banking Association and the relevant banks, and the Association of Hungarian Mortgage Banks to a consultation held on 27 August 2015 in order to assess the market adaptation process and difficulties related to the introduction of the MFAR. In this consultation the central bank experts mentioned the legal constraint that prevent the issuance of mortgage bonds with the existing loan portfolio as collateral, and to take out refinancing mortgage loan from a mortgage bank. At the same time they invited the Banking Association to assess the full range of issues and to inform the central bank thereof.
Complying with this request on 14 September the Hungarian Banking Association sent a letter to the Vice President of the central bank on the issues collected, and sent that letter to the competent persons is the Ministry for National Economy and the Ministry of Justice. After this the Head of Department for Financial Regulation in the Ministry for National Economy initiated a further consultation, with the participation of the representatives of the Ministry of Justice, the NBH, the retail banks, the Hungarian Banking Association and the Association of Hungarian Mortgage Banks.

On the 25 September meeting it was established that the refinancing possibility of the existing portfolios (introduction of transitional measures), and the safe refinancing of future portfolios presumes the amendment of the Mortgage Lending Act[1], the Civil Code[2], and the Civil Code Interpretation Act[3]. According to the Ministry of Justice, the amendment of the Civil Code is likely with the effect of summer of 2016, while the Civil Code Interpretation Act can be amended in this December if necessary. The Ministry for National Economy stated that, keeping in mind the minimization of the legislation risk, it considers feasible only the complex solution, i.e. the simultaneous amendment of the Mortgage Lending Act and the Civil Code. In addition, they intend to fully comply with the covered bond requirements of the CRR.
In the Banking Association's opinion, the original schedule containing the MFAR decree's entry into force in October 2016 presumed the availability of the required amendments to the legislation in October 2015. Subject to the above deadlines, the earlier indicated one year from the actual entry into force of the amendments is required for the safe preparation.

Proposal by the NBH to repeal its decree related to the CRR-related transitional regulation

The NBH contacted the Banking Association in early July 2015, indicating that it intends to repeal *Decree 10/2014 of the NBH on the transitional national rules related to the introduction of the CRR* as of 1 January 2016, and it requested the professional opinion of the Banking Association in connection with this. The NBH justified the intention to withdraw the temporary easing with the lack of data in appropriate breakdown to prepare the impact assessment studies. According to the latest surveys this repeal would have little effect on the credit institutions' capital position, however it would have a positive impact on the international views on the stability of the Hungarian financial system and it would be in line with the similar measures of several EU Member States.
Following the survey carried out amongst our members, in our reply sent to the central bank we indicated that the repeal of the transitional rules could question predictability, which is a step decreasing financial stability. Albeit the measure is neutral for institutions already compliant with the CRR rules but it can have adverse effects on institutions that are able to comply with it in the long term only. With full knowledge of the comprehensively available data there are no grounds for the central bank to decide on the sector average data on the withdrawal of the transitional measures, since there are rather large deviations between individual institutions in terms of the solvency capital and the capital adequacy ratios.
At the end of July, the NBH granted the opportunity for face-to-face consultation with the involvement of the adversely affected member banks, where the arguments for keeping the decree, adopted just over one and a half year, were not accepted. The amendment of the NBH decree in question was published on 15 October. Although the decree will remain formally effective during the entire transition period, as of 1 January 2016, in practice, it will provide no easing compared to the final CRR rules, due to the amendment of the temporary weights assigned to individual items.

Data reporting

o *Changes in data reporting in 2016*

Over the summer, the NBH sent its letter on the regular data reporting plan of 2016 to credit institutions. Concurrently, it asked that credit institutions report data necessary for assessing the expenses of the changes made. The draft contained significantly more changes than what we had expected, since during the transition to IFRS workshops we accentuated that due to the mandatory

[1]Act XXX of 1997 on the Mortgage Banks and the Mortgage Bonds
[2] Act V of 2013 on the Civil Code,
[3] Act CLXXVII of 2013 on the Transitional and Authorizing Measures related to the Entry into Force of Act V of 2013 on the Civil Code

conversion for 2017, we ask that they do not prescribe new data reporting obligations, and postpone bigger changes. The preparations for the transition to IFRS in 2017 absorbs all capacity, therefore applying the changes required by the 2016 draft (which would only be valid for a year) presents an extremely heavy and disproportionate burden for credit institutions.
The 2016 data reporting draft decree contained several significant modifications. The changes concern both daily and monthly reports. Therefore, in addition to income statement, they also concern other reports on credit and deposit interest rate about daily derivatives and other payments (quantity of payment accounts, cash processing, currency, bank note commerce, network units for cash flow, location of ATMs). In addition they demand new data reporting in the form of a monthly report on FX balance ratio, a quarterly report on the mortgage financing adequacy ratio, a report on distributing risk weight exposure in connection with COREP, as well as a report on the market activity of FX markets and derivative transaction markets, which include traffic/volume data too.
The material was published for public dispute. The NBH considered several of the Banking Association's remarks, voiced during the data reporting consultation.

- *2017 reports: managing the transition to IFRS*

In line with the transition process to the International Financial Reporting Standards (IFRS), the National Bank of Hungary prepared and sent in for comments the new data reporting plans (to be implemented from 2017) and disclosed its main aspects in the form of a consultation. The data reporting of credit institutions will go through a significant change starting from 2017. A new, more detailed data request form is planned, which is built on a uniform data model. The current monthly "Supervisory Balance Sheet and Income Statement" report (which is a central element of the new changes), will be replaced by another monthly balance sheet and income statement, which aims to serve a different statistical purpose through structure. Every quarter this will be complemented by the FINREP obligatory report, which will be based on individual credit institution accounts. (Currently FINREP data reporting is built on consolidated data according to IFRS methodology, and in Hungary, according to the European Single Rulebook, 8 credit institution groups are obligated to make the report). In addition to all of this, we can expect data requests, which are built on the data model dimensioned on financial instruments (loans, deposits, derivatives), and which demand a detailed presentation of product features. The new reports will integrate earlier data, as for example data on payment balance sheet reports in addition to supervisory data. Opinions are currently being provided for the data reporting requirement system, which will be in effect from 2017.

VII. Payments

GIRO – shifting to the 10-cycle system

On 7 September 2015, the new 10-cycle GIRO domestic clearing system was introduced. The previous 5 cycles were doubled due to the following reasons:

- All over the world, the number of countries, which apply instant payment systems is increasing fast, and Hungary needs to take substantive steps to speed up clearing. (However, increasing the number of cycles past 10 is not part of the plan.)
- The majority of electronic payment transactions was also credited within two hours in the old system, therefore this change did not demand significant development of either parties.
- While the new, earlier first cycle benefits retail clientele (since the system carries out their order from the day before – given through internet banking – sooner), the closing cycle, which is now later, primarily helps the liquidity management of corporate clientele.
- The maximum 4-hour credit entry rule will stay, thus if one cycle happens to be left out, the system continues functioning safely and properly.

GIRO Zrt. consulted with banks through several forums – Bankközi Szakértői Albizottság, Bankszakmai Bizottság, Konzultatív Testület ("Professional Interbank Subcommittee", "Professional Banking Committee", "Consultative Body") – on the project (which is also supported by the NBH). The banks recognized the proposed changes and after successful testing, prepared for them and the mutually determined deadline, appropriately.

