

REPORT

on Activities of the Hungarian Banking Association
1th Quarter 2017

Budapest, June 2017

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I. Executive Summary

In the first quarter of 2017, there has been a slight acceleration in ***world economic*** growth compared to the previous quarters. Based on the IMF's April forecast, after the 3.1% growth of GDP in 2016, this expansion will accelerate to 3.5% in 2017. The growth prospects of developed and developing economies are both improving. Positive retail and business expectations are somewhat held back by the increase in raw material and energy prices, particularly for oil. The monetary policy pursued by the *central banks of global importance* is still diverging: at its meeting held in March, the Fed raised its base rate by 25 basis points again, while the European Central Bank and the Japanese Central Bank did not change their existing asset purchase schemes.

After the inauguration of the new president of the *United States*, the development of the new direction of economic policy started with less vehemence than had been expected; no significant steps had been taken by the end of March. Economic growth was rather subdued (only 0.7%) in the first quarter. The most important reason for this was the significant drop in the expansion of consumption. The 4.5% unemployment is close to full employment but, in certain economic sectors, the initial signs of labour market tensions derived from the inappropriate supply structure are starting to show in the US as well. The impact of the new administration's expected measures to boost the economy (infrastructural investments, tax reduction programme and deregulation) that will improve productivity may offset unfavourable developments.

The expansion of the economy of the *European Union* was favourable; it seems that the positive market mood has overwritten the worries about political risks (the official launch of the Brexit and the earlier advance of populist parties). From an economic point of view, the labour market in particular performed well, and the generally still high unemployment in the individual member states fell significantly to a record eight-year low. The accompanying increase in real wages made a favourable impact on growth and dispelled the expectations of deflation. A 2% inflation was registered in February.

Based on the seasonally adjusted data for the first quarter, ***Hungarian GDP*** rose by 4.2 per cent compared to the same period of the previous year, resulting in the EU's fifth largest growth rate. From the *production* side, the expansion of industry and market services contributed the most to growth, while on the *consumption side*, in addition to the positive impact of net exports, still strengthening domestic demand was the driving force. In terms of *balance indicators*, the position of the budget remains favourable. The cash deficit of HUF 198 billion as at the end of the first quarter corresponds to 17% of the combined estimate. The level of government debt (74.6%) also increased, compared to the end of the previous year's 74.1%. *Inflation* increased significantly by 2.7% compared to the previous periods and approached the MNB¹ inflation target. The central bank did not change the policy rate and it further narrowed access to the three-month deposit instrument. The EUR/HUF exchange rate continued to fluctuate in the band between 305 and 315.

In the first quarter of 2017, the *aggregate balance sheet total of credit institutions* rose by 1.8% (HUF 602 billion). (Due to the slight strengthening of the forint and the impact of IFRS implementation, the recognised growth in the balance sheet total may be lower than the actual value.) The portfolio of all important types of *liabilities* grew; total deposits increased by HUF 241 billion (+1%). As a favourable development, the gross deposit portfolio of non-financial corporations and households rose above the average level. On the *asset* side, the net loan portfolio expanded at a healthy 3.3% (HUF 556 billion). Besides the 2.8% growth in loans, it included a significant reversal of impairments (17%). The valuation differences recognized due to the institutions migrating to IFRS made a decreasing impact on the net portfolio. The gross loan portfolio of non-financial corporations rose by 2% during the quarter, that of gross household loans by 1.3%. The *net loan/deposit ratio* of

the credit institution sector, as opposed to the formerly experienced decrease, rose substantially, to 102.5%, and in addition to the growth of loans in excess of deposits, changes in accounting standards may also have played a role. The quarterly *profit* was HUF 190 billion but without the significant individual effects (reversal of impairment, dividend income of subsidiaries), the sector would have reached a profit of around HUF 95 billion, which would mean a 10.4% return on equity and a 1.1% return on assets on an annualized basis. At the same time, the good profit figures mask the falling margins from net interest rate revenues, dividend income and profits from other financial and investment activities, as well as the dynamic increase of general costs.

The strengthening of *lending to small and medium-sized companies* is shown in that banks fulfilled 150 per cent of their undertakings assumed at the beginning of 2016 within the framework of the MNB's Market-Based Lending Scheme.

