



HUNGARIAN BANKING ASSOCIATION

REPORT

on Activities of the Hungarian Banking Association

4th Quarter 2015

Budapest, February 2016

Table of Contents

I. Executive Summary	4
II. Macroeconomic outlook, the banking sector's operating criteria.....	7
III. Corporate Lending.....	10
PHASE III OF THE FUNDING FOR GROWTH SCHEME AND THE NEW INSTRUMENTS OF THE MARKET-BASED LENDING SCHEME.....	10
THE RATE OF UTILIZATION IN PHASE II OF THE FUNDING FOR GROWTH SCHEME	10
IV. Retail Lending.....	11
IMPLEMENTING THE MORTGAGE CREDIT DIRECTIVE (MCD).....	11
CONVERSION OF CLAIMS ARISING FROM CERTAIN CONSUMER LOANS TO FORINT.....	12
EXTENDING THE REACH OF THE FAMILY HOME CREATION ALLOWANCE (CSOK)	12
ASKING FOR A RESOLUTION ON THE NAMA GOVERNMENT DECREE.....	13
V. Further important regulatory events influencing the operations of the banking sector	13
DEVELOPMENTS ON THE REGULATION OF PERSONAL INSOLVENCY.....	14
REVIEW OF THE CIVIL CODE.....	15
THE AMENDMENT OF THE ACT ON CIVIL PROCEDURE, ELECTRONIC LIAISON WITH COURTS	15
ACT "ON CERTAIN DAMAGE COMPENSATION MEASURES TAKEN IN ORDER TO STRENGTHEN THE STABILITY OF THE CAPITAL MARKET" REPLACING THE QUAESTOR ACT	15
PROPOSAL FOR THE AMENDMENT OF THE CRIMINAL CODE	16
COURT ENFORCEMENT	17
PROPOSAL TO AMEND LEGISLATION AFFECTING THE BANKING SECURITY ASPECTS OF SECURITIES TRADE.....	17
VI. National Bank of Hungary: Developments.....	17
CONSULTATIONS IN CONNECTION WITH SREP.....	17
APPLYING THE MACROPRUDENTIAL CAPITAL BUFFERS.....	18
PROBABLE CHANGES REGARDING THE PAYMENT-TO-INCOME RATIO (PTI) – CONSULTATIONS WITH THE NBH.....	18
LIQUIDITY STRESS TESTS	19
DEVELOPMENTS IN CONNECTION WITH MARK	19
DATA REPORTING: PREPARATION FOR THE 2017 TRANSITION TO IFRS	20
VII. Payments.....	20
HANDLING THE BULK TRANSFER OF CUSTOMERS BETWEEN SERVICE PROVIDERS WITH REGARD TO DIRECT DEBIT	20
BANK CARDS	21
INTRODUCING THE NEW 20,000 FORINT BANKNOTE	22
COMPLETION OF THE CLS PROJECT: SUCCESSFUL INCLUSION OF THE FORINT	23
THE INFORMATION PACKET AND THE COMMUNICATIONS PLAN RELATED TO THE SEPA END DATE REGULATION	23
MAIN DECISIONS OF THE EPC GENERAL ASSEMBLY MEETING IN DECEMBER.....	24
VIII. Tax and Accountancy	24
CHANGES IN TAX LEGISLATION.....	25
ACCOUNTING REGULATION	25
IX. Developments within the Banking Association.....	26
THE MODIFIED CODE OF CONDUCT	26
PREVIOUSLY NOT MENTIONED WORKING COMMITTEES, WORKING GROUPS.....	26
COMMUNICATIONS	29
MONEY WEEK: REALIZING SCHOOL COMPETITIONS AND PREPARING FOR 2016	29
INTERNATIONAL RELATIONS: THE V6 CONVENTION.....	30

APPENDIX - INTERNATIONAL OUTLOOK: REGULATION AND SUPERVISION	31
I Global regulation	31
I.1 FINANCIAL STABILITY BOARD (FSB)	31
I.2 THE BASEL COMMITTEE ON BANKING SUPERVISION	33
II European Regulation	37
II.1 GENERAL FRAMEWORKS	37
II.2 BANKING UNION	38
THE EUROPEAN DEPOSIT INSURANCE SCHEME (EDIS) – THE COMMISSIONS PRESS RELEASE ON THE COMPLETION OF THE BANKING UNION	40
II.3 THE CAPITAL MARKETS UNION (CMU)	41
II.4 GREEN PAPER ON RETAIL FINANCIAL SERVICES	42

I. Executive Summary

In Q4 of 2015, no significant changes took place compared to the previous quarter in terms of ***global economic processes***. In fact, the strengthening of certain factors further enhanced differences between individual regions. Global economic processes were mainly determined by low raw material prices and an even more significant fall in oil prices compared to before; the gradual slowing of the growth of the Chinese economy, followed by intense financial reactions; escalating geopolitical events, which started in the Middle-East (the expansion of the Islamic State and as a result, the migration crisis in the EU, the increasing threat of terrorism, and Russia's entering the Syrian conflict); as well as the USA's stricter monetary policy. The US economy continued its stable development, as before. EU economy continued to grow, though at a slower pace. In late 2015 it still seemed as if Russia would be able to stop its downturn, despite the shock to its oil industry. China continued its shift towards a new economic structure, sacrificing as much of its growth as this needed. The monetary stimulus in Japan was not enough to push its economy towards growth due to a lack of structural reforms, while the recession in Brazil seems unstoppable due to a lack of political consensus.

In Q4 of 2015, low energy and raw material prices, and a favorable external financing environment had a positive effect on the ***Hungarian economy's*** growth, however, global effects of China's slowing economy, geopolitical tensions and the economic consequences of the increasing migratory pressure were major setbacks. The strengthening of short-term business indicators and the upswing in investments due to the drawdown of EU funds led to a slight improvement in GDP data, therefore it can be predicted a growth of a few decimals below 3% for the whole year. On the production side, GDP growth continued to be aided by industrial growth; on the consumption side, net export remained the primary driving force. Household consumption also strengthened, due to improving employment, and a significant increase in real wage. By the end of the quarter, inflation grew by 0.9% on a year-to-year basis, but once again reached into the negatives compared to previous months. Core inflation is stable at 1.2%; therefore domestically caused deflation risks are unlikely. Balance indicators continue to be favorable. Despite the high deficit at the end of December, it is probable that central government deficit will be less than the planned 2.4%. Current account surplus is lastingly high, external financing capacity remains 10% of the GDP.

In Q4, by the end of November, the balance sheet total of ***credit institutions*** increased by 2,9% in nominal terms, and reached a little over HUF 33 trillion. (The overall impact of the exchange rate was neutral.) Within the asset portfolio, the ratio of liquid assets continued to increase, however total loan portfolio also started to grow: by 0.4% (HUF 63 billion) in nominal terms. Depreciation was similar (HUF 52 billion) and concerned both corporate and retail portfolio. On the liability side, deposit balances grew by 4.2% (HUF 673 billion). This is the result of growth in the bank account and short-term deposit portfolio of the non-financial corporate sector and individual entrepreneurs – partly due to the drawdown dumping of EU funds at the end of the year. Retail deposits increased moderately (by 1%, HUF 67 billion). As a result of the above effects, the net loan-to-deposit ratio of the credit institutions sector fell to 91% by the end of November. The profit of the credit institutions sector for October and November was HUF 82 billion before taxes, and amounted to HUF 163 billion total in the first three quarters of 2015. Based on the cumulative data results from November, the sector's annualized average return on assets, before taxation (ROA) was +0.81%, and its return on equity (ROE) was 8.4%, the same as in August.

Concerning the ***external legal environment***, the biggest change for the banking sector was the modification of the Quaestor Act, which was created with record speed in April, and the cut in banking surtax.

In November 2015, The Constitutional Court has ruled that certain provisions of the **“Quaestor law”** contradict the Fundamental Law, therefore it annulled them. According to the CC, vagueness over liability, arbitrary determination of the eligible entities, and disproportionate restriction of right to property contradict the Fundamental Law. In view of the above the Government has drafted, back in December 2015, *Act CCXIV of 2015 on certain damage compensation measures taken in order to strengthen the stability of the capital market*, the personal scope of which relates not only to the buyers of Quaestor bonds, but also those of Hungária bonds. For BEVA member banks and investment service providers, the new law resolves the issues related to payment obligations in a more advantageous way than earlier (it considers the returns paid since the beginning of 2008; in claims exceeding HUF 3 million 11% counts as downpayment; the annual payments by BEVA members to the Compensation Fund can be a maximum of HUF 7 billion), and makes it possible to deduct the amounts paid to the Fund from tax payment obligations in the year of payment. Since the European Commission’s competition department objected to the tax reduction (applicable in connection with the increasing extension of loan), the 2016 rule for the decreasing **banking surtax** was also changed at the end of 2015, The adopted amendment provides that the tax base in 2016 continue to be the adjusted balance sheet total for 2009, and the tax rate for above HUF 50 billion decrease from 0.53% to 0.24%, rather than to 0.31%, as adopted in the summer.

In its decree of late 2015, the government greatly increased the **Family Home Creation Allowance (CSOK)**. In addition to considerably easing previous criteria, they are trying to incentivize families to agree to have three children by: offering maximum HUF 10 million support, which does not have to be repaid; a loan of HUF 10 million with a more preferable interest rate, tied to the previously mentioned support; and VAT relief. In early 2016, banks had difficulty satisfying greatly increased client interest. They had to admit the requests of clients and inform them professionally without having the necessary exact detailed rules at their disposal. The Ministry for National Economy (responsible for elaborating the legislation) is helping to prepare for the CSOK scheme by compiling a FAQ – in response to the initiative request of the Banking Association.

In Q4, the sector and the Banking Association continued to dedicate much of their attention to the **HUF conversion of consumer loans remained in FX**. Act CXLV of 2015 on the Settlement of certain issues related to the conversion of claims arising from certain consumer loans to forint was published on October 2nd and entered into force on October 5th. Professional work concentrated on the consultations with regard to the NBH recommendation and the FAQ (both relevant to the Act), executing the HUF conversion according to the December 1 value date, and informing clients as required.

The intensity of the **work on personal insolvency regulation** could not even be hindered by the entry into force of *Act CV of 2015 on Debt Settlement Procedure for Private Individuals* on 1 September 2015. Experts of banks and the Banking Association held in-depth consultations on the content of relevant decrees and the necessary modification of the law with the Ministry of Justice (responsible for legislation). Its entry into force triggered increased attention from the press but public interest was subdued, due, among other things, to the unreasonably great demand of documentation from applicants. Q4’s other main event concerning legislation was **preparing to amend the Civil Code**.

Credit institutions will need to apply the provisions of the Mortgage Credit Directive (now implemented in Hungarian law) from March of 2016, while the NBH’s **Growth Supporting Program** is available to banks from the beginning of this year. Also from early on this year, a modified **code of conduct** provides the principles of conduct for banks. The code does not regulate the commercial practices of financial institutions.

In Q4, the **National Bank of Hungary initiated** consultations with the sector in several important issues. Thus, it granted information on probable changes to the payment-to-income ratio (PTI), as

well as on the envisaged implementation of macroprudential capital buffers. In addition, it informed us about the planned changes – in part, based on the indications of banks – to the Supervisory Review and Evaluation Process and gave an account of the results of liquidity stress tests and its plan for banking implementation of the tests. Concerning data reporting, in order to prepare for the transition to IFRS in 2017, the NBH initiated the creation of a joint working group with the Banking Association. The NBH also notified the relevant working group's experts about the newest developments in relation to MARK.

Regarding **payments**, handling the bulk transfer of customers between service providers with regard to direct debit; including the forint in the Continuous Linked Settlement (CLS) system in November; and the introduction of the new 20,000 banknote are worthy of mention.

An important development in **global regulation** was that the Financial Stability Board (FSB) – in preparing for the G20 summit – published a report on the implementation and effects of regulatory reforms. In addition to this general account, other reports were made on the reform of OTC derivatives markets and shadow banking activities. To promote resolution (including cross-border resolution) the FSB compiled a complete regulation package, which includes the finalized fundamental principles of the regulations on the total loss absorbing capacity (TLAC) applicable in the resolution of G-SIBs, and a relevant Term Sheet too. The most important documents from the prudential regulation materials published in Q4 by the Basel Committee on Banking Supervision were: the capital treatment for simple, transparent and comparable securitizations; revisions to the standardized approach for credit risk; the regulatory consistency of risk-weighted assets for counterparty credit risk; the identification and measurement of step-in risk; and documents regarding TLAC regulation.

Last fall, in the **European Union**, the Commission started the implementation of Stage 1 of the *“Five Presidents’ Report”* and announced that it will take concrete steps to strengthen the EMU. The 2016 work program of the Commission upholds and reaffirms the commitment to the ten political priorities set by the Juncker-led Commission the year before. Within the framework of the Single Supervisory Mechanism (SSM), the European Central Bank, which is the direct supervisor of the Banking Union's largest institutions and groups, evaluated the first year of the SSM and set the most important priorities for 2016. It also held a public consultation on the implementation of options and national discretions. According to the agreement made between the Council and the Parliament in 2014, the single resolution mechanism will start its activities fully in January, 2016. To prepare for this, the Single Resolution Board published its 2016 work program in November, signed the Intergovernmental Agreement, and worked out the system for calculating contributions to the Single Resolution Fund. To complete the Banking Union, the Commission issued a press release on the gradual introduction of the European Deposit Insurance Scheme (EDIS). Another important development is that the European Council supported and complemented with further priorities the Commission's Action plan for realizing the Capital Markets Union, as well as that in December, the Commission began a consultation on strengthening, and integrating the market for retail financial services by publishing the Green Paper.

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

In Q4 of 2015, no significant changes took place compared to the previous quarter in terms of global economic processes. In fact, the strengthening of certain factors further enhanced the differing trends between individual regions. Global economic processes were mainly determined by low raw material prices; an even more significant fall in oil prices compared to before; the gradual slowing of the growth of the Chinese economy, followed by intense financial reactions; escalating geopolitical events, which started in the Middle-East (the expansion of the Islamic State and as a result, the migration crisis in the EU, the increasing threat of terrorism, and Russia's entering the Syrian conflict); as well as the start of stricter monetary measures in the USA.