Managing the mass transfer of clientele between service providers in direct debit

In the upcoming period the main – basically retail – public services (district heating, gas, electricity) will be provided by prioritized state service provider companies. It is especially important that service fee payments – therefore direct debit as well – be executed without any problems, during this change. It is also very important to avoid that the changes for large numbers of clients who pay by direct debit be applied individually. For gas provision, this issue will apply from 1 January 2016, since FŐGÁZ will take over E.On's clientele then (hundreds of thousands of clients).
Understanding the weight of the issue, the Banking Association's Board discussed it, and instructed the apparatus, to take steps in preparing for regulation that will aid in conducting the switching process (which will affect direct debit) and require interbank collaboration, as soon as possible. Acting as instructed, the payments working group of the Banking Association elaborated a legislation amendment proposal, and contacted the NBH (responsible for payments regulation), the MNE, and the secretary of state conducting the infrastructural changing process. Our proposal recommends that authorizations, which direct debits are based on should be modified legally to the new service provider, and that the collector bank forward the authorization data (payee's name, bank account, identification) to the banks of the payors, which will adapt these changes.
At the time this report was written, the consultations were in progress. The Banking Association's advocated that the necessary changes should be regulated uniformly, in the payments Act, and not in laws that apply to individual sectors.

Responding to NAV on the management of client demands, which are exempt from foreclosure

The NAV asked for information from the Banking Association in a letter to the Vice-President, on an activity that banks practice, which the tax authority considers unlawful: banks do not disclose the sums that clients have on their own account, which are "exempt" from collection by authorities and which they are therefore entitled to, arguing that they are necessary for transfers made by the authorities.
The Banking Association asked for the opinions of its member banks, from which it found out that in special cases, there is a short, justifiable amount of time, when clients cannot access these sums, which are exempt from authority collection. This can happen in the following cases:

- when the authority tries to collect the sum at nighttime and the bank freezes the client's account until the transaction is processed during the day. This is justified by the court ruling of a case where the authority issued the collection to the bank at nighttime, and the next morning the client withdrew cash from his account by card, thwarting the collection. The court ruling established this as unlawful coverage withdrawal.
- when the bank has an IT system, which would make the collection possible without checking for exemption, if there is enough money on the account. A danger of this is that when the collection request from the authority comes in, the bank would transfer the "exempt sum" as well – a sum that is reserved so that the client is not left without any money. That is why the account is frozen when the authority issues the collection: the bank checks whether there is enough money for collection in addition to the exempt sum. In the vast majority of cases the account is frozen for a minimum amount of time.

In our response to NAV, we indicated that:

- banks seek to keep in mind the interest of both authorities entitled to issue collections, and account holding clients to the best of their abilities, however,
- bank procedures are different when managing collections made by authorities – this is due to the differing account management system and IT infrastructure from bank to bank, but
- banks do not break any kind of law with the practice in question, since there is no detailed legislation for this issue.

Compiling the common bank card service list prescribed by the Payment Accounts Directive (PAD)

The Payment Account Directive regulates the steps member countries and EU authorities need to take to make bank switching easier on an EU level. A fundamental requirement for this is that most important bank card services possess uniform content and names. To achieve this, every member country compiled and disputed (on a national level) the 10-15 most important services belonging to its payment accounts. In September, 2015, the member states sent their lists to the European Banking Authority (EBA); these will be compiled into a common European payment accounts list within a year.
In Hungary, the NBH is responsible for this process, and before sending its list of 19 items to the EBA, it asked the Banking Association for comments. In the opinion of the Cards working group, the Banking Association (in addition to other actions):

- Drew attention to the fact that the list contains several items (e.g. VIBER transfer, demand for bank account verification, limit change), which are entirely marginal services, and will probably not make the EU list;
- Proposed the clarification of certain service names, and their content;
- Missed certain services which have been gaining increased popularity (e.g. ATM payment with bank card);
- Considered it a problem in principle that the document does not contain fee-lowering conditions in addition to fee cancellation.

The NBH added several of the Banking Association's suggestions to the final Hungarian proposal, which was sent to the EBA.

Bank Cards – fraud events and threats

The summer often brings about higher bank card activity, due to the use of bank cards during travel. However, this quarter, there were several instances of bank card fraud, which caught the eye of the general public through heightened media attention. On August 13th, the Banking Association had to actively carry on public communication to "cool down" the media in connection with the ***data thefts at Hungarian ATMs***, which also brought small losses to the sector. We confirmed to the media that in the middle of July, debit card data was stolen at several Hungarian ATMs, after which the fraudsters withdrew cash from ATMs in foreign countries with the acquired data. We also stressed, however that, to our best knowledge, the number of cards from which data had been stolen was 110 total, and the total amount of loss these frauds caused the banking sector was around HUF 1-2 million. The sector took the necessary steps, in tight collaboration with authorities and supervisory bodies. We also used this media attention to draw card holders' attention to the safe use of bank cards.

It is important to highlight that according to the European Central Banks's comparative report, from the 30 inspected countries, Hungary is the one with the lowest number of bank card frauds committed – the number here is one tenth of that in larger European countries. According to the professional analysis, there are 20 frauds committed for every 1 million card transactions, therefore it is safe to state that fraud prevention and management is effective.

On 24 September 2015, in collaboration with the police, we gave a public ***warning in connection with a series of cell phone "sweepstakes" scams***. During these scams more than 10 Hungarian banks received dozens of scam reports. Through a press release, we drew clients' attention to the fact that in these cases, card holders willingly made completely legal transactions by charging their calling cards; therefore, banks have no possibility of revoking the transaction and cannot compensate the victims. We asked card holders to give out their card data carefully, and to not disclose them if requested by phone or through social networking sites, in order to avoid similar incidents. We asked the victims to turn to the police to help in their investigation.

NBH recommendation on the security of internet payments

This Spring the National Bank of Hungary (NBH) conducted self-assessment on the security of internet payments among domestic banks and other payment service providers, in the form of a questionnaire. The questionnaire's content was based on the European Banking Authority's (EBA) "*Guidelines on the security of internet payments*" recommendation (19 December 2014). The NBH invited the Hungarian Banking Association to participate in the implementation of the assessment, and the HBA's IT security working group helped in the uniform analysis of the questionnaires, as well as with meeting of its deadlines. The NBH deduced that the questionnaires showed mixed results, and that the majority of payment service providers need development in order to fully meet the recommendation's criteria.

This Spring the NBH already announced to the EBA that it wishes to comply with the EBA's recommendations, then it started working on its central bank recommendation, which will help domestic payment service providers satisfy the EBA's internet payment security criteria. The NBH sent the draft recommendation for comments to the HBA's IT security working group, and held a consultation upon receiving these, where the aim, content, legal status, scope of application and wording were discussed and clarified. The recommendation:

- Aims to disclose the recommendations and guidelines based on the international "best practice" in order to make internet payment services safer, and thus help the payment service providers which are under the NBH's supervision to defend themselves against internet payment fraud attempts.
- In terms of content, it deals with internal guidance and operational rules which are connected to providing online services, as well as the development and internal defense elements of applications accessible on the internet.
- Its scope of application includes the IT systems of institutions which are accessible from the internet and all systemic elements of their online network environment.
- Does not influence the obligation to act in accordance with legislation: these laws still apply, and must be adhered to, despite the recommendation. Keeping to the recommendation is not a legal obligation, however based on the NBH's experience and opinion, it is indispensable for providing secure internet payment service and helps institutions significantly in fulfilling their legal obligations concerning IT security. The guidelines given in the recommendation are minimum expectations, and when they refer to a result, the result can be achieved through different, other means as well.

