



HUNGARIAN BANKING ASSOCIATION

REPORT

on Activities of the Hungarian Banking Association

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I. Executive summary

The growth of ***global economy*** somewhat accelerated compared to the previous quarters, but it still remained at a relatively low level. The IMF's latest, January forecast for 2017 expects growth at a rate of 2.3 per cent in the United States, 1.6 per cent in the euro area, 0.8 per cent in Japan and 6.5 per cent in China, while the Russian economy will continue to decelerate, at an expected rate of -1.2 per cent. The *monetary policy of the central banks of global importance* changed in different direction. At its December meeting the Fed raised its policy rate by 25 basis points, the European Central Bank prolonged its asset purchase programme, while Japan did not change its existing schemes, facilitating additional asset purchases.

Global economic prospects are rather uncertain as a result of Donald Trump having been elected as US president. The protectionist economic policy – accelerating the growth of the USA, creating jobs and increasing infrastructural projects – forecasts increasing US yields and thereby stronger dollar, but the increasing deficit that accompanies the stimulation of the economy may as well have an opposite effect. Following the presidential election, bond yields increased significantly in the USA (the yield of the 10-year government bond rose from 1.7 per cent to 2.5 per cent), and more moderately in other regions.

In Europe the unresolved problems of the Italian banking system may continue to represent a threat to the stability of the euro area in the medium and long run, while the stability of the *European Union* may be jeopardised – in addition to the shift in the US foreign policy, the elections due in 2017 and uncertainties caused by Brexit – by putting off the resolution of the refugee crisis.

Based on the final data for the third quarter, the *Hungarian GDP* rose by 2.2 per cent year on year. The worse-than-expected figure is attributable to the poor performance of the industry and construction. The lower growth in 2016 – falling short of that seen in the previous two years – is attributable to the slower-than-expected pick-up in the investments related to EU transfers. Presumably, this only represents a temporal shift, hence in 2017, as a result of the major growth in investments linked to EU transfers, the dynamic increase in wages, the pick-up in home construction, and a potential fiscal stimulus, the annual growth may be surprisingly high, i.e. over 4 per cent per annum. The *fiscal* position is still very good; the annual cash-based deficit is HUF 848 billion, representing 2.4 per cent of the GDP, while the deficit on an accruals basis is presumably even more favourable. By the end of 2016, *government debt* fell below 74 per cent of GDP. The significant fall in vulnerability is reflected by the fact that 20 per cent of the government debt is financed directly by the households, and only about a quarter thereof is denominated in foreign currency. *Inflation* is persistently low; in 2016 the price increase was merely 0.4 per cent. In 2017, an increase in oil prices and wages may push up prices, while the external environment characterised by low inflation and the domestic value added tax cuts may reduce them. During the quarter, the National Bank of Hungary (MNB) did not change the *central bank base rate*. Apart from a few peaks, the *EUR/HUF exchange rate* continued to fluctuate in a relatively narrow band, i.e. between 305 and 315.

In October-November 2016 the ***credit institutions' aggregated balance sheet total*** did not change compared to the end of the third quarter. (The stagnation stated in forint is attributable to the minor fall in the aggregated holding resulting from the depreciation of the domestic currency.) On the *liability side* the largest change was represented by the replacement of a major part of the interbank credits and deposits taken by corporate and household deposits. Within the *assets* the level of the loan portfolio also stagnated; the moderate (0.1 per cent) rise in the net loan portfolio was the combined effect of a more substantial decrease in gross lending (- HUF 90 billion) and the improved asset valuation (+ HUF 144 billion). The moderate improvement in asset quality was accompanied by a slight increase in loans to non-financial enterprises, with a significant increase recorded in lending to individual enterprises. As a result of the shrinking mortgage loan portfolio, gross-household debt continued to fall, which could not be offset by the release of impairment provisions. The *net loan-to-*

deposit ratio of the credit institutions sector dropped from 97.3 per cent, recorded in the third quarter, to 94.4 per cent by the end of November. The pre-tax profit, in year-on-year terms, also developed very positively; in the period of January-November 2016, the sector realised a pre-tax profit of HUF 488 billion. Compared to the previous years, this is still outstanding (16.6 per cent annualised RoE). However, the high profitability ratios are typically attributable to one-off factors and those unrelated to the operation of the Hungarian banking system. Over the medium term, the persistently high non-performing loan portfolio and the low yield environment have a negative impact on the profitability of the banking system in Hungary as well.

Lending to small- and medium enterprises may be encouraged by the fact that the Monetary Council extended the contracting period related to Phase 3 of the Funding for Growth Scheme (FGS) until 31 March 2017, without amending the drawdown period that ends on 29 June 2018. According to the MNB's forecast, the growth in the SMEs' outstanding borrowing may remain – after the closing of FGS – in the band of 5-10 per cent, supporting sustainable economic growth, in the next two years as well, with credit guarantees playing an increasing role.

The *MNB recommendation*, soon to be finalised, related to the *out-of-court restructuring of non-performing corporate loans* may provide some incentive for the management of the ***frozen corporate portfolio***; however, no efficient corporate restructuring is feasible without eliminating the legal restrictions related to enforcement, bankruptcy and liquidation.

The ***draft amendment of the bankruptcy act***, recently put on the agenda, did not aim at the comprehensive review of the act enacted in 1991, it merely intended to clarify certain provisions and eliminate some of the loopholes. The most significant effect may be produced by clarification of the bankruptcy estate, according to which the assets received from general government, EU or international sources – subject to settlement obligation – do not belong to the enterprise's assets, and must be treated separately. The amendments related to the redistribution of the proceeds from the sale of the pledged property may have a negative impact on lending.

In the last quarter the ***preparation for compliance with the Mortgage Funding Adequacy Ratio (MFAR)***, entering into force from April 2017, continued to be the most important task for banks with substantial retail mortgage loan portfolio. For many of the affected banks compliance is ensured by the creation of the *legal institution of converted independent mortgage*, which permits the financial institutions to convert the collateral mortgage encumbering the property into an independent mortgage, thereby making it marketable. The necessary amendments of the law regulated the entire process of the conversion, from the notification of the customer to the registration by the Land Registry, and also created the link to the previous mortgage. The uniform notice to the customers and the "frequently asked questions" on the conversion were also elaborated with the cooperation of the MNB, thus the affected banks could start the notification of the customers on the conversion in autumn 2016.

Although the ***MNB Decree related to MFAR*** will enter into force on spring 2017, the central bank announced the ***tightening of the regulation*** already in autumn 2016. After consultations with the sector, from October 2018 the MNB will introduce an amendment that is slightly milder than originally intended: the expected minimum value of MFAR will be raised from 0.15 to 0.2; above a certain threshold it prescribes the netting of the mortgage bonds accounted for among the assets and the liabilities originating from the instruments stipulated in the Act on mortgage credit institutions; and extends the original maturity of the eligible instruments from one to two years.

Several of our members are affected by ***the Curia's decision passed in respect of the Competition Authority's proceeding related to the final repayment of foreign currency loans***, which established – concordantly with the previous two courts that acted in the case – that the banks showed an anti-competitive behaviour upon selling the loans for the refinancing of the foreign currency mortgage loans, but in respect of the penalties it obliged the Competition Authority to conduct a new

proceeding, in the course of which the Competition Authority must recalculate the penalties based on the criteria specified by the Curia.

The **revision of the Competition Authority's decision on the BankAdat case** also started at the Administrative and Labour Court of Budapest in the beginning of December.

As regards the area of **payments**, the basic payment account service and switching of banks, prescribed by the EU payment accounts directive, and the practical implementation thereof represented a major operative task; by developing the necessary forms Giro Zrt. also played an active role in the latter one. After the completion of the task related to the SEPA end-date project, the simultaneous preparation for the implementation of the new payment services directive and for the instant payments will represent yet another serious technical challenge for the sector.

As regards the **global regulation**, the finalisation of the still missing components of the regulatory reform package, decided upon in the wake of the financial crisis, reached its final stage. The Financial Stability Board (FSB) elaborated, in the spirit of managing the "too-big-to-fail" problem, a methodology for the evaluation of the resolution schemes and draft recommendations for the feasibility of cross-border resolution, facilitating resolution and supporting resolution planning. One of the draft recommendations deals with the calculation of the global systematically important banks' (G-SIBs) internal total loss-absorbing capacity (TLAC) needs and the principles regulating the cooperation of crisis management groups, while the other one elaborates on the ensuring of the continuous availability of the money market infrastructures for the company under resolution. Based on the 2015 data, the FSB once again specified the list of global systematically important institutions (banks and insurers). During its November meeting, held in London, it reviewed the development trends and vulnerabilities of the financial markets, discussed the regulatory works in progress and accepted the 2017 work plan.

The Basel Committee on Banking Supervision published a consultation document and discussion paper, considering the new international accounting standards, about the regulatory management of accounting provisions. In the beginning of October, it also published the final standard on TLAC holdings and capital requirements of TLAC instruments, the purpose of which is to mitigate the contagion effect arising upon the potential resolution of global systematically important banks (G-SIBs). BCBS prepared a status report on the adoption of the Basel III regulation for the eleventh time. On the other hand, contrary to the prior announcement, it postponed the finalisation of the package, as – according to the published notice – the Basel Committee needs more time for the completion of the work and the final calibration.

Based on the results of the extensive survey, the **European Commission** is of the opinion that it is not necessary to change the *general EU framework for the regulation of financial services*. Nevertheless, in the future it will make efforts to eliminate the unnecessary regulatory constraints that hinder the financing of the economy, to improve the proportionality of the rules, to reduce the regulatory burdens and to strengthen the consistency and forward-looking nature of the rules. These principles were also borne in mind during the elaboration of the package decided upon in the wake of the crisis, aimed at finishing the adoption of the regulatory reform and the further strengthening of the banks' resilience in the EU. The proposed package also contains the amendments *to the Capital Requirements Regulation and Directive (CRR/CRD4), the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR)*. The Commission prepared a separate report on the European Market Infrastructure Regulation (EMIR), which deals with the improvement of the regulation of OTC derivatives, central counterparties and trade repositories.

As regards the elements of the Banking Union, the efforts of the European Central Bank are focused on creating a standard practice in the Single Supervisory Mechanism (SSM). Accordingly, it wished to harmonise the use of the national options and discretions specified in the EU laws in the case of the significant banks directly supervised by it, as well as in the case of the less significant institutions. The summary of the 2016 experiences of the supervisory review and evaluation process (SREP) and the

draft guideline on the adequate and reliable assessment of the management body were also created in the spirit of standard, unified practice. The creation of the Single Resolution Mechanism (SRM) was fostered by the publication of the *Resolution Planning Manual*, the elaboration of the resolution planning practice and the development of the data requirements necessary for the determination of the minimum requirement for own funds and eligible liabilities (MREL). It is probable that the implementation of the European Deposit Insurance Scheme (EDIS) will not follow the schedule anticipated by the Commission, and opinions also differ with regard to the form of its realisation. The Commission's proposal for the *bankruptcy directive (insolvency, restructuring, second chance)* and for the *money market funds regulation* is an important building block in the creation of the Capital Markets Union (CMU) , treated as top priority. Still no progress has been made yet in terms of the banking structural reform.

II. Macroeconomic outlook, operational environment of the banking sector

Although remaining relatively subdued, there has been a slight acceleration in **world economy** growth compared to the previous quarters. According to the latest IMF forecast for January, annual GDP growth in 2016 was 1.6% in the United States, 1.7% in the euro area, 0.9% in Japan and 6.7% in China. Compared to previous forecasts, growth accelerated in the United States and slowed in Japan. For 2017, the institute expects growth at 2.3% in the United States, 1.6% in the euro area, 0.8% in Japan and 6.5% in China, while the Russian economy is set to decelerate further, at the expected rate of -1.2%.

The **monetary policies of globally dominant central banks** have been diverging. At its December meeting, the Fed raised its policy rate by 25 bps, and another three increases are foreseen by FOMC¹ members for 2017. The European Central Bank has extended its bond purchase programme. Japan has made no adjustments to its existing programmes that enable additional asset purchases to be made.

Donald Trump has been elected **president of the United States**. The most important market trends over this past period have been related to Trump's victory. His economic programme focuses on accelerating US growth and creating jobs, which he proposes to implement, among other measures, through a protectionist economic policy and by boosting infrastructure projects. The market is pricing the scenario whereby demand in the US economy intensifies as a result of Trump's economic policy, driving inflation to grow at a faster rate, which in turn prompts the Fed to raise its rate more quickly. Thus, while central bank policy can remain relaxed for longer, the US may start tightening sooner. This scenario points to US yields rising at a faster rate, and a stronger dollar as a result.

Since Trump's election, the yield on the US 10-year government bonds has increased from 1.7 per cent to around 2.5 per cent. Although at comparatively moderate rates, yields in other dominant and developed economies have also increased: the yield on the German 10-year government security from 0.1 per cent to 0.35 per cent, while that on the Japanese one from -0.08 per cent to 0.05 per cent.

However, the instruments of economic stimulus proposed by Trump may simultaneously lead to a major increase in deficit, raising the question of what savers it could be funded by. It seems obvious that it is the central bank that will have to undertake the funding of the deficit as part of some new asset purchase programme. Additionally, Trump argues for a weaker dollar to drive exports and cut imports. For these reasons, the trend of rising yields and an appreciating dollar, as seen in recent months, may be reversed.

Apart from the uncertainty caused by the change in the direction of US foreign policy, the elections to be held in 2017 and Brexit, the **stability of the European Union** is also at risk from the delayed solution to the refugee issue.

Italy's December referendum resulted in the failure of Matteo Renzi's initiative on the reform of the Italian legislative system. In the aftermath of the referendum, the prime minister resigned and was replaced by former foreign minister Paolo Gentiloni. Although several opposition parties called for early elections following the referendum, none have been held, and the replacement of the premier has not brought about a shift in policy. For that reason, although the problems of the Italian banking system are still unresolved and remain a potential threat to the stability of the euro area over the medium to long term, the markets have largely ignored the result of the referendum.