The USA's economy continued its stable growth at the same rate as before and the EU also showed growth, but at a slower rate. Russia, it seems is able to stop its downturn, despite the shock to its oil industry, and China continued its shift to a new economic structure, sacrificing as much of its growth as this needed. The monetary stimulus in Japan was not enough to push its economy towards growth, due to a lack of structural reforms, while the recession in Brazil seems unstoppable due to a lack of political consensus.

The **USA's** economy continued to develop the same as before; its growth continues to be supported by the favorable development of internal factors. Since the employee market continued to improve, it, and the improving state of incomes – due to low inflation: a result of low raw material prices – allow for domestic consumption to remain the engine of growth. Investments are low on a national economy level; however, this is fundamentally the result of the cutbacks in the extractive industry's significant capacity, in reaction to low raw material prices. Leading technological industries saw a considerable increase in investments. The Fed's actual monetary restrictions keep the dollar lastingly strong, which has a negative influence on the export industry. Political debates on the sustainability and ceiling of the federal budget once again became prevalent throughout this quarter.

The **European Union's** economy continues to grow slowly, however, after having resolved the Greek debt crisis and despite the refugee crisis, there is little risk of recession processes starting anytime in the near future. In fact, certain member states of a more significant size show quite positive growth data (e.g. Spain). Export performance was better than expected due to the weak Euro: a result of ECB policy. The employee market somewhat improved. Domestic demand, aided by low inflation (due to the low prices of raw materials) and higher disposable income, was the primary engine of growth, while investments remain frozen at a low level.

The four biggest economies of the Eurozone differ considerably. Germany's growth is stable, driven fundamentally by domestic demand. However, the weak Euro had a positive effect on its traditionally strong export performance. Nevertheless, the low level of investments may cause problems medium-term. Spain showed outstanding growth, while Italy visibly overcame its recession. France is the black sheep here, its economy is still weak – that is why the French president is thinking about implementing a significant fiscal stimulus. The pound, stronger than the Euro, had a negative impact on the United Kingdom's export performance, but other macroeconomic indicators are positive.

The **Chinese** economy is still on its prolonged path of adjustment. According to official statistics, growth rate is now the smallest since 2009, but some analysts say that growth rate decreased more than it was revealed. There are two important factors behind this. First, a large amount of capacity in the heavy and building industries is idle; a significant part of their previous performance is now financed by official commercial bank or shadow banking loans. Because of the excess capacity, investment activity decreased considerably, especially on the part of foreign investors. Second, due to moderate global demand, China's export sector has also become weaker than before. This is reinforced by the fact that despite Chinese efforts, the RMB remains stronger than the USD, and therefore has grown significantly stronger than the Euro and the Yen – this gave it a disadvantage in terms of export competition. So far, Chinese authorities tried to put a stop to these unfavorable

processes with monetary easing (decreasing the base rate and cutting bank reserve ratios), and capital market interference, but with little success.

Russia hit the so-far bottom of its recession in Q4. This was brought about by the decrease in oil revenues (as the country is dependent on oil and gas export) and Western sanctions, in reaction to its role in the geopolitical crisis. To decrease the economic and financial effects of its recession, the state is slowly consuming its liquid assets and contemplates making up for these by partly privatizing its largest oil industry companies.

In Q4 of 2015, low energy and raw material prices, and the favorable external financing environment had a positive effect on the **Hungarian economy's** growth, however, global effects of China's slowing economy – the effects of which can be felt in Hungary through the Western European market - geopolitical tensions and the economic consequences of the resulting increasing migratory pressure were major setbacks. For Q4, the strengthening of short-term business indicators and the upswing in investments due to the drawdown of EU funds led to a slight improvement in **GDP** data (which has been decelerating in past quarters), therefore we can predict a growth of a few decimals below 3% for the whole year.

In Q4, on the production side, GDP growth was aided by **industrial growth** (+9.5% in October and November on a year to year basis), showing significant increase since last quarter (+6%). So far, here, the Hungarian industry's vulnerability to the German auto industry's scandal is not visible. Production in the **construction industry** fluctuated: the high growth data in October (+7.8%) was followed by weak performance in November (0.2%). Growth is expected for December, after using EU funds.

On the consumption side, **net export** remains the primary driving force. Additional foreign trade in October and November remained stable: around HUF 200 billion in current prices for each month. The cumulative foreign trade balance exceeded last year's by 23% in the first 11 months of the year. In the last month of the year – as a result of the import demand of investments and the expected growth in domestic retail sale – the surplus will probably be less, but may remain significant, when considering the whole year.

Household consumption also strengthened, thanks to improving employment, and a significant increase in real wage, which will probably exceed 4% during the quarter). Retail sales grew by over 4.5% in the first two months of the quarter compared to the same time last year, and a similar increase is predicted for December.

By August, compared to this same period of last year, the number of persons **employed** increased by 117,000, reaching a total of nearly 4.3 million. Compared to the same time last year, this year's **unemployment rate** decreased by one percentage point, to 6.2% by the last month of autumn. This improvement is primarily still due to increased public employment. According the MNE's statements, around 10% of these employees can be successfully reintegrated into the private sector later on.

By the end of the quarter, **inflation** grew by 0.9% on a year-to-year basis, but once again reached into the negatives compared to previous months (data from December/November shows -0.3%, but stagnation in November compared to October). Core inflation stayed stable at 1.2%, therefore domestically caused deflation risks are unlikely.

The **balance indicators** of the Hungarian **economy** continued to move in a favorable direction. The **central government deficit** at the end of December (HUF 1,219 billion) seems very high compared to the annual amended legal appropriation (HUF 892 billion), however, what caused this was the considerably late drawdown of EU funds (HUF 560 billion). The government pre-financed this amount in order to complete the affected investments. Though it is possible that the drawdown will be less, it is still probable that the result at the end of the year will be better than the planned 2.4%.

Significantly higher tax income from main taxes (VAT, personal income tax, corporate tax) play a substantial role in the likely outcome of favorable indicators.

External balance also continued to improve. Current account surplus is lastingly high, external financing capacity remains 10% of the quarter's GDP.

In Q4, by late November, the **balance sheet total of credit institutions** increased considerably compared to the shortness of the observed period (in nominal terms +2,9%, HUF 934 billion), and reached a little over HUF 33 trillion. Meanwhile, the Hungarian Forint – compared to important European currencies which represent a larger share of balance sheets – grew somewhat stronger, and weakened considerably compared to the US dollar; therefore the impact of the exchange rate on total asset portfolio is nearly neutral.

Within the **asset portfolio**, the ratio of liquid assets continued to increase, however total loan portfolio also started to grow. Within liquid assets, significant structural changes took place due primarily to the self-financing measures of the Central Bank. The amount of money on the central bank's account decreased quite significantly (-27%, HUF -227 billion), while the volume of long-term government securities increased considerably (+6%, HUF 327 billion). In addition, the sum of interbank FX deposits also grew significantly (by HUF 450 billion), most of which is probably due to the temporary term deposit of foreign currency bought in order to convert FX loans into HUF loans.

The total gross **loan portfolio** increased by 0.4% (HUF 63 billion) in nominal terms. The cumulative value of impairment improved similarly (by HUF 52 billion). The 2.2% (HUF 138 billion) increase in loans granted to non-financial corporations and the 1.3% (HUF 78 billion) decrease in retail loans were responsible for a significant part of the above mentioned change. The release of claims granted to the clients concerned by institutions, which had already done the HUF conversion in November, also played an important part in the latter. A decrease in impairment was visible in both portfolios.

On the **liability side**, deposit balances grew by 4.2% (HUF 673 billion). This is due to the 11% (nearly HUF 560 billion) growth in the bank accounts, sight and short-term deposit portfolio of the non-financial sector and the 25% increase in the deposits of entrepreneurs (HUF 52 billion) – the dumping of EU funds drawdown at the end of the year might have played a role in this. There was also a significant increase in the case of other financial institutions (+6%, HUF 104 billion); it was short-term deposit portfolio that grew here as well. The temporary placement of reserves for the HUF conversion of retail loans, which are handled by leasing companies, also played a role in this presumably. In addition, retail deposits increased by 1% (+HUF 67 billion). Interbank liabilities also increased considerably: while in the case of interbank deposits on the assets side it was the growth in foreign currency placed at EMU credit institutions which caused changes, here it was forint deposits placed at these institutions that brought it about (+23%, HUF 280 billion, 194 billion out of these is in forint deposits). As an overall result of the above effects, the net loan-to-deposit ratio of the credit institutions sector fell to 91% by the end of November.

In terms of **profit**, the credit institutions sector reported improvement in performance during October through November (HUF 82 billion in July-August as opposed to HUF 163 billion before taxes total in the first three quarters of 2015). Net income of fundamental business activities came in on a pro-rata basis, the stronger performance of this period was due to profit from securities investments, and the significantly increased reversal of impairment loss in connection with lending.

As a result of these effects, based on the cumulative data results from November, the sector's annualized average return on assets, before taxation (ROA) was +0.81%, and its return on equity (ROE) was 8.4%, which is the same as in August.

III. Corporate Lending

In the third quarter of 2015, credit institutions' outstanding loans to corporations increased by HUF 28 billion as a result of disbursements and repayments. However, in annual terms, outstanding loans fell by 4.4 percent due to base effects. The outstanding borrowing of the SME sector continued to expand, with the annual rate of growth of the portfolio rising to 3.5 percent. Thus, lending to the sector is still fundamentally characterized by a dual trend depending on corporate size.

Based on banks' answers to the Lending Survey, the terms of corporate loans eased further during the quarter, followed by a fall in financing costs both in the case of small-amount and high-amount forint loans. Banks participating in the survey perceived an increased demand for long-term loans and predict that it may be followed by additional easing in the next quarters.

Phase III of the Funding for Growth Scheme and the new instruments of the Market-based Lending Scheme

The National Bank of Hungary announced the Growth Supporting Programme (GSP) on November 3, 2015 with which it wishes to help banks return to market-based lending, while gradually phasing out the Funding for Growth Scheme (FGS).

Signing loan and leasing contracts is possible from January 1, 2016 to December 30, 2016 as part of the two pillars of the FGS's third phase. In both pillars – announced as having a budget of HUF 300 billion each – similarly to the previous phase, the NBH provides refinancing with 0% interest to institutions. The institutions can further lend this sum to enterprises with a maximum of 2.5% interest margin, but exclusively for new investments. The maximum credit is HUF 1 billion in the first pillar. In the second pillar, the NBH will do a cross-currency interest rate swap (CIRS) at market price, and swap HUF for EUR with credit institutions. Credit institutions can pass on the sources they received this way to SMEs, which possess natural FX reserves, in the form of an FX loan with a maximum maturity of 10 years.

To decrease lending risk, the NBH introduced instruments which support banks' transition to market lending and have positive incentives. The interest rate swap conditional on lending activity (LIRS) has a maturity of 3 years and will be available to credit institutions from January, 2016, while additional preferential deposit opportunities will be available from February, 2016.

The NBH consulted with the Hungarian Banking Association while it worked out detailed arrangements and included those recommendations of banks in the product information sheets which were compatible with central bank aims.

The rate of utilization in Phase II of the Funding for Growth Scheme

According to NBH statistics, the credit institutions, which participated in the second phase of the program until December 31, 2015, reported it data on a total of HUF 1402.1 billion's worth in contracts. Phase II of the NHP was utilized by HUF 227 billion more in 2015 than in the previous year. The contract signing period of the FGS+ was also concluded at the end of 2015; the contracts' worth here was nearly HUF 23 billion. Since the start of the FGS, roughly 31,000 enterprises received financing – amounting to about HUF 2126 billion – as part of the programs.

95% of the contracts signed in phase II of the FGS (worth HUF 1402.1 billion) are new loans.

New investment loans constitute 61%, new working capital loans are 29%, while loans to pre-finance EU subsidies amount to 10%. 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 81% of loans were taken out in pillar II to redeem HUF loans, while 19% to redeem FX loans. Within transactions created in pillar I, new investment loans amount to HUF 24 million on average, new working capital loans to HUF 61 million, while EU loans to HUF 31 million.

IV. Retail Lending

According to the NBH report on lending based on the latest data from September: “In the third quarter of 2015, the outstanding loans of credit institutions to households declined by HUF 67 billion as a result of disbursements and repayments. Outstanding forint loans decreased by HUF 45 billion, while total foreign currency loans fell by HUF 22 billion. The annual rate of portfolio contraction was 14.6 per cent. The volume of gross new loans extended to households by the entire sector of credit institutions totaled HUF 213 billion, representing an increase of 18 per cent in year on-year terms. Based on banks’ responses to the Lending Survey, conditions on housing loans remained broadly unchanged in Q3, while conditions on consumer loans were eased. Banks participating in the survey reported primarily easing conditions related to maximum maturity. 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. All respondents reported a pick-up in demand for housing loans, while most banks anticipate an expansion in demand for consumer loans in the next two quarters. The APR and the interest rate spread on new household loans declined overall both for housing loans and consumer loans in the period under review.”

Implementing the Mortgage Credit Directive (MCD¹)

At the end of December 2015, the implementation of the MCD took place *with the modification of the Act on consumer loans* and the *Act on credit institutions* and the implementing decrees to the Act were published. These laws have to be applied by credit institutions as of March 2016.

The Ministry for National Economy, in charge of the preparation of this Act, has involved the Banking Association in the consultations from the outset. Since this Directive is primarily of a consumer protection nature, the consultation was characterized by fierce debates and, although we achieved significant results during the negotiations, the application of this Act obviously makes lending by the banks more costly and complicated. The key issues during the negotiations were as follows:

- *Customer information* The current legislation already poured an excessive amount of information on customers; the new standards increased it even further. Customers must be informed in four phases, orally and in writing, in general and tailor made to the customer. We succeeded in enabling the bank to perform this information provision electronically for three of these four phases.
- *Regulation of intermediaries* The Directive provided for significantly more detailed and strict rules for intermediaries, from which it must be highlighted that the commission is capped at 2%.
- *Remuneration* The Directive has strict provisions on the remuneration of bank employees who influence loan decisions and come into direct contact with clients. During the negotiations, banks tried to achieve that the interest of the employees in direct contact with the customers be maintained, since they are key in sales.
- *Ban on bundle* The legislator will not consider it a bundle where the bank requires holding a payment account to be used for the repayment. A requirement for a savings account is also not subject to the ban (building savings account combined loan). It is possible to prescribe asset or life

¹ Mortgage Credit Directive

insurance as a condition to the loan, but, contrary to our intentions, the banks can only apply one of those.