The recommendation is connected to the NBH's *Guide on the protection of the information technology systems* and should be considered as its internet security supplementation; and will replace the Hungarian Financial Supervisory Authority's "*The security of internet banking services*" guidelines published under the number 7/2011, and the NBH's publication with the number 2/2015 and the same title.

Instant Payments in SEPA (SCT Inst[4])

Instant payments are understood by the European Central Bank as "cashless *cash*" payments, i.e. as if payment took place by the transfer of cash. The customers of electronic commerce and telecommunications service providers expect payment solutions that deliver the same payment experience as cash, where not only the availability on the payer's bank account of the sum to be paid is promptly confirmed but the immediate availability of the same sum for spending by the payee is also guaranteed. The same concept is adopted by the working group of the EPC[5] when the ERPB [6] definition is taken as the starting point for the evolution of the scheme. Instant payments are low-value electronic payment solutions that are permanently (24/7/365) available and that result in crediting the payees' account due to the immediate or close to immediate interbank clearing of the transaction, confirming the same to the payer (within seconds of payment initiation). All this is irrespective of the underlying payment instrument used (credit transfer, direct debit or payment card), of the underlying clearing arrangements (bilateral or multilateral, based on some infrastructure) or of the way of settlement (e.g. real-time or being based on guarantees) that make payment possible.
SCT Inst will be a new and independent scheme, to which PSPs[7]) may adhere at their own discretion. The PSP shall be *reachable* for instant transfer, i.e. it shall, at the minimum, be able to receive the cash transfer to the credit of its customer (the payee) otherwise the transaction becomes aborted. All other elements of the scheme follow the rulebook of the existing SEPA Transfer Scheme. Under the SEPA End-Date Regulation (Regulation (EU) No 260/2012), the participants of the scheme represent a majority of PSPs within the majority of Member States and within the Union. Based upon the Regulation, it is, however, possible to create a new (entrant) scheme for an exemption period of 3 years where the PSP participants are present in at least eight Member States. Following that period, the SCT Inst scheme shall also meet the "majority" requirements referred to before. The development of a fully-fledged scheme is expected by the end of this year.

Preparation of setting the fees[8] for participating in the EPC payment scheme for 2016

Guaranteeing the continuous operation and maintenance of the three payment schemes incorporating 3,500 to 4,500 payment service providers each and being basic to the realization of the SEPA has resulted in the EPC to separate the relevant activities and costs within its organization and economic administration and to make their financing mandatory for all scheme participants.
The obligation to pay the scheme participation fee as well as the way of setting, and the rules related to, the fee have been published in Annex III of the individual payment scheme Rulebooks. For 2015, being the first year of fee payment, the scheme participation fee payable by the Hungarian payment service providers participating in the transfer scheme shall be 193 euros.
The principles of calculating the scheme participation fee applicable to the Hungarian scheme participants in 2016 are laid down in Version 8.1 of the SEPA Credit Transfer Scheme Rulebook, which shall be effective as of 22 November 2015. According to the rules set therein, any change in the number of scheme members and the resulting changes in costs, with particular respect to payment service providers constituting a single group, shall be recalculated every year. The calculations are preceded by data collection, where the NASO[9] and all Hungarian stakeholders are involved. In mind August 2015, the EPC requested in a letter all scheme participants and the NASO to notify the EPC by 25 September in writing, in the format and with the data content requested by the EPC, of all

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[4] Instant SEPA Credit Transfer Scheme
[5] European Payments Council
[6] Euro Retail Payments Board
[7] Payment Service Provider
[8] Scheme participation fees
[9] National Adherence Support Organization, i.e. in our case the Hungarian Banking Association

changes that have taken place in comparison to last year so that the calculations necessary for setting the 2016 scheme participation fee can be made. The Hungarian Banking Association has called the stakeholders' attention to the importance of data supply.
The EPC Secretariat will inform the stakeholders about the actual scheme participation fee payable in 2016 as calculated from the above data at the beginning of next year.

VIII. Tax and accountancy

Tax issues affecting credit institutions

In terms of taxation the settlement of foreign currency loans required under the Curia decision under the corporation tax; the applicability of transaction levy to the cash-back service of a retail chain simultaneously with card payments and the management of savings held in long-term investment accounts, maturing first on 31 December 2015 were the main issues on the agenda. Concerning the details of the corporation tax refund in 2016 in relation to foreign currency loans several banks look forward to a response to the request for a position statement from the regulator, and therefore the Banking Association did not send any further questions to the MNE. The retail chain stopped the cash back service and paid the transaction levy, and therefore the taxation issue was resolved and the former urgency to develop regulation has disappeared. We received the position statement of the MNE for the large number of issues representing practical uncertainties in relation to long-term investment contract. As new conditions emerged in relation to the respective data supply obligation, we turned to the ministry and proposed eliminating the data supply for income on which no tax is payable and which is not to be included in the tax return.

Automatic tax data exchange[10]

At the beginning of September we appealed to the Ministry for National Economy for information on the future of our proposals made in relation to the CRS[11]/DAC2[12] taxation data exchange and their submission to the European Commission. We also enquired about the date of publication of the Hungarian legal regulations because some of our member institutions began preparations for which awareness of the Hungarian legal regulations would be helpful. We pointed out that the time allocated to preparation was too short for the planned implementation deadline (also including customer information and system development) and proposed consultation offering cooperation. In response to our request, at the end of September we received for review the draft of *Act XXXVII of 2013 on certain rules of international administrative cooperation in taxation and other public charges and the draft amendments of related sectorial acts* aimed at the transposition in Hungary of the regulations on data supply and due diligence. The experts of our member banks began consultations on the details of the Hungarian legal regulation, in relation to which we made several proposals for adjustments.

Accounting and tax regulations for the transition to IFRS

The draft act on the transition to IFRS was sent to us for review in September. In our remarks we indicated that the hierarchy of accounting regulations in the application of IFRS and the Hungarian accounting regulations was not clearly regulated for credit institutions and requested clarification. In relation to the IFRS transition, obligatory for credit institutions from 2017, we requested defining the

[10] See our previous quarterly report for the former developments in that topic.
[11] Common reporting standard of OECD
[12] Directive on Administrative Cooperation

other minor credit institutions, for which the deadline will be postponed by one year, as recommended by us earlier, because in the draft that definition refers to a practically empty category: there are no credit institutions with real market activity below the specified HUF 5 billion balance sheet total threshold.
In relation to taxation, we stressed that we did not agree with the sales revenue definition used in connection with the local business tax (LBT) as it was very extensive and did not comply with the effective principles in its concept either. We do not support the provision of the draft act either that introduces the minimum tax base for the local business tax and the minimum payable tax amount for the corporation tax. We also requested numerous clarifications and adjustments in the draft. The MNE addressed the most criticized minimum tax issue in the version submitted to Parliament, but our Association proposed further consultations in relation to the local business tax.