According to final Q3 data, Hungarian GDP was up 2.2 per cent year on year. On the production side, services contributed to growth by 1.3 ppts, industry by 0.2 ppt and agriculture by 1.0 ppt, while the construction industry represented a 0.4 ppt brake. As regards the expenditure side, final

¹ Federal Open Market Committee; the Fed's body for monetary decision making

consumption increased the rate of GDP growth by 2.0 ppts and gross capital formation by 0.4 ppt, against a 0.2 ppt decrease from trade balance. The Q3 figure is therefore lower than expected, due to a shortfall in the performance of industry and construction.

Figures for Q4 are not yet available. For the time being, the Ministry for National Economy has not raised its previous 2.1 per cent forecast for the whole of 2016, although it has indicated the inherent upward risks. This estimate may assume Q4 growth around or above 2.7 per cent. According to available monthly component data, previous tendencies may continue, with industry remaining more or less level, construction recovering, although at a slower rate than expected, after a drop in H1, and the driving force being provided by services (domestic consumption).

In 2016, the relatively modest growth rate compared to the preceding two years was, apart from the stagnation of industry, primarily attributable to the fact that the pick-up in investments related to EU assistance was slower than expected. However, this presumably represents a time lag only, which may paint an extremely bright picture for 2017. In 2017, EU assistance is expected to be paid in an amount higher by at least 1.5 per cent of GDP than in 2016. Moreover, a significant part of the amount paid in 2016, exceeding 2 per cent of GDP, was transferred in the last months of the year, which could mean that no actual economic activity has yet been linked to those payments. Accordingly, the growth in investments financed from EU funds may contribute over 3.5 per cent of GDP to growth in 2017.

In addition to the pick-up in EU assistance, a further boost to GDP in 2017 may come from the wage agreement, pursuant to which the minimum wage is set to increase by 15 per cent and the wage minimum, i.e. the minimum wage for skilled workers, by 25 per cent as of 1 January 2017, and by an additional 8 and 12 per cent, respectively, as of 2018. The government supports the wage increase by cutting the social contribution by 5 per cent in 2017, and by an additional 2 per cent in 2018. As a result of these measures, average net incomes could increase by over 10 per cent in 2017, pointing to additional significant growth in consumption.

Growth may also be supported by the pick-up in the CSOK subsidy, and the start of residential construction subsidised through a reduced VAT rate. (The number of building permits issued continues to point to a dynamic pick-up.) The extremely favourable developments in the budget may also give room for further fiscal stimulus.

Considering the foregoing (the significant growth in investments linked to EU assistance, the dynamic increase in wages, the pick-up in residential construction, and the option of additional fiscal stimulus), there is a possibility for a surprisingly high annual growth rate well over 4 per cent.

In terms of **balance indicators**, the position of the *budget* remains extremely favourable, with high revenues from nearly all taxes. The annual cash deficit of HUF 848 billion corresponds to 2.4 per cent of GDP. On an accruals basis, however, this presumably reflects a more favourable deficit figure. In the period from January to November, the budget had accumulated a surplus, and the deficit of the annual budget was solely attributable to the HUF 900 billion deficit recorded in December. Presumably, the deficit was mainly due to the Hungarian State's funding of EU projects instead of the EU. On a cash basis, the amount of that funding, in the order of HUF 600 billion, may emerge as a surplus in 2017, when the amount of project funding is actually transferred by the EU to the Hungarian State.

By the end of 2016, *public debt* had been reduced below 74 per cent of GDP, a tendency that may also continue into the next two years. Households' direct share in government bonds passed the 20 per cent mark, a significant pick-up compared to the 2 per cent recorded in 2010. Approximately 25 per cent of the public debt is denominated in foreign currency. Overall, the country became significantly less vulnerable. The yields on 10-year government bonds increased from around 3 per cent to approximately 3.6 per cent, which is in line with global bond market trends.

Inflation remains low: the Hungarian Central Statistical Office recorded a price movement of 0.4 per cent for 2016. In 2017, prices may be driven up by increases in oil prices and wages, although the impact of wages on prices is questionable for the time being. Inflation may be slowed by an

environment of persistently low external inflation, as well as a handful of domestic measures such as the reduction of the VAT on pork, eggs, milk, the internet, and restaurant meals.

The **National Bank of Hungary** (MNB) left its policy rate unchanged. In keeping with previous MNB announcements, holdings in the 3-month deposit instrument receded to approximately HUF 900 billion.

Apart from a few breaks, the HUF/EUR rate continued to move in a relatively narrow range between 305 and 315. There was no change in the dynamics of forint demand and supply: the huge surplus of the current account exerts a continuous buying pressure, while the tapering of net external debt generates forint supply. Over time, the central bank may be forced to implement additional measures to prevent the appreciation of the forint.

In October to November 2016, **the aggregated balance sheet total** of credit institutions in effect remained at the level seen at the end of the previous quarter (recording a slight 0.2% decrease by HUF 73 billion). The forint depreciated slightly (by around 1%) against major European currencies, and more significantly (by 5.8%) against the dollar, as a result of which the stagnation in forint terms corresponds to a slight decrease in the aggregate. Assets and liabilities denominated in forint both decreased moderately (by less than 1%), while those denominated in euro increased at a rate above the change in the exchange rate, accompanied by an overall decrease in those denominated in other currencies.

On the **liability side**, the most significant restructuring took place from interbank deposits and borrowing to other deposits. Total deposits increased by HUF 495 billion (2.9%). This is primarily attributable to a major increase in corporate deposits (non-financial enterprises HUF 387 billion, +6.7%, sole traders HUF 50 billion, +21.1%), but the more moderate increase in retail deposits (HUF 118 billion, +1.8%) also had a role to play.

In the case of *interbank funds*, the processes occurring in October and November were the exact opposite of those in the previous quarter, resulting in a significant decrease in such funds (-7.1%, HUF 674 billion). Over these two months, borrowing from the central bank changed nearly in the same amount as in the preceding period, but with the opposite sign (HUF -645 billion). Interbank loans decreased more moderately by HUF 147 billion, while deposits taken from banks increased by HUF 275 billion. No significant movements took place in foreign liabilities.

Within **assets**, lending remained level, with a slight (0.1%) increase in net lending accompanied by the opposite effects of a more significant decrease in gross lending (HUF -90 billion) and improving asset valuation (HUF +114 billion).

A moderate improvement in asset quality was accompanied by a 1.8% (HUF +100 billion) increase in loans to non-financial enterprises, with a significant 22% (HUF +57 billion) increase recorded in lending to sole traders. Despite improving trends, in October and November gross lending to households continued to decline (-2.8%, HUF -153 billion), which could not be compensated for the release of impairment provisions (HUF 104 billion). The decrease remains attributable to a shrinking mortgage portfolio (-3.8%, HUF -170 billion).

In total, sight and interbank assets decreased by 3.1% (HUF 273 billion), mainly as a result of the central bank's programme to drive out bank liquidity. Banks withdrew a total of HUF 563 billion from their clearing accounts and short-term deposits with the central bank. This was accompanied by a significant (HUF +192 billion) increase in nostro holdings with foreign banks. Relations with domestic and foreign credit institutions saw movements in opposite directions. Loans to domestic credit institutions decreased significantly (-7.4%, HUF -158 billion), while deposits with such institutions increased by nearly one-third (+32.5%, HUF 278 billion). Conversely, deposits with foreign banks decreased (-12.1%, HUF -234 billion), accompanied by an increase in lending (+22.4%, HUF 117 billion).

As a combined effect of the above, the **net loan-to-deposit ratio** of the credit institutions sector dropped from 97.3% at the end of Q3 to 94.4% at the end of November.

Year on year, **profit before taxes** remained highly positive, but showed a steady decline in the quarters of 2016 (after HUF 199 billion [Q1], 162 billion [Q2] and 83 billion [Q3], in October and November HUF 45 billion was generated in profit before taxes). In the aggregate, from January to November 2016 the sector generated HUF 488 billion in profit before taxes, which remained outstandingly high year on year (a RoE of 16.6% in annual terms). However, the high profitability ratios are largely attributable to single factors and those unrelated to the operations of the Hungarian banking system (release of impairment provisions, sale of Visa Europe shares by several banks, dividends from foreign subsidiaries). Over the medium term, the persistently large portfolio of non-performing loans and the environment of low returns have a negative impact on the profitability of the banking system in Hungary as well.

III. Corporate lending

According to the MNB trends in lending report for November in September 2016, the annual growth rate of the total corporate lending of credit institutions was 1.8 per cent. After adjustment for the portfolio separation implemented within the framework of the resolution of MKB Bank, the growth rate amounted to 3.4 per cent. It was mainly transactions that contributed to the annual expansion of lending in the third quarter, as disbursements exceeded repayments by HUF 98 billion. This expansion primarily reflected the increase in HUF-denominated loans. On a transaction basis, SME loans increased by 6 per cent in an annual comparison, with the Funding for Growth Scheme contributing substantially to this development. The outstanding loans of the self-employed showed dynamic expansion during the quarter, partly due to the Funding for Growth Scheme and loans related to state land sales. The annual growth rate of the outstanding loans of the SME sector including the self-employed came to 7.3 per cent in the third quarter of 2016.

According to the banks' responses to the Lending Survey, credit conditions for corporations continued to ease during the quarter, which was justified by the favourable economic prospects and ample liquidity, in addition to increasing competition. Similarly to the previous quarters, easing was primarily seen in the relaxation of price conditions. During the quarter, the banks registered a rise in demand for long-term loans in particular, which they expect to continue for the next six months as well. The average spread of small-amount HUF loans typically taken out by SMEs decreased somewhat during the quarter.

Results of the Funding for Growth Scheme (FGS)

Concerning Stage 3 of the FGS, pursuant to the Monetary Council's decision of 23 November 2016, the MNB changed the deadline for contracting small and medium-sized enterprises (SMEs) to 31 March 2017, with no changes to the drawing period ending 29 June 2018. The measure was needed because with certain loan purposes, administrative factors hindered the completion of contracting before the end of the year. The adjustment to the contracting deadline was also appropriate because following the Monetary Council's decision, credit institutions can, at their option, use the remaining part of the facility available in the foreign exchange pillar for forint lending under the terms of the forint pillar.

Between 1 January to 30 December 2016, credit institutions participating in Stage 3 of the scheme reported data on HUF 473 billion worth of contracts in relation to 16,628 transactions and 11,024 enterprises. Of the contracts made in Stage 3 ending 30 December 2016, 76.5% are new investments loans, and 23.5% are new lease transactions. (Stage 3 is limited to these types of financing; working capital finance and replacement loans are not available.) Of the HUF 320.4 billion worth of contracts

made in Pillar I, available for forint lending, investment loans amount to HUF 239.4 billion, and lease transactions to HUF 81 billion. Of the HUF 152.3 billion (~EUR 488 million) worth of contracts made in Pillar II, available for foreign exchange lending, investment loans amount to HUF 122.2 billion (EUR 391.3 million), and lease transactions to HUF 30.1 billion (EUR 96.7 million).

In Pillar I, the average maturity, weighted by contract amount, is 7.9 years – 9 years for new investment loans and 4.8 for lease transactions, whereas in Pillar II, the average is 8 years – 8.9 years and 4.1 years respectively for the two forms of financing.

In the three stages of the Scheme since its launch in June 2013, funding was provided to 37,399 enterprises in the total amount of HUF 2,599 billion.

According to the MNB's forecast, in the coming two years, even after the FGS is closed, SME loans may continue to grow at a rate of 5-10% in support of sustainable economic growth. Credit guarantees may take on a more prominent role, which, through the increased activity of guarantee organisations, may further support the upturn in SME lending. Additionally, significant amounts in both non-reimbursable and reimbursable grants from the EU are available to the domestic SME sector, and due to the interest rate cuts applied in recent years, market-based credit products from credit institutions are available under increasingly favourable terms.

IV. Retail lending

According to the MNB trends in lending report for November in 2016 Q3, household loans extended by credit institutions amounted to a total of HUF 37 billion, and accordingly the annual rate of decline of the household loan portfolio dropped to 2.5 per cent in September. After adjusting for FGS-loans, the volume of new loan contracts amounted to HUF 249 billion in total in the period under review, representing an annual average increase of 43 per cent compared to the same period of the previous year. Within the total volume, new housing loans increased by 48 per cent over the past one year. Based on the bank's responses in the Lending Survey, housing loan conditions remained unchanged while consumer loan conditions eased during the third quarter. Based on the feedback of the banks, similar developments can be expected for the next six months. The continuing expansion of loan demand observed by the banks taking part in the survey was seen, but looking forward, a smaller proportion of banks expect further recovery. The Home Purchase Subsidy Scheme for families (HPS) continues to boost loan demand: during the quarter, 15 per cent of new housing loans were related to the HPS. Overall, the impact of the programme on the construction of new homes is still muted since only one third of the concluded subsidy contracts were used for the construction or the purchase of new homes. The average APR on new housing loans remained unchanged as a result of composition effect, while the average interest rate spread increased during the period under review, owing to the increased financing of riskier customers.

V. Further important regulatory developments influencing the operation of the banking sector

Developments relating to the establishment and regulation of converted independent liens

As of 1 October 2016, Act LXXVII of 2016 amending Act V of 2013 on the Civil Code (Civil Code Amendments Act) repealed the provisions on seceded liens, and reintroduced the legal instrument of independent liens, regulating converted independent liens in the transitional provisions. Additionally, in the context of that change, further legal amendments were needed concerning Act CXLI of 1997 on Real Estate Registration and the Civil Code Amendments Act.

Converted independent liens enable financial institutions to restructure former accessory mortgages on real property into independent liens. This means that an independent lien on property is

negotiable even without the associated credit agreement, i.e. transferable, either in whole or in part, to another financial institution. The Act regulates the entire restructuring process from customer notification to entry in the land register, and also establishes the relationship with the former lien, as set out in the Civil Code Amendments Act and related sectoral regulations.

A standard customer notification letter and a publication on frequently asked questions about restructuring were also developed. This latter was also published by the MNB on its website. The banks concerned started to notify customers and lienors about the restructuring from autumn 2016.

On the draft amendments to the decree implementing the Real Estate Registration Act, we submitted a proposal concerning the re-registration of restraints on alienation and encumbrance and the document underlying the re-registration with a view to implementing a standard land registry practice on portfolio transfers, reducing the burdens on public administration, and ensuring consistent legal practices.