- *Vocational training* The Directive's priority is to ensure a high standard of professional knowledge for those engaged in mortgage lending, therefore it provides for training requirements and participation in continuous training. During the negotiations, our efforts meant that exams will take place less frequently.

- *Early repayment* The Directive enables the lender to enforce its actual costs in the event of early repayment. On this basis, we managed to achieve a simplified regulation of fees and to delete a few disproportionate customer discounts.

Conversion of claims arising from certain consumer loans to forint

Act CXLV of 2015 on the Settlement of certain issues related to the conversion of claims arising from certain consumer loans to forint was published on 2 October and entered into force on 5 October. In early October, the NBH issued a draft recommendation to further detail the act's annexes on information, which was consulted on in three rounds with the Banking Association and the Leasing Association. During these consultations, most interpretation uncertainties were successfully clarified. The solutions established jointly were published by the NBH in the FAQ² published on 26 October and in its Recommendation a day later. However, the following issues remained unsolved:

- the interpretation of the weighting of the interest rate under Section 9 of the Act,
- the uncertainty whether contracts ended by other means than termination are subject to the Act,
- the treatment of contracts terminated due to repayment before the deadline for clients to opt out from the provisions related to the conversion to forint,
- the treatment of loans combined with other products (such as building savings or insurance),
- and the timing of notifications required to the Central Credit Bureau.

In these issues, the NBH requested interpretation from the Ministry for National Economy. Further uncertainties were caused by an opinion published in the FAQ, making conversion into forint by the banks impossible, due to which the recording of the changes in the banks' book would be possible only after the opt-out deadline has elapsed. To clarify the above issues, we initiated a consultation with the NBH, as a result of which the NBH deleted from the FAQ its opinion that made this operation difficult.

The Ministry for National Economy convened a consultation to clarify the above open issues and there was a separate consultation on issues related to the Central Credit Bureau. Finally, a uniform interpretation was agreed in all issues and the FAQ was supplemented accordingly by the NBH.

Extending the reach of the Family Home Creation Allowance (CSOK)

Though the housing promotion allowances that came into effect in July of 2015 also brought a great revival for housing loans, the government approved a new support package (of much bigger value than previous ones) in its decree towards the end of the year. The amendments particularly incentivize having three children in the family. For these families, moving into a new home will be aided by the following:

- maximum HUF 10 million support, which does not have to be repaid;
- another HUF 10 million loan – tied to the previously mentioned support – with lower interest;
- VAT relief.

² Frequently asked questions and replies

In order for the support to be accessible to a wider audience, several limitations have been canceled:

- Energy-saving requirements have been removed;
- There is no longer a maximum floor space ratio for new homes;
- There is no longer a maximum price for one square meter;
- Ownership or the renting of another real estate no longer presents an obstacle, and one does not have to terminate ownership of these when moving into the new home;
- Existing children can be considered when applying for the allowance (however, any previous support will be deducted from the sum of the newly determined one).

The Banking Association was only informed during the last phase of the legislation process. Thus, it was a tremendous task for banks to prepare for the new, extensive legislation (which came out at the end of December, 2015 and entered into force on January 1, 2016) and to inform their clients – at least provide preliminary information – professionally. The issues, recommendations that arose in banks regarding the preparation for providing the new scheme, were compiled by the Banking Association and sent to the Ministry for National Economy (the legislator), asking them for the opportunity to consult. We also gave the ministry a list of questions from our member banks, which – together with the answer provided by the ministry – will be published on the Banking Association's and member banks' websites, in the form of FAQ.

Asking for a resolution on the NAMA government decree

Several of our member banks recommended that we ask an authority statement regarding the proper interpretation of the amendment (in the fall of 2015) to the government decree, which regulates the National Asset Management Agency (NAMA). The government decree extended the range of real estate that the NAMA may buy to those of non-paying debtors, where the household's income per consumer (as an artificial unit) does not exceed 250% of the lowest old-age pension.

The following meant a problem:

- The legislator, when determining the unit for the consumer only had a traditional model of the family in mind (mother/father/child), not counting other family members (uncle, aunt, brother-in-law). The income of these family members or their dependent status may influence the household's financial status considerably.
- The legislation did not provide for how private entrepreneurs, primary producers, etc. can authentically verify their previous month's income (they may only be asked for the previous year's tax returns to NAV); and
- How to verify that the person in question has no income.

In response to our request, the MNE sent us its resolution (our member banks also received this).

The resolution includes the following:

- If the legislation does not mention someone in the household, then that person may not/cannot be considered;
- Income from the previous year cannot be extended to this year (taking a one-month portion of the previous year's NAV-verified income); and
- Lack of income may be proved with the relevant declaration.

V. Further important regulatory events influencing the operations of the banking sector

Developments on the regulation of personal insolvency

On 1 September 2015, Act CV of 2015 on Debt Settlement Procedure for Private Individuals entered into force. Its entry into force triggered increased attention from the press but public interest was subdued. It has already been demonstrated that it was premature to launch this system this early, since at the beginning of September the website and the electronic system of the Family Protection Service was not operable and several of the implementation measures of the law were also missing. The following acts were published in September on the debt settlement procedure of private individuals:

- Decree 240/2015(IX.8.) of the Government on the detailed tasks of the Family Bankruptcy Protection Service (FBPS) and the family administrator, and Decree 235/2015 (IX.4.) of the Government
- on the rules related to the participation of other debtors,
- Decree 234/2015 (IX. 4.) of the Government on the professional supervision by the FBPS over the family administrators,
- Decree 241/2015 (IX. 8.) of the Government on the determination of the acceptable housing need and the rent or tenure fee,
- Decree 21/2015 (IX.2.) of the Minister of Justice on the rules related to the completion of the social inquiry report on the debtor, co-debtor,
- Decree 29/2015 (X.30.) of the Minister of Justice on the rules for the cooperation between the family administrator and the parties, and on the payment accounts of the debtor,
- Decree 274/2015 (IX. 21.) of the Government on the support to the instalments granted to keep the housing conditions for natural persons involved in the debt settlement.

We formed an opinion on the drafts of these decrees and we were involved in personal consultations on their content with the expert from the Ministry of Justice. Some of the implementing decrees have not been adopted to date: the Government Decree regulating the sale of elements from the debtor's assets by the debtor or the family administrator is still missing. Data supply by the Central Credit Bureau started with a temporary solution. Through the regulation of the personal insolvency, liaison with the Ministry of Justice was continuous; we requested their opinion and consultation on numerous issues. In the autumn months, several conferences and professional fora dealt with personal insolvency, at which the Banking Association and the members of the personal insolvency working group participated as presenters.

At the beginning of November, the first amendment to the Act on Personal Insolvency was adopted to clarify the status of other debtors and made clear that, in the event of loan contracts and financial leases for property secured by mortgage, the duration of the loan can exceed the five years debt repayment period. This act extended the submission deadline for the application of those eligible for the procedure under the conditions of the first period until 1 March 2016; however, it has not extended the moratorium for enforcement. We supported this solution. This amendment makes the submission of the application at the FBPS and at the main creditors. In addition, Act CLXVI of 2015 contained numerous important codification clarifications. In the context of this amendment, certain implementing decrees have also been amended.

At the end of 2015, we submitted a detailed comprehensive proposal for the amendment to the Act on Personal Insolvency to the Ministry of Justice, in view of the fact that in the first half of 2016 the Government envisages the comprehensive amendment to the Act on Personal Insolvency. The material sent to the Ministry of Justice included numerous proposals for the amendment to the Act on Court Enforcement.

At the end of December 2015, we held a meeting with a large number of participants with the Ministry of Justice and the Office for Justice to present the current state of the electronic system of the FBPSs.

Review of the Civil Code

The Ministry of Justice initiated consultations with the involvement of the stakeholder organizations (NBH, Ministry for National Development, Chamber of Public Notaries, Banking Association) on the amendment to the Civil Code, with particular attention to the rules of mortgage and the new regulation of the individual lien. The acceleration of the domestic mortgage bond market and the bank refinancing market, and the increase of the safety of the mortgage bond issuance would also require the amendment of the regulation of lien. In addition to the new regulation of the individual lien, the amendment concerns the review of the ban on fiduciary collateral, the register of loan collateral and the rules on the transfer of contracts. Amongst the contract law provisions, rules on limitation periods, lump-sum collection costs, rent, lease and, from the banking contracts, the rules on payment accounts need to be corrected. Also, the necessity to amend the rules on financial leasing and factoring was raised. With regard to the rules on legal persons, the optionality rule and the liability of senior officers cause interpretation problems.

The Ministry of Justice, after several rounds of consultations with the above participants, launched a wider debate on the theses of this amendment. The amendment to the Civil Code is on the agenda of the spring session of the Parliament.

The amendment of the Act on Civil Procedure, electronic liaison with courts

In October we issued an opinion on the bill on the amendment to Act III of 1952 on the Civil Procedure, containing the amendments related to the mandatory electronic liaison with courts. We submitted our proposal to the senior officials in the Ministry of Justice in several rounds to provide for the opportunity to open a company gateway or an office gateway for economic actors for the purpose of sending documents. (In the meantime, several member organizations initiated the opening of an office gateway, some of them successfully.) Despite promises, the amendment to the Civil Procedure only provided a solution for the legalization of the office gateways opened earlier. The entities of the Ministry of Interior Affairs do not authorize new office gateways, with reference to the unchanged implementing decrees, which have not been harmonized with the Civil Procedure. We requested an expert consultation with the Department of Electronic Services of the National Judiciary Office, where, in the meeting held in December, we managed to resolve and discuss several methodological issues related to the preparation. At the end of the parliamentary session in December the entry into force of the mandatory electronic liaison for economic actors was postponed until 1 July 2016. We keep on lobbying in this issue, because the extension of this deadline has not resolved the basic issues.

Act "On certain damage compensation measures taken in order to strengthen the stability of the capital market" replacing the Quaestor Act

The Constitutional Court (hereinafter: the CC) has ruled in November 2015 that Sections 1, 4 (5)–(9), 6 (d) and 13 of Act XXXIX of 2015 on the establishment of a debt management fund for the compensation of the parties injured in the Quaestor case, effective since the springtime, contradict the Fundamental Law, therefore it annulled the affected provisions.

The sections contradicting the Fundamental Law affected the following issues:

Vagueness over liability From the wording of the Act, exactly what was the extent and duration of the payment obligation required by the advance payment requested by the Board of the Quaestor Fund was unclear. The CC considered the relevant provision contradictory to the Fundamental Law due the vagueness of liability, and for the year 2015 due to there being a lack of possibility to be actually prepared.

Arbitrary determination of the eligible entities: Although the legislator has a wide margin of discretion when setting the range of entities eligible for compensation, the determination of the eligible entities nevertheless cannot be arbitrary; a homogenous group of entities must be determined as eligible.

Disproportionate restriction of right to property: The state has decided in the interest of equity to compensate the customers of a certain group of companies; however, it intended, indirectly and temporarily but clearly, to charge the burden of it to BEVA members. The restriction of property suffered by BEVA members in this way took place without consideration; what is more, its extent and duration was also completely unforeseeable. Due to the above, the CC considered the restriction of property disproportionately serious, and annulled the relevant provisions due to the disproportionate restriction of a fundamental right. The CC noted furthermore that, in terms of discrimination, the circumstance that the injured parties' compensation takes place without taking into account the advantages they realized earlier is of concern. The legislator has to take this circumstance into account in an eventual re-regulation.

In view of the above the Government has drafted, back in December 2015, Act CCXIV of 2015 on certain damage compensation measures taken in order to strengthen the stability of the capital market, the essential provisions different from the earlier law of which are as follows:

On the basis of the re-drafted personal scope, it relates not only to the buyers of Quaestor bonds, but also those of Hungária bonds.

For BEVA members, the new law resolves the issues related to payment obligations in a more advantageous way than earlier, essentially in four aspects:

- The amount payable from the Compensation Fund is to be decreased by the returns paid since the beginning of 2008.
- 11% of the claims exceeding HUF 3 million is considered as quasi own contribution and not charged to BEVA members.
- The annual payments by BEVA members to the Compensation Fund can be a maximum of HUF 7 billion; the first payment takes place in March 2017.
- BEVA members can deduct the amounts paid to the Fund from their tax payment obligation. (The one-off annual payment already ordered in connection with the financing of the Fund can already be deducted from the corporate tax payable; the special tax of financial institutions or the special tax of credit institutions, as well as the financial transaction tax already from 2017. The tax refund is not conditional upon the termination of the Fund, contrary to what had been provided for by the tax legislation adopted in July 2015.)

Proposal for the amendment of the Criminal Code

Upon the initiative of a member organization, we proposed the amendment of the criminal law regulation to the Ministry of Justice. Recently, several credit institutions fell victim to attacks where rumors stating the upcoming bankruptcy and insolvency of credit institutions were distributed, so effectively that crowds of customers raided the branches. The current Criminal Code provides no adequate protection for this situation, therefore we developed a proposal, with the involvement of criminal law professionals, on the criminal law regulation of distribution of rumors affecting credit institutions. This proposal was supplemented with the act of compromising the operation of credit institutions, in view of the fact that since July 2013 there have been nearly 600 demonstrations

against banks. Of these, 86 demonstrations took place within branches, compromising the safety of customers and business continuity.

We have not received a reply to this initiative from the Ministry of Justice.

Court enforcement

In the framework of professional consultations, we issued an opinion on the draft amendment to the Decree on the tariff of bailiffs, then, Decree 35/2015 (XI.10.) of the Minister of Justice was published several months after we submitted our observations. The new decree is more favorable than the earlier tariff; however, it contained reversals in several issues compared to the draft that had been subject to consultations, at the expense of the parties requesting enforcement. Certain fee items are still very high, and in general it can still be concluded that the fees due to the bailiff are not always proportionate with the work done but are established pro rata to the claim.