IX. Developments within the Banking Association

Previously not mentioned working committees, working groups

o *Data protection working committee*

At its latest meeting, the Data protection working committee disputed the provision, which has recently been added to the Act on Credit Institutions and Financial Enterprises: the obligation to inform the decedent's relative about any loans taken out by the deceased which has not bee repaid or financial leasing. Based on the discussion we approached the MNE with a request for resolution and an amendment proposal, then we asked for a professional consultation. As a result, the financial "salad" legislation will receive another amending provision, which will narrow down the obligation of notification to close relatives, clarify which data can be released, and will restrict data release until the date the bank finds out about the inheritance decision.
Another agenda of the meeting was the internal system of data management communication, the possibility of business regulation; confiscation of those documents at the financial institution, which also contain personal data, and handing them over in market supervisory proceedings with regard to the amendment to NBH legislation; and the registry of data protection incidents.

o *The agricultural working group*

During its meeting in June, the Agricultural working group discussed the issues concerning the introduction of the FGS+, which has been expanded to include loan guarantee. In the following months, the NBH and the Agriculture and Rural Development Agency's representatives held consultations, with the following results:

- In August, the cooperation agreement between the Agricultural and Rural Development Agency and the financial institutions, which participate in the FGS+ was elaborated and signed;
- furthermore – based on the observations of the working group - the statement about the general de minimis support, which was in the annex of FGS+ product information and the verification for the small agricultural support have been finalized.

In 2015, the electronic interface and the legislations regarding the submission of the "Uniform Application Form" (to apply for agricultural support) changed significantly. As a result, we held further discussions with the representatives of the Agricultural and Rural Development Agency. The meetings were followed by detailed consultations, and a thorough discussion of professional recommendations. The authorities involved accepted most of the comments and modification proposals given by member organizations.

o *The e-working group – continuing the incubational program*

The NFC Mobile Wallet Service was launched in February, 2015: as a result of collaboration between the Hungarian Banking Association and the Hungarian Mobile Wallet Association. The main goal of this project is to provide a comprehensive professional training program in the field of mobile payments. Active interest was shown in the first phase of the innovative themed project; professionals from 7 of our member banks participated in the training program series, which had four parts, a half-a-day each. Out of the participating banks 3 decided to continue, and participate in the second phase of the program, which had a more "individual company-based" approach with individual professional consultations for each participating bank. Based on the positive feedback from participants, the program saw a high-quality exchange of knowledge and innovational work. This success means that the mobile wallet program may also be announced next year, for those banks that are interested.

- *Documentary credits working group*

The Documentary credits working group held several meetings this year. During these it discussed the professional issues on the letters of risk guarantee of the National Tax and Customs Administration (NAV) in connection with the Electronic Public Road Trade Control System. As a result of this, the text of the risk guarantee drafts accepted by NAV were modified and call-off criteria were clarified.
The working group held a multilateral professional consultation on completion, expiry and warranty guarantees, which are most often used in construction. The TSZTSZ ("Professional Organization for the Verification of Completion") and the National Federation of Hungarian Building Contractors were also invited to participate in these. During their meeting, the parties consulted on the issues and proposals, which were raised two years ago, in the TSZSZ's proceedings. Based on the discussions at the working group meeting, the TSZSZ will compile a "Guideline" in the near future, which will also be available on its website.

Communications

The most prominent banking communications topics for Q3 were the Act on private insolvency coming into effect, and granting information on the HUF conversion of car loans, as well as how banks prepared for it. In addition to this, the settlement of HUF-based loans being repaid in FX received great and constant media attention. This is considered the second cycle of the settlement process. On September 30th we summarized and emphasized the most important information relevant to this topic through press materials, which stated that: a truly exceptional process had been concluded within the banking sector, bringing about changes in decade-old contracts. Banks accomplished the settlement precisely, according to legislation, and met the deadline. The process demanded nearly a year's worth of extra developmental and administrative work. The HUF conversion and settlement amounts to one-third of the banking sector's entire own capital.

We continued our press club and interviews – which had previously proved useful – and we summarized and commented on current events through them. During the press release on the 31st of August, the Hungarian Banking Association's Vice-President and Secretary General gave a summary of information useful to clients in connection with the introduction of private insolvency legislation – including the practical elements of the system. The Vice-President emphasized that, even though the HBA – and the Vice-President himself – supports the institution of private insolvency, he considers its introduction to have been hasty.
The press club's other important topic was the HUF conversion of car loans, in connection with which we emphasized that the Banking Association has already recommended introducing the new legislation and that it deems this a logical step from a consumer's point of view.

The professional working group, which deals with private insolvency presented at and moderated several conferences, professional forums in connection with the interpretation and implementation of the legislation.

In the quarter's press release we drew bank card holders' attention to the previously mentioned series of cell phone scams. Over the past 3 months we had approximately 720 online media appearances, followed by around 270 in print media, and roughly 200 appearances in electronic media. Throughout the entire quarter, the Hungarian Banking Association had over 1190 appearances in Hungarian media.

Money Week – assessing the 2015 results and preparing for 2016

Through broad professional collaboration, the 2015 Money Week program created a new, cross-sector platform for developing financial literacy. This European-level cooperation also achieved significant results in Hungary, in terms of drawing attention to and acquiring basic financial knowledge through fun methods.

The Banking Association's Board approved that the HBA join the Pan-European program once again, as well as the new 2016 concept for Money Week at its meeting in September. In 2016 the program will be able to reach schools nationwide with the help of the Money Compass Foundation as a co-organizer and through the professional support granted by the Ministry of Human Capacities. Topics will be: conscious management of financial affairs, and savings. In 2016, the Banking Association will be the chief coordinator of the Money Week program, and will therefore manage the main organizational tasks, coordinate communication, organize the opening event, and provide a framework for the events of Money Week, as well as for relevant financial literacy events. The Hungarian one-week school program will take place a week before the European framework program, i.e. 7- 11 March 2016. Afterwards (between the 14th and the 20th), member institutions will have the chance to participate and diversify the program through their own financial literacy promoting initiatives. One of the scopes of the 2016 program week is to increase the number, and the role of financial professionals who volunteer to visit schools.

APPENDIX - INTERNATIONAL OUTLOOK: REGULATION AND SUPERVISION

I Global regulation

I.1 Financial Stability Board (FSB)[13]

In the beginning of July, the FSB announced that it will launch a ***peer review on the implementation of its policy framework for Shadow Banking Entities,*** other than money market funds**.** During the survey, the FSB invited feedback from those concerned (supervisory authorities, financial institutions, industry and consumer associations, and other stakeholders in the areas covered by the peer review) to the following issues:

- institutional arrangements needed to define and update the regulatory perimeter to capture new forms of shadow banking if necessary, to ensure financial stability;
- types of information that may be necessary to assess shadow banking risks for entities identified as having the potential to pose risks to the financial system;
- possible ways to enhance public disclosure of shadow bank entities' risks;
- the design of economic policy tools to mitigate identified financial stability risks.

The consultation period lasted until 24 July. The FSB plans to publish the peer review at the start of 2016, which will be compiled from the collected results.

In July of 2014 the group responsible for reforming major interest rate benchmarks (OSSG[14]) gave two proposals for the reform. The first one was that steps should be taken to strengthen existing benchmarks (LIBOR, EURIBOR, TIBOR – all together the "IBORs"), using the largest database possible. The other proposal was to develop alternative benchmark(s), RFR(s)[15] – to be used with nearly risk-free transactions. According to the following year's status report, significant progress was made concerning both. Work on the IBORs reform included reviewing respective benchmark methodologies and definitions, collecting data, making feasibility studies, looking into legal aspects, and broad consultations with submitting banks, users and other stakeholders. Though the FSB proposals are directed at the three most important IBORs, other jurisdictions, which are FSB members (Australia, Canada, Hong Kong, Mexico, Singapore, South Africa) have also reformed their existing rates. Data were collected in key markets, to identify potential RFRs. Work is now underway to identify potential RFRs where these do not currently exist, in both the Eurozone, Japan, United Kingdom, USA and some other member countries.