Proposed amendments to the Bankruptcy Act

The Ministry of Justice proposed amendments to the chapter on liquidation proceedings of Act XLIX of 1991 on Bankruptcy and Liquidation Proceedings. Based on recommendations by judges and liquidators, the amendments aim to clarify certain provisions giving rise to problems in legal practices, and to eliminate regulatory gaps.

The draft clarifies the concept of estate by excluding assets that the company received subject to an accounting obligation from public finances, the EU or international sources, and must be managed in segregation.

We submitted proposals to the Ministry on the subsequent fate and management of segregated assets. With a view to the consistency of legal practices, we recommended that the entities in charge of the intermediation of grants should be specified, and that provisions on the assignment of new liquidators should be added to the rules concerning the dismissal of liquidators. We expressed our concern about the rules for the reallocation of the amount collected from the sale of pledged assets, as they restrain recovery from liens, and impede lending. We also opposed the introduction of the 50% satisfaction rule with respect to the sale of pledged assets identified by description, as this is not identical with the former floating charge, and results in the undue devaluation of collateral. We also recommended transitional rules in order that the detrimental provisions to be introduced are not applicable (in essence, retroactively) to satisfaction from previously pledged assets. We also made a number of comments for clarification purposes.

Legislative amendments concerning the banking sector proposed to the Ministry for National Economy (NGM)

We collected proposals for legislative amendments concerning the banking sector on a wide scale, which we submitted to the NGM requesting it to consider the proposals at the time of a subsequent opportunity for legislative amendments. The package included a number of proposed amendments to the Credit Institutions Act, also with a view to ensuring consistency with the changed legislative environment, concerning electronic signatures, portfolio transfers, corporate governance systems, the making of legal statements by identified electronic means, internal credit rules, and 0% interest.

We proposed amendments to the Act on the Central Credit Information System concerning customer consent and extended access to the system. We also submitted proposals concerning Act CXXXVIII of 2007 on Investment Firms and Commodity Dealers, and on the Regulations Governing their Activities. We also proposed a number of minor amendments of a technical nature to the Act on Building Societies, the Act on Consumer Credit, the Act on Commercial Advertising, and other regulations at decree level. Our hope is that our proposals will be utilised in the course of legislation in the first half of 2017.

Proposal for amendments to the Money Laundering Act

In October 2016, the anti-money laundering working group compiled and submitted comments to the competent department of the Ministry for National Economy, which the working group proposes to consider as part of legislative amendments due to the Hungarian implementation of the Fourth Anti-Money Laundering Directive. The main themes which, on the basis of practical experience from the past years, the working group considers fit for a review, include, without limitation, all three limits of customer due diligence (extensive, simplified, normal), the identification of beneficial owners, and the prohibition on disclosure.

At a consultative forum, the NGM presented its own concept and responded to most comments, underlying the fact that on a number of themes the solutions have yet to take shape.

The NGM is planning to meet its legislative obligation by drafting a new act and setting out detailed regulations in NGM and MNB decrees. Once available, the specific proposed texts will be submitted to representatives of the Hungarian Banking Association (HBA) for consultation.

Electronic communication with courts

Pursuant to the Act on the Code of Civil Procedure as amended, in civil action lodged after 1 July 2016, and in any other civil proceedings as provided for in the Act, domestic business entities or their representatives may only submit their applications as well as any other petitions, documentary evidence and their attachments (with certain exceptions) electronically. The documents to be submitted must be signed using one of the authentication solutions available. Signatures must be added either in a *signature application (e-Szignó, Mokka)*, or using the “Authenticate form with the AVDH service” function in the General Form Filler program (ÁNYK), which enables the joint authentication of forms and attachments. The *ADVH (document authentication traced to identification) service* enables natural persons to use the ÁNYK to authenticate forms and their attachments before uploading. Client gateway registration is sufficient for authentication, yet in a number of cases courts refuse to accept AVDH-authenticated documents in e-proceedings, arguing that AVDH signatures fail to prove that the documents were signed by attorneys.

In our opinion, courts are under an obligation to accept AVDH-authenticated documents in e-proceedings, and the misinformed view occurring in judicial practice, which is also unsupported by legal provisions, hinders the smooth application of electronic communication.

We submitted a request for a resolution from the Electronic Proceedings Department of the National Judiciary Office, and have yet to receive a response.

Opinion on the concept of the Act on Attorneys concerning the status of legal counsels

In the framework of a social consultation, the Ministry of Justice published the argument for the new Act on Attorneys on its website in October 2016. The draft is set to make fundamental changes to the framework of legal counsels’ operations, in several respects to the detriment of legal counsels. The management board of the Hungarian Banking Association discussed the proposed arguments, and requested the apparatus to engage the legal working group in consultations on the possibilities of joint action with other advocacy organisations and other organisations employing large numbers of legal counsels. Following extensive consultations, we sent a detailed letter to the Minister of Justice. The Leasing Association and the Association of Investment Service Providers have expressed their support for the letter, while other organisations, primarily those representing industrial companies, sent their comments to the Ministry separately.

We requested for regulations to take into account the difference in the legal statuses of attorneys and legal counsels, and consider the dissimilarities in training needs resulting from the dissimilar responsibilities. Regarding the remuneration of legal counsels and their liability for damages and disciplinary responsibility, we did not support the development of parallel regulations in departure from those currently in place, as these issues are adequately governed by the legal provisions in

effect. We proposed regulations on communication protected against the competition authority and other authorities, the introduction of photo IDs and the right to free counseling of public interest, and mobility between the professions of attorneys and legal counsels. The argument is currently being refined.

Preparations for the payment of risk based contribution- to the Investor Protection Fund (Beva)

The Beva introduced the payment of risk based fees in two stages in 2011 and 2012, which it subsequently discontinued in 2015 in the aftermath of the broker failures. The greatest problem with the methodology applied was that it required reduced fee payments in the case of bankrupt companies, which resulted in its failure to enforce the principle of risk based fee payments that members with a higher level of risk in their operations should make greater contributions to the Investor Protection Fund. Consequently, the Beva Board of Directors suspended risk-rated fee payments, but rather than denying the need for such payments, it decided to review the methodology. In the course of that review, apart from technical considerations, the Beva considered it crucial that the lessons learned from the events leading up to the compensations in 2015 should also be taken into account.

At the recommendation of the Beva's working organisation, a technical working group was set up for the review of the methodology, which includes, in addition to the Beva's experts, delegates from the MNB (subsequently the NGM), the Banking Association, and the Association of Investment Service Providers. The working group became operational in November. It carried out an overview of the objectives to be accomplished by a methodology for risk based contribution, the key requirements for the introduction of risk based payments and the effect of risk on fees, the prominent risk factors, and the possibilities of incorporating risk factors into calculation methods. Pursuant to the decision in principle adopted by the Beva Board of Directors, the methodology may be developed in detail in the first half of 2017, and implementation is expected as of 2018 at the earliest.

Curia decision in the GVH proceedings on early repayment

At the end of 2013, the Hungarian Competition Authority (GVH) imposed penalties in the total amount of approximately HUF 10 billion on 11 financial institutions, and established the involvement of one additional bank in cartel operations without imposing a penalty. The authority found that in the period of early repayments on foreign-exchange based mortgage loans at rates fixed below those of the market, between autumn 2011 to January 2012, the banks aligned their strategies with a view to restricting the sale of the forint loans suitable to replace foreign-exchange based loans. That decision was challenged by nine of the penalised banks and the bank on which no penalty was imposed. The lower-level courts proceeding in the first two instances, the Budapest Court of Public Administration and Labour, then the General Court of Budapest, upheld the GVH's decision, and found it lawful in every respect. Proceeding in the last instance, in its judgement of 13 December 2016, the Curia confirmed the finding of the two courts proceeding in the earlier instances that the banks had aligned their strategies with a view to restricting the sale of the forint loans suitable to replace foreign-exchange based loans, i.e. they had been involved in cartel operations. However, the Curia also found that in determining the penalty of nearly HUF 10 billion, the GVH made serious consideration and calculation errors in the case of eight banks. On those grounds, the Curia imposed an obligation on the GVH to conduct new proceedings in respect of the penalties. In the new proceedings, the GVH is required to recalculate the penalties based on the criteria specified by the Curia, and adopt a new decision in that regard.

The communication issued by the Curia on the matter also confirmed that the courts had not committed any procedural errors, proceeded fairly, provided sufficient explanations for their decisions, and their legal assessments were different from the Curia's legal position only on the matter of calculating the penalties.

The review of the Competition Authority's decision in the BankAdat case also started at the Budapest Court of Public Administration and Labour in early December.

VI. Developments relating to the National Bank of Hungary (MNB)

Amendments to the decree on the mortgage financing adequacy ratio (MFAR)

In a consultation with bank CEOs in late September 2016, the competent Deputy Governor of the MNB announced the need to fine tune the MFAR further. The announcement outlined three likely restrictive measures:

- the increase of the MFAR from 0.15 to 0.3;
- the introduction of netting at sectoral level between mortgage bonds held among assets and liabilities arising from instruments defined in the Mortgage Credit Institutions Act; and
- the increase of the initial maturity of the instruments taken into account from one year to two years.

The Deputy Governor indicated that the restrictions would be applied one year following the introduction of MFAR, as of April 2018.

The Banking Association sent its comments to the MNB in early October. We expressed our concern about the central bank doubling its requirement following the overview of existing retail mortgage loan files and the restructuring of mortgage collateral. According to the banks concerned, taking into account the expected rates of portfolio growth, a ratio of 0.2 is perfectly viable as of 2020. As netting significantly reduces the investor base of mortgage bonds, we recommended its application above a minimum level.

By mid-November, the central bank completed the wording of amendments to the normative text that had not even taken effect. This already reflected the Banking Association's recommendation on the rate of the MFAR, and postponed the originally announced implementation date by half a year. The draft permits mortgage bonds to be held among assets for up to 85-90% of the liabilities used, and for the purpose of calculating the ratio, netting is required for the amount of assets above that threshold.

In the consultation on the normative text, in addition to proposed clarifications, we requested that building societies be exempted from netting as of its implementation in 2017, but the MNB insisted on the date of 2018 as originally foreseen. (From 1st October 2018 the numerator of the ratio shall not be deducted with the amount of mortgage bonds kept in the books of building societies that are within the scope of consolidated supervision of a mortgage bank.)

Effective as of October 2018, the amended MNB decree was promulgated in the second half of December.

Out of court restructuring of non-performing corporate loans

Following a consultation in late September on the proposals of bank experts, the draft recommendation completed in late August 2016 was substantially revised by Köves & Co. Law Office on behalf of the MNB, as part of technical assistance by EBRD.

The revised document was presented in the first week of October at a professional conference. At the event, speakers from both the MNB and the EBRD expressed their expectation that the Banking Association might act as a catalyst in the technical implementation of the recommendation.

The experts of the Banking Association continued to underline that efficient out of court corporate restructuring was not conceivable without the review and removal of the legal constraints of enforcement, bankruptcy and liquidation, which currently impede such restructuring. As regards technical implementation, the experts indicated that the Banking Association could support the

implementation of the recommendation subject to a review of the specimen agreements currently annexed to the Budapest Principles.

Following the approval in principle of the Financial Stability Council, the MNB redistributed the Hungarian draft of the recommendation for consultation. Due to delays in codification, the planned consultation was only held at the beginning of 2017.

MNB recommendation on remuneration

At the end of October, the MNB supplied the Banking Association with its draft recommendation prepared in accordance with the remuneration guideline of the European Banking Authority (EBA). On that subject, in the context of a thematic audit covering several banks, consultations were already held with the MNB on several disputed interpretation issues, of which the draft recommendation concerns the following three:

- the application of thresholds regarding deferred payments and payments with non-financial instruments, taking the principle of proportionality into account,
- the application of proportionality with regard to small institutions, and
- interpreting the definition of performance-based remuneration, pursuant to which the MNB limited base remuneration exclusively to the base salary, and classified as performance-based remuneration all other elements of salary that, by content, could otherwise be considered fixed remuneration (such as fixed salary supplements related to management positions or jobs).

Regarding the application of the principle of proportionality, the draft reflects the European Commission's current interpretation of the Directive – which prescribes the application of the Directive as a minimum standard, regardless of the characteristics of the institutions and the remuneration level of the employees.

Although the cover letter sent with the draft also referred to the ongoing European legislation process, after the recommendation became effective in 2017 it has become uncertain whether the bank practices that take into account proportionality are still sustainable.

We submitted our comments on the draft to the MNB in early November, requesting, in addition to the discussion of other technical matters, the possibility to continue the application of the principle of proportionality until the transitional situation of European law was settled.

In early December, with a view to clarifying problematic issues, we held a consultation with the heads of the methodology area of the MNB that drafted the recommendation. At the consultation, the MNB approved the continued application of the principle of proportionality as provided for in the relevant government decree, and promised to make an explicit reference to that effect in the recommendation as well. A temporary solution to the problem resulting from differences between the remuneration concepts under the rules of labour law as set out in the Credit Institutions Act (base performance-based remuneration) and the concepts used in CRD4 (fixed and variable income) is assisted by the central bank by incorporating into its recommendation the wage components, as listed by bank experts, that are not part of base wages but qualify as fixed income.

The MNB also accepted the proposal of the Banking Association that the recommendation should only become effective as of July 2017.

MNB Recommendation No. 13/2016 on product oversight and governance arrangements for retail money market products

In the interest of fair money market operations and of growth that is sustainable in the long term and is built on consumer trust, the MNB considers it crucial that operators in the money market offer products suited to actual consumer needs. To that end, the MNB issued a recommendation to specify the actions and good practices that it expects any institution operating in the money market to apply in the course of developing retail money market products and selling those products to consumers.

In general, the actions taken in the course of product design and marketing must aim to ensure that consumers' interests, goals and characteristics are taken into account, to avoid any potential damage to consumers, and to minimise conflicts of interest. The requirements state that the actions should incorporate the steps to be taken and the characteristics to be considered in the course of identifying the target market for each product, the testing, monitoring and correction of the products, the selection of the appropriate distribution channels, and the criteria of providing information. The MNB expects institutions to regularly review and document their actions, and to ensure that the actions are integrated into the institutions' governance, risk management and internal audit frameworks.