With the implementation of the *Certified Consumer-Friendly Housing Loan product*, the MNB intends to incentivize market competition, which, based on its own judgement, currently is of low intensity. We have indicated several times during the discussion that credit institutions are in intensive competition, as 77 institutions with nearly 500 products are in the market. With the establishment of the title which can be applied for and is awarded by the MNB, the central bank aims at decreasing the interest rate of housing loans, the stimulation of loan replacement, the limitation of prepayment and final repayment fees and, generally, the maximization of fees as well as reducing the loan assessment time. The MNB helps customers to choose the right banking product by operating a comparison system that is accessible via its website. Based on the parameters of acceptance defined by the banks, it ranks the individual banks' offers according to the full price of the loan. The MNB held intensive consultations with the experts of the HBA on the concept of the Certified Consumer-Friendly Housing Loan product and, later, the details of the scheme, during which the conditions set for the product became less stringent and technically manageable. The comparison site operated by the MNB is expected to be launched at the beginning of September but the central bank encourages banks to apply in advance and to submit loans meeting the conditions of the Certified Consumer-Friendly Housing Loan product already from June.

Safe retail lending would be greatly facilitated by comprehensive banking access to central income and loan data. In order to **use the data of the Central Credit Information System (KHR) more effectively**, we initiated full-list retrievability and made a comprehensive proposal in order to better serve those requesting data from the KHR. Having expressed our opinion on the package of amendments in the "financial omnibus" act, our proposals made to the Ministry for National Economy were not submitted to the spring session of the Parliament.

According to the intention of the legislator, the *spring "financial omnibus" act* primarily concentrated on the amendments of the Capital Market Act and the Act on Investment Services necessitated by their *MIFID 2 implementation*. The modification of the act on mortgage credit institutions, which interpreted the notion of *performing, problem-free receivables* that can be purchased by mortgage credit institutions, also formed part of the package, besides incorporating the text of the EU's law. With the acceptance of the law modification package, the old banking initiative that the *compliance function* should be included in the Act on Credit Institutions became a reality.

The banks' everyday operations and customer relations are greatly influenced by the *new Money Laundering Act* that incorporates the fourth Anti-Money Laundering Directive. After the adoption of the act, several open issues awaiting a solution remained, and these will be settled in one of the implementation rules.

The new **Act on Advocacy** will enter into force on 1 January 2018, simultaneously with the new Code of Civil Procedure. A new feature of the legislation worth mentioning is that in-house legal advisors are integrated into the bar association, so only bar member legal advisors will be entitled to act as a legal representative in matters requiring mandatory legal representation and to countersign documents. In preparing the legislation, the Hungarian Banking Association has coordinated the representation of the legal advisors' profession. As a result of the discussions, the Ministry of Justice amended the bill in dozens of places to the benefit of legal advisors.

Based on the authorization granted in the EMIR, a regulatory technical standard (RTS) provides that, as of 1 March 2017, for derivative transactions not settled by a central counterparty, concluded OTC **a variation margin needs to be calculated and made available to the partner**. Compliance with the deadline caused a problem for the institution providing the investment service because of the relatively short preparation time allowed by the regulators; the HBA therefore contacted the MNB to request a 6-month grace period for the preparation, similar to the practice of the international regulatory authorities. In its response, sent at the end of May, the MNB said that it treats the issue flexibly, in the way recommended by the European authorities.

During the first quarter, several **acts affecting the recovery of banking receivables** were also amended /debated. Although the **modification** of the **Act on Enforcement** regarding the enforced sales of residential properties within the framework of a court enforcement procedure was created with the purpose of protecting consumers, it may represent a setback for debtors living in rural small settlements as well as for the banks themselves. The purpose of the **amendment of the Act on Bankruptcy Procedures and Liquidation Procedures** is to collect the debtor's assets more efficiently and to create harmony with the amendment of the Civil Code. As a result of the consultations, the deduction related to the sales of the pledged asset, which served to recover the costs of the liquidators, succeeded in being mitigated, as opposed to the 15% appearing in the original draft, only 7.5% must be allocated for this purpose. The amendment of the Bankruptcy Act, which makes it clear that, prior to the launching of the liquidation, the pledge established on future receivables covers the receivables due to the debtor which were generated after the launch of the liquidation procedure, shall be favourable from the perspective of the mortgagee. The **Private Bankruptcy Act on Debt Settlement of Private Individuals** is planned to be amended in such a way that the number of customers included in the procedure will increase.

In the **bankcard business line**, the **scheme** of the Ministry for National Economy **incentivizing the installation of POS terminals** will facilitate the further spread of **contactless technology**, in addition to increasing significantly (by 28%) the number of card payment enabling units. In the following period, the **application of the PSD2** and the preparation for the **instant payment system** give the banks major tasks. The application of the **EU's General Data Protection Regulation (GDPR)** from 25 May 2018 affects other banking areas but it also poses a serious challenge.