This July, the FSB published its ninth progress report on ***OTC derivatives market reforms*** – accepted by the leaders of the G20 in 2009. According to the document:

- Implementation of the report is most advanced for trade reporting and for higher capital requirements for non-centrally cleared derivatives (those not cleared at CCPs[16])
- There has been further progress in promoting the central clearing of standardized OTC derivatives: at present five jurisdictions have central clearing requirements in effect for one

[13] The highest international financial legislative body
[14] Official Sector Steering Group
[15] risk-free interest rate benchmark
[16] central counterparties

or more specific product types, and over the next year further progress is anticipated in several other countries.

- A few jurisdictions have regulatory frameworks in place for execution of standardized contracts on organized trading platforms.
- Most jurisdictions are only in the early phases of implementing the BCBS-IOSCO framework for margin requirements for non-centrally cleared derivatives.
- Availability and use of centralized infrastructure to support OTC derivatives reforms continues to expand.

Authorities continue to follow the implementation of these reforms, including the harmonization of transaction reporting, the establishment of uniform trade and product identifiers, synchronizing the regulations for the recovery and resolution of CCPs, as well as addressing cross-border regulatory issues.

At the end of July, the FSB decided that it will wait until work on financial stability risks from asset management activities is completed, before it finalizes the ***assessment methodologies for non-bank non-insurer global systemically important financial institutions*** (***(NBNI G-SIFIs).*** The FSB will report its findings from the work on asset management activities to the G20 within this year, and will develop activities-based policy recommendations by next Spring. Only afterwards will it finalize the NBNI G-SIFIs asset management assessment methodology, jointly with IOSCO.

At the end of August, the FSB disclosed its proposal for the finalization of the ***Total Loss Absorbency Capacity (TLAC[17]) to be calculated for the resolution G-SIBs[18],*** and the corresponding Term Sheet***.*** No final decision has been made yet on the timing and minimum TLAC requirement. According to the valid proposal, the regulation has to be implemented for G-SIBs from 1 January 2019. The minimum TLAC requirement will be set at 16-20% of RWA, the minimum TLAC leverage ratio will be 6% (after the Basel III regulations concerning leverage ratio come into effect, it will be set at double the amount included therein). G-SIBs will have 36 months to meet TLAC requirements.

The FSB put together three reports before the G20 Finance Ministers and Central Bank Governors met in Ankara. The report entitled ***"Corporate Funding Structures and Incentives"*** was requested by the G20, and was compiled in collaboration with IMF, OECD, BIS, IOSCO and World Bank Group experts. It aims to examine the factors that shape the liability structure of corporates, and the influence of financial structure on financial stability. The report is comprised of 5 parts, which describe:

- the growth of non-financial corporate debt since the crisis, including differences across countries and regions;
- a presentation of trend-influencing incentives, including structural and regulatory factors;
- possible related financial stability concerns;
- the potential role of macroprudential policies;
- and possible next steps.

The report proposes filling data gaps (eliminating them), addressing debt-equity tax bias, using macroprudential tools to address the conjunctural factors, and further work on these in 2016.

Following the global financial crisis, the G20 established that the then identified data gaps significantly hindered risk recognition, identification and management. Thus, in 2009 they started the

[17] This is more or less equal to the MREL (Minimum Requirement for own funds and Eligible Liabilities), which is present in the EU BRRD and is required of all banks.

[18]Global systemically important banks

Data Gaps Initiative (DGI). Together, the FSB and the IMF published their sixth common progress report in September, according to which, the implementation of the DGI recommendations will be fully completed by end-2015/early 2016. The data gained from the program is increasingly being used to support financial stability analysis and macro-policy decision making at national, regional and international levels. Experts recommend extending the DGI-2 data reporting program by another five years in order to facilitate regular, good quality, consistent data provision in G20 countries, and the compilation and publishing of adequate statistics. The program's extension - as announced in September – was accepted by the relevant G20 decision makers.

The FSB, BIS and IMF also compiled reports on the data reporting related to foreign currency exposure. The main scope of the current phase of work in this area is the better assessment and evaluation of cross-border risk. Data reporting concerning foreign currency exposure will continue as part of the extended DGI program.

I.2 Basel Committee on Banking Supervision (BCBS)

In the beginning of September, the Bank for International Settlements (BIS) – the Board of Directors at BIS formally – elected Jens ***Weidmann*** as its ***new Chairman***, the President of the Deutsche Bundesbank. Mr. Weidmann will succeed Christian Noyer, who will serve as Chairman of the Board until he retires as Governor of the Bank of France on 31 October 2015. Mr. Noyer assumed his responsibilities as Chairman in March 2010.

In the beginning of July, the Basel Committee undertook to ***review the Credit Valuation Adjustment (CVA) Risk Framework***. The review had three main objectives: namely, to (i) ensure that all important drivers of CVA risk and CVA hedges are covered in the Basel regulatory capital standard; (ii) align the capital standard with the fair value measurement of CVA employed under various accounting regimes; and (iii) ensure consistency with the proposed revisions to the market risk framework under the Basel Committee's fundamental review of the trading book. The consultative paper therefore proposes an internal models approach and a standardized approach for CVA risk, which take into account the revisions of the Fundamental review of the trading book. At the same time, a basic approach for CVA risk is also proposed for banks that are less likely to regularly compute CVA, owing to the nature of their trading operations.

The BCBS also published its ***Report on the impact and accountability of banking supervision*** in the beginning of July. The report is based on the idea that the regulatory reforms made in response to the global financial crisis, cannot alone assure the soundness and stability of financial institutions; they must be supported by effective supervision. In recent years, supervisors have revised their strategy and practice. Supervision has become more comprehensive and "intrusive," taking additional dimensions of bank's business into account. Supervisors also aim to gain more insight into the impact of their own activities. Measuring the impact of supervision is a relatively new field, and although individual supervisors developed various practices to understand the impact of their work, there is no unique method or indicator to measure these. Thus, current experiences are being discussed, while practices are still evolving. The report also shows how a well designed system of accountability can support operational independence and enhance transparency, while safeguarding confidential, institution-specific information. The report consists of the following separate sections: supervisory trends, objectives of supervision, measuring impact, accountability management, and the observations made based on the submitted answers to the questionnaire.

The BCBS published its ***Corporate governance principles for banks*** in the middle of July, which supersedes the guidance published in 2010. The revised principles:

- Expand the guidance on the role of the board of directors in overseeing the implementation of effective risk management systems;
- Emphasize the importance of the board's collective competence as well as the obligation of individual board members to dedicate sufficient time to their mandates and to keep abreast of developments in banking;
- Strengthen the guidance on risk governance, including the risk management roles played by business units, risk management teams, and internal audit and control functions, as well as underline the importance of a sound risk culture to drive risk management within a bank;
- Provide guidance for bank supervisors in evaluating the processes used by banks to select board members and senior management; and
- Recognize that compensation systems form a key component of the governance and incentive structure through which the board and senior management of a bank convey acceptable (desirable) risk-taking behavior and reinforce the bank's operating and risk culture.