The recommendation is virtually a literal adoption of the EBA guidelines issued under a similar title. Out of the proposals made as part of our opinions, the MNB primarily considered those concerning the discrepancies between the EBA guidelines and the text of the recommendation. Our other recommendations, primarily concerning clarifications and unambiguous wording, were eventually not incorporated by the MNB into the text of the issued recommendation.

Developments concerning reference rate quotation, expected adjustments to the rules of quotation

The MNB's takeover of the administration of the BUBOR, HUFONIA and BIRS reference rates as of 1 November was completed seamlessly. With a view to the adequate professional governance of reference rate administration, the MNB set up its Reference Rate Quotation Committee (RJB), which held its inaugural meeting in late September. Committee meetings are attended by delegates of the Hungarian Forex Association (MFT) and the Banking Association's representative as permanent invitees.

In its November meeting, the RJB adopted a decision to add the following to reference rate regulations:

- introduction of detailed procedures for cases where an insufficient number of quotations are available in the quoting timeframe;
- regulations on the possibility of and requirements for voluntary applications for quoting bank status, and on the process of terminating quoting bank status;
- specification of the procedures to follow in the event of misquotations and quotation errors, and the impact of such situations on the transactional obligation of quoting banks.

The RJB is currently consulting quoting banks on the draft regulations laying down the new rules. The additional regulations are expected to take effect as of February.

Amendments to the regulations in the MNB Act concerning the Financial Arbitration Board

Act LIII of 2016 amending certain acts related to the financial intermediation system amended the provisions of the MNB Act concerning the Financial Arbitration Board (PBT) to the effect that up to HUF 1 million, the PBT is authorised to adopt binding and enforceable decisions against service providers without any statement of submission by the latter. However, the new provision, foreseen to take effect as of early 2017, violated the right to fair proceedings as it failed to grant financial service providers the right to legal remedies. On those grounds, we made several requests to the MNB and the NGM to repeal the provision.

Instead of repealing the provision, the legislator laid down detailed regulations for remedies against PBT decisions in the *Act amending the Public Finances Act*. A binding decision can be opposed, which will cause the procedure to be transformed into legal action.

Reporting obligations for 2017

In line with the requirements laid down in MiFIR, in 2017 the MNB is looking to require data on structured deposits as part of extraordinary reporting. The MNB does not have information on innovative savings products, and before imposing the reporting obligation, it gave the credit institutions concerned the opportunity to provide opinions on the proposed data contents.

As part of our opinions, in addition to a number of questions and proposals, we indicated that the reporting deadline foreseen was rather tight in terms of the resources that may be assigned to reporting, due to the transition to the IFRS methodology, the preparation of countless reports in connection with the closing of fiscal 2016, and the implementation of the new reporting requirements for 2017. On those grounds, we requested the postponement of the reporting obligation by 2 months. Following our request, we received the revised version of the proposed reports, opinions on which are currently being formulated. In the meantime, we have been notified that the MNB has accepted our request for an extended deadline.

In the last quarter of 2016, the consultation on regular reports for 2017 was completed, and the final version was published on the MNB's website.

VII. Payment Services

Adoption of the Payment Accounts Directive (PAD) of the European Union

Comprising three topics, the Payment Accounts Directive was introduced differently for each topic:

- banks had to apply the law concerning payment accounts with basic features starting from mid-October 2016, which due to the delayed codification and the short preparation time required strained work; after the introduction, however, relatively few issues arose that impeded implementation,
- time to prepare for the application of the bank account switching regulation as of end-October 2016—for reasons similar as in the case of basic accounts—was again insufficient, and even after the introduction many significant issues remained that had to be clarified,
- comments on the EBA guide that is to constitute the basis for the regulation concerning the comparability of fees related to payment accounts had to be made by end-December 2016; however, its introduction is likely to be delayed until end-2017.

While as regards basic accounts there was some latitude for the interpretation of the law in the course of practical application, in the case of bank account switching it was essential that the customer data and information transmitted between banks should be interpreted uniformly by all stakeholders. As far as implementation is concerned, it was decisive that GIRO Zrt. undertook to help interbank data flow—essential for bank switching—with standardised messages. To facilitate all this, the model forms that practically determine—subject to the relevant statutory framework—which customer data, with what content and in what form are necessary for the bank switching had to be elaborated in the coordination of GIRO and the Hungarian Banking Association.

The task force set up for this purpose (consisting of the experts of banks and of GIRO) elaborated the basic form to be used for bank switching, i.e. the Authorisation for Bank Switching to be completed by each customer requesting switching, and its necessary annexes; as well as the other statutory documents serving communication between the bank and the customer. In the course of this, the task force:

- ensured that when direct debit mandates are transferred to the new bank, the customer can focus on the direct debit,
- determined the frequency that may facilitate execution in the case of regular credits,

- clarified by what deadlines account closing and the transfer of the credit balance should take place at the old bank, and
- how the customer's need that following a specific date transfer orders incoming to the customer's credit should not be credited by the old bank can be managed.

GIRO as well as the Hungarian Banking Association called the attention of banks to use the forms—finalised for the time being—and at the same time they were warned that early in 2017—based on initial experiences—the forms as well as the practice to be developed by the banks are to be reviewed.

According to non-official information in the initial period only a very small number of basic account openings and bank switchings occurred.

In order to ensure that the banks' customers can make decisions on an informed basis when switching bank accounts, the PAD required the conditions to be developed at European Union as well as national level for the comparability of the fees charged for bank account services. In view for this, the EBA—based on the national proposals—compiled a common EU list of bank account services and determined the way in which such services are to be included in the preliminary customer information document (FID²) to be given to the customer prior to the account switching decision and in the subsequent information (SoF³), to be handed to the customer at least once a year.

The Bank Account Task Force dealt with the comments to be made on the EBA draft at two meetings.

- It was proposed that the common EU list of 8 elements—compiled from the national lists of bank account services—should not include credit cards, as credit card is not directly connected to payment accounts.
- The 8-element list was found to be too general, nevertheless it was found that as the fees are compared in two tables (FID, SoF) (supplemented with the services included in the national lists), attention should be focused on the national work. It should be defined unambiguously how a given basic service (e.g. credit transfer) can be divided into “sub-services” (e.g. in-bank transfers, transfers to other domestic banks, cross-border transfers, transfer orders given on paper, etc.), and fees should be attached to these clearly. It is also important that all sub-services should be placed in the tables unambiguously, and the tables of the different banks should be comparable.
- The task force found the management of account packages in accordance with the EBA proposal to be problematic, as the tables are not able to adequately manage the terms associated with the different packages (e.g. crediting of a monthly minimum amount to the account) and the relevant benefits (e.g. if a specific amount is credited to the account per month, transfer orders are cheaper, and such benefit may change in brackets).
- According to the EBA guide, the statement of fees (SoF) should include how many services the customer used of the given service type, and how much it cost for the customer. The table is supposed to include the per unit price of the given service as well, which may be subject to change, even several times a year, making the table even more complicated and even less transparent, therefore the task force proposed the per unit price to be omitted.

The Hungarian Banking Association sent its opinion to the EBA—based on the comments of the task force—by the deadline requested by the EBA.

Preparation for the Application of the Revised Payment Services Directive (PSD2)

Preparation for the introduction of the new Payment Services Directive (PSD2) in January 2018 is a rather complex task, therefore the HBA decided that—similarly to the preparation for the SEPA End

²Fee Information Document

³Statement of Fees

Date Regulation—it will support the legal, technological and security preparation of the banks and the HBA task forces concerned in the preparation. It is going to develop a framework program that will help the implementation of the directive in the remaining one year with regulatory consultations, workshops and professional programs organised with foreign and domestic technology service providers, adequate monitoring, and targeted communication.

○ *Activity of the PSD2 Specialised Task Force*

The purpose of the PSD2 specialised task force (STF)—organised within the Payment Services Task Force—is to formulate for the authorities in charge of the Hungarian adoption of PSD2 the banks' position concerning the directive, to make concrete proposals in the given topic, and to identify the issues in respect of which the regulation should provide clear guidance.

In accordance with those laid down in its work schedule, starting from autumn 2016 the STF has been elaborating at regular meetings the different topics of the EU regulation, including for example:

- the customer information and responsibility aspects of so-called “one-leg” transactions (where only one of the counterparties is located in the EU, or where the transaction takes place in a currency other than EU currencies),
- new services to fall within the scope of the regulation, and new exceptions from the regulation,
- responsibilities of new payment service providers regarding instances of their access to bank accounts,
- the practical utilisation of regulatory latitudes (derogations) delegated to national competence.

○ *Commenting on EBA Technical Standards Connected to the Payment Services Directive*

This time preparation connected to PSD2 by payment service providers is not limited to getting acquainted with the new legislation, but comprises the technological and security requirements of payment services as well, and creates significant development needs. Two new elements are added to payment services: *payment initiation service (PIS)* and *account information service (AIS)*, where consolidated information is provided on the balance of the different payment accounts of the same customer. The third party providers (TPP) offering such services may carry on these activities as *license holding* (in the case of PIS) or *registered* (in the case of AIS) service providers falling within the scope of the Directive. Such extension of the payment chain requires an increased focus on the credibility of the participants and the security of the communication among them. The Directive authorised the EBA to elaborate the detailed rules relevant to this. EBA prepared a draft regulatory technical standard (RTS) for strong customer authentication and safe communication among the parties participating in the payment chain, which was released for public consultation in October 2016. In response to this, the HBA also developed and sent in due course the position of the Hungarian banking profession connected to the draft. The information lecture held by the MNB previously had an important role in the development of the relevant opinion, and the representatives of the central bank also participated in an active manner in the reconciliation where the experts of the banks providing written comments on the draft finalised their comments.

The commenting banks expressed serious reservations against TPP-s as a new type of payment service providers created by the PSD2. In their opinion, the legal tools of the regulation providing access for TPP-s to the bank accounts of customers (official license, market supervision, liability insurance to be concluded or guarantee to be provided by the TPP on a mandatory basis) are insufficient, and they would rather demand better accountable technical criteria and a larger latitude for the account-keeping bank; in particular:

- In the course of the licensing procedure, the supervisory authorities should not only examine statutory compliance, but entities applying for the PIS service should also be subjected to runtime tests (executed by accredited expert companies) to prove that TPP-s may not access to the data managed by them.
- Account-keeping banks should not be required to be continuously available for the TPP-s that wish to test the account access process.
- Strong customer authentication (SCA) is an important achievement of PSD2; however, as these identifiers are disclosed to the TPP-s in the course of e-commerce, exceptions from the use of SCA will be appreciated. Besides (or instead of) using SCA, banks would rather leave it to the customers which TPP-s and up to what amount they will allow to access their accounts.
- In the scope of preparation for security requirements it would also be necessary to make sure that the application programming interface (API) necessary for the TPP-s to access the banks' account-keeping systems should be uniform.

Major Topics and Decisions of the December Plenary Meeting of the European Payments Council

At its December plenary meeting, the European Payments Council (EPC) closed the first two-year cycle following its transformation in 2014. Accordingly, one of the tasks of the meeting was the election of officials. In the scope of this, Javier Santamaria and Narinda You were re-elected as Chair and Vice-Chair, respectively. Besides personnel issues, the agenda included the report of the Board, which comprised a survey of the activities that are to arise in 2017 as well from the relationship of the EPC with the ERPB⁴ and the ECSG⁵, and the management of payment schemes. In connection with retail payments, the general secretary emphasised that the EPC completed the instant payment scheme (SCT Instant) in due course, publishing the rulebook of the new model in November. The EPC provided an ongoing secretarial support to the activities of the Mobile Proxy Forum (P2P mobile payments) and the task force dealing with e-billing, going on in the scope of the ERPB. In 2017, they will additionally support the *Payment Initiation Services* task force as well. As regards the ECSG it was announced that the task force—which since 2009 has been operating as a de facto association—has transformed into an association officially as well. As regards standardisation, which has constituted the focus of its activities (SCSV⁶), it was announced that due to the extreme volume of comments received in the course of public consultation, publication of the updated SCSV is not to be expected before the end of Q1 2017. As regards the payment schemes managed by the EPC, the general secretary announced that following the publication of the instant payment scheme rulebook numerous SCT members have given note of their being interested in joining it. Adherence shall be possible starting from January 2017, and by then the EPC will have supplied each NASO⁷ with the required documentation.

As regards the strategic meeting of the Board in October, the general secretary mentioned that the Board is committed to the idea of a so-called “EPC+”. In this spirit, the organisation wishes to participate in the digitalisation and development of European payment services in a proactive and foreseeing manner. As regards mobile payments, the Board decided on setting up a task force with the aim of elaborating two guides in 2017, and whose activity is to be supported by the PSSG⁸.

The *work plan* for 2017 identified as one of the principal tasks the practical implementation of the SCT Instant payment scheme, and the actual launch of the scheme as of 21 November 2017. As regarding already operating schemes, the goal is to increase quality, security and the value embodied by the schemes. The efficient and effective use of the information generated from the oversight of the schemes may as well contribute to the achievement of this goal. Besides, sufficient attention

⁴ Euro Retail Payments Board

⁵ European Card Stakeholder Group

⁶ SEPA Cards Standardisation Volume

⁷ National Adherence Support Organisation

⁸ Payment Security Support Group

should also be paid to the implementation of PSD2, the tasks arising from cooperation with the ERPB, and the aforementioned mobile payments.

Scheme Membership Fees in Year 2017

Upon the transformation of the EPC in 2014, the goals included the economical operation of the organisation, and covering operation from the costs connected to the payment schemes. Accordingly, the amount of membership fees remained the same as it was in 2016, that is EUR 10,000. The members who participate in Module2 as well shall pay a so-called combined membership fee of EUR 20,481 for 2017. This means a decrease of 11.3% as compared with 2016. On the other hand, the membership fees of the payment models in 2017 shall increase by 12.3% in nominal terms, which is due to two factors:

- the number of institutions participating in the different payment schemes has decreased by 4% (or has been rearranged),
- the governance and management costs associated with the schemes have increased by 8.5%. (In connection this latter item, in 2017 the EPC will review its financing model.)

The individual participation fees of the different payment schemes shall be as follows in 2017:

SEPA Credit Transfer	SEPA Direct Debit Core	SEPA Direct Debit B2B	Combined fee of the three schemes
EUR 219	EUR 327	EUR 434	EUR 980

Due invoices shall be sent out by the EPC in Q1 2017, and shall be payable within 30 days. Starting from this year, the EPC—due to the high amount of overdue fees seen in 2016—basically wants to collect the fees via the SDD core model, but institutions may continue using SEPA credit transfer as well.