In the area of **global regulation**, the chair of the **Financial Stability Board** specified four areas as a priority for 2017: (i) the transformation of the shadow banking activity into reliable, safe market funding, the mitigation of the structural vulnerability of asset management; (ii) making the derivative markets safer, carrying on the reforms of the OTC derivative markets, acceptance of the guideline for the recovery and resolution of the central counterparties; (iii) support for the full and consistent implementation of post-crisis reforms, development of a structured framework for post-implementation evaluation of the effects of reforms; (iv) and managing the new and emerging vulnerabilities. The operative tasks of this year were phrased in the light of the above priorities.

Despite postponing the finalization of the reforms, the **Basel Committee on Banking Supervision** confirmed its commitment to Basel III. During the quarter, the Committee announced a consultation on the guidelines for the identification and management of step-in risks, gave a report on the

banking implementation of the principles of effective data aggregation and reporting, and disclosed additional details regarding the temporary management of accounting provisions by the regulatory authority and the measures on the interim period. It enhanced the disclosure requirements under the third pillar, reviewed the evaluation framework of global systematically important banks (G-SIBs) and, according to custom, it prepared the evaluation of the effects and implementation of the Basel III reforms.

The **general framework of European regulation** is defined by the jointly declared *legislative priorities* of the presidents of the European Council, the European Parliament and the European Commission and, at an operating level, the main emphases specified by the presidency of Malta. The White Paper of the Commission outlining the future of Europe, which was published in March, showcases five potential scenarios under the titles of “*more or less Europe*” and “*federalist or nation-based integration*”, in respect of which the European Council may draw its first conclusions by the end of the year. The Commission’s proposal for the *amendment of the comitology regulation* intends to improve the transparency of the procedures serving the implementation of the EU’s legal regulations, along with enhancing accountability. The open consultation initiated on the operation and future of the European Supervisory Authorities aims at strengthening and improving the usefulness and effectiveness of the EU’s supervisory authorities.

In the light of the pillars of the *banking union*, in the *Single Supervisory Mechanism (SSM)*, (i) business models and the profitability-moving factors, (ii) credit risk, particularly, non-performing loans and concentration, and (iii) risk management represent priorities for 2017. The European Central Bank pays special attention to the targeted review of internal models (TRIM). The 2017 stress test targets interest rate risk in the banking book (IRRBB). The supervisory authority finalized its guidelines on the management of non-performing loans (NPL) and, in line with IFRS adoption, it reviewed the supervisory reporting obligations. In the *Single Resolution Mechanism (SRM)*, the Single Resolution Board (SRB) has performed the role of the resolution authority empowered with comprehensive responsibility since January 2016. In the past year, the SRB developed the reports necessary for resolution planning in cooperation with the banks, started to define the minimum requirements for eligible liabilities (MREL) that can be taken into account per bank, and published the related document in February. There was no breakthrough regarding the *European Deposit Insurance Scheme (EDIS)*; the discussion of the technical details continued at the working group level.

The European Commission announced a consultation in January on the medium-term review of its *Capital Markets Union (CMU)* action plan and in February published its report titled “Accelerating the capital markets union: addressing national barriers to capital flows”. Within the framework of the Vienna Initiative, a special working group was formed focusing on the capital markets of the Central, Eastern and South Eastern European (CESEE) region, in order to examine the obstacles in the way of implementing the Capital Markets Union.

II. Macroeconomic outlook, operating environment of the banking sector

In 2017Q1 the **world economy** grew a little in a slightly further accelerated manner compared to the previous quarters. Based on the IMF's April forecast, after the 3.1% growth in GDP in 2016, growth accelerated to 3.5% in 2017, which can be observed in the improvement in the aggregated growth outlooks of both the developed and the emerging economies. A more significant improvement could also be observed in household and business expectations, the positive effect of which was somewhat held back by the increasing prices of raw materials and fuels, in particular oil. In developed countries, an expectation of a uniform level of inflation is increasingly spreading.

The still diverging **monetary policy of globally dominant central banks** continued to develop in a similar way to the previous quarter. After its December meeting, the March meeting of the FED increased its base rate by a further 25 basis points. The European Central Bank and the central bank of Japan have not changed their existing asset purchase programmes.