In the context of the Act on Personal Insolvency, we made several proposals for the amendments to the Act on Court Enforcement to the Ministry of Justice. In January, the Ministry of Justice initiated the establishment of a codification committee and it requested the Banking Association to participate.

Proposal to amend legislation affecting the banking security aspects of securities trade

Upon the initiative of a member bank, the Banking Association made a proposal to the Ministry for National Economy with the view to amend the Government Decree on the personal and material conditions required for certain investment activities.

The current regulation provides that within the building of the service provider a “guard service must be provided where the average daily turnover of cash or printed securities exceeds HUF 20 million.” The Government Decree in question was adopted in 2001, and the HUF 20 million threshold specified therein would be reasonably higher in recent terms. An even more important aspect is that the electronic security technology applied by banks and investment service providers has developed to a great extent during the past 15 years, thus, in practice, in many cases making the activity of live personnel (guards) unnecessary. It is particularly true for smaller branches and service units serving customers where the new technology (such as tills equipped with time locks, safes, electronic entry systems) can guarantee the appropriate security much more efficiently and cheaply than live forces. Therefore, we proposed in our letter that the regulation should allow for banks and investment service providers to – below a certain turnover threshold, a lot higher than today (we suggested HUF 100 million) - decide themselves on the combination of security methods available to them for achieving the security level - also indispensable for them.

The Ministry for National Economy has made a promise to consider our proposal.

VI. National Bank of Hungary: Developments

Consultations in connection with SREP

As requested by the NBH in the beginning of October, the Hungarian Banking Association compiled its observations in connection with the Supervisory Review and Evaluation Process (SREP). This was due to the fact that within the NBH, the SREP assessments were once again placed under the

competence of the Deputy Governor who is responsible for the supervision of financial institutions. Based on the comments of member banks, we compiled a letter containing 18 problem areas – this provided the basis for the consultation on November 26th.

During the discussion, the Deputy Governor of the NBH emphasized that they consider SREP to be a constantly ongoing consultation between the institutions and the NBH. The ultimate goal is for the supervisors not to have to contribute to the private, internal supervisory process within credit institutions [Internal Capital and Liquidity Adequacy Assessment Processes (ICAAP/ILAAP)]. He suggested the establishment of a new, small working group for the improvement and standardization of this process, with the participation of NBH and HBA experts. The Deputy Governor added that, in terms of SREP rates, the central bank is quite conservative in its practice even compared to other neighboring countries, however, the SREP review is currently underway.

The head of the Special Supervisory Competencies Directorate responded to the problems indicated in the HBA's letter by demonstrating the directions taken in connection with the changes to SREP. He discussed the SREP process' elements (assessment planning, preparation, dialogue, decision and feedback) and methodology (scoring criteria, being in harmony with the international practice, benchmark models, methodologies) separately. He emphasized that in determining future practice they will aim to consider banks' propositions, whenever possible, within the frame of guidelines given by the European Banking Authority. These aims were reinforced by the fact that specific questions were answered. The director promised (without giving a deadline) that they would publish the ICAAP/ILAAP handbook as soon as possible.

Applying the macroprudential capital buffers

In December, the NBH held a verbal consultation on the application of macroprudential capital buffers. European regulation provides that the anticyclical capital buffer, which reflects the economic trend, will need to be applied from January, 2016, at a rate between 0% and 2.5%. Concerning Hungary's exposure, the Financial Stability Board set the anticyclical capital buffer at 0%. The requirement will be reviewed each quarter and it will need to be met after one year.

The aim of the capital buffer prescribable for other systemically important institutions (O-SII) is to increase the stability of systemically significant institutions. It may range from 0 to 2%. This capital reserve will be activated from January 1, 2017. Its specific values will be determined according to the guidelines of the European Banking Authority, based on the data audited on December 30, 2015, and taking into account specific Hungarian features. They plan to communicate the requirement to the institutions concerned in September of 2016.

The national authority may apply the systemic risk buffer to manage a given risk, which causes problems within a member state. The European Commission must be notified of the introduction of a 1-3% buffer. Furthermore, the Commission must agree to the application of a systemic risk buffer that exceeds this (which may be maximum 5%). The Financial Stability Board – following the basically full HUF conversion of FX loans – only wishes to introduce the systemic risk buffer at the range of 0-2% in the case of real estate included in the balance sheet of banks, which are problematic and have expired over 90 days ago. This would be done from January 1, 2017, in the case of portfolios over HUF 5 billion, and based on data from the end of the year 2016.

From January 1, 2016 credit institutions will also have to phase-in a capital conservation buffer, as provided in Article 298 of the Act on Credit Institutions and Financial Enterprises.

Probable changes regarding the payment-to-income ratio (PTI) – consultations with the NBH

To fine-tune the PTI ratio, the NBH held a consultation in August, and after processing the proposals of banks, it called them to another consultation in November.

During the meeting, central bank experts stated their viewpoints in connection with banks' proposals. They indicated that they are ready to submit three proposals involving strategic questions to the Financial Stability Board: increasing the de minimis threshold, decreasing the top rate threshold of the PTI ratio, and in the case of interest periods of several years, calculating PTI ratios by considering decreased installment value (e.g. 85%).

The smaller portion of further – mostly technical – proposals requires for the NBH decree to be modified, while the majority are issues which can be resolved by consulting the Frequently Asked Questions page on the NBH's website. Central bank experts believe the modification of the relevant NBH decree to be possible towards the second half of 2016, in light of the fact that the FSB still needs to decide on some strategic issues. They believed the FAQ would be ready by the end of 2015, but we are still awaiting its publication. NBH experts are planning a new related consultation in January, 2016.

Liquidity stress tests

In Q3 and Q4 2015, the NBH carried out a stress test on the basis of the data from the mandatory reporting and the extraordinary reporting on the daily use of credit lines, on the proportion of secured and unsecured deposits and in particular deposits exceeding the upper insurance limit, the outcome of which was reported on in November 2015, together with the expected supervisory measures, at a consultation held for the banking industry.

The NBH established the methodology of the supervisory liquidity stress test (SLST) based on the LCR indicator; however, it amended the range and the assessment of liquid assets to be taken into account in view of the stress scenario, as well as the various outflow factors affecting liquidity. The range of liquid assets was extended compared to those that can be considered for the LCR indicator; it covered the full range of assets eligible for the NBH and ECB operations. In the calculations the haircuts applied by the NBH for the valuation of collateral was applied for the market value of assets. For deposits and calls from credit lines, stricter outflow factors, VaR-based outflow factors, were taken into account. For deposits, a further important difference compared to the LCR calculations was that, in the calculations related to deposits exceeding the insurance limits, the NBH assumed that due to the treatment of the uninsured part the insured part might be also withdrawn by the depositors affected, thus their outflow factors were corrected significantly.

All in all, according to the outcome of these calculations, liquid assets grew by HUF 1,192 billion and outflows by HUF 2,368 billion at sector level.

The Supervisor indicated that the SLST methodology will be integrated in the 2016 review of the supervised institutions' own ILAAP methodology, then after the experience-based fine tuning, the methodology will be finalized as of 2017. It requested the institutions to make calculations, in addition to the calculations provided for by banking methods, by including their own institutions' parameters into the NBH methodology.

Developments in connection with MARK

After intensive work in Q1, from April, consultations with MARK were suspended. Though MARK did not officially explain the suspension, the press and informal information from NBH experts shed light on the fact that consultations were being suspended due to the significant delay in EU consultations. MARK contacted the Banking Association again in late October, and presented how work was coming along in connection with starting their activities.

They indicated that in addition to the acquisition of receivables and debt management, as well as real estate management and development related to it, they will start a new activity (in order to clean bank portfolios as much as possible): contractual debt servicing to third parties, for which they have already acquired the necessary NBH permit. In connection with their other two activities, they were awaiting the permission of European authorities, which they believe they will receive in January. Within the modified receivable acquisition framework system of MARK, the previously established portfolio definition will be simplified and will be linked to the NPL concept, well known in EU law. The methodology of creating the portfolios-to-be-taken over will also change. Elements of receivable portfolio offered by banks and satisfying MARK requirements will be chosen randomly and filtered into HUF 50 billion portfolios. MARK will make an offer for these and the bank will decide whether it will accept it and have it marketed as a unit within the given portfolio or deny it, and stop the portfolio from being marketed.

After permission from the EU is granted, MARK will contact all banks concerned and give them a document package, based on which the acquisition process of bad debt may start.

Data Reporting: preparation for the 2017 transition to IFRS

In early November 2015, the representatives of the Banking Association agreed with the Statistics area of the NBH to set up a joint operative working group in connection with the changing reporting due to the mandatory transition to the IFRS as of 2017. The objective of the expert group is to review the 2017 reporting package prepared by the central bank to enable the adoption of a decree by mid 2016 that can be applied by all, by providing sufficient time for the transition.

At the call of the Banking Association, initially 11 member institutions indicated their intention to participate actively, then others also joined the work. At the end-November founding meeting, the group agreed on the framework rules for the operation, and the main topic was the central bank questionnaire on the reporting burden related to the changing in the reporting as prepared for 2017. At the December meeting, the experts discussed the statistical balance sheet and profit/loss account that replace the current supervisory balance sheet and profit/loss account as of 2017, as well as the methodology issues related to the related new loan and deposit data sets, and also their correlations with the lines in the balance sheet and profit/loss account.

The establishment of and the work done by the expert group is welcomed and considered useful by both the central bank and the member banks. The Banking Association informs all member institutions of the meetings: the memos agreed with the NBH are sent to the reporting areas of the member institutions.

VII. Payments

Handling the bulk transfer of customers between service providers with regard to direct debit

Significant changes have started among the domestic universal electricity and gas service providers in the consumer market. As of autumn this year, a unified service provider has been created by an official decision, first for electricity supply, then in the gas supply; ELMŰ-ÉMÁSZ Zrt and FŐGÁZ Zrt, respectively. First, the latter is taking over the retail customers of E.On. This change in the service providers had to be effected in both markets at the turn of 2015/2016, and in 2016 further service provider changes and customer takeovers have to be anticipated. The change in the service provider implies that the authorizations granted by those customers paying via direct debit to their payment service providers cease to be valid, i.e. in several hundreds of thousand individual cases, customers

need to grant a new authorization under the effective rules to the benefit of the new beneficiary, which in practice is not feasible or only with great difficulty.

The “transcription” of this vast volume of payment orders to the new beneficiaries would require the amendment of the current payment service and other sectorial legislation, on the one hand, and a coordinated transfer between service providers and the affected banks, on the other hand.

In order to achieve these two goals within this short period of time available, the experts from the Banking Association’s Payment working group have been engaged in intense consultations with the regulators, the above energy service providers, and the representatives of the banks providing direct debit to the affected customers. In the framework of this consultation, we succeeded to develop the timetables ensuring the smooth transition processes and, in the framework of those timetables, to organize the coordination of the data transmission between service providers and the banks, required for the new individual *authorizations* to be created in bulk, and the information to customers on the change in their service provider. We succeeded in achieving the amendment of sectorial and payment services legislation, which serves as a sound basis for the service provider changes upcoming in the future.

Bank Cards

- *Bank card statistics*

Based on the data published by the NBH on December 31, 2015, the number of bank cards in Hungary has not changed significantly over the past year: according to the status report of 2015’s third quarter, there are about 8,960,000 cards that were issued domestically. The constant and dynamic increase in the number of contactless payment cards saw a significant change; there are now over 4.5 million, and they constitute over half of the entire Hungarian bank card portfolio. In addition, contactless payment is now possible at 60% of POS terminals. The number of acceptance points in Hungary is 80,000; POS terminals at these points amount to 99,000. The increase in electronic payments is visible from quarterly statistics since 2014: there is a more than 15% increase in its use between quarters. In the third quarter of 2015, the number and value of card transactions grew by over 20% each, and the number of committed fraud – according to NBH evaluations – continues to be low, though it is slowly increasing.

- *Implementing the EU regulation on MIF*

On December 9, 2015 Regulation (EU) 2015/751 entered into force, which requires that acquirer banks provide transparent pricing and itemized information with regard to merchant fees and other costs to their merchant partners. Card scheme participation fees must be handled similarly from June 9, 2016. Satisfying legal criteria presents a significant administrative task for acquirer banks, and informing and preparing commercial partners for this modification also received considerable emphasis. It was requested by our member banks that we seek guidance from the central bank and ask card companies to collaborate regarding transactions in order to render the administrative process more effective. Thus, we contacted both the central bank’s competent department and the card companies concerned. The sole purpose of these consultations was to have the administration satisfy the EU regulation’s criteria on informing clients.

Also, consultations on business cards were held for preparing the legislation in connection with the Hungarian implementation of the EU MIF regulation. MNE and NBH experts and the HBA all participated in these consultations. While the Hungarian MIF regulation (which entered into force in January, 2014) also covered business (company) cards, and the therefore the interchange maximum had to be applied, according to EU regulation these cards counted as exceptions. The consultation resulted in a draft, which was accepted by Parliament and in which Hungarian regulation is aligned with EU requirements. At the same time, the NBH will monitor the changes in the field of business

cards (e.g. if banks do market development or for any effects, unfavorable towards clients). With the help of its members, the European Banking Federation published a European overview, in which it compiles the information of the countries concerned in MIF.

- *Fraud*

On November 11th, 10 members of the Bank Cards working group were granted the opportunity to participate in the Private Bankers Financial Innovation Conference for free.

On November 26, the National Bank of Hungary hosted the Professional Fraud Consultation, for the second time. The event, which was organized in collaboration with the National Bureau of Investigation, the experts of the central bank provided a domestic summary, while the expert of the Europol European Cybercrime Centre from Hague discussed the characteristics of current fraud events, patterns, by presenting fraud statistics. The representative of the Mol International Training Centre talked about the establishment (in progress) of the Cyber Crime Cabinet and a central fraud knowledge base. The Cabinet will aid the fight against bank card and electronic fraud through trainings and the practical presentation of these cases. The professional presentation of the National Bureau of Investigation was followed by summaries from the card companies. The advantages, risks, and points worthy of consideration associated with the effective, so-called geoblocking³ (which is quickly spreading around Europe) as a preventive method, was a main topic of discussion.