The BCBS continuously monitors the operations of supervisory colleges. Last year it revised the 2010 good practice principles on supervisory colleges, and this year it published its ***progress report on the implementation of principles for the effective supervisory colleges.*** The key findings of the progress report can be summarized as follows:

- While there is room for improvement in several areas, the broad sense of supervisors – from both a home and a host perspective – is that the functioning of supervisory colleges has continued to improve and that supervisors have made considerable advances in implementing the college principles.
- Colleges play a key role in assisting supervisors by giving both home and host supervisors a comprehensive view of risks and vulnerabilities to a firm and identifying emerging risks on a timely basis.
- Colleges have evolved into key forums for rigorous discussion of broader issues that enhance supervision of global firms and contribute to the planning of supervisory assessments.
- A wide range of college structures has been developed by home supervisors to reflect the differing size, complexity and global reach of internationally active banks, and home supervisors have a greater sensitivity to host supervisor concerns in developing criteria for college membership.
- Legal and institutional arrangements are important contributors to successful colleges and have been enhanced in recent years, but trust and mutual understanding among members are at least as important.
- The collaborative work among college members contributes to improving the effectiveness of the oversight of cross-border banking groups.
- While supervisors report that interaction with firms has improved in supervisory colleges, many firms have indicated that they would like to receive more feedback on college discussions.
- Although some progress has been made as regards the role of colleges in crisis preparedness, this principle has also been cited as the area with the most implementation challenges, in part because crisis management groups have assumed some of the responsibilities formerly undertaken in supervisory colleges.

In light of the significant post-crisis developments in financial markets, the Basel Committee updated its 2002 Supervisory guidance on dealing with weak banks, and published the ***Guidelines for identifying and dealing with weak banks***. Key changes include:

- Emphasizing the need for early intervention and the use of recovery and resolution tools, and updating supervisory communication policies for distressed banks;

- Providing further guidance for improving supervisory processes, such as incorporating macroprudential assessments, stress testing and business model analysis, and reinforcing the importance of sound corporate governance at banks;
- Highlighting the issues of liquidity shortfalls, excessive risk concentrations, misaligned compensation and inadequate risk management; and
- Expanding guidelines for information-sharing and cooperation among relevant authorities

The BCBS and IOSCO worked on and published the ***criteria for identifying simple, transparent and comparable (STC) securitizations*** together. The purpose of the document is to assist institutions in the development of STC structures, but it is not intended to serve as a substitute for detailed inspection. The STC securitization criteria are non-exhaustive and non-binding. Additional criteria may be necessary based on specific needs and applications.
Criteria promoting simplicity refer to the homogeneity of underlying assets with simple characteristics, and a transaction structure that is not overly complex. Criteria on transparency provide that investors receive sufficient information on the underlying assets, the structure of the transaction and the parties involved in the transaction. The form in which the information is available should not hinder transparency, but instead it should support investors in their assessment. Criteria promoting comparability could assist investors in their understanding of such investment and enable more straightforward comparison between securitization products within an asset class.

The eighth ***monitoring report*** on the latest ***Basel III monitoring exercise*** was completed in September. The results of the monitoring exercise assume that the final Basel III package is fully in force. Data have been provided from a total of 221 banks, comprising 100 large internationally active banks (Group 1) and 121 smaller banks of a capital less than EUR 3 billion (Group 2). Data as of 31 December 2014 show that ratios improved during the half year. CET and Tier 1 capital shortfalls – if there were any – were reduced in both groups. The average CET1 capital ratio was 11.1% for Group 1, and 12.3% for Group 2 banks. Liquidity Coverage Ratio (LCR) was 125% in Group 1, which shows a 4 percentage point improvement compared to half a year earlier. In Group 2 banks, the average LCR 144%, up from 140% six months earlier. Banks also fulfilled the Net Stable Funding Ratio (NFSR) requirements: Group 1 average NFSR was 111%, Group 2 was 114%. (In Group1, 75% of banks reached the 100% value, in Group2, 85% did.)

II European Regulation

On September 9th, Jean-Claude Juncker, President of the European Commission presented the current State of the Union Address, entitled ***"Time for Honesty, Unity and Solidarity***". At the same time the Commission gave a written review of the progress made in the past year by the EU, regarding the 10 priorities given last June. These are: (i) a new boost for jobs, growth and investment; (ii) a connected digital single market; (iii) a resilient Energy Union with a forward-looking climate change policy; (iv) a deeper and fairer internal market with a strengthened industrial base; (v) a deeper and fairer Economic and Monetary Union (EMU); (vi) a reasonable and balanced free trade agreement with the United States; (vii) an area of Justice and Fundamental Rights based on mutual trust; (viii) steps towards a new policy on migration (ix) Europe as a stronger global actor; (x) a Union of democratic change. In his parliamentary speech, Juncker highlighted that this is not the time for business as usual, in the Union. He emphasized that those problems, which the EU now faces must be addressed openly, and that in the current situation there is not enough Europe or Union in the European Union, which needs to be changed.

II.1 Single Supervisory Mechanism (SSM), European Central Bank

Managing of Options and National Discretions

It was in this role that the ECB (which directly supervises European big banks) realized that the rules and supervisory practices implemented in each member country differ from each other in many ways, despite the Single Rulebook. As the leader of the SSM voiced in a presentation, the widely used Options and National Discretions (ONDs),

- significantly influence strictness in prudential regulation;
- make the comparability of capital ratios more difficult;
- make it hard for investors to price capital and funding;
- render regulation even more complex and complicated;
- are a source of regulatory arbitrage;
- create competitive disadvantages for banks in those member countries which have stricter regulation;
- pose a risk to the financial sector;
- make the job of the SSM supervisory authority more difficult.

The SSM prioritizes the elimination of Options and National Discretions, at least in the banks and groups, which it supervises directly. With this in mind, on July 2nd the ECB Supervisory Board approved the work program, which envisages the harmonization of ONDs. The program contains nearly 100 ONDs and does not concern transitional ONDs, which expire within the next three years. The legal phase-out of ONDs is being carried out in the form of an ECB Decision. During the preparation period general discretions must be disentangled from individual discretion, since they require different legal acts. A public consultation is expected to be launched on the draft Decision in November (although this is not legally required). The work will not stop when the decision is adopted; the SSM is initiating the total harmonization of differences under the authority of national legislatures, and of the Capital Requirements Regulation (CRR).

Developments concerning the AnaCredit[19] project

The European Banking Federation consulted with the statistics department of the European Central Bank, in connection with the analytical credit data set (AnaCredit) planned by the ECB. The EBF has doubts whether the project on granular data collection has legal basis and objected that there will be no public consultation prior to its introduction. The EBF voiced these objections in its letter to the president of the ECB as well. In his response, the president emphasized that according to the ECB, the harmonization of reporting standards and definitions is useful for the banking sector, and improves effectiveness and efficiency. More feedback loops and cross-border benchmarking will help banks to improve their own assessment of credit risk. He also pointed out that AnaCredit is a statistical measure and, therefore does not legally require public consultation. Furthermore, the ECB, and the central banks of member countries are carrying on diverse consultation with those interested.

European parliamentary representatives also asked the ECB for more information on the AnaCredit project, primarily concerning public consultation, adherence to data protection regulations and implementation of the principle of proportionality. In his extensive response, Mr. Draghi elaborated on the monetary policy of AnaCredit and its financial stability perspective. Concerning the principle of proportionality, a cautious approach is needed when determining thresholds, as AnaCredit collects granular data. Nevertheless, there will be a possibility for national central banks to grant derogations. The EU personal data protection framework will apply during implementation, moreover, information on households will be reported on an anonymized basis. According to the latest

[19] Analytical Credit Dataset (credit database containing granular data)

information, the AnaCredit Regulation was discussed by the ECB Statistics Committee again in September, but it has not yet gone to the Governing Council for approval.