For the payment service providers that are to adhere the launching SCT Instant Scheme, membership shall be free of charge in 2017.

Launching of the Euro Instant Payment System

The last quarter has been extremely important for the establishment of the Single Euro Payments Area, as non-euro zone member states also had to complete their migration to the common pan-European rules and standards as regards payments (credit transfers and direct debits) in euro. This standardisation process was somewhat counteracted by the fact that several member states independently set up instant payment systems in respect of their domestic currencies and payments. This is for example what the United Kingdom, Denmark and Poland did; and Hungary also started developments in this direction. In the eyes of the European regulators, these initiatives of the member states may jeopardise the development of the SEPA, as they might result in the fragmentation of the payments market, therefore they encouraged a uniform euro based instant payment scheme to be elaborated and put into operation as soon as possible.

Based on the SEPA credit transfer model, by November 2016 the EPC elaborated its SCT Instant Scheme, which—contrary to the credit transfer and direct debit schemes—is not mandatory. The participating payment service providers may as well participate in the model—which shall be accessible in 34 states (28 EU member states, plus Iceland, Norway, Lichtenstein, Switzerland, Monaco and San Marino)—as recipients only. For the service providers that are members of the credit transfer scheme it shall be quite simple to adhere the SCT Instant Scheme . At the level of individual transactions, the scheme shall enable the transfer of 15,000 euro *within ten seconds* between the two payment accounts concerned. These initial parameters are not set in stone; the members of the scheme may bilaterally or even multilaterally agree on higher amounts and shorter

payment times. The ten seconds means that within such time the amount in question will be available in the account of the beneficiary; the bank of the beneficiary notifies the bank of the payer that it has made this amount available to the beneficiary or that it rejects the transaction. The service providers joining the model must be technically able to process instant credit transfers at any time of the day and on each day of the week throughout the year, irrespective of non-business days and holidays. Payment service providers may join the SCT Instant payment scheme I—similarly than the other payment schemes—via NASO-s. The EPC has already made the documentation necessary for adherence available to us, therefore there should be no obstacle to Hungarian payment service providers also participating in the launching of the model on 21 November 2017.

Regional SEPA Conference in Prague

At the *regional SEPA conference* held early November in Prague the Hungarian Banking Association was represented by the chairman and secretary of the SEPA task force and the secretary of the Payments task force of the HBA. Organised on a yearly basis, the regular participants of the forum are: the Slovak Banking Association, the Polish Banking Association, the Croatian Banking Association, and people from-STUZZA⁹ representing Austrian Banks. The meeting covered the experiences of the non-euro zone member states concerning preparation for the migration, as well as the implementation of the SEPA End Date Regulation. The meeting spent a significant amount of time on authentication, communication and security issues related to the new payment services and service providers concerned by the PSD2 and the EBA regulatory technical standards completing it, and on the liability rules established for payment service providers. In the scope of the PAD, the topics of payment accounts with basic features, the most frequent services associated with basic accounts, and bank switching or bank account switching were surveyed. Apart from professional issues we talked about the election of officials due in the EPC Board, and on the basis of the latest SEPA payment data the composition of the coalitions that may form for the acquisition or retention of Board positions.

Hungarian Instant Payment System Model Approved by the FSB

With the cooperation of the Hungarian Banking Association, the MNB organised several forums during the year in connection with the creation of the instant payment system; first for the discussion of the concept, and then for the elaboration of the operating model. Besides these occasions, bilateral consultations also took place between the Financial Infrastructures area of the central bank and the payment experts of our member banks. The operating model—developed taking into account the comments made by banks and payment service providers on the instant payment system concept and connected to the operating model and liquidity management—was approved by the Financial Stability Board at its December meeting. Via the instant payment service, through state-of-the-art IT and communication solutions it will become possible to carry out credit transfers in a matter of seconds on any day of the year, around the clock, up to HUF 10 million in a wide range of payment situations. Within five seconds of sending, the amount in question will be credited to the payment account of the beneficiary, and will be available at the free disposal of the beneficiary. In the scope of the service, apart from account numbers one can also initiate transactions knowing so-called secondary account identifiers only (the telephone number, e-mail address or even tax number of the recipient). The system will also be enabled to accommodate accessory services, for example mobile payment solutions.

As currently neither the Hungarian central infrastructure, nor the systems of our credit institutions or other payment service providers are enabled to process payments in accordance with the

⁹ Studiengesellschaft für Zusammenarbeit im Zahlungsverkehr GmbH (Association for Cooperation in Payment Transfers): the cooperation platform of Austrian banks to facilitate payments

requirements of the established model, in 2017 a *national financial infrastructure modernisation project* will be launched in the coordination of the MNB. Under the project, all stakeholders must carry out the required developments so that the service shall become available to users in the second half of 2019 at the latest.

Bankcard News

In accordance with the data of the MNB, in Q3 2016 the number of payment cards issued in Hungary exceeded 9 million. The number of POS terminals enabling contactless payment increased significantly, by almost 9 percent, and partly as a result of this more than half of all purchase transactions made with payment cards during the quarter used the new technology. The volume of domestic payment card purchases continues to increase significantly. Transactions administered in the Hungarian acceptance network with cards issued in Hungary totalled HUF 869 billion at annual level, which means an increase of 23 percent. The average value of contactless payments is still significantly lower than that of traditional transactions (HUF 4,769 and HUF 9,034, respectively), which means that the spreading of the new technology has enabled the redemption of an increasing number of cash transactions of low value primarily. The considerable increase of the volume of Internet purchases has continued (there is an almost 41 percent increase in terms of value); however, with a total value of HUF 81 billion online transactions still account for only 9 percent of total purchases.

In Q4, the Bankcards task force focused mainly on the following topics:

- In connection with the preparation for PSD2, on 12 December a kick-off workshop was organised with Hungarian and international lecturers and the participation of the MNB on the technical possibilities of the preparation and solution models, in order to give a comprehensive picture for our members on the requirements (e.g. the introduction of strong customer authentication in the bankcard area). As regards the quality service of customers with disabilities an MNB recommendation was prepared, whose bankcard-relevant aspects are known to and processed by us, and we also monitor the work of the Committee dealing with the establishment of equal treatment.
- In connection with the Hungarian (recipient side) introduction of the MasterCard MoneySend service, three-sided discussions took place with the involvement of the MNB as a supervisory and regulatory authority regarding the integration of the new service (sending of cash quickly and simply between cardholders) in the Hungarian regulatory environment.
- In the last week of October, with the active participation of our members and communication taking place in the own channels of the HBA, we joined the international anti-cybercrime campaign of the EUROPOL. In the scope of this, we advertised via outdoor posters and shared information in online platforms, calling attention to the different potential threats and fraud types that may be facilitated via electronic channels.
- Starting from the second half of October, we participated in the professional consultations arranged and lead by the Ministry of National Economy in connection with the preparation of the payment blockage of prohibited gambling transactions.
- A significant part of bankcard fraud events occurring during the quarter was constituted by traditional prepaid telephone card replenishment frauds, and in the pre-Christmas period instances of phishing via fake online stores also occurred. We continued with the preparation of the OF2CEN international program, which we hope will provide an efficient platform in the future for prevention.

Developments Related to Banknote Replacement

In November 2016, the MNB organised a forum for the participants of the cash market, in which the time schedule of banknote replacement was presented in detail, from the end-December 2016 deadline for the withdrawal of old 20,000 forint notes to the extremely rapid replacement of 2,000 and 5,000 banknotes in 2017 (planned to be completed within a few months).

In this context it took the banks by surprise when the central bank—shortly after the forum—announced that the withdrawal of 20,000 notes is postponed by one year. In order to analyse the new situation, the Cash task force held an extraordinary meeting, to which the management of the Cash Logistics area of the MNB was also invited. The representatives of the central bank told us that—although it can be regarded as a success that in a matter of one year the ratio of new 20,000 banknotes rose to 80%—nevertheless the volume of old 20,000 banknotes that are currently in circulation is still significant, and it is a priority that this stock should be withdrawn gradually, at a natural pace. Accordingly, banks can continue to exchange old 20,000 banknotes into new ones at the central bank free of charge, and the prohibition of recycling also remains effective. The schedule set for year 2017 regarding 2,000 and 5,000 banknotes, however, will not change. As regards banknote counters/processors, the issue that there is one additional banknote version (the old 20,000) in circulation should be solved in time.

The members of the task force took note of the central bank's position; they let it be known, however, that in specific cases they might not carry out the exchange of old 20,000 banknotes into new ones automatically and free of charge, as the replacement of large amounts may upset the cash management of the given branch.

Consultation with the Bar Association on Escrow Accounts Kept for Attorneys

The Budapest Bar Association (Budapesti Ügyvédi Kamara, BÜK) asked for the help of the Hungarian Banking Association in a letter, as several members of theirs have complained that there are problems regarding disposal over escrow accounts in the case of attorneys acting as substitutes. They emphasised that in the event the attorney who placed the deposit is hindered it is essential that an attorney acting as substitute should be able to dispose of the account seamlessly.

The Payments task force was assigned to clarify the issue. First of all the chairman and secretary of the task force reconciled with the experts of BÜK, then the task force met to discuss the issue. In our response letter written on this basis we explained that we are not informed of any concrete complaints by attorneys, and basically in our opinion this issue is unproblematic; nevertheless, due to the complexity of rules concerning attorneys and payments disturbances may occur, for example

- if in respect of an escrow account comprising numerous cases the attorney wishes to empower different substitutes for the different cases (~~whereas~~ the bank is able to accept only one fully authorised substitute),
- if the customer has objections to the identity of the substitute assigned in the particular case,
- if the attorney placing the deposit authorises the substitute inappropriately from the bank's aspect.

In addition, we also called attention to the possibility for the attorney placing the deposit to check the transactions carried out by his substitute in respect of the account by requesting sms messages on each transaction.

Official Requests Concerning Transactional Accounts

As a result of cooperation with the Constitution Protection Office (AH), in October the *request and response forms to be used in the course of data exchange with the office* were finalised.

At the end of October, we also *reconciled with the managers of the Military National Security Service (KNBSZ)*, where we presented the technical solution and order of procedure developed in connection with AH requests, and the representatives of the KNBSZ were also interested in introducing similar arrangements.

VIII. Taxation, accounting

Changes affecting tax laws

In the last quarter of 2016, in close succession, Parliament adopted decisions on two tax packages for the following year.

The first legislative package essentially included provisions that serve tax policy purposes, reduce administration, and provide technical specifications. In the *Personal Income Tax Act*, in the context of non-taxable employer's housing assistance, clarifications were made to the concepts of eligible housing needs, and family members moving or living together. Additionally, with long-term investment agreements, from 2017 onwards, following the expiry of the 5-year preferential commitment period, individuals will have the choice of recommitting either the full amount of their matured savings, or only a part, with the possibility to make a non-taxable withdrawal on the remaining part. As of 2017, the *6% health contribution (EHO) on interest income* will be cancelled. In the context of the IFRS transition, primarily in response to taxpayer comments (including proposals by the tax working group), the *rules on the corporate tax and the local business tax* have been adjusted further to improve their applicability. Legislative changes have also been made concerning the *mandatory exchange of tax data between tax authorities*, in response to the proposed specifications emerging in practice, and to the domestic adoption of EU DAC3. Additionally, favourable regulatory changes have also been introduced in support of small businesses, with several measures for the reduction of administration and payable tax taking effect as of 2017.

The Banking Association's expert work group played an active role in initiating the changes and in providing opinions on the draft act produced.

The second legislative package adopted by Parliament, following the first one in close succession, concerned the enforcement of the wage agreement with employers' advocacy bodies. In addition to increases to the minimum wage and the wage minimum, a decision was also adopted on reductions to tax rates. Within the meaning of the key changes, for 2017 the corporate tax rate will be reduced uniformly to 9% from the previous dual rates (10% up to tax base of HUF 500 million, and 19% above that threshold), and the rate of the social contribution tax will be reduced from 27% to 22% for 2017, and by an additional 2 pts to 20% for 2018. The upper rate of the health contribution will also be reduced from 27% to 22%. The contribution, applied in 2016 at five different rates (6%, 14%, 15%, 20% and 27%) varying by income, will be levied at two rates (14% and 22%).

Changes concerning accounting regulations (amendments to an act and a government decree)

The *Government Decree on Special Provisions Regarding the Annual Reporting and Bookkeeping Obligations of Credit Institutions and Financial Enterprises* is amended as of 2017 due to interim amendments to *Act C of 2000 on Accounting*, and to alignment with the rules set out in *MNB Decree 39/2016 on Non-performing Exposures and Restructured (forbearance) Receivables* as part of prudential requirements.

In respect of the Accounting Act, adjustments to the Government Decree are primarily called for the closer alignment with IFRS and specification of regulations on derivatives and hedge accounting. Conversely, the new MNB Decree entails significant changes in the methodology and current practice

of rating credit granted and receivables, and of collateral valuation. The rules for rating will be transferred from the government decree on accounting to the new MNB decree, which follows the principles of the standard European regulations on capital requirements (CRR). One of the resulting key changes as of 2017 is that even credit institutions that follow Hungarian accounting standards will not be required to apply the former five categories (performing, specific attention, below average, dubious, bad) for the purposes of rating receivables/credit granted, and the bands of provisions required for each category have also been discontinued.

Promulgated at the end of 2016, the legislative package amending the rules for 2017 also adjusted the deadline for the registration of IFRS transition by enabling entities that had registered by 30 September 2016 to withdraw their 2017 optional IFRS transition by 15 December 2016 at the latest.