Guidelines for providing accessibility to bank services for the blind and visually impaired

The IT Security working group realized one of its 2015 plans by elaborating these Guidelines. It aims to contribute to and help establish a professionally founded, unified basis for those institutions, which wish to offer modern, client-friendly financial services to blind or visually impaired clients.

The general recommendations of the Guidelines aim to improve client experience. They include – in view of the special health conditions – the issue of data protection, proper informing of these clients, as well as requirements for the preparation of administrators in connection with opening an account, modification of a package, cash withdrawals and the use of other services. The Guidelines discuss in detail those aspects and suggestions, which concern online interfaces, telephone customer service, ATM use and administration at branches. Under technical solutions, it mentions internationally accepted standards and highlights the importance of a proper time limit for these services. To improve the quality of client service in branches, it proposes that administrators take part in regular “sensitizing” trainings, in order to be able to provide better help to persons with disabilities.

The Guidelines are well in line with the execution of Government decision (1653/2015. (IX.14.)), which regards “*the execution of the action plan concerning the National Disability Program for 2015-2018*”. This specifies that the legal framework to establish equal and secure access to financial services should be created”.

Introducing the new 20,000 forint banknote

The introduction of the new 20,000 forint bill in December, 2015 continued the series of introductions of new banknotes. Experts of the concerned parties (NBH, cash processing companies and banks) consulted many times before the date the banknote was put into circulation in December, and immediately afterwards, to make sure that the introduction of the new bill was problem-free. The meeting of the Banking Association’s Cash Working Group classified as part of

³ Blocking bank cards automatically outside a certain area.

these. The central bank's competent head of directorate participated in this meeting, and engaged in discussing introduction criteria:

- Since there is only a short period of time (1 year) to replace the old banknotes, the central bank asked banks not to recirculate the old bank notes, if possible.
- Banks were asked to help handle the mass demand for new bills when the old banknotes will be removed from circulation.
- Credit institutions should use the daily replacement service provided by the NBH, as well as using those central bank services where the NBH makes the payment of large volumes of new banknotes and smaller volumes of old banknotes free.

Putting the new bill into circulation – which meant banks needed to carry out additional tasks – went without problems. The cash working group will evaluate its initial experience two months after the introduction of the new banknote.

Completion of the CLS⁴ project: successful inclusion of the Forint

Nearly two years have passed since the Financial Stability Board of the NBH issued a letter of intent to the CLS Bank to make the Forint a settlement currency in the continuous linked settlement system, in cooperation with the Board. This process was completed successfully on 16 November 2015, when the CLS system commenced the settlement of payment orders in Hungarian Forint. As of that day the Forint has been the 18th settlement currency in the CLS. As was recalled by the speakers at the festive conference held on the day after the commencement of the settlement, *Lajos Bartha*, Director of Financial Infrastructures, and *Peter Went*, Director of CLS, the support activity and organizational work of the Hungarian Banking Association and the cooperation of the banking system also contributed to this success. During these nearly two years, the HBA contributed to the organization of several fora and conferences and to the surveys preparing the implementation phase by following up the preparation phases and providing continuous information to the member banks. The *forint* (HUF) was the first from the CEE region to join the global FX market leader's payment and settlement system, which provides risk mitigation services. At the launch, 11 domestic credit institutions started in the system as direct participants.

The information packet and the communications plan related to the SEPA End date regulation

The SEPA working committee established a migrations working group to enumerate the requirements of the End Date Regulation, which must be met by the domestic banking community and payment service providers (PSPs) until October 31, 2016. The working group's task was to identify the difficulties of meeting these requirements and to propose solutions. It created an *Information Packet*, which was presented not just to Banking Association members, but to other representatives of financial service providers, at a professional forum. Representatives of the HBA and NBH experts – a year before the Regulation entered into force – held presentations to draw attention to the importance of costly and time-consuming preparation that must accompany the migration phenomenon. The Forum was the first step of the communications plan and professional support program through which the Banking Association wishes to aid the preparation of not just PSPs, but their clients as well. This will be done from 2015 to 2016 thematically, and with the help of media publicity. (We hereby remark that the Regulation also requires that clients be informed.) The working group's second step will be to publish a written article through specialized press on the most important information for clients to know concerning SEPA and migration. The article will be clear and concise.

⁴ CLS: Continuous Linked Settlement

The press materials concerning the issue of bundling for corporate clients will already be available online in Q1 of 2016. At the same time, the SEPA committee will send a letter template to payment service providers on conversion services. This will be complemented by the presentation of PSPs' own conversion service.

In Q2, the HBA will provide a summary on professional readiness for PSPs. This will be based on a questionnaire on PSPs' preparedness, completed by May, 2016 by the HBA and the SEPA working committee together. Finally, in Q3, *retail customers* will be informed, which will concern the start of simplified Euro payments on November 1, 2016; the end of having to provide Business Identifier Codes (BIC) for clients; and the exclusive use of international bank account numbers (IBAN).

The working group believes that this level of proactivity will guarantee a problem-free preparation process for both service providers and clients.

Main decisions of the EPC General Assembly meeting in December

At its second general assembly in 2015, the European Payments Council made important decisions concerning identity and its 2016 activities and budget. It also approved a document on its reformation. It appointed the company Mazars as the new external auditor, in charge of auditing the Annual Accounts and Balance Sheet of the EPC for the financial year 2015.

After the account of 2015 activities, the work plan, budget and EPC membership and scheme participation fees for 2016 were approved. According to the work plan, ERPB⁵-related work will continue, such as completing the rulebook for instant payments, organizing P2P mobile payments⁶ workshop, and participation in the ERPB's electronic invoicing working group. There will be a shift in the priorities of the Cards working group: within the framework of the CFPF⁷, it will concentrate more on card fraud and its prevention, and it will revoke the SCF⁸, since this became outdated in light of the Interchange Fee Regulation. However, the SCF documentation, the so-called *Volume*, remains available on the EPC website. Another change is that the EPC will work towards reaching the goals set by the ERPB as a member of the ECSG⁹. This participation means providing 20% of the ECSG's financing costs: this has already been counted in the 2016 budget.

The General Assembly approved the proposed budget, the sum of which is EUR 3,093,400 – 1.8% less than in 2015. This sum includes the financing costs of the EPC, the two Modules and the ECSG.

The budget will continue to be funded from membership fees. Membership fees will be collected from 71 members, 62 of which are members of Module 2. Hungarian credit institutions are primarily concerned in the *transfer models* within Module 1's framework. For us, the plus 6 Euros will be added to the 2015 membership fee, thus in 2016 it will increase to EUR 199, since the number of participants has decreased, due to various reasons. At the time the budget was approved, the number of participating domestic financial service providers was 21. One domestic bank remains in the direct debit scheme. Membership fee for the HBA did not change. According to the approved budget, membership fee for the core SEPA direct debit scheme will be EUR 293, and participation in the business-to-business direct debits scheme will cost EUR 391. Participation in all three schemes will cost EUR 873.

VIII. Tax and Accountancy

⁵ European Retail Payments Board: the field of small Euro payments

⁶ Mobile payments between private individuals

⁷ Card Fraud Prevention Forum

⁸ SEPA Card Framework

⁹ European Cards Stakeholders Group

Changes in tax legislation

After the amendments to the tax laws for 2016, in early October 2015 a newer tax package was submitted to the Parliament. This change basically concerned the taxation rules, the amendment to the Act XCII of 2003 on Taxation. The bill adopted by the Parliament contained measures incentivizing law abiding behavior rather than restrictions. The Act on the taxation procedures introduces, amongst others, classification criteria for taxpayers; taxpayers with a good qualification, classified as reliable taxpayers, will be granted discounts (sanctions imposed in the event of mistakes or failures will decrease significantly), while risky i.e. bad taxpayers will be subject to stricter regulation.

In addition to this, for the regulation of personal income tax, it was adopted that the remission rule for claims from money loans can be applied to claims from financial leases, i.e. exemption from tax. The earlier differentiation between these two was not justified from the bank industry point of view. In practice, it was indeed not possible to explain to the banks' clients that the remission of a money loan (e.g. a housing loan) had been exempt from the tax, and when loan debts arising from a financial lease were remitted the client's debt remitted by the bank had been taxable. Earlier this legislative change had been also urged repeatedly at the Ministry for National Economy by the tax working group of the Banking Association.

At the end of 2015, the 2016 rule of the decreasing banks' special tax was also changed, due to the tax reduction applicable in connection with the increasing extension of loans as objected by the European Commission. In the last quarter of the year several versions have been prepared. The version adopted finally provides that the tax base in 2016 continues to be the corrected balance sheet total for 2009 (in the earlier adopted version the year of reference would have changed to 2014), and the tax rate for the band above HUF 50 billion decreased from 0.53% to 0.24% rather than to 0.31% as adopted in the summer.

In the last quarter of 2015, the Parliament held consultations with the Banking Association in the context of the CRS/DAC2 taxation data exchange, and adopted the amendment to Act XXXVII of 2013 on certain rules related to international administrative cooperation in the matters of taxation and other public charges as consulted with the Banking Association.

Accounting regulation

At the end of 2015 the Parliament adopted the legislative package on the transition to IFRS. This package comprehensively affects every related law and contains the transition-related obligations in detail. Accordingly, as of 1 January 2017, credit institutions have to apply the IFRS standards on a mandatory basis for individual reporting purposes, with the exception of cooperative credit institutions participating in the integration of cooperative credit institutions, and the credit institutions in the tail as specified in the Accounting Act, as well as Takarékbank Zrt and the Magyar Export-Import Bank Zrt. This exception is for a one year transition period; from 2018, the application of IFRS standards for individual reporting purposes will also be mandatory for them. After the transition in 2017, the rule will remain applicable that asset and liability accounts, and cost and profit/loss accounts have to be closed for the last day of the month, their balance must be established and a ledger extract must be prepared, for the purposes of the mid-year reports (reporting) prepared to the NBH. The availability of the related subledgers must also be ensured. FX assets and liabilities must be revaluated monthly, on the basis of the official FX rates published by the NBH as valid on the last day of the month and the last day of the year.

At the end of 2015, Decree 250/2000 (XII. 24.) of the Government on the characteristics of the annual reporting and accounting obligation of credit institutions and financial undertakings was also amended. This amendment was justified basically by the transposition of the rules in the new EU Accounting Directive into the national Act C of 2000 on Accounting, as well as the fact that other legislation affecting the business of credit institutions has also changed (such as the Capital Market Act). When delivering our opinion on the draft amendment to the Government Decree, we highlighted to the Ministry for National Economy that the national Government Decree provides for stricter rules on customer and counterparty rating than the European Capital Requirement Regulation (CRR), and on the basis of our request the law was adjusted.

IX. Developments within the Banking Association

The modified Code of Conduct

The previous Code of Conduct came into effect in 2010. It regulated fair conduct towards a smaller group of clients, tied to lending. In January, 2015, as a result of legislative processes, most of the Code's provisions became outdated. Therefore, in the beginning of 2015, a significantly shorter, revised text came into effect and replaced the previous **one**. The parties – based on continuous legislative work – declared the revised Code to be in effect, as of the end of last year.

With the simple derecognition of the Code of Conduct, the self-regulation of the sector would be restricted to a narrower scope. Thus, in the autumn of 2015, before the previous Code was rescinded, the Board decided to create a new Code, which lays down the fundamental principles of member institutions' conduct towards clients. In addition to lending, the scope of the recently adopted Code applies to all financial and investment service providers, as well as to other partner relations of the institutions, besides their clients.

The revised Code of Conduct contains solely the principles of conduct to be followed, and no longer directly regulates the trade practices of financial institutions. Therefore, the Code no longer classifies as a Code of Conduct referred to in Act XLVII of 2008 on the Prohibition of Unfair Commercial Practices against Consumers. The special legislative requirements – among others, those concerning submission declarations or government approvals – therefore will not be applicable to the Code in the future.

The supervising NBH also sent a letter, in which it welcomed this solution. After the Board approved the Code, the Secretary General published it as a Guideline of the Banking Association, which may be applied after January 1, 2016 by member institutions without any further measures.

Previously not mentioned working committees, working groups

- *Data protection working committee*

The data protection working committee held two meetings in the quarter. During its October meeting, we discussed the aspects of the practical implementation of the new provision in the Act on

Credit Institutions and Financial Enterprises in connection with the information that may be given to the relative of the testator regarding unpaid loans.

Other topics were:

- The internal system of data management, issues with regulating business regulation;
- Confiscating those documents at a financial institution which also contain personal data in market supervisory proceedings, with regard to the amendment to NBH legislation; and
- The deputy state secretary of public law's (from the Ministry of Justice) resolution on the succession of mortgage banks, the data managing rights and responsibilities of the predecessor in this respect.

The agenda of the November meeting included the recommendation of the Hungarian National Authority for Data Protection and Freedom of Information (NAIH) on the data protection requirements of preliminary information, and the amendment to Section 164, adding y) (providing information for the relatives of the deceased on the data in the loan contract). In addition to this, data protection difficulties in connection with satisfying the data supply obligation prescribed by the draft law on tax, which is still under discussion in Parliament were also mentioned.

○ *The agricultural working group*

The Agricultural working group invited the representative of the Prime Minister's Office. The representative held a presentation on the status of the Rural Development Program for 2014-2020, changes, the probable introduction of tenders, financial allocation, and the changes in the conditions of the agricultural- environmental management support. The presentation was followed by a consultation and the thorough discussion of professional recommendations.

As initiated by the Hungarian Development Bank, the working group – having included the Prime Minister's Office and the representative of the National Land Fund Management Organization – consulted several times in the past quarter on the interpretation of land auction notice and the relevant government decrees. It also commented on the to-be-signed cooperation agreement between the National Land Fund Management Organization and credit institutions. As a result of the consultation, in December 2015 the National Land Fund Management Organization and nine commercial banks signed a cooperation agreement within the framework of the "Land for farmers" program, in connection with selling state owned lands to farmers. Other commercial banks also indicated that they would like to join.