After the inauguration of the new President of the **United States**, the development of the new economic policy trend started less forcefully than had been expected and no significant steps had been taken by the end of March. As such, the active president's communications and the related expectations continued to affect the US economy to a greater extent. In the first half of the year, the country's economic development was rather subdued; growth was only 0.7% at an annualised level. The main underlying reason for it was a more significant drop in consumption, which is an interesting phenomenon considering that the disposable income of the economic actors did not decrease. The labour market is robust in essence; the 4.5% unemployment rate is close to full employment but, in certain sectors, the early signs of labour market tension arising from the inappropriate supply structure are starting to show in the US as well. Alongside a weak-medium real wage increase, productivity did not increase to a perceptible degree, which in the medium term can put the country under significant inflationary pressure if the conditions are unchanged. The productivity improving effect of the new administration's expected measures to boost the economy (infrastructural investments, tax reduction programme and deregulation) can compensate for the negative developments. Within the growth drives, the more significant growth in investments and exports was positive; it broke the trend of many quarters, subject to strengthening USD exchange rates.

The growth of the **European Union economy** was positive in the specific mix of the economic and political environment in the first quarter; it seems that, in this period, the positive market mood has nearly entirely overwritten the worries caused by political risks (official launch of Brexit, earlier advance of populist parties in Member State elections). From an economic point of view, in the EU, the labour market in particular performed well. Although in certain Member States unemployment is still high, in general however it decreased significantly, to an eight-year record low. The attached increase in real wages had a positive effect on growth via consumption, on the one hand, and the deflationary expectations of a year earlier became a thing of the past as a result, since inflation in February increased to the two percent level.

In the leading EU economy, **Germany**, the processes developed particularly well. In addition to household consumption and government, exports were the main driver, while subdued investments were typical there, too.

In Japan, the positive effects of government economic policy to weaken the yen became visible. Japanese exports performed particularly well in Q1, and the trend in consumer price developments turned around; a moderate price increase could be seen.

In China the slow structural transformation, kept in hand by the government and requiring growth sacrifices, appears to continue. By now, average Chinese salaries typically exceed those in Latin America and they are slowly reaching those of certain peripheral EU countries (Portugal, Greece), as a consequence of which its extensive growth based on low wages is not sustainable. In addition to this, the trend, according to which growth is primarily based on infrastructural and real estate investments, the rate of growth of which is not reflected in actual GDP growth, continued in Q1. This

raises efficiency issues and also makes the medium term sustainability of the ever-increasing debt, from which the investments are financed, questionable.

Based on the Q1 data, **Hungarian GDP** rose by 4.2 per cent year on year. Based on seasonally adjusted data, the growth in Hungary is the fifth highest in the EU. Looking from the production side, growing industry and market services contributed to this growth to the greatest extent. Out of the individual industries, in addition to the automotive capacity created in recent years, the strengthening of electronics (considered a driving sector for a long time) and optics contributed significantly to the good performance. The nominal contribution of the construction sector could be subdued but due to the low base, its year on year acceleration is relatively high (above 30% in March). The added value from agriculture shows a flat performance. On the consumption side, strengthening domestic demand continues to be the driver of growth. This was supported in structural terms by the labour market, with a supply surplus and the resulting significant increase in real wages (exceeding 10% in March), the supply withholding effect of which was significantly moderated by the long term wage agreements concluded by social partners. Despite the strong domestic demand, the contribution of net exports continued to be positive, to which the restrained dynamic on the import side also contributed.

In terms of **balance indicators**, the position of the budget continues to be favourable. The end Q1 cash flow deficit was 198 BHUF, which is 17% of the combined estimate. Although this shows some increase compared to the year earlier's 15% implementation, it does not compromise fiscal stability. By the end of the quarter, the level of government debt (74.6%) had also increased, compared to the end of the previous year's 74.1%.

In Q1, **inflation** increased significantly, by 2.7% compared to earlier periods, and approached the MNB inflation target. The growth is primarily caused by increasing fuel prices (+17%).

The **National Bank of Hungary** left its policy rate unchanged. In line with previous MNB announcements, holdings in the 3-month deposit instrument receded to approximately 750 BHUF, and the central bank announced a further decrease by the end of the second quarter to 500 BHUF.

The EUR/HUF exchange rate continued to fluctuate in a relatively narrow band, i.e. 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 Q1 2017² **the aggregated balance sheet total of credit institutions** increased by 1.8% (602 BHUF). During this period, the forint somewhat gained strength compared to key currencies, which had a mitigating effect on the balance sheet total. IFRS migration could have had a similar effect, since for certain assets the value of earlier portfolios could have decreased due to the decreasing interest rate environment. As such, it can be concluded that overall the actual growth in the balance sheet total was higher than the recognised level.