IX. Developments concerning the Banking Association

Pénz7 ('Money Week') – Preparations for 2017

In the fourth quarter, following the Management Board approval of 4 July, active arrangements were made in preparation for the 2017 Money Week event series. In Hungary, the Money Week will take place between 6 and 10 March 2017, preceding, also due to our national holiday on 15 March, and opening the European and global series held at the end of March. Nevertheless, the Hungarian events are part of both the European Money Week and the Global Money Week series. As a major achievement, in 2017 for the first time, the thematic weeks are incorporated into the official programme of the academic year, which the EMMI (Ministry of Human Resources) distributed to all educational institutions in August. The Ministry has endorsed the Money Week programme also in the capacity of project owner, and the Hungarian Banking Association and the Money Compass Foundation retained their roles as financial programme organisers. The 2017 syllabus is extended to include business development through the engagement of the NGM and the Junior Achievement Foundation as co-organisers. The contributing parties are scheduled to stage a high-profile contract signing ceremony on 9 February 2017 in the Mirror Hall of the EMMI. As usual, the thematic week will be kicked off on 6 March with a large-scale opening evening at the Treasury Hall of the NGM. A new event in the week is a professional conference that also features higher education, hosted by the University of Miskolc to underline the nationwide character of the programme.

Member institutions of the Hungarian Banking Association contribute to the Money Week series with hundreds of volunteering financial experts, and a number of fun features to complement the programme and to strengthen its appeal. The programme is sponsored on behalf of the Management Board by Board Member Éva Hegedüs, while General Secretary Levente Kovács is in charge of operational control.

Communication statistics and current issues

In the last three months of 2016 we were covered by the online media on approximately 400 occasions. Printed press coverage exceeded a hundred items, while electronic media carried approximately 130 news items on the Hungarian Banking Association. Overall, the Hungarian Banking Association was covered by the Hungarian media more than 630 times during the quarter, apparently a relatively quiet time compared to the more intensive previous periods.

During the quarter, we highlighted current issues concerning the sector in a number of professional communications and General Secretary statements and interviews. The General Secretary statements and interviews addressed the process of the mandatory notification of customers with arrears on their mortgage loans, the launch of basic payment accounts, and bank switching. In the

press, we addressed the MNB's package to regulate credit risk, and offered professional arguments to support our proposal for the extension of the NET by an additional 15,000 items. At the end of October, on the Privátbankár website we reported SEPA changes affecting customers. On 30 November, in a joint press conference with the National Police Headquarters and the Budapest Police Headquarters, we warned the public about the mobile top-up fraud incidents that had been continuing for months. Additionally, the Money Week programme was featured prominently in communication. During the quarter, we held personal consultations and defined joint actions with the Hungarian Publishers' Association concerning the responsible treatment of confidential banking information in press news. In the last days of December, the annual closing interview by the President for Thomson Reuters gave a round-up on the Hungarian Banking Association's year 2016, and provided an outlook for 2017.

Regional cooperation: V6 meeting in Budapest

On this occasion, the semi-annual banking associations' meeting held in the spirit of regional cooperation was hosted by the Hungarian Banking Association. At the meetings, the operational heads of the banking associations of Croatia, the Czech Republic, Slovakia, Slovenia, Poland and Hungary review the events and major financial, economic and regulatory developments occurring in the financial sectors of their respective countries.

Participants in the Budapest meeting confirmed that in general, the macroeconomic environment had become more favourable in all countries across the region, and that the performance of the banking sectors had improved despite an environment of low interest rates prevailing in all member countries. Additionally, opinions were exchanged on regulatory issues and the implementation and scheduling of regulatory measures, as well as issues relating to the financing of the economy with particular regard to SMEs, the Payment Accounts Directive, the Payment Services Directive, competition authority proceedings, remuneration and the implementation of IFRS 9.

To complement the successful professional programme, participants paid visits to the MNB's Cash Logistics Centre and OTP's Museum of Bank History.

Working committees and working groups not mentioned in the foregoing

- *Data Protection Committee*

The *Data Protection Committee* developed its methodology guide on *financial institutions' system of initial information on data controlling*, which we discussed at a Committee meeting, and submitted for auditing to the National Authority for Data Protection and Freedom of Information (NAIH) back in December. (A mandatory requirement for institutions, the aim of data controlling information is to enable customers, based on information about the control of their personal data, to make informed decisions on using credit institutions' services.)

The methodology guide was developed with a view to considering the industry-specific features of credit institutions in order to assist the overview of the system of credit institutions' data controlling information, and to provide a model for the adoption of good practice. The achievement is greatly facilitated and made more secure by the NAIH's audit of the guide. Offering a detailed explanation of the criteria, contents and methods of information in 70 pages, the guide must be adopted by each credit institution to its own circumstances and business operations.

The Data Protection Committee started preparations for the implementation of the new General Data Protection Regulation (*Regulation (EU) 2016/679 of the European Parliament and of the Council on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC*, GDPR). Committee members have participated in several seminars and talks on the subject. In the period leading up to the effective

date of the Regulation (25 May 2018), the Committee will work on the interpretation and application issues of the Regulation on the regular basis.

- *Working Group on Agriculture*

The Working Group on Agriculture held several meetings during the quarter. At the initiative of the Ministry of Agriculture, members of the working group held a consultation on *lending secured by warehouse receipts*, called for the significant decrease in the issue of warehouse receipts since 2008. The Working Group gave a detailed response to the Ministry's questionnaire, which was designed to identify problems and to develop possible solutions.

The representative of KAVOSZ Zrt. informed the Working Group about the *Agro Széchenyi Card and its subtypes*, including the *plan to cover ice and frost damage, and transitional aid to the milk and pork sectors*. To date, four financial institutions and the network of savings cooperatives have joined the Agro Széchenyi Card Scheme.

With contributions from the Hungarian Warehousing Association, the Public Warehouse Supervision briefed the Working Group on the results of the thematic audit "*inspection of endorsements on warehouse receipts and the relationship of creditors and warehouses*". In the consultation, among other aspects the Working Group highlighted the importance of filling in the endorsements on warehouse receipts with due care and completely in order to ensure that the turnover of goods and payments remains predictable, and that the warehousing system is transparent and secure for all of the parties concerned.

- *Compliance Working Committee*

In October 2016, members of the Compliance Working Committee resolved to develop guidelines for market operators by compiling best compliance practices in a single document (*Compliance Best Practice Code*). The compilation of the Code was motivated by the fact that it was not possible for the MNB's updated recommendation on internal lines of defence to present the common market practices that have emerged in recent years.

The first draft of the Code has been completed and consists of four chapters, addressing respectively the key pillars of compliance awareness, the framework for the cooperation of areas in charge of control functions, the characteristics of conventional compliance functions and methods, and specific organisational features. All members contributed actively to the development of the draft either by compiling specific subchapters or by providing comprehensive comments on the material, ensuring that the Code effectively reflects the best market practice in Hungary.

Once we are familiar with the final contents, we will formulate a proposal on the status of the Code, i.e. whether it should be released as a recommendation requiring voluntary endorsement by member organisations, or as self-regulatory material proposing guidelines for member organisations.

- *EXIM Sub-working Group*

As part of *Eximbank's credit scheme to promote exports*, the EXIM Sub-working Group was informed about the *standardisation of the collateral guarantee scheme*. In the context of the *Domestic Working Capital Credit Scheme to Improve Competitiveness*, Eximbank's representatives gave an account of the results achieved up to 2016Q3, the conditions of operations going forward, and Eximbank's *new monitoring regulations* that took effect as of Q4. Based on the comments made in the meetings, Eximbank developed *updated product documentation for the working capital refinancing plan to improve domestic competitiveness*.

- *Jelzálogbank Working Group*

The activities of the Working Group in the fourth quarter focused on active participation in legislation on restructured independent liens. In order to ensure that the Act on Mortgage Credit Institutions and Mortgage Bonds meets market needs, the Working Group developed a proposal for amendments to the Act.

The Working Group also played an active role on the regulatory platforms and themes initiated by the MNB.

Arrangements were made and members were designated for the participation of Hungarian mortgage bank experts in EU working groups (European Mortgage Federation, European Covered Bond Council), and the semi-annual general meetings of these organisations were held. The working groups also contributed to preparatory works on the Mortgage Bonds Directive.

- *Working Group on Training*

In October, we consulted the Ministry for National Economy on the requirements for bank experts' *applications for membership in examination boards* as part of the cash desk manager and foreign currency cash desk officer sub-qualification. We forwarded the requirements to member banks' experts.

At the request of the NGM, in early November we reviewed and completed the European Commission's *ESCO¹⁰ list and its translation concerning the area of banking and finance*. The aim of the European Commission is to develop a multilingual classification at a European level to assist both Member States that do not have a classification system of their own and those where a nationwide and sectoral classification system is already in place, given the possibility to link and compare occupations between Member States at a European level via the single ESCO system.

- *Working Group on Leasing*

In its meeting held in 2016Q4, the Working Group on Leasing *reelected its incumbent chair András Cserép*, Head of Leasing at K&H Bank Zrt.

The Working Group developed and submitted to the NGM its proposal for amendments to Articles 69 and 72 of the Credit Institutions Act concerning the regulation of brokerage fees. In its response, the NGM advised the Working Group that the proposed amendments would be addressed during the next review of the Credit Institutions Act, which is expected to be scheduled for spring 2017.

The *Document Offices Sub-working Group* of the Working Group on Leasing designed and submitted to the Central Office for Administrative and Electronic Public Services (KEKKH) the *specimen private deed for the registration of motor vehicle details in the vehicle register, the registration of title transfers, and the registration of lease customers' operator rights*. The Working Group held a personal consultation with the representatives of the KEKKH for the review of the registration process of the details and rights to be entered in the transportation register. The KEKKH updated the specimen private deed with the adjustments proposed as part of the consultation, and also compiled *information material for document offices* accordingly, which it published on the document office notice board on 27 December 2016, providing access to all document offices and government one-stop shops.

- *Setup of the Treasury Back Office Working Group*

¹⁰European Skills, Competences, Qualifications and Occupations, a project of the European Commission for the development of a single classification system for occupations at a European level

Pursuant to Management Board approval, in December we set up the *Treasury Back Office Working Group*. Before defining the responsibilities of the Working Group, we contacted the MNB's units in charge of regulatory issues concerning the capital market in order to align our work.

As one aim of the Working Group is to facilitate the implementation of new capital market regulations (MiFIR/MiFID2), in mid-December we identified the issues that currently pose interpretation problems for banks.

At the MNB's request, in December we distributed to members the draft of the Code compiled at the initiative of the BIS in order to develop consistent regulations with a view to providing consistent foundations for the operations of the global foreign exchange market.

I. Global regulation

I.1 Financial Stability Board (FSB)¹¹

I.1.1 Assessment of the situation and the workplan for 2017

At its November meeting in London, the Financial Stability Board **reviewed the growth trends and vulnerabilities of financial markets, discussed the ongoing regulatory projects and adopted the workplan for 2017.**

According to the assessment of the FSB, the financial system works well despite considerable uncertainties and risk aversion, however, the substantial sovereign and corporate indebtedness are still causes for concern. In developed economies, asset quality and low profitability are key when assessing banks. As a result of the regulatory reform programme introduced after the financial crisis, the global financial system has undoubtedly become more stable.

The tasks of the FSB for 2017 include the preparation of a guideline for the resolution and resolution planning of central counterparties, managing the decline in correspondent banking activities, working on misconduct risk, the transformation of shadow banking activities into a reliable market-based form of financing as well as authorities' duties with respect to fintech challenges. A separate task force is responsible for financial disclosure related to climate change. The workplan also stipulates that the third *Annual Report* assessing the reforms, which will be published before the G20 summit in July 2017, should be drawn up.

I.1.2 Defining systemically important global institutions

Based on data from the end of December 2015, the FSB, in cooperation with the Basel Committee on Banking Supervision, **defined global systemically important banks (G-SIBs), and updated the methodology for identifying G-SIBs** published in July 2013. The group of 30 banks identified as G-SIBs has not changed as compared to the list published in November 2015. G-SIBs are required to create a capital buffer of 1–3.5%, depending on their size, meet total loss-absorbing capacity (TLAC) requirements as well as recovery requirements and more stringent supervisory requirements. Based on 2015 data, none of the 30 G-SIBs belongs to the 3.5% surplus capital buffer bucket, while 2, 4, 7 and 17 bank(ing group)s have to create a capital buffer of 2.5%, 2%, 1.5% and 1%, respectively. The capital add-on requirement has to be implemented from January 2018 (fully from January 2019).

At the same time, the 9-member list of global systemically important insurers, which also remained the same as in the previous year, was also published.

I.1.3 Resolution-related documents

Drawing on the basic document on resolution, “Key Attributes of Effective Resolution Regimes for Financial Institutions” (*Key Attributes*) published in 2011, the FSB **published a methodology** in October **for assessing the implementation of Key Attributes in the banking sector.** The methodology sets out the crucial requirements enabling the assessment of whether the individual jurisdictions comply with the resolution frameworks determined in *Key Attributes*. The objectives include the facilitation of uniform implementation across the jurisdictions and uniform assessment of the introduction.

¹¹ The highest-level international body for financial regulation

In mid-December, the FSB **published two consultative documents fostering resolution planning and resolvability**, expecting comments until 10 February. The first defines the basic principles **facilitating the establishment of G-SIBs' internal TLAC requirement** and regulating the cooperation of crisis management groups (CMGs). The issues discussed in the document include:

- the process of determining the material subgroups of G-SIBs (that do not constitute a resolution entity), the composition of the subgroups, the distribution of the internal TLAC requirement within the material subgroups, and the treatment of unregulated non-bank entities;
- the role of home and host authorities; the factors that need to be taken into account when determining the size of the internal TLAC requirement;¹²
- the practical considerations with respect to the issuance and composition of internal TLAC instruments;
- the characteristics of the internal TLAC's trigger mechanism with regard to write-downs and capital conversion;
- the cooperation and coordination between home and host authorities during the application of the internal TLAC's trigger mechanism with regard to write-downs and capital conversion.

The guideline on internal TLAC will be reviewed by the FSB in 2019 based on the practical experiences.

The second draft guideline issued in December seeks to facilitate **the continuous access to financial market infrastructures (FMIs) by companies under resolution**. The basic aim of resolution planning is to maintain the critical functions of the institutions under resolution. Continuous access to financial market infrastructures is vital for performing payment, clearing, settlement and custody tasks. The document discusses the necessary preparatory measures with respect to (i) providers of FMI services, (ii) institutions and (iii) the relevant authorities – the supervisory and resolution authorities – of the institutions and the providers of FMI services.