○ *The energy working group*

The Energy working group held two meetings in 2015. At the first meeting the representatives of the Association of Hungarian District Heating Enterprises informed us that as they were participating in the developmental framework for 2015 as the strategic partner of the Ministry of National Development, and therefore in the review of the Environmental and Energy Efficiency Operative Program's (EEEOP) projects. They told us about the simultaneous: compiling of the EEEOP project list for 2016-2020; the review of the experience gained from operating the pricing regulation currently in effect and its influence on the financing of investments; as well as the work on the proposals for solving systemic problems that have been discovered and the submission of these to the Hungarian Energy and Public Utility Regulatory Authority (MEKH) and to the Ministry of National Development. MEKH representatives participated in the Energy working group's second meeting. The reason for the consultation was that Act LVII of 2015 on reaching the aims for national energy efficiency was completed, which required MEKH to create a website providing information on energy efficiency. At the meeting the working group made suggestions about what the website content should include. The website was launched in December 2015.

- *Void FX loan contracts working group*

The working group dedicated to dealing with lawsuits on void of loan contracts met once during the quarter. The topics discussed were the developments in FX loan lawsuits, and the analysis of new court decisions. New risks arose in connection with the decency and legality of the general terms and conditions of bank contracts. Civil Division judgment 2/2012 and civil uniformity decision 2/2014 pose stricter requirements towards bank contracts' general terms and conditions. Thus, banks must prepare for this. During the meeting we drew attention to the summarizing remarks of the Supreme Court group which analyzes legal practice to the following topics: the possible application of the legal consequences of void loan contracts, and the lawsuits for terminating a simultaneous void loan contract lawsuit and execution.

- *The EXIM sub-working group*

The EXIM sub-working group also held several meetings in Q4, where it gained information on EXIM's current refinancing, on developmental directions for 2016, and about the recently introduced Credit Program for the Improvement of Competitiveness – with special regard to domestic investment loans. In addition to these, the first product concept of the standardized Loan Guarantee Program was presented. The working group participated in working out the order of proceedings for domestic investment and refinancing loans in banks, for the Credit Program for the Improvement of Competitiveness. Based on the comments given at the meeting, the Exim modified its model contracts for domestic investment loans.

After Dávid Gulyás left, the sub-working group elected Gabriella Kárpáti, director of refinancing at Eximbank, as its new president.

- *The new Leasing working group*

In Q4 of 2015, with the participation of 13 commercial banks and leasing companies and the approval of the Hungarian Banking Association's Board, the leasing working group was formed. The Secretary General of the HBA asked Andár Cserép, leader of the leasing branch at K&H Bank Zrt. to be president of the working group. The first task of the working group will be to comment on the regulation concerning leasing financing and to dispute the arising problems in interpreting legislation. At the meeting of the working group's formation, EXIM representatives summarized the results of leasing financing, and provided information on the future concept of leasing companies directly signing export-aimed framework contracts regarding leasing refinancing.

In addition to these, the working group commented on the draft version of the Financial Navigator Booklet entitled Loan or Lease, which the National Bank of Hungary plans to publish. It reviewed the NBH's 14/2015. (X.27) recommendation on sorting out the issues regarding the settlement of certain issues related to the conversion of claims arising from certain consumer loans to forint. The working group also participated in compiling the Frequently Asked Questions – published on the NBH's website – designed for the execution of Act CXLV of 2015.

- *NAV's electronic criminal requests*

The National Tax and Customs Administration (NAV) held a consultation in November, in which it announced that, with a few technical changes, it wishes to introduce electronic requests (previously created by the tax enforcement and tax audit departments) in the criminal department. According to the schedule they planned, this will be completed by December 2015 and January 2016, and the operation will be in action from February 2016. Though based on tax law, financial institutions are obliged to apply the system once it has been introduced, according to what was said at the consultation, NAV will grant a sort of grace period: if the institution is not able to accept and send items on through the new channel, they will redirect communication to go by post. According to NAV

experts, it is to be expected however that the tax authority will change this practice and sanction those institutions, which do not use the required electronic channel to receive and reply to requests.

- *Documentary credits working group*

In Q4, TSZTSZ (“Professional Organization for the Verification of Completion”) representatives participated in the Documentary credits working group’s meeting. They informed us about the laws that govern the operation and proceedings of the TSZTSZ, its scope of application, tasks, and the proceedings process. In the second half of the meeting, the working group commented on the TSZTSZ’s guidelines for construction companies and market actors.

Communications

In Q4, the second phase of the settlement of consumer loans (i.e. the settlement of FX loan contracts which are HUF-based and repaid in FX) received great media interest, as well as personal insolvency and the development of SME lending. In October, we informed media representatives and the public on up-to-date information and our experience regarding the above topics through a press conference. There was simultaneous great interest in Quaestor compensation, for which we granted information through interviews and speeches.

In December, our president, Mihály Patai, and secretary general, Levente Kovács held a press conference to evaluate the year; here they summarized the most important events that concerned the banking sector and mentioned that as a result of consultations, consensus was achieved regarding several important issues. Some of these are: expanding the National Asset Management Agency’s program, introducing personal insolvency, and the first steps towards the termination of banking tax. They highlighted that in 2015, the sector fulfilled one of its hardest tasks throughout its history in terms of logistics and administration: the settlement of debtors and the HUF conversion of FX loans. It also invested a great amount in developing digital banking. It was also mentioned that confidence in the banking sector is still little, which is preventing bank from contributing to the growth of the national economy, and creates great uncertainty for economic actors.

The activities of the Hungarian Banking Association continued to draw intense media attention in Q4 of 2015, though over the course of the past 3 months our media presence was a little less, mainly due to the holiday season in December. We had approximately 600 online media appearances, followed by around 280 in print media, and roughly 170 appearances in electronic media. Throughout the entire quarter, the Hungarian Banking Association’s standpoint was communicated over 1050 times to the media and to the public.

We also published – as is tradition – the names of those bank leaders whom the Board decided should be given the Golden Beehive Award for their outstanding work in the credit institutions sector. 2015 is the fourth year in which the lifetime achievement award was given. The two awards were received by Dr. Matthias Kunsch for his contributions towards establishing and extending the Hungarian two-tier banking system, and Mr. Béla Singlovics, for his several decades of successful leadership in the banking community.

Money Week: realizing school competitions and preparing for 2016

The experience from the 2015 Money Week and its success are what the 2016 preparations and organizations are based on. We once again wish to realize the improvement of financial literacy in schools through a wide network of professional collaboration. The primary objective of this Europe-wide cooperation is to draw attention to financial literacy – this is also how Money Week helps other

initiatives, which support the acquisition, expansion of this knowledge for youngsters. After the Board of the Hungarian Banking Association approved the base concept for the 2016 Money Week during its meeting in September, we started working out, testing, professionally evaluating the new materials, lesson plans and rehearsing them in trial classes, in collaboration with the Money Compass Foundation. In 2016 the program will once again reach schools with the professional support and of the Ministry of Human Capacities, who will also act as proofreader. The main theme of 2016 will be the conscious management of financial affairs, and savings. These themes were developed in 4 different versions, with regard to different age groups, and were received by both professional proofreaders and the Hungarian Institute for Educational Research and Development (OFI). As the main coordinator of Money Week, the Banking Association invited its member banks to join the program, through providing volunteer bank experts for the program, as well as organizing financial games, quizzes and competitions for the follow-up week between March 14th and 20th. Meanwhile, in addition to our basic organizational tasks, we are working on the opening event, on communications and other complementary program elements. In Hungary, Money Week 2016 will take place March 7-11.

International relations: the V6 convention

In addition to the Visgerád countries (Czech Republic, Poland, Slovakia, and Hungary), Croatia and Slovenia also participated in the V6 professional consultation forum. This time, it was held in Warsaw, Poland at the end of November. Those banking associations and bank representatives of the counties, who joined the consultation carry out their activities on a common economic basis, and often face very similar or uniform challenges. Therefore an exchange of experience facilitates the tracking of regional international events and makes it easier to work out adequate and effective professional solutions. The main points of focus for the 2015 consultation were: cybersecurity overview – trends, opportunities and practices that effectively prevent and manage it; current events and new regulations, directions in payment (PSD2, Payments Accounts Directive, the likely impact of European MIF regulation); experience concerning SME lending development, obstacles; going through the effects of the Capital Markets Union; the impact of banking tax and other burdens on banks.

APPENDIX - INTERNATIONAL OUTLOOK: REGULATION AND SUPERVISION

I Global regulation

I.1 Financial Stability Board (FSB)¹⁰

Report on the implementation and effects of the G20 financial regulatory reforms

For the first time, this year, before the usual annual G20 summit, the FSB published a report on the implementation and effects of the regulatory reforms agreed in the wake of the crisis. Across the breadth of reforms, the report notes that implementation has been steady, but uneven. The implementation of the Basel III reforms to bank capital and liquidity is ahead of schedule, the OTC derivatives reform is well underway but behind schedule, shadow banking reforms are at an early stage, while there is substantial work remaining to implement effective resolution regimes. The most tangible effect of the reforms has been to make the global banking sector more resilient, which has been achieved while maintaining the overall provision of credit to the real economy. No major unintended consequences have been identified to date; the FSB will continue to monitor this going forward.

The FSB asked G20 Leaders to help overcome legal and other challenges to the implementation of parts of the reform program, including:

- Putting in place legal powers to enable resolution authorities to share information across borders and to be able to give prompt effect to resolution actions by foreign authorities;
- Promoting cooperation to address duplicative or overlapping requirements to cross-border OTC derivatives transactions;
- Removing legal barriers to the reporting of OTC derivatives transactions to trade repositories and permitting authorities' access to trade repository data; and
- Ensuring that national authorities are adequately resourced for full and timely implementation of reforms as well as for supporting their effective monitoring.

The following areas were identified as meriting close ongoing attention:

- Spill-overs on some emerging market and developing economies from the implementation of reforms in home jurisdictions of global financial institutions;
- Effective use of resources for implementation;
- The maintenance of an open and integrated global financial system;
- The causes and financial stability consequences of recent shifts in liquidity in fixed income markets.

Reports on OTC derivatives market reforms

In connection with the FSB report, in its report to G20 leaders the Basel Committee on Banking Supervision (BCBS) presents in detail how much progress has been made over the past year in the implementation of Basel III regulation reforms. The report measures whether each jurisdiction has acted consistently, and with proper timing.

Before the Anatolian summit, the Committee also reported on the completion of post-crisis reforms. Reviewing standardized methods and reducing the excessive variability of risk-weighted assets are

¹⁰ The highest international financial legislative body

important elements of completing the reforms. The finalization of the regulation of global banks is on track.

To complement its general report, the FSB released two reports on the progress of the reforms to OTC derivatives markets and the further work that needs to be undertaken. One of these is the *Thematic Peer Review of OTC Derivatives Trade Reporting*. FSB member countries agreed to address remaining legal and regulatory barriers to reporting complete information concerning OTC derivatives transactions and to facilitate data access for authorities by June, 2018. Member countries will be asked to report by June, 2016 on their planned actions to address remaining barriers to full reporting.

The second document is the *OTC Derivatives Market Reforms: Tenth Progress Report on Implementation*. According to this report, nineteen of the 24 FSB jurisdictions have trade reporting requirements in force in connection with OTC derivatives (covering over 90% of transactions in their markets). Half of these jurisdictions established central clearing frameworks in force (which apply to over 90% of transactions as well). Most countries are in the early phases of implementing the BCBS-IOSCO framework for margin requirements for non-centrally cleared derivatives; authorities should continue to push forward with the implementation of these requirements to ensure a smooth commencement to the phase-in period in September, 2016.

Regulation package (new measures) to promote resolvability, including effective cross-border resolution

In November, the FSB released two finalized guidance papers and three consultative documents as part of its policy agenda to end “too-big-to-fail” and promote the resolvability of all financial institutions that could be systemic in failure.

The *Principles for Cross-border Effectiveness of Resolution Actions* set out statutory and contractual mechanisms that jurisdictions should consider including in their legal frameworks to give cross-border effect to resolution.

The other guidance paper regulates how to cooperate and share information with the authorities of countries where G-SIFIs¹¹ pose a systemic risk, but host countries are not members of the CMG¹².

One of the three consultative documents lays down the *guiding principles for the temporary funding needed to support the orderly resolution of a G-SIB*¹³, the other deals with the *arrangements to support operation continuity in resolution*, while the third one aids the *development of effective resolution strategies and plans for systemically important insurers*.

The array of documents aiding successful resolution was complemented by the *principles on loss-absorbing and recapitalization capacity of G-SIBs in resolution and the TLAC*¹⁴ *Term Sheet*.

Reports on shadow banking

The publication of the list of G-SIBs in 2015 also falls under the too-big-to-fail theme. Only minimal changes have been made since last year: China Construction Bank was added to, while Banco Bilbao Vizcaya Argentaria was taken off the list. Thus, the number of banks on the list remains 30. From January 1, 2017, due to their size, the two upper banks will need to hold an extra 2.5 percentage points, four will need an extra 2 percentage points, and five an extra 1.5 percentage points in capital,

¹¹ Global systemically important financial institutions

¹² Crisis Management Group

¹³ Global systemically important banks

¹⁴ Total Loss Absorbing Capacity, this is more or less the same as the MREL (Minimum Requirement for own funds and Eligible Liabilities), which is included in the EU BRRD directive and applies to all banks

while the remaining G-SIBs will have a +1 percent capital requirement. (The top bucket requiring a 3.5 percent additional capital is currently empty.) These banks will also have to satisfy TLAC requirements from 2019. The Basel Committee on Banking Supervision disclosed additional information concerning G-SIBs in connection with the FSB's list.

Concerning shadow banking regulation, they published the report on *transforming shadow banking into resilient market-based finance* and the *global shadow banking monitoring report 2015*, before the G20 summit. In addition, they elaborated the *regulatory framework for haircuts on non-centrally cleared securities financing*. The document entitled *Standards and processes for global securities financing data collection and aggregation* was also published in this topic.