On the **passive side**, growth is visible for each key liability type. Total deposits increased by HUF 241 billion (+1%). Both interbank and other deposits increased (1.1 and 0.9%, respectively). Within the latter, it is a positive development that both non-financial corporations and the household gross deposit portfolio grew by more than the average level (by 2.7%, i.e. 176 BHUF, and 1.9%, i.e. 141 BHUF, respectively). For interbank assets, it is to be noted that, in addition to the above, the portfolio of loans taken out increased by 3.2% (152 BHUF).

Within the **asset portfolio**, apart from the decrease in the interbank accounts and extended deposit portfolios, all other major asset types increased. The changes in the **loan portfolio** show a positive development; the net loan portfolio increased at a healthy pace, by 3.3% during the quarter (+556

² 2017 is a transition year, in that Hungarian banks could have migrated to IFRS reporting, based on their own decision. This was chosen by five bank of more significant size and, due to this, the comparability of certain Q12017 data can be ensured only subject to certain limitations.

BHUF). This included the gross 2.8% (502 BHUF) growth in loans and the significant, 17% reversal of impairments (-196 BHUF); for retail loans this was above 21%. The valuation differences (-243 BHUF) recognised due to the institutions migrating to IFRS and the accrued and deferred interest (+102 BHUF) moved to this balance sheet item have a decreasing effect overall on the net portfolio. The gross loan portfolio of non-financial undertakings increased by 2% during the quarter (117 BHUF); this was somewhat more moderate for households (+1.3%, i.e. 74 BHUF). Also, the increase of gross portfolios extended to foreigners was significant (+7.6%, i.e. 210 BHUF). All in all the interbank account and deposit portfolio fell by 12% (i.e. 705 BHUF); the greatest role in this was played by the continuation by the MNB to crowd out banks' liquidity kept in central bank deposits (-36%, i.e. 644 BHUF). Parallel with this, the portfolio of debt instruments kept amongst assets increased (+10.2%, i.e. 875 BHUF), in which the effect of further investment dominates (+6.4%, i.e. 473 BHUF); in terms of growth pace, however, the purchase of securities issued by credit institutions is the most significant (+32.7%, i.e. 270 BHUF).

As the combined result of the above effects, the *net loan/deposit ratio* in the credit institution sector increased significantly, from the end 2016 91% to 102.5% by end Q1, in which changes in accounting standards could have a role, in addition to the growth of the loan portfolio exceeding that of the deposit portfolio.

Profit was similar to the quarter a year earlier, and reached 190 BHUF, which means a 20.6% annualised return on equity and a 2.2% annualised return on assets. However, in the above profit there were significant one-off items (for example impairment reversal), and items occurring only in this quarter (dividend revenue from subsidiaries), in the absence of which the sector's profit would have been roughly 95 BHUF, which means a 10.4% annualised return on equity and a 1.1% annualised return on assets. However, the good profit figures cover up the further decrease in the profit from net interest revenue and dividend revenue, as well as in other financial and investment activities (8.3, 9.7, and 25.1% compared to 2016Q1). Compared to the same period of the previous year, fee and commission income grew markedly (by 13.2%), and to a small degree compared to the previous quarter. Compared to a year ago, overheads dynamically increased (by +9.2%). Wages remained level, but other expenditure increased significantly (+21.4%), presumably due to the improving business activity, which is supported by the fact that the increase compared to the last quarter of 2016 is not significant either.

III. Corporate lending

According to the March lending report by the National Bank of Hungary, in Q42016 corporate lending grew by more than 4% by annual comparison, which corresponds to a 240 BHUF transaction-based portfolio increase. The underlying reason for the growing loan portfolio was the increase in the volume of forint loans and, in addition to the FGS's forint loans, market-based forint lending also grew significantly. Increase in lending to small and medium-sized companies went on; by annual comparison the growth rate was 8%.

(The loan portfolio of self entrepreneurs classified into the household sector grew dynamically during the quarter, in which borrowings in the context of the sale of state-owned land played a significant role. The annual growth rate of the loan portfolio of the SME sector including self entrepreneurs was some 12% in 2016.)

Based on the banks' responses to the lending survey, the terms and conditions of corporate loans did not change in essence; at the same time, increasing competition, the liquidity supply and the continuing improvement of the economic outlook led to the widespread decrease in the spreads between loan interest rates and funding costs. The banks participating in the survey foresee a further loosening of the conditions for the next half year, which is expected to materialise via the further loosening of terms of a price condition. Changes in their liquidity situation and market share targets can primarily contribute to this. In Q4, the banks perceived an invigorated demand for loans, which

can be followed by a further increase in demand in subsequent quarters. The average funding costs for new contracts for corporate forint loans decreased further during the quarter.