In connection with these two documents, Elke König, the chair of the FSB Resolution Steering Group and the European Single Resolution Board (SRB) claimed that the distribution of TLAC instruments within the G-SIBs is key for the proper functioning of cross-border resolution, and that the FSB provided valuable guidance to the authorities concerned about its application in the individual jurisdictions. Similarly, continuous access to market infrastructures is a crucial element in maintaining stability and market confidence during resolution. The implementation of the two guidelines will go a long way towards the feasibility and credibility of G-SIBs' resolution, and thus, ultimately, the solution of the "too-big-to-fail" issue.

1.2 Basel Committee on Banking Supervision (BCBS)

1.2.1 Regulatory treatment of accounting provisions

In early October, the BCBS issued a consultative document and a discussion paper – with a deadline for responses of 13 January 2017 – about the regulatory treatment of accounting provisions. The documents were written taking into consideration the new international and US accounting standards, which replace the model of actually realised losses with the expected credit loss (ECL) model, i.e. they use forward-looking assessment to estimate credit loss. The consultative document recommends the current method for an interim period, in the case of both the standard and the

¹² The internal TLAC requirement of the material subgroup may not be lower than 75–90% of the external TLAC requirement that would be applicable if the material subgroup was a resolution entity.

advanced model. The committee expects to learn whether a temporary rule is necessary, which would give banks time for adjusting to the new ECL model.

The discussion paper issued at the same time discusses the possible means of longer-term treatment. The suggested alternative solutions are the following:

- retaining the current regulatory practice of treating provisions,
- maintaining the distinction between general and special provisions in line with a uniform regulatory definition in all the jurisdictions,
- the introduction of a standard regulatory expected loss (EL) component,
- another solution based on the answers received during the consultation.

The appendix of the discussion paper presents the chief differences between the accounting expected credit loss models and the Basel EL model.

1.2.2 The final TLAC regulation

In early October, the BCBS also disclosed the final regulation on holding TLAC instruments with respect to capital requirements. The aim of the standard is to mitigate the contagion effect during the potential resolution of global systemically important banks (G-SIBs).

One year earlier, in November 2015, the FBS published *the principles on the total loss-absorbing capacity (TLAC) of G-SIBs in resolution as well as the corresponding term sheet*, prescribing a minimum TLAC requirement for G-SIBs. In parallel with this, the BCBS consulted with the stakeholders – G-SIBs and non-G-SIBs – about the prudential treatment of TLAC instruments in its portfolio.

The final standard reflects the changes after the consultation and includes the following elements:

- The TLAC instruments in the portfolio and the other instruments ranking *pari passu* with them – which were not included in the regulatory capital – have to be deducted from the Tier 2 capital.
- The deduction has to be performed in the case of the TLAC instruments exceeding a certain threshold value of the regulatory capital, and an additional 5% threshold should be applied to TLAC instruments with respect to non-regulatory capital.
- For the utilisation of the 5% additional threshold, G-SIB instruments have to meet further requirements, including the fact that they must be held in the trading book.

The new regulation enters into force together with G-SIBs' minimum TLAC requirement, on 1 January 2019.

1.2.3 Eleventh progress report on the introduction of the Basel III regulation

The eleventh progress report presents the introduction of the Basel III regulatory package in the jurisdictions of the BCBS members, based on the situation at the end of September 2016. The Regulatory Consistency Assessment Programme (RCAP) was introduced by the Committee in October 2011, and since then the Committee has monitored the introduction of the risk-based capital requirement. The Committee has monitored the introduction of the regulation on systemically important banks (SIBs) and the LCR regulation since 2013, and since 2015 it has assessed the implementation of all standards effective in 2019.

The eleventh progress report found that

- the rules on the risk-based capital requirement, LCR and capital-conservation buffer have been introduced in all (27) member jurisdictions;
- the regulation on the countercyclical capital buffer has been prepared in 26 jurisdictions;
- the (recommended or final) regulatory framework with regard to D-SIBs (domestic systemically important banks) has been set up in 25 jurisdictions;
- and the (recommended or final) margin requirements with respect to the derivatives not cleared with the central counterparty have been created in 18 jurisdictions.

With respect to G-SIBs, the regulation is final in all the jurisdictions concerned, while the leverage ratio and NSFR regulations are currently being drafted. Some jurisdictions have indicated that they experience difficulties with the introduction of certain standards by the deadline.

Meanwhile, a study assessing the impact of the Basel III regulation and published as a BIS working document has shown that even when the necessity of changing business models is taken into account, the regulation has substantial net macroeconomic advantages.

In early December, the BCBS also announced that with the assessment of Indonesia, Japan and Singapore, it has finished reviewing the implementation of the risk-based capital-regulation framework in all its members. The evaluation of the LCR regulation's introduction will be finished by December 2017.

1.2.4 The results of the BCBS meeting held in Santiago de Chile

In Santiago de Chile, the BCBS finalised its recommendations concerning the completion of the Basel III regulatory package. In his speech held at the 19th International Conference of Banking Supervisors, the outgoing chairman of the Committee, Stefan Ingves asserted that they had made very good progress in finalising the package, and summarised the results as follows:

- The standard method of credit risk has been reviewed. The new method is neutral from the perspective of the capital requirement, more risk-sensitive than the current one and better aligned with the IRB method based on the internal model.
- The option of using the internal models has been by and large preserved, but input floors have been put in place and the basic IRB method has been revised.
- An aggregate output floor based on the standard method is also expected to be used, and its final quantification will be accepted by the GHOS¹³.
- The revised standardised approach to operational risk replaces the four methods currently in use, including the AMA. With respect to its capital impact, this is also expected to be neutral overall, but at the level of individual banks, the differences between capital requirements may be quite significant.
- A stricter leverage ratio requirement will be introduced for G-SIBs, complementing the higher risk-based capital requirement.
- The package also contains a longer introductory, transitional period, which enables an orderly transition.

The chairman of the BCBS stressed that the package will reduce the excessive differences observed in the case of risk-weighted assets (RWAs), and will not increase the general capital requirement significantly. The chairman added that it was time to regard the package as final, and to concentrate on the introduction and supervision in the future.

In its letter to the European members of the BCBS, the representatives of the European Commission and European finance ministers, the EBF objected to the use of output floors with respect to internal models. Due to the mortgage loans remaining in their portfolio, banks' substantial share in financing and the Pillar 2 capital add-ons, output floors put European banks at a competitive disadvantage. As the TLAC and MREL requirements are also calculated based on risk-weighted assets, the output floor prescribed for risk-weight assets (RWAs) is actually imposed on IRB banks twice.

In the first days of January, the GHOS published a press release to announce the postponement of the adoption of the post-crisis regulation's missing elements. According to the announcement, the Basel Committee needs more time to finish certain tasks and for the final quantification.

¹³ Governors and Heads of Supervisions: the body of central bank governors and heads of supervisory authorities from the Basel Committee members.

II European regulation

II.1 General framework: The Commission's communication on the review of the regulation of financial services

On 23 November, the Commission published a communication about the results of the call for evidence on EU financial services. The Commission's 2015 call for evidence asked stakeholders whether the 40 pieces of legislation adopted in the wake of the financial crisis were in line with the targets. Based on the responses, the EU Commission evaluated the interaction and aggregate economic impact of the individual rules, and uncovered the unintended effects and inconsistencies linked to and the gaps in the regulatory framework. Having carefully reviewed and analysed the responses and having held a public hearing in May 2016, the Commission concluded that the general EU framework for financial services regulation does not need to be changed. Nonetheless, for the purposes of fine-tuning, targeted follow-up measures were proposed in the following four areas:

- Reducing unnecessary constraints on financing the economy. (This requirement was also taken into account with respect to the regulatory adjustment package published at the same time and discussed below.)
- Enhancing the proportionality of rules.
- Reducing undue regulatory burdens.
- Making rules more consistent and forward-looking.

The Commission prepared a separate report on the European Market Infrastructure Regulation (EMIR), which is about the improvement of the regulation of OTC derivatives, central counterparties and trade repositories.

II.2 Concluding the implementation of the regulatory package determined in the wake of the crisis; further boosting the resilience of banks in the EU

In parallel with the communication, the European Commission also published its proposal on the conclusion of the Basel reform package's implementation, which contains the amendments to the Capital Requirements Regulation and Directive (CRR/CRD4), the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR). The rules were developed based on the accepted global standards, taking into account the features of the European banking sector.

The proposals can be divided into the following subject areas:

1. Measures aimed at increasing the resilience of EU institutions and enhancing financial stability.
2. Measures aimed at improving the lending capacity of banks, which supports the EU economy (including the expansion of banks' capacity to lend to SMEs and fund infrastructure projects, as well as the application of the proportionality principle).
3. Measures aimed at facilitating the role of banks in achieving deeper and more liquid EU capital markets to support the creation of a Capital Market Union.

The key elements of the Commission's proposal were summarised by Valdis Dombrovskis, the vice-president of the Commission and the commissioner in charge of financial regulation, as follows:

- The introduction of a 3% leverage ratio in order to prevent the build-up of excessive leverages (not to be applied to development banks). This acts as a limit in determining the capital requirement with internal models;

- The introduction of the net stable funding ratio (in order to encourage banks to finance their long-term loans from long-term funds);
- The overhaul of the trading book regulation, and the reduction of STC¹⁴ securitisation and the capital requirement of covered bonds in the spirit of risk-sensitivity;
- The inclusion of the TLAC rules on G-SIBs in the MREL requirements (the TLAC requirements have to be met by 13 banking groups in the EU);
- Harmonising the regulation on the hierarchy between lenders (in order to increase the legal security of investors and resolution authorities);
- Strengthening and harmonising the right to impose a moratorium in order to facilitate early intervention by supervisory authorities;
- Strengthening the proportional application, reducing the reporting and disclosure burden in the case of smaller banks, simplifying the capital requirement calculation of trading positions, easing the remuneration rules;
- Maintaining the SME supporting factor and expanding it to all SME loans; and
- Reducing the capital requirement of infrastructure projects.

At the same time, the Commission also supports the creation of deeper and more liquid European capital markets.

II.3 Banking union

II.3.1 The Single Supervisory Mechanism (SSM), the European Central Bank

ECB guideline on handling national options and discretions (NODs) available in Union law

In November, the ECB published the consolidated version of the guideline on handling national options and discretions. The guideline presents the ECB procedure with respect to the uniform exercise of the options and discretions covered in the capital requirements regulation (CRR/CRD4) and concerning the prudential supervision of credit institutions. It aims to provide a coherent, efficient and transparent approach to the supervision of significant banks under the SSM, thereby assisting the activities of the Joint Supervisory Teams (JSTs). From a legal perspective, the guideline is not binding, and it should be applied taking into account the relevant provisions of the CRR/CRD4 and the SSM regulation.

As required, the ECB has reviewed the list of significant banks under its direct supervision. The list contained 129 banks in 2016, and it will contain 127 from 1 January 2017, due to the inclusion of Citibank Holdings Ireland Ltd. and various other changes.

ECB consultation on the exercise of NODs in the case of less significant institutions

As a further step in the standardisation of the supervisory practice, the ECB presented a draft guideline and recommendation for consultation on the exercise of options and discretions in the case of less significant institutions to establish the uniform practice of the competent national authorities. The exercise of seven NODs in the guideline will be legally binding after the adoption, while exercise of 43 NODs in the recommendation should be determined on a case-by-case basis. Furthermore, the recommendation advocates a common approach in the case of another eight special NODs for less significant institutions. The draft guideline and recommendation is supplemented by an explanatory memorandum and frequent questions and answers. The contents of the document have to be applied by the competent national authorities in a flexible manner, taking into account the proportionality principle. The consultation about this issue was closed on 5 January, and the public hearing was held on 17 November.

ECB consultation on the appropriate and reliable assessment of the management body

In November, the ECB published a draft guideline on the appropriate and reliable assessment of the management bodies of the credit institutions under its direct supervision. The CRD4 provided a relatively large room for manoeuvre with respect to the implementation of the relevant rules in the various Member States, therefore this was one of the areas where substantial changes were made in the rules of procedure after the supervisory powers were acquired by the ECB. The aim of the draft guideline is to give a detailed overview about the strategies, practices and processes that are used by the ECB when assessing the suitability of board members. (The guideline is not legally binding, and does not replace the relevant legislation in the EU or in the Member States in any way.)

The experiences from the 2016 SREP¹⁵

In December, the ECB published the results of the 2016 SREP. Among the banks directly supervised by the ECB, the Pillar 2 capital requirement did not change significantly as compared to the previous year, and its average and median were around 10% of the common share capital (CET1). As part of the SREP, the ECB also imposed additional liquidity requirements, typically in cases where banks rely excessively on wholesale short-term funding or inadequately manage risks associated with collateral management. In such cases, the ECB requires higher LCR indicators than the minimum requirement or the holding of specific liquid assets. Due to poor governance, the ECB set out qualitative requirements. At the same time, it made proposals about the 2017 dividend policy and the application of the variable remuneration elements.

ECB statistics, AnaCredit Manual

In early December, the European Central Bank disclosed the statistical data about the significant credit institutions under its supervision. In addition to general statistics, the publication contains information on the balance sheet and profits, capital adequacy and asset quality, as well as funding and data quality. The ECB also published significant banks' unique indicators with respect to capital adequacy, CET 1 capital adequacy and leverage ratio. Since November, the AnaCredit Manual has also been available on the ECB's website.

II.3.2 The Single Resolution Mechanism (SRM)

In November, the Single Resolution Board (SRB) held a public meeting with the participation of the banking sector and other stakeholders for the fourth time. The more than 120 participants at the consultation included the representatives of the EU (Commission, Parliament, ECB, EBA) as well as the banking federations and authorities of the countries in the banking union. The agenda of the meeting covered resolution planning, the recent developments related to the MREL regulation, the ex-ante contribution to the Single Resolution Fund in 2017 and the contribution to the administrative expenses of the SRB.

In connection with resolution planning, Elke König, the chair of the SRB, highlighted the publication of the *Resolution Planning Manual* among the achievements in 2016. The first round of resolution planning has almost been completed (by the end of November, 65 resolution plans and 30 temporary resolution plans had been prepared), and experience has shown that banks are increasingly able to formulate the questions necessary for the operationalisation of resolution strategies. The resolution plans prepared by the SRB are sent to the banks in January, which initiates the dialogue with the

¹⁵ Supervisory Review and Evaluation Process

Internal Resolution Teams (IRTs). (IRTs' operation is modelled on the Joint Supervisory Teams, and they act as the basic links between banks and the SRB.)