The *fourth progress report on implementing the FSB principles for sound compensation practices and their implementation standards* was also published in the fourth quarter. In addition to the above, progress reports were made on the *measures to reduce misconduct risk* and on *actions taken to assess and address the decline in correspondent banking*.

1.2 The Basel Committee on Banking Supervision

The regulatory consistency of risk-weighted assets for counterparty credit risk

As part of its Regulatory Consistency Assessment Programme (RCAP), *the Committee published a report on the regulatory consistency of risk-weighted assets (RWAs¹⁵) for counterparty credit risk (CCR¹⁶)*. The report was published in the beginning of October. This is the last report on trading-related internal models to be studied by the Committee. It discusses the CCR models, which are primarily applied to OTC derivative transactions and securities financing transactions. The result of the calculations during the test portfolio show considerable variability, which is similar to the variability of other market risk model outcomes. In addition to communicating test results, the report lists good practices and identifies areas where banks and supervisors may seek to harmonize practices to reduce variability in outcomes. Based on these test results, the Committee is considering whether it may be necessary to narrow down certain modeling choices for banks and/or harmonizing supervisory practices to enhance consistency outcomes. The fundamental review of the trading book and changing the CVA risk capital charge alone will mitigate some of the observed variability of CCR model outcomes.

Documents related to TLAC regulation

The BCBS created further documents relating to the FSB's finalized regulations on total loss absorbing capacity. A *report* was made on the *TLAC Quantitative Impact Study*, which analyzes the TLAC levels and shortfalls of G-SIBs based on the FSB's November 2014 consultative version of the TLAC term sheet. The impact study also examines the extent to which G-SIBs and non-G-SIBs invest in TLAC instruments. The Committee took the results of this examination into account while creating the *TLAC Holdings consultative document*, which regulates the treatment of TLAC instruments. The proposed treatment in TLAC Holdings is for banks to deduct holdings of TLAC instruments from their regulatory capital above a certain threshold. (This also applies to those instruments, which rank *pari passu* to TLAC instruments in the creditor hierarchy.) The aim of the treatment is to limit contagion within the financial system if G-SIBs were to enter resolution. The introduction of the TLAC regime also necessitates changes to Basel III to specify how G-SIBs must take account of the TLAC

¹⁵ Risk Weighted Assets

¹⁶ Counterparty Credit Risk

requirement when calculating their regulatory capital buffers. (Common Equity Tier 1, which is being used to meet the TLAC requirement, cannot be used to meet the regulatory capital buffers.)

At the request of the FSB a group of experts conducted *an assessment of the economic costs and benefits of TLAC implementation*. On a microeconomic level, TLAC requirements raise the cost of funds, and lending becomes more expensive as a result. It is rather possible that the more structural resolution frameworks regulated by TLAC will influence banks' risk taking. From a macroeconomic point of view, the increased costs of lending should be compared to the advantages gained from more effective resolution and decreased risk taking.

Capital treatment for simple, transparent and comparable securitizations

In December, 2014, the Basel Committee on Banking Supervision issued a document which regulated revised capital standards. Following this, in July, 2015 the Committee, in collaboration with IOSCO, released the criteria for identifying simple, transparent and comparable securitizations (STC).¹⁷ These criteria are designed to mitigate securitization risks, including uncertainty related to asset risk, structural risk, governance and operational risk. The document in July already noted that the criteria might need further detail to suit special needs and application methods, for example by taking into consideration the credit risk of those assets, which provide the basis for securitization. Given that greater prescriptiveness is required for using the STC criteria in regulatory capital requirements, the Committee proposes to supplement the July 2015 STC criteria with additional criteria for the specific purpose of differentiating the capital treatment of STC from that of other securitization transactions. The additional criteria would, for example, exclude transactions in which the standardized risk weights for the underlying assets exceed certain levels. The Committee reduced minimum capital requirements for such STC securitizations that satisfy the additional criteria by reducing the maximum risk weight floor for senior and other exposures. The Committee will make a final decision on the actual amount (final calibration) in 2016 based on further analysis and assessment of the quantitative impact of proposals.

Second consultative document on the revisions to the standardized approach for credit risk

The revisions to the standardized approach for credit risk form part of the Committee's broader review of the capital framework to balance simplicity and risk sensitivity, and to promote comparability by reducing variability in risk-weighted assets across banks and jurisdictions.

The second consultative document, which was published in December, 2015 differs from the previous year's in several ways. The proposal of 2014 removed all references to external credit rating. In response to received opinions, the Committee decided to reintroduce the use of external ratings, in a non-mechanistic manner, when rating demands for corporations. The revised proposal also includes alternative approaches for jurisdictions that do not allow the use of external ratings for regulatory purposes.

The proposed risk weighting of real estate loans was also modified, with the loan-to-value ratio (LTV) as the main risk driver. The Committee proposes requiring the assessment of a borrower's ability to pay as a key underwriting criterion instead. According to the proposal, all exposures related to real estate, including specialized lending exposures should be categorized under the same asset class, and higher risk weights should be applied to real estate exposures where repayment is materially dependent on the cash flows generated by the property securing the exposure.

The proposal, among others, categorizes loans granted to multilateral development banks, retail and defaulted exposures and off-balance sheet items as separate risk classes. The credit risk standardized treatment for sovereigns, central banks and public sector entities are not within the scope of these

¹⁷ Please see our previous quarterly report for more information.

proposals. The Committee is considering these exposures as part of a broader and holistic review of sovereign-related risks.

The Committee will conduct a comprehensive impact study in 2016 in relation to the consultation. Thus, the numerical proposals in the document are provisional; the final calibration will be done taking into consideration the results of the quantitative impact study, ensuring that banks are provided sufficient time for implementation.

Consultative document on the identification and measuring of step-in risk

The Basel Committee's proposal is part of the G20 initiative to strengthen the oversight and regulation of shadow banking system and mitigate the associated potential systemic risks. The objective of the concept of regulation on the identification and measurement of step-in risk is to mitigate potential spillover effects from the shadow banking system to banks.

As put in the document, step-in risk refers to the risk that a bank will provide financial support to an entity beyond, or in the absence of, its contractual obligations should the entity experience financial stress. To capture and address such risk, the focus is on the identification of unconsolidated entities to which a bank may nevertheless provide financial support, in order to protect itself from any adverse reputational risk stemming from its connection to the entities. Therefore, the proposal applies to the management of entities which fall outside of prudential consolidation and regulation. The document includes discussions of primary and secondary indicators which suggest the presence of step-in risk in relationships between a bank and shadow banking entities, and proposes how to possibly manage these risks. However, these proposals are preliminary and the Committee has yet to decide how the proposals will fall within the prudential regulatory framework, including whether they will fall within Pillar 1 and/or Pillar 2. The consultative document is complemented by a quantitative impact survey, which, in addition to helping elicit discussion will provide the Committee with empirical information.

Other documents

In October, the BCBS published its ninth progress report on the adoption of the Basel regulatory framework. The report discusses the implementation of the Basel III regulations by jurisdiction – the increased capital standards, the liquidity standards (LCR, NFSR), SIBs requirements, the leverage ratio, Pillar 3 disclosure requirements and the large exposure framework – including its analysis on whether the implementation complies with international agreements.

The Committee conducted an interim impact analysis of its fundamental review of the trading book, the results of which were published in November. The data of those 44 banks that provided usable data for the study shows that the new standards would significantly increase the capital requirement of market risks in all scenarios. Concerning the analyzed sample – using data from the end of December, 2014 – the full implementation of the new trading book standards raised the Basel III minimum capital requirement by 4.7% (and disregarded the changing of securitization regulation).

The *third progress report on adopting the Principles for effective risk data aggregation and risk reporting*, after examining the way G-SIBs implemented the principles published in 2013, drew up three proposals in order to meet the requirements laid down by the principles better:

- Supervisors should conduct more in-depth examination on data aggregation requirements to evaluate weaknesses;
- Banks should have governance arrangements in place for manual processes;
- Banks' compliance with the Principles should be subject to an independent evaluation in early 2016.

The *BCBS guidance on credit risk and accounting for expected credit losses* sets out supervisory guidance on sound credit risk practices associated with the implementation and ongoing application of expected credit loss (ECL) accounting frameworks. (The move to ECL accounting frameworks by accounting standard setters is an important step forward in resolving the weakness identified during the recent financial crisis that credit loss recognition was too little, too late.) The guidance should be regarded as complementary to the accounting standards, and presents the Committee's view of the appropriate application of ECL accounting standards. It provides banks with supervisory guidance on how the ECL accounting model should interact with a bank's overall credit risk practices and prudential regulatory framework.

The Committee also published a consultative document, which gives *guidance on the application of the core principles for effective banking supervision in the case of those institutions which play an important role in financial integration*. The document, which contains the core principles on banking supervision (and was reviewed in 2012), had its 29 principles examined and 19 of them were labeled as needing additional guidance in the case of institutions engaged in serving the financially unserved and underserved and where Essential Criteria and Additional Criteria have special significance for inclusion purposes.

In December, two BIS colleagues disclosed a study on *calibrating the leverage ratio*. The authors worked out conceptual framework for the calibration of the leverage ratio, focusing on the leverage ratio's cyclical and structural dimensions as well as its consistency with the risk-weighted capital requirements. They applied the framework to historical data, and found that there is considerable room to raise the 3% test level to 4-5%.

II European Regulation

II.1 General Frameworks

Last fall, the European Commission started the implementation of *Stage 1* of the “*Five Presidents’ Report*”¹⁸ and announced that it will *take concrete steps to strengthen the EMU*. The package, which was adopted by the College of Commissioners, contains the following elements:

- **The External Representation of the Euro Area**
The external representation of the euro area has not kept up with the currency area’s increasing economic and financial weight. The Commission therefore outlines a roadmap towards allowing euro area member states to speak for with one voice for their common interest. Unified representation would be especially important in the IMF, with the President of the Eurogroup as the representative for the euro area.
- **Steps towards a Financial Union**
In spite of the progress made in completing the Banking Union, banks and sovereigns in the euro area are still too interlinked. The Commission wishes to limit this. Completing Banking Union requires implementing the already agreed legislation and further measures to reinforce financial stability. A common system for deposit insurance¹⁹ is still a missing piece of the Banking Union. In addition, alongside the completion of the Banking Union, the Capital Markets Union is a key priority.
- **A Revamped European Semester**
The Juncker Commission has already substantially streamlined the European Semester in its first year in office, enabling more genuine dialogue with member states. The country reports have already been published in February; three months before the country-specific recommendation were finalized. Employment and social aspects will feature strongly in the Semester and in the process to deepen the EMU.
- **Improving the tools of economic governance**
The economic governance framework has deepened and widened in scope over the past years, but has also gained complexity. President Juncker committed in his Political Guidelines to a stability-oriented review of the “six-pack” and “two-pack” legislation. In order to complement and reinforce the economic toolbox, the Commission is also proposing, in line with the Five Presidents’ Report, to establish National Competitiveness Boards as well as an advisory European Fiscal Board.

The 2016 work program of the European Commission upholds and reaffirms the commitment to the ten political priorities set by the Juncker-led Commission the year before.²⁰ In 2016, new initiatives will be made in the following areas:

- Migration management and border management
- Implementation of the digital single market, follow-up to the single market strategy, space strategy for Europe, and a European defense action plan;
- A circular economy, next steps for a sustainable European future, and legislation to implement the energy union;

¹⁸ More information in our report from Q2 of 2015.

¹⁹ Juncker said in his State of the Union speech, the Commission will present a legislative proposal on the first steps towards a European Deposit Insurance Scheme before the end of the year, which – as we will discuss later – already took place in November.

²⁰ For more information see our Q4 report from 2014.

- A new skills agenda for Europe, a new start for working parents, and a pillar of social rights as part of a deepening of the economic and monetary union;
- A corporate tax package and an action plan on VAT.

In addition to the actions announced in 2015 (13), 27 new ones will be introduced within the framework of REFIT (a program to simplify legislation).

II.2 Banking Union

The Single Supervisory Mechanism, the European Central Bank

The SSM after one year

Around November 4th – the official date of implementation of the SSM – numerous evaluations on single supervisory operations were published. Sabine Lautenschläger member of the ECB Executive Board and Vice-President of the SSM highlighted the following SSM activities carried out so far:

- Recruiting over 1,000 ECB supervisors and support staff;
- Setting up central supervisory infrastructures;
- Carrying out the comprehensive assessment and translating the results into supervisory actions;
- Developing and implementing the SSM's legal and methodological framework;
- Setting up the joint supervisory teams (JSTs) and establishing a consistent and standardized database;
- Identifying key risks within Europe's banking sector, drawing up our strategic plan for 2015 and planning our supervisory activities accordingly;
- Enhancing our supervisory methodology further, in particular regarding the Supervisory Review and Evaluation Process (SREP)
- Harmonizing supervisory approaches and perspectives, going beyond options and national discretions;
- Gaining an overview of the 19 national banking sectors with their 3,500 less significant banks; and
- Conducting day-to-day supervision of the 123 banking groups with 1,100 directly supervised banks.

The European Banking Federation expressed in a press release its commitment to the SSM as the first step to realizing the Banking Union. It emphasized that smooth collaboration with supervisors outside the Eurozone and other international supervisors is a task that lies before the SSM and highlighted its participation in the creation of the single rule book.

SSM priorities 2016

The ECB, which manages the direct supervision of the Banking Union's significant banks, set the priorities below for 2016:

- Examining business models with special regard to sustainability and profitability

The high ratio of non-performing loans and protracted period of low interest rates both endanger profitability and the sustainability of business models. In 2016, building on previous work, the ECB is launching a thematic review of the elements of profitability on an individual institution level, taking into account business models. The analysis will facilitate the identification of banks with structurally low profitability.

- Credit risk, analyzing non-performing loans (NPLs)

The ECB established an ad hoc task force to manage NPLs. The task force is reviewing the situation of institutions with high levels of NPLs (and will propose follow-up actions). Extra attention will be paid to exposure concentrations in areas such as real estate. Another credit-related topic is the implementation of IFRS 9. A thematic review will assess the potential impact of IFRS 9 on banks' provisioning practices and how banks are preparing for its introduction.