Results of the Funding for Growth Scheme (FGS)

Between 1 January 2016 and 31 March 2017, credit institutions participating in Stage 3 of the scheme reported data on 685 billion HUF worth of contracts in relation to 21,766 transactions and 13,934 enterprises. The actual currently outstanding loan portfolio, excluding repaid and not drawn down loan (parts) is 442 BHUF.

Of the some 684.9 BHUF by value contracts made in Stage 3 until 31 March 2017, 78% are new investments loans, and 22% are new lease transactions. (Stage 3 is limited to these types of financing; working capital finance and replacement loans are not available.) Of the 474.3 BHUF worth of contracts made in (forint) Pillar I, available for forint lending, investment loans amount to 365.9 BHUF, and lease transactions to 108.4 BHUF. Of the 210.6 BHUF (~EUR 676.3 million) worth of contracts made in (FX) Pillar II, available for foreign exchange lending, investment loans amount to 168.2 HUF (EUR 540.2 million), and lease transactions to 42.4 BHUF (EUR 136.1 million). In both Pillars, the average maturity, weighted by contract amount, is 8 years; in Pillar I it is 9 years for new investment loans and 4.8 for lease transactions, whereas in the FX Pillar, the average is 8.9 years and 4.2 years respectively for the two forms of financing.

Since June 2013, in the three stages of FGS and in FGS+, altogether 39,253 businesses received funding of 2,811 BHUF overall.

Results of the first year of the Market Lending Scheme

In January 2016 the National Bank of Hungary launched the Lending for Growth Supporting Programme (GSP), which supports the banks' return to market lending, by phasing out the Funding for Growth Scheme and the announcement of the new Market-Based Lending Scheme (MLS). Under the MLS, the MNB established an incentive system for long-term market-based lending by means of interest rate swaps (LIRS) with commercial banks. As condition for using a LIRS transaction, the banks made commitments implicitly to increase SME lending proportionate to the allocated transaction volume, in the total value of 195 BHUF. Verification of this lending commitment takes place annually, on the basis of a lending criterion indicator defined by the MNB. Under the Market- Based Lending Scheme, the banks performed 150% of their commitments made in early 2016, of which 15 institutions materially overperformed. (This condition was not fully performed by two institutions; the sanction set out in the product information was imposed on them.) According to the MNB's report, next year the Market-Based Lending Scheme might be one of the holding pillars of SME lending in the banking sector, even after the end of the Funding for Growth Scheme.

Consultations on the government project affecting the local governments account link

The Ministry of Interior Affairs requested Banking Association's assistance in establishing the relation between the banks keeping local governments' payments accounts and the project manager company responsible for developing local governments' data management systems (ASP). To enable the ASP systems operating at local government bodies to establish appropriate account links with banks, the ASP project manager needed exact information on

- the type of the IT account link maintained by banks with their local government clientele,
- the nature and timing of the envisaged changes to these links.

For this purpose, the Ministry of Interior Affairs requested each bank to appoint a responsible contact person to provide the actual information and for testing requests as necessary.

In line with the Ministry's request, the Banking Association collected the contact persons' particulars and handed them over to the project management company. In the consultation organised in this issue, the experts of the affected member banks and the project management company could directly discuss the manner and procedure for information transmission.

IV. Retail lending

According to the MNB's March lending report, in 2016 the decrease in household lending stopped, and so a clear improvement can be seen in the annual dynamics, compared to previous years. In Q4 the household loan transactions from credit institutions accounted for 36 BHUF. The increase of loans taken out by freelance entrepreneurs had a significant positive effect on transactions, but the balance of retail borrowing and repayments also shows an improving trend. New contract volume was, in addition to freelance entrepreneurs' FGS borrowings, 260 BHUF in the period considered, which meant a 50% growth on an annual average. Within this entire volume, new home loan extensions grew by 42 per cent in the past year, while personal loans showed a 61 per cent increase. Based on the banks' responses to the lending survey, no substantial change took place in home purpose loan conditions, while consumer loan conditions eased in Q4. Based on banks' feedback, in the next half year lending conditions can substantially ease in both product ranges. In addition to this, the banks widely perceived increasing demand in Q4, while they project a further intensive increase. The Family Housing Allowance continues to affect it positively: during this quarter 17% of the new housing loan volumes could be linked to CSOK. The average full loan cost of new housing loans decreased, while the average spread remained unchanged in the period considered, which can be traced back to the effect of funding riskier customers.