The ECB considers the AnaCredit project to be an introductory part of the new European Reporting Framework (ERF) and the Banks' Integrated Reporting Dictionary (B.I.R.D.), which the ECB wishes to develop in coming years. Within the ERF, data collection would be realized through the "single point of entry" principle. Banks will have to generate, on the basis of transaction level data which are available in their operational systems, reports in a highly automated and integrated way. The project demands considerable initial input from banks, while results that are useful to them will probably only be available years from now.

ESRB[20] report on misconduct risk in the banking sector

The ESRB report identified two dimensions of the potential systemic impact of typically firm-specific conduct risk. On the one hand, misconduct at banks imposes costs on society, damages confidence in the sector and may discourage users of financial services from utilizing the system. On the other hand, while financial and other penalties applied in misconduct cases serve as a correcting mechanism, in certain cases, they may themselves entail systemic risks that could impose costs on users of the financial system. The report proposes the following for addressing the above mentioned systemic risks:

- Prevent misconduct at all levels by requiring banks to adopt behaviors, practices and internal control, and compliance mechanisms that are conducive to limiting the opportunities for misconduct.
- Explore extending the Legal Entity Identifier (LEI) scheme to a larger range of counterparties.
- Ensure that Supervisory Review and Evaluation Process (SREP) assessments take into consideration the systemic impact of potential misconduct. Where relevant, authorities can apply Pillar 2 measures, such as requiring the strengthening of internal governance and compliance or applying capital add-ons.
- Promote improved coordination between the members of international bodies, such as the FSB and the BCBS by establishing a framework for coordination that embraces best practices to ensure that any spillover effects associated with sanctioning actions are well managed.
- Take potential misconduct risks into consideration adequately in future stress tests. The EBA should devise a methodology for this, in cooperation with the ESRB.

II.2 Capital Markets Union (CMU)

Medium to long-term priorities of Capital Markets Union

At the Eurofi conference in September, Yves Mersch, member of the European Central Bank's Executive Board, talked about the CMU's medium to long-term priorities concerning the Eurosystem. He discussed the following:
1. To bring about its expected benefits, the CMU should foster and result in a high level of financial integration, based on an adequate legal regulatory framework. This would imply the greater harmonization of bankruptcy law, company law and taxation of financial products that pose great political challenges. The aim is to ensure that investors have the same costs and equal access to finance irrespective of where they are located in the EU. Ultimately, the supervisory architecture will also warrant revision. The final destination in the path towards CMU will need to include the development of a single rulebook. All these elements pose a great political challenge.

[20] European Systemic Risk Board:

2. A schedule with clear milestones and deadlines in the upcoming Action plan will facilitate implementation.
3. Market-led initiatives to promote capital markets are important but insufficient. Therefore, legislative action in targeted areas is warranted. While bold action towards the completion of the single rulebook for capital markets will be beneficial, a gradual approach to harmonization should be envisaged in those areas where political sensitivities prevent action at EU level in the short term.
4. Sufficient attention should be devoted to safeguarding financial stability, such as in the area of shadow banking.
5. A single rulebook for EU capital markets needs to be complemented with strengthened supervisory convergence, delivering a common implementation and enforcement of rules.
6. Further reducing still existing fragmentation in financial market infrastructures is at the core of CMU. It needs to be recognized that banks will continue to play an important role in financing the real economy and in providing access to capital markets.

CMU Action plan to stimulate business and investment financing

On September 30th, the European Commission introduced the Action Plan on Building a Capital Markets Union, which sets out to build a true single market for capital for all 28 member states. One of the most important goals of the Commission is job creation, stimulating growth in the economy and investment. The Capital Markets Union is a key pillar of the Investment Plan, aiming to tackle investment shortages by increasing and diversifying funding sources. The Capital Markets Union Action plan is based on the following four principles:

- Creating more and bigger opportunities for investors.
- Connecting financing to the real economy.
- Fostering a stronger and more resilient financial system.
- Deepening financial integration and increasing competition.

The Action plan contains the following set of early actions:

- Establishing new rules on securitization.
- New rules on Solvency II treatment of infrastructure projects.
- Public consultation on venture capital regulation.
- Public consultation on the role of covered bonds.
- The cumulative impact assessment of financial regulation.

The Commission has an ambitious, pragmatic step-by-step approach, based on rigorous economic analysis and mindful of financial stability risks.

In its press release on September 30th, the European Banking Federation supported the Capital Markets Union Action plan. It expressed its pleasure at hearing that the European Commission appreciates the important role that banks play in economic growth and is seeking a complementary approach. Risk-averse banking regulation introduced during recent years has made it more difficult for banks to lend to European companies, in particular to small and medium sized companies. By broadening the financing options for companies in need of equity investment, including by revitalizing securitization, CMU can now help unlock the latent growth potential of capital markets.

Securitization

Parallel with the Capital Markets Union Action plan, the European Commission also published its proposal for amending the Capital Requirements Regulation (CRR). Through the need for sustainable securitization, they clearly defined the set of criteria for ***simple, standardized and transparent securitization (STS).*** (Simple securitization criteria include homogeneity, prohibition of resecuritization, requirement for loans to have a long credit history, and transfer of loan ownership to the securitization issuer. Satisfying transparent and standardized securitization criteria means that

loans packaged in securitization must have been created using the same lending standards as any other loan (no “cherry-picking” is allowed); at least 5% of the loans portfolio must be retained by the originator, information is sufficiently detailed and data is published on an ongoing basis; and the contractual obligations, duties and responsibilities are clearly defined.)
The objectives of the Securitization Regulation and the securitization package which comprises the CRR amendment are:

1. To revive markets on a more sustainable basis so that STS securitization can act as an effective funding channel to the economy;
2. To allow for efficient and effective risk transfers to a road set of institutional investors;
3. To allow securitization to function as an effective funding mechanism for some non-banks (such as insurance companies) as well as banks;
4. To protect investors and to manage systemic risk.

The Commission does not intend to go back to the “bad old days” of opaque and complex subprime instruments. Rather, with its proposal, it aims to differentiate between simpler and more transparent securitization products and other products which don’t satisfy such criteria and through this differentiation, create a funding channel for the EU economy without endangering financial stability.
The proposal includes precise disclosure requirements from the originator, the sponsor and the issuer – the activities of these will be overseen by supervisory authorities, according to location and activity type. The issuer of securitization will need to confirm an instrument’s compliance with all STS criteria and will communicate it to the ESMA[21], which will keep a record of STS securitizations. If the securitization does not fulfill STS criteria, it will be taken off the list. In case of wrongdoing, the originator may be heavily sanctioned (from EUR 5 billion to up to 10% of the annual turnover) and member states have the possibility to introduce criminal charges against him, though they are not obliged to do so.

In addition to the securitization regulation, a proposal for amending the Capital Requirements Directive was published, which prescribes a capital requirement for managing STS securitizations that is more favorable than the current one. Solvency II, which regulates capital requirement for insurance companies will also be amended for the same reason, however this will only happen after the securitization regulation has been adopted.

The Commission will publish an easy-to-understand Fact Sheet on securitization facts at the same time as the proposal, to provide information to a wider audience.