The SRB has prepared the data need that serves as a basis for determining the MREL (liability data template [LDT]), and started developing the MREL policies in cooperation with the stakeholders. Furthermore, the SRB conducts negotiations about the critical functions, the access to FMIs, the provision of liquidity during resolution and international cooperation. In addition to the assessment of resolvability, the goals also include the identification and elimination of the obstacles to resolvability. In 2017, the SRB plans to determine the legally binding, institution-specific MREL requirements.¹⁶

With respect to the ex-ante contribution to the Resolution Fund, the SRB seeks to increase predictability, transparency and understanding. Accordingly, the SRB cooperates with the national resolution authorities to harmonise the information on calculation outcomes, improve the understanding of the calculation methodology and make more active use of the SRB's website to present the statistics on calculations. The total contribution to the SRB's administrative expenses amounts to EUR 169.7 million, which, due to a lack of necessary regulation, is paid by merely 114 systemically important institutions in the 2014–2017 transitional period. In 2018, the contribution proportions will be recalculated and the differences will be adjusted, taking into account all the institutions in the banking union. As of next year, all institutions under the SRM will pay the contribution continuously.

II.3.3 The European Deposit Insurance Scheme (EDIS)

The Commission's effects analysis

In line with earlier requests and notices, the Commission conducted an evaluation of the expected impact of European deposit insurance implemented in various forms, and published its results in October. The Commission assessed three possible arrangements with respect to deposit insurance in the banking union: mandatory reinsurance, mandatory lending and a common (deposit insurance) fund. The assessment focused primarily on risk absorption, efficiency, cost neutrality and moral hazard. The results show that all three options entail significantly stronger deposit guarantees than a purely national system with voluntary lending. With respect to risk absorption, the common fund (the EDIS) produced the best results in all simulations. From the perspective of efficiency and cost neutrality, the common fund and the centrally coordinated reinsurance model fared equally well. Due to the loan repayment requirement, the best protection against moral hazard is offered by the mandatory lending model, but banks' risk-based payment obligation acts as an effective deterrent. The analysis also examined the schedule of the transition to the common fund, and found that a steady, gradual transition was the most favourable.

The preliminary report of the parliamentary rapporteur

In addition to underlining the compromise that was reached, the preliminary report of the parliamentary rapporteur highlighted the finding of the Commission's effects analysis that all three options under review entail a stronger deposit insurance scheme than the present national-based system. According to the rapporteur's proposal, the reinsurance phase would be implemented as early as 2019, however, the other two phases (co-insurance, fully common fund) would be introduced later, after the adoption of certain risk-reducing measures specified in the report. The rapporteur states that the substance of the system, as well as the schedule and conditionality of its

¹⁶ According to the ESMA, listed banks have to disclose the MREL target value determined by the resolution authority in accordance with the Market Abuse Regulation. The ESMA does not differentiate between an authority guidance and a requirement, if the guidance is specific enough to be deemed inside information. This opinion holds true for all Pillar 2 requirements.

introduction are closely interrelated. The more ambitious the goal is, the more conditions are necessary for its achievement, therefore the more time is needed for the full and credible functioning of the system. Therefore, according to the rapporteur, the reinsurance phase has to last longer than the period recommended by the Commission, thereby providing an opportunity for implementing the risk-reducing measures vital to the operation of the EDIS. The rapporteur recommends a binary approach: funding at both the national and the European level, while preserving the target level for the fund at 0.8% of the insured deposits. Banks' contributions would be distributed equally between the national and the European deposit insurance fund (DIF¹⁷). The national funds would have the opportunity to provide a portion of the contribution to the DIF by making irrevocable payment commitments (IPCs).

Presidential summary

Continuing the previously started work, the Slovak Presidency and the Ad Hoc Working Party (AHWP) established for this purpose strove to identify and address the problems manageable at the technical level.

With respect to the *scope of the EDIS*, opinions differ whether it should include all national credit institutions covered by deposit insurance or only the institutions in the banking union. The treatment of third-country branches and credit unions not subject to CRR/CRD4 is also under discussion. The *implementation of the various phases of the EDIS* proved to be a highly sensitive political issue. In addition to the Commission's proposal, the detailed technical assessment of other options is warranted. Most of the Member States agreed that the originally proposed schedule cannot be met. The deposit insurance of the banking union should be established by respecting the principles of subsidiarity, proportionality and cost-effectiveness. With regard to the *governance structure of the EDIS*, the role of the national authorities and the SRB as well as the potential conflicts of interest were examined, and the issues related to information exchange, data collection and data protection were discussed. There was widespread agreement with respect to the preservation of the seven-day payment deadline. Regarding the *financing of the fund's administrative expenses*, there was a preference for treating it separately from the SRF's.

Member States seek to supplement the Commission's *effects analysis* with further assessments. During the negotiations, the AHWP also considered the option of fulfilling the payment obligation through IPCs, but no consensus was reached in this issue either. Furthermore, discussions were held about the provision of liquidity, the alternative, preventive use of the EDIS's instruments and the calculation methodology of the contribution.

The Presidency recommended that

- the EDIS regulation contain a regular stress test requirement;
- the opportunity for funding the host country's deposit guarantee system be created;
- the provision on exclusion be amended with the option for gradual sanctions;
- the process of future accession and exit be regulated.

II.4 The Capital Market Union (CMU)

The Commission's proposal on the bankruptcy regulation (insolvency, restructuring, second chance) directive

In November, the European Commission published a draft directive on the uniform European regulation of restructuring at the appropriate time, the effective insolvency proceedings and the second chance offered to entrepreneurs. The regulation is intended to increase the security of cross-border investments, facilitates job creation and preservation, and it may also play a role in reducing the high proportion of non-performing loans. The draft directive presents a common framework for

¹⁷ Deposit Insurance Fund

early reconstruction, provides a second chance to honest entrepreneurs a second chance through a full discharge of their debts within a maximum three years, and boosts the efficiency of Member States' insolvency proceedings with targeted measures. The draft is based on the following principles:

- Businesses in dire financial straits, especially SMEs, will be able to recognise business problems in time, and they will have the opportunity to perform restructuring at an early stage.
- The flexible, preventive restructuring framework will simplify the protracted and costly court proceedings. If necessary, national courts will take part in the process to safeguard the interests of the stakeholders.
- Debtors will have a “breathing space” of up to four months from the launching of the procedures for making agreements and performing successful restructuring.
- Dissenting minority creditors and stakeholders will not be able to block the adoption of the recovery plan, but their legitimate interests will also be taken into consideration.
- New financing to businesses will enjoy special protection, thereby increasing the chances of successful reconstruction.
- During the proceedings, workers will enjoy full protection, in accordance with the prevailing EU legislation.
- The training of practitioners and courts, and the use of the solutions offered by technology will improve the efficiency of insolvency, restructuring and second chance proceedings.

The Commission's proposal for the regulation on money market funds

On 14 November 2016, the Presidency reached an agreement with the European Parliament about the draft regulation on money market funds (MMFs), which aims to make money market funds more resilient to financial shocks. The draft regulation is intended to ensure the smooth operation of the short-term funding market, while maintaining the central role of money market funds in the financing of the real economy. Money market funds are important instruments for investors, since they enable the diversification of excess cash holdings, while maintaining a high level of liquidity. (MMFs manage assets of around EUR 1 trillion.) The draft is in line with the efforts of the G20 and the Financial Stability Board to strengthen the supervision and regulation of lending outside the banking system.

The draft regulation published on 30 November 2016 in the wake of the agreement regulates the operation of MMFs, the composition of their portfolio and the establishment of their asset value. This ensures the stability of the MMFs' structures and that they invest in appropriately diversified assets with the best credit quality. In order to increase the liquidity of the funds, the draft regulation introduces uniform requirements, which enable MMFs to meet sudden redemption requests even under stressed market conditions. In addition, the text determines common rules to ensure that fund managers have ample knowledge about investors' behaviour, so that they are prepared for future redemption requests. Furthermore, the document stipulates that appropriate and transparent information should be provided to investors and the supervisory authority.

The draft requires the European Commission to prepare a report about the functioning of the regulation based on the experiences, and it also contains a review clause.

II.5 Structural reform

There is still no agreement among the various groups in the European Parliament regarding the necessity of the banking sector's structural reform. The initiative currently lies with the parliamentary rapporteur and shadow rapporteur, and the Commission does not particularly urge progress either.

II.6 European Banking Authority

II.6.1 Risk assessment

In early December, the EBA published its ninth report on the risks and vulnerabilities of the European banking system. The report is accompanied by the presentation of the results from the 2016 “transparency exercise”, which shows the basic data of 131 European banks in a comparable and accessible format. Overall, banks have further strengthened their capital position, but the high proportion of non-performing loans (NPLs) and sustained low profitability continue to pose problems. Operational risk heightens, and the volatility of funding markets continues to be high. According to data from June 2016, the CET 1¹⁸ capital adequacy ratio calculated by taking into consideration the transitional rules rose by 80 basis points, to 13.6%, in one year. The proportion of non-performing loans dropped from 6.5% at the end of 2014 to 5.4%, however, the differences between countries remained significant. In more than one-third of the EU’s jurisdictions, the share of NPLs is above 10 per cent. Any substantial improvement requires supervisory actions, structural reforms and the development of secondary markets. EU banks’ return on equity (ROE) of 5.7% reported in June 2016 shrank more than 100 basis points year-on-year, but it was higher than the 2014 and 2015 year-end figures. The fact that the profitability of capital is below the cost of capital is a cause for concern. IT-related risks keep increasing, while legal and conduct risks are also substantial.

II.6.2 The EBA’s 2017 work programme

The EBA’s 2017 work programme embedded into the longer-term strategic plan is based on the tasks listed in the regulation on creating the Authority and determined in other EU legislation. The programme specifies seven strategic areas for 2017:

- developing and maintaining the Single Rulebook for the EU;
- fostering the efficient and coordinated crisis management of credit institutions, investment firms and financial market infrastructures;
- promoting the convergence of supervisory methodologies and practices to a high standard so that the rules concerning functioning institutions and crisis situations and the supervision are implemented consistently across the EU;
- identifying and analysing the potential cross-border and cross-sector risks, vulnerabilities and trends stemming from the microprudential level;
- developing and maintaining a common supervisory reporting framework, as well as acting as a data hub for EU banks with respect to the collection, use and dissemination of data;
- protecting consumers, monitoring financial innovations, contributing to the simplification and facilitation of retail payments within the EU;
- making the EBA’s organisation competent, responsible and professional, as well as implementing efficient corporate governance and procedures.

The EBA’s priorities for 2017 are: (i) the liquidity and the leverage ratio, (ii) credit risk and modelling credit risk, (iii) recovery planning and early intervention (iv) facilitating convergence, and (v) improving the consumer protection framework and monitoring financial innovations.

In addition, the EBA expects a significant legislative reform from the Commission, which will affect the work planned for 2017 (CRR amendment, the tasks resulting from the trading book regulation review by the BCBS, the implementation of the TLAC regulation, the strengthening of the application of proportionality, changes in the securitisation framework).

¹⁸ Common Equity Tier 1

II.6.3 Other relevant EBA's documents in Q4

Guidelines

Final Guidelines on implicit support for securitisation transactions (EBA/GL/2016/08)

Final Guidelines on corrections to modified duration for debt instruments (EBA/GL/2016/09)

Final Guidelines on ICAAP and ILAAP information (EBA/GL/2016/10)

ESAs' guidance on anti-money laundering and counter-terrorist financing supervision (ESAs/GL/2016/72)

Final guidelines on revised Pillar 3 disclosures requirements (EBA/GL/2016/11)

Consultation papers

Consultation paper on Guidelines on ICT¹⁹ Risk Assessment under SREP (EBA/CP/2016/14)

Consultation paper on technical standards on MREL reporting by Resolution Authorities (EBA/CP/2016/15)

Consultation paper on guidelines on internal governance (EBA/CP/2016/16)

Consultation paper on assessing the suitability of banks and investment firms members of the management body and key function holders (EBA/CP/2016/17)

Consultation paper on Guidelines on authorisation and registration under PSD2 (EBA/CP/2016/18)

Consultation paper on standards specifying information requirements for the authorisation of credit institutions (EBA/CP/2016/19)

Consultation paper on revised standards on supervisory reporting (EBA/CP/2016/20)

Consultation paper on guidelines for the application of the IRB approach (EBA/CP/2016/21)

Consultation paper on Guidelines on the reporting of operational or security incidents under the PSD2 (EBA/CP/2016/23)

Consultation paper on Guidelines on supervision of significant branches (EBA/CP/2016/24)

Discussion papers

Discussion paper on new prudential regime for investment firms (EBA/DP/2016/02)

Discussion paper on the use of Big Data by financial institutions (JC/2016/86)

Opinions

EBA recommends that only investment firms identified as GSIIIs and OSIIIs be subject to the full CRR/CRD4 (EBA/OP/2016/16)

Review of large exposures regime (EBA/OP/2016/17)

Recommendations on the implementation of new counterparty and market risk frameworks (EBA/OP/2016/19)

Overview on the proportionate application of remuneration requirements across the EU (EBA/OP/2016/20)

Final recommendations for strengthening loss-absorbing capacity of banks in Europe (EBA/OP/2016/21)

Report on liquidity measures and the review of the phase-in of the liquidity coverage requirement (EBA/OP/2016/22)

Report on covered bonds (EBA/OP/2016/23)

Report on cyclicity of capital requirements (EBA/OP/2016/24)

Regulatory and implementing technical standards

Final standards on assessment methodology to validate market risk models (EBA/RTS/2016/07)

Final draft ITS amending ITS on Supervisory Reporting of FINREP due to IFRS9 (EBA/ITS/2016/07)

Final draft technical standards on cooperation and exchange of information for passporting under PSD2 (EBA/RTS/2016/08)

¹⁹ Information and Communication Technology

Reports and other documents

Update of the Additional Tier1 (AT1) instruments monitoring report

Report on the appropriate target level basis for resolution financing arrangements under BRRD

Report on impact assessment of IFRS9

Second impact assessment of IFRS9 on EU banks

Updated list of CET1 instruments

Revised list of ITS validation rules

Qualitative survey on internal models