Consultations on the MNB's Certified consumer friendly housing loan product

The MNB has expressed its opinion in several forums that, by regional comparison, the interest rates on housing loans are high, the level of loan replacement is low and the loan assessment period is long. It evaluated this as the sign of the low intensity of competition in the market; therefore it launched the ***Certified consumer friendly housing loan product*** as a step to invigorate competition. The representatives of the Banking Association have stated several times during the discussions that competition in the loan market is intense, which is shown by 77 institutions offering nearly 500 products to consumers. They also stressed that the adverse change in the legal environment, especially the tightening of the rules on auctions in enforcement procedures, increases the risk costs of the banks and may affect the interest level as well.

The ***Certified consumer friendly housing loan product*** is a title awarded by the MNB, that can be applied for by banks dealing with housing loans, and nominate their products that

- have lower maximum interest rates,
- have lower early and final repayment fees,
- have a shorter loan assessment period than applicable in the market generally, and
- in addition to the interest rate, fees are also maximized.

The loan applicant customer sends the basic data of the loan requested to the MNB website (amount, term, real estate's value, income data, etc.), and the system operated by the central bank ***ranks*** the offers of individual bank according to their full ***price*** (APR), based on the parameters specified by the banks. After this, the customer decides to which bank he/she submits the application, and the banks would be bound by their offer based on the data submitted to the MNB within a certain period of time and interest rate fluctuation.

The MNB first informed the top managers of banks engaged in housing lending of the concept of the Certified consumer friendly housing loan product, then consulted on the details of this arrangement in several rounds, orally and in writing, with the negotiating team of the Banking Association, consisting of the bank's experts. During these negotiations the conditions set for the product became less stringent and technically manageable.

The MNB promised to encourage the competent authorities, with a view to ensure more substantiated and quicker loan assessment, to make it possible to query the entire earlier loan portfolio from KHR, and with the involvement of the tax authority, the actual income data of the customer are available for the loan assessment.

The launch of the MNB-operated comparison website is expected from early September; however, the central bank encourages banks to apply in advance, and to submit loans products with conditions meeting the certified consumer friendly housing loan product's conditions.

Development of amendment proposal to the KHR Act

During this quarter two initiatives were made with a view to exploit the KHR data more efficiently:

- we wrote a letter to the authorities affected by these regulations in the issue of ***the full list of queries***, and
- relying on prior experience, ***we made a comprehensive proposal to better serve those requesting data from the KHR.***

The current regulations allow access to the full credit history of the customer subject to the customer's approval only; however, to set a realistic loan volume, it is necessary to know the earlier repayment burdens. This is reinforced by the MNB Decree providing for the use of the payment-to-income ratio (PTI). In the event of a customer prohibition on querying KHR, the bank is unable to meet its statutory obligation, therefore we proposed to delete this right of consent. Unfortunately, this proposal was supported only by the MNB; the other two requested authorities (Ministry for National Economy, Ministry of Justice) failed to respond to our suggestion.

On the basis of preliminary consultation with the Ministry for National Economy, we proposed a comprehensive amendment of the KHR. The proposals compiled by the KHR manager BISZ were discussed by the KHR Working Group of the Banking Association, and it forwarded, amongst others, the following proposals to the Ministry:

- It should be possible to make queries from the KHR for ***monitoring purposes*** during the duration of the loan, in order to provide the lender with a realistic picture of the repayment probability of the loan, and to enable it to make the justified steps that can save the loan; we call the attention that monitoring was left out during the transposition of the EU Mortgage Credit Directive.),
- We proposed ***amendments to the conditions of entry into the negative list***, to shorten the 90 days delay for prudential reasons,
- The amendment supposed to facilitate ***KHR-related communication*** between the customer and its bank via ***electronic channels***,
- More intensive use the KHR database was also raised (e.g. calculating customer specific indicators from KHR data, linking them with external data), but only in a long-term due to data protection principles.

These proposals sent to the Ministry for National Economy were not tabled to the Parliament in the spring session.

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

The „financial omnibus” amendment package

○ *MiFID 2 implementation*

After a one year extension, MiFID 2 provides for the inclusion of the new provisions in Member State laws by July 2017, and their entry into force is due from the beginning of 2018.