Public call for evidence on the regulatory framework of financial services

On September 30th the Commission – as part of the CMU Action plan – announced a public call for evidence on the regulatory framework of financial services. In the wake of the crisis, the EU put in place more than 40 regulatory measures over a short period, to restore financial stability and public confidence in the financial system. As a result of this intensive rulemaking and improved supervision, the sector became more resilient. However, it is still important for EU legislation to find the right balance between reducing risk and enabling growth, and to not create unintended barriers. The aim of this call for evidence is to help establish the efficiency, consistency and coherence of the regulatory framework for financial services. The call for evidence is an essential part of the Commission’s Better Regulation Agenda[22] and is coherent with the global efforts of international regulatory bodies.
The Commission is looking for evidence and concrete feedback on the following:

[21] European Securities and Markets Authority

[22] Better Regulation for Better Results – An EU Agenda (please see the previous quarterly report for the program)

- Rules affecting the ability of the economy to finance itself and to grow;
- Unnecessary regulatory burdens;
- Interactions, inconsistencies and gaps;
- Rules giving rise to possible other unintended consequences.

The Commission expects feedback from all interested parties (including national parliaments and other EU institutions, member states, citizens, small and medium enterprises, the non-governmental sector as well as the financial sector) by 6 January 2016. Based on the received feedback the Commission may initiate regulatory action in certain areas. It will make use of these results during the review of existing regulations (e.g. CRR, MIFIR), as well as in its contributions to ongoing global debates.
At the same time, the call for evidence definitely does not aim to return to the lax regulation that was in place before the crisis.

II.3 The European Banking Authority (EBA)

In the middle of July, the EBA published a report on ***macroprudential policy measures communicated to the EBA***. The report examines the interaction of macroprudential and microprudential objectives and tools, and contributes to the ongoing discussions of the macroprudential toolbox and provides information on the regulatory work carried out by the European Commission, the EBA, and the ESRB. It analyzes the notifications and other information received by the EBA in the first five quarters following the implementation of the CRR/CRD IV[23] (in January of 2014), on the implementation of the macroprudential toolbox. Based on the information available, 14 EU countries and Norway introduced 32[24] macroprudential measures altogether, half of which relate to real estate financing. Stricter criteria were most often implemented in standardized risk weights for exposures secured by mortgages. Pillar 2 was applied for macroprudential purposes in six cases. All measures but one have capital requirements in scope, while no measures were applied for the setting of liquidity requirements.
The report makes important observations in connection with the implementation of the toolbox. It highlights the need for clarification and transparency of the measures, with special reference to the objectives of implementation and its corresponding processes. It acknowledges that there are significant interactions with the results of stress tests as well as the interpretation of solvency ratios. Finally, the report concludes that the implementation of macroprudential measures requires a strong coordination between macroprudential and microprudential authorities.

Another important development during the summer was renewing information on the ***upcoming transparency exercise*** and the ***2016 EU-wide stress test***. The EBA published the approximate list of banks which will participate in the transparency exercise as well as publishing detailed data on EU banks' balance sheets, covering their composition of capital, leverage ratio, risk weighted assets by risk type, sovereign exposures and credit risk exposures. The 2016 stress test will be similar to the 2014 one in several ways. Notably, 2016 exercise will be based on a constrained bottom up approach, including a static balance sheet assumption and wide risk coverage to assess EU banks' solvency. The 2016 stress test will build on the lessons learned from previous exercises and will be more closely aligned with SREP, to ensure that its results are incorporated as an input to that process. The detailed scenario and methodology as well as the test will be launched in the first quarter of 2016. Results on a banking level will be concluded by the third quarter of 2016.

[23] Capital Requirements Regulation and Directive
[24] Other sources, e.g. ESRB show a higher value. This difference stems from the fact that the EBA report in question only examined the macroprudential measures, which are in accordance with CRR/CRD IV.

At the end of July, the EBA launched a ***discussion paper and call for evidence on SMEs and the SME supporting factor*** (SF). Upon accepting the CRR/CRD IV, the EBA received the mandate from the European Commission to (a) analyze the trends and condition of SME lending, (b) analyze the effective riskiness of Union SMEs over a full economic cycle, (c) examine if the capital requirement determined in the CRR for SME risk is in consistency with the outcomes of analysis under point (a) and (b). The analysis also needs to determine whether the 0.7619 supporting factor (implemented from 1 January 2014 is appropriate. The discussion and the call for evidence prepares the EBA's response to these questions. The document posed 16 questions over 4 chapters. The EBA expects a response from all those concerned by 1 October 2015. The EBA will publish its report on SMEs and the SME supporting factor in February, 2016, taking into consideration the feedback it receives. The study will be backed up by two empirical projects: one will examine the credit supply effects related to the introduction of the SME factor, the other, relative calibration of capital requirements associated to the exposures to SMEs.

An important event at EBA was that in September, the Board of Supervisors announced ***the extension of the mandates of Andrea Enria (Chairperson) and Ádám Farkas (Executive Director)***, for another ***five year term from 2016 to 2021***. The decision was based on the evaluation of the work of the past five years, as well as on future work requirements.

Other EBA and ESA[25] documents published in Q3

Reports

EBA's seventh semi-annual report on risks and vulnerabilities of the EU banking sector

EBA identifies divergent supervisory practices in the implementation of its Guidelines on the assessment of the suitability of members of the management body and key function holders

EBA publishes RWA assessment as the next step in improving consistency of internal model outcomes

EBA updates on remuneration practices and high earners data for 2013 across the EU

EBA publishes results of the Basel III monitoring exercise as of 31 December 2014

EBA looks at asset encumbrance in EU banks

ESAs see continued risks in EU financial markets and call for rigorous action on assets and liabilities

Consultations

EBA consults on conditions for capital requirements for mortgage exposures (EBA/CP/2015/12)

EBA consults on draft Guidelines on cooperation agreements between deposit guarantee schemes (EBA/CP/2015/13)

EBA consults on technical standards on exemption of non-financial counterparties (NFCs) from CVA risk charge (EBA/CP/2015/14)

EBA consults on harmonized definition of default (EBA/CP/2015/15)

EBA, EIOPA and ESMA consult on the prudential assessment of acquisitions and increases of qualifying holdings (JC/CP/2015/003)

Opinions

EBA issues advice on securitization (EBA/OP/2015/14)

EBA publishes technical advice on protected arrangements in a resolution situation (EBA/OP/2015/15)

EBA recommends to the EU Commission retention of maturity ladder in the ITS on additional liquidity monitoring metrics (EBA/OP/2015/16)

Technical standards

[25] European Supervisory Authorities (EBA, ESMA, EIOPA)

EBA defines functioning of EU banking resolution colleges (EBA/RTS/2015/03)
EBA issues final standards on processes for notifying that a banking institution is failing (EBA/RTS/2015/04)
EBA publishes final technical standards to ensure effective resolution under the BRRD (EBA/RTS/2015/05)
EBA publishes technical standards on independent valuers (EBA/RTS/2015/07)
EBA proposes corrections to the adopted technical standards on non-delta risk options and identified staff (EBA/RTS/2015/09)
EBA publishes technical standards and guidelines on simplified obligations (EBA/ITS/2015/05)

Guidelines
EBA streamlines intra-group financial support for banking institutions (EBA/GL/2015/17)
EBA publishes final product oversight and governance requirements for manufactures and distributors of retail banking products (EBA/GL/2015/18)
The EBA issues final Guidelines on passport notifications for mortgage credit intermediaries (EBA/GL/2015/19)

Other documents
Overview of options and discretions set out in Directive 2013/36/EU and Regulation (EU) N° 575/2013.
EBA to conduct further analysis on Net Stable Funding Requirements and Leverage Ratio (Call for advice)
EBA publishes key information on the systemic importance of the 37 largest banks in the EU