- Capital adequacy

Assessing capital adequacy remains a high priority in 2016. The ECB focuses on the quality and consistency of the Internal Capital Adequacy Assessment Process (ICAAP), including banks' internal stress-testing capacities, and the conduct of supervisory stress tests such as the EU-side stress test coordinated by the EBA. A further pivotal element is the follow-up on the quality and composition of banks' capital (also in relation to the ongoing efforts to harmonize options and national discretions). Another priority is the examination of banks' preparedness for new regulatory standards (TLAC, MREL), as well as review of their internal models.

- Risk governance and data quality

Experience from the financial crisis has shown that banks' management boards did not always have at their disposal adequate information to make risk management decisions. The ECB clearly articulates supervisory expectations towards banks' boards, and will examine whether they keep to the BCBS principles on effective risk data aggregation and risk reporting. They propose follow-up actions to the SSM's 2015 thematic review of risk governance and risk appetite. Ensuring data quality and security necessitates adequate IT infrastructure, therefore, IT risks will form part of the analysis.

- Liquidity

The 2015 SREP revealed that a number of banks do not yet fully meet supervisory expectations regarding the sound management of liquidity risks. The ECB will therefore also focus on the Internal Liquidity Adequacy Assessment Process (ILAAP) as well as on communication with banks.

Public consultation on options and national discretions

On November 11th the ECB launched a five-week public consultation on its policy package on tackling national options and discretions (NODs). The package consists of the ECB draft regulation on the tackling of NODs, the relevant ECB draft guide and documents explaining these former two.

The aim of the initiative is to strengthen financial integration and to establish high level supervisory standards according to the mandate received in the SSM of the ECB, while keeping the banking union in mind. The harmonized management of options and discretions makes it possible for the SSM to supervise banks more effectively, from a truly unified perspective.

The draft regulation follows the structure of the capital requirements directive, therefore it discusses (i) own funds, (ii) capital requirements, (iii) large exposures, (iv) liquidity, and (v) transitional provisions in separate chapters.

During the consultation, the European Banking Federation drew attention to the danger of, by way of the proposal, replacing the European Single Rulebook with three rulebooks: one for directly supervised SSM banks, one for the other SSM banks, and one for the European banks outside the Eurozone. The EBF also pointed out that some provisions of the draft regulation implicitly modify the CRR, and poses supplementary requirements towards credit institutions – the legal foundations of this are dubitable.

The Single Resolution Mechanism (SRM)

According to the agreement made between the Council and the Parliament in 2014, the single resolution mechanism will start its activities fully in January, 2016. To prepare for this, the Single Resolution Board published its 2016 work program in November; signed the Intergovernmental Agreement (this complements the SRM regulation) to replenish the Single Resolution Fund (SRF), which was ratified by the majority of participating member states by the end of the year; and worked out the system for contributing to SRF. (As agreed on previously, the fund will be replenished over

the course of 8 years, by 2024). To ensure that the SRM can operate during this period of transition, member states of the banking union agreed on its bridge financing back in 2013. Thus, as of 2016, participating member states provide the SRF with a harmonized credit line of EUR 55 billion maximum. The Fund will use this when it deems necessary.

The SRB signed a Memorandum of Understanding (MoU) with the European Central Bank in respect of cooperation and information exchange between the two. An agreement was also made between the SRB and the European Parliament on the practical modalities of the exercise of democratic accountability and oversight over the exercise of the tasks conferred on the Single Resolution Board. The SRB'S 2016 work program sets the following priorities: finalizing resolution plans, working out the resolution planning manual, preparing for resolution action, elaborating the crisis management manual, and putting in place tools and policies for resolution.

The problem-free start of the Single Resolution Mechanism is being held back by the fact that some member states under its scope have failed to transpose the Bank Recovery and Resolution Directive (BRRD). In October, the European Commission referred the Czech Republic, Luxembourg, the Netherlands, Poland, Romania and Sweden to the Court of Justice of the EU, as despite the reasoned opinion sent to them on May 28th, they failed to fully implement the BRRD Directive.

The European Deposit Insurance Scheme (EDIS) – the Commissions press release on the completion of the Banking Union

When the Banking Union was announced, the establishment of integrated deposit insurance was an important element, but when SSM was created – due to a lack of political consensus – this was temporarily taken off the agenda. Establishing a common deposit insurance system came up once again in the program aimed at completing the European economic and monetary union – reported by the Five Presidents – and the European Commission published its proposal for the European Deposit Insurance Scheme.

The proposed scheme will be:

- built on the existing system, composed of national deposit guarantee schemes set up in line with European rules; individual depositors will continue to enjoy the same level of protection (€100 000);
- introduced gradually, step by step;
- overall cost-neutral for the banking sector: the contributions banks make to EDIS can be deducted from their national contributions to deposit guarantee schemes;
- risk-weighted; riskier banks will pay higher contributions than safer banks, and this will be strengthened as EDIS is introduced gradually; risk adjustments will apply from the outset;
- accompanied by strict safeguards: for example it will only insure those national systems, which comply with the DGSD²¹ and are being built up in line with EU rules;
- accompanied by a Communication setting out measures to reduce risks, such as future proposals to ensure that banks' exposures to individual sovereigns risk is sufficiently diversified; and
- Mandatory for euro area Member States whose banks are today covered by the Single Supervisory Mechanism; but open to other EU Member States who want to join the Banking Union.

To establish EDIS the Commission recommended the following timing:

Phase 1: Re-insurance (until 2020)

²¹ Deposit Guarantee Scheme Directive

A national DGS can access EDIS funds only when it has first exhausted all its own resources. EDIS funds would provide extra funds to a national scheme, but only up to a certain level. The share contributed by the European Deposit Insurance Scheme will start at a relatively low level (20%) and will gradually increase over a four year period.

Phase 2: Co-insurance

After 3 years as a re-insurance scheme, in 2020 EDIS would become a progressively mutualized system. This “co-insurance” will increase by steps of 20% over the course of four years. Compared to the previous phase, the key difference in this phase is that a national scheme would not be required to exhaust its own funds before accessing EDIS funds. The European scheme’s resources would be available to contribute a share of the costs from the moment that bank depositors need to be reimbursed.

Phase 3: Full insurance

The share of risk that EDIS assumes will increase to 100% by 2024; from then on, member states will only pay into the common trust. This is the same year when the Single Resolution Fund and the requirements on finances of the current DGS Directive will be fully phased in (target level: 0.8%).

The European Banking Federation presented a communication after the Commission’s proposal was published. The Communication emphasized – in addition to voicing the Federation’s surprise – the importance of the national implementation of the DGSD, and the need to thoroughly examine the EDIS proposal.

II.3 The Capital Markets Union (CMU)

With regards to its *Action Plan on building a Capital Markets Union*, the *European Council* – taking into account the Commission’s proposals – supports the following priorities:

- increasing the variety of financing sources available for all businesses, in particular SMEs and small mid caps²². High-growth potential and innovative SMEs should be connected to a wider basis of prospective investors. This should be achieved by using a balanced approach based amongst others on market-led initiatives and self-regulation of the market, as well as legislative initiatives where unjustified barriers warrant an intervention from the legislator (e.g. the Prospectus Directive, Venture Capital, Crowdfunding, Private Placements, Mini Bonds, SME growth markets and SME credit information);
- ensuring an appropriate regulatory environment for long-term, sustainable investment and financing of Europe's infrastructure, including steps to attract private capital in order to realize the targets of the Investment Plan for Europe;
- increasing investment and choices for retail and institutional investors within a framework of adequate investor protection, beginning with the publication of a Green Paper as well as through exploratory work on the potential merits of a European framework for long-term individual savings schemes such as third pillar personal pensions;
- enhancing the capacity of banks to lend, in particular to SMEs, notably through establishing an appropriate framework to revive simple, transparent and standardized securitization and exploratory work on the potential merits of a European framework for covered bonds, building on national regimes that work well, and addressing the issue of Non-Performing Loans;

²² Middle capitalization sector: companies with a capital of \$2-10 billion belong here

- assessing the coherence, consistency and the cumulative impact of the financial reforms on the financing of the real economy; and
- examining and dismantling unjustified cross-border barriers to the development of capital markets for all 28 Member States, including capital market infrastructures, and long-standing tax obstacles such as double taxation as well as tax withholding arrangements.

The Council recommends that the Parliament of the EU approve the uniform regulation of securitization as soon as possible, and awaits the Commission's proposals on the Prospectus Directive.

In October, the European Commission initiated a consultation on covered bonds. The relevant consultative document consists of three parts. The first part contains an in-depth analysis of covered bond market data. (Market data show relatively strong issuance volumes throughout the crisis years but spread widening in secondary markets could have been a symptom of significant fragmentation on jurisdictional lines.) The second part considers the disparity between legal frameworks and supervisory practices of the various member states that have adopted the laws. (These factors could have contributed to market fragmentation themselves.) The third part discusses the elements of integrated covered bonds regulations, including unified disclosure requirements.

II.4 Green Paper on retail financial services

The Commission began consulting in December on the uniformization and strengthening of the retail financial services market. The goal is to strengthen competition in everyday financial services (bank accounts, bank cards, mortgages, insurance, pension investments, etc.), to have consumers receive the product that is best for them, to have more choices and to have competitive prices. It is also fundamental that service providers who wish to should be able to offer their products across borders, in any EU member state. Through the Green Paper, the Commission, wishes to discover the obstacles preventing the integration of the retail market, and how to get rid of these obstacles as effectively as possible. The consultation also extends to trends in digitalization regarding retail services.

The Commission already announced the consultation (which will last until March 18th) in the action plan of the capital markets union. The Green Paper also relates to numerous other initiatives, which are currently underway, such as the Payment Accounts Directive, the Mortgage Credit Directive, Insurance Distribution Directive, and the Commission's Single Market and Digital Single Market strategies.

After having assessed the replies given at the consultation, it is probable that the Commission will create an action plan regarding retail financial services in the second half of 2016.

EBA and ESA²³ documents published in Q4

Technical standards

ESAs define risk weights for credit ratings in the EU (JC/2015/067)

EBA defines harmonized prudential requirements for Central Securities Depositories (CSDs) (EBA/RTS/2015/10)

EBA issues methodology for valuation of liabilities arising from derivatives (EBA/RTS/2015/11)

EBA delivers guidance for business reorganization plans under the BRRD (EBA/RTS/2015/12)

EBA defines the minimum set of information on financial contracts for detailed records (EBA/RTS/2015/13)

EBA updates on the status of its final Implementing Technical Standards on benchmarking portfolios

Opinions

EBA seeks legislative clarifications on mortgage lending value (EBA/OP/2015/17)

EBA reports on the publication of administrative penalties on an anonymous basis (EBA/OP/2015/18)

EBA identifies areas of improvement in the cooperation between EU and third countries (EBA/OP/2015/19)

EBA recommends introducing the NSFR in the EU (EBA/OP/2015/22)

EBA calls for more certainty and consistency in the application of restrictions to profits pay-outs to restore capital adequacy (EBA/OP/2015/24)

EBA issues advice on synthetic securitization for SMEs (EBA/OP/2015/26)

Consultation

EBA consults on its benchmark rate under the Mortgage Credit Directive (EBA/CP/2015/16)

EBA consults on communication between competent authorities supervising credit institutions and statutory auditors (EBA/CP/2015/17)

EBA consults on Guidelines on how confidential information collected under the BRRD should be disclosed (EBA/CP/2015/18)

EBA consults on stress tests for deposit guarantee schemes (EBA/CP/2015/19)

²³ European Supervisory Authorities (EBA, ESMA, EIOPA)

EBA consults on information exchanges between authorities regarding qualifying holdings (EBA/CP/2015/20)

EBA consults on draft Guidelines on the treatment of CVA risk under SREP (EBA/CP/2015/21)

EBA consults on criteria for a preferential treatment in cross-border intragroup financial support under LCR (EBA/CP/2015/22)

EBA launches consultation on FINREP using IFRS 9 (EBA/CP/2015/23)

EBA consults on separation of payment card schemes and processing entities under the IFR (EBA/CP/2015/24)

EBA consults on cooperation and exchange of information for passporting under PSD2 (EBA/CP/2015/25)

EBA consults on draft Guidelines on ICAAP and ILAAP information collected for SREP purposes (EBA/CP/2015/26)

EBA consults on assessment methodology on the use of internal models for market risk (EBA/CP/2015/27)

EBA, EIOPA and ESMA consult on anti-money laundering and countering the financing of terrorism (JC/2015/061)

ESAs consult on PRIIPs key information for EU retail investors (JC/2015/073)

EBA consults on draft Guidelines on stress testing (EBA/CP/2015/28)

EBA consults on draft guidelines on remuneration requirements for sales staff (EBA/CP/2015/29)

Reports

EBA publishes benchmarking report on the use of higher ratios for variable remuneration

EBA updates on remuneration practices and the use of allowances across the EU

2015 EU-wide transparency exercise - aggregate report

EBA provides assessment of banks Pillar 3 reports for 2015

EBA benchmarks approaches on scenarios in recovery plans

EBA issues recommendations for sound prudential regime for investment firms

EBA updates on risks and vulnerabilities in the EU banking sector

Guidelines

EBA issues final Guidelines on institutions exposures to shadow banking entities and recommends approach to limiting risks (EBA/GL/2015/20)

EBA publishes final Guidelines on sound remuneration policies and its Opinion on the application of proportionality (EBA/GL/2015/22)

Other documents

ESAs set out joint work plan for 2016 (JC/2015/055)

EBA publishes work programme for 2016

EBA updates list of Common Equity Tier 1 (CET1) capital instruments

EBA publishes final templates and instructions for the Quantitative Impact Study on the definition of default

EBA Risk dashboard Q3 2015

EBA announces details of 2016 EU-wide stress test

ESAs update list of identified Financial Conglomerates (JC/2015/079)

ESAs seek stakeholder input on automation in financial advice (JC/2015/080)

EBA seeks input on strong customer authentication and secure communication under PSD2 (EBA/DP/2015/03)

EBA issues revised list of ITS validation rules