In early March, the Ministry for National Economy started the implementation tasks with preliminary consultations, involving organisations engaged in market representation (Banking Association, BAMOSZ, BSZSZ). Also in view of the relatively short time available, the Ministry for National Economy decided to deal, at this stage, ***only with the transposition of the primary level EU law, without change.*** It will come back to the transposition of the EU Commission Directive, issued on the basis of the authorisation granted in the MiFID 2 Directive, in a Government Decree during the summer, excluding the additions of concepts in the delegated Directive. Thus, during the March consultations, in addition to raising numerous issues in the context of the application of MiFID 2 rules, it was possible to find a solution only to a few issues by the appropriate text inserted in the Acts on Capital Markets (Capital Markets Act) and on Investment services (Investment Services Act). ***Texts aiming at clarification are typically inserted in the Statement of Reasons of the amending law.***

After the consultations with professional organisations, it remained unresolved that the concept of ***order*** under MiFID 2 and the Civil Code are different, since the former includes where the investment service provider sells a financial instrument owned or bought on its own account, upon the instruction of its client, while the latter identifies it as brokerage activity.

During these consultations, it was raised that, in the ***current Investment Services Act, the regulation of undertakings is occasionally stricter than in MiFID 2.*** For example, restrictions on activities other than investment services, conflict of interest rules on executive employees and sales representatives, or standards on professional requirements. This seems to be positive from the customer protection point of view, but, considering the freedom of services within the EU, the level playing field for Hungarian market actors is not guaranteed vis-a-vis actors supervised in other Member States. In this context, a further supervisory issue was identified, i.e. that the question of EU equivalence of third country regulations is decided by the European Commission; as such, the Hungarian authorities will not have statutory powers in controlling their entry to the Hungarian market.

During the administrative consultation of the draft laws in early April, a repeated opportunity was given to make proposals to be dealt with at statutory level. In connection with several earlier ideas, we requested the amendment of the draft; however, in the version submitted to the Parliament, only the proposals that facilitated the precise insertion of the MiFID2 text were integrated.

At the end of April the Government submitted the draft law containing amendments to the Investment Services Act and the Capital Markets Act, i.e. draft law NoT/15347 on the *harmonisation purpose amendments to laws on the operation of financial markets and the trade in financial instruments*. The adopted law is due for promulgation.

○ **Definition of performing**

Certain credit institutions intend to comply with the expectations on the mortgage financing adequacy ratio by way of refinancing. During the refinancing process, under *Act XXX of 1997 on the Mortgage lending credit institution and mortgage bonds (Jht)*, the mortgage-credit institution can exclusively purchase claims that are classified as performing according to the seller financial institution's or insurance undertaking's auditor. The concept of performing was defined earlier by

Government Decree 250/2000 (XII. 24.); however, the related Sections were repealed by the legislator as of 1 January 2017. Simultaneously, the MNB Decree on the prudential requirements on non-performing exposures and re-structures claims, under which the five earlier categories (performing, specific attention, below average, dubious, bad) were replaced by two categories only, performing and non-performing exposures, where restructured claims must be separated within both categories. In order to ensure consistency between the classification of individual claims, we sent several letters to the relevant Ministry and the Supervisor. Under the proposal *on the harmonisation purpose amendments to laws on the operation of financial markets and the trade in financial instruments* the *Jht.* was finally amended to allow the mortgage lending credit institution to purchase claims that are not classified as non-performing or restructured claims according to the seller financial institution's auditor.

- *Integration of the compliance function in the Hpt.*

The Compliance Working Group initiated for the first time in autumn 2015 to insert into *Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises, following the example of Act CXXXVIII of 2007 on investment companies and commodity exchange service providers, and their activities (Hpt.)*, an obligation to establish an organisational unit or to appoint a person in charge of compliance.

In the justification annexed to our proposal on the draft law, we highlighted that, for credit institutions, Compliance plays an important role in the continuous maintenance and qualification of the bank's internal controls, risk management and governance tasks, not only with regard to investment services, but also for financial services. This support activity is in the fundamental interest of the authority performing supervision. The regulatory environment shows significant differences in various countries, but in most EU countries the need to establish a **compliance organisation operating as independent body** or the appointment of a **compliance officer/manager** appears at least as a minimum recommendation.

In Hungary, even in the absence of a legislative requirement, the MNB expects all financial organisations to employ compliance officer(s) and/or to establish a stand-alone compliance organisational unit; however in order to make this standard enforceable, it is necessary to have a binding rule inserted into the Credit Institution Act, similarly to the Hpt.

The text proposed by the Working Group was inserted into the Hpt. without a material change, at the same time with the springtime amendments to financial laws.

The new AML law and the related proposals from the Banking Association

The Draft law transposing the 4th AML Directive was sent in January by the Ministry for National Economy to the Banking Association for consultation. The key issues were discussed by a meeting of the Working Group on the Prevention of Money Laundering within the consultation period. In view of the volume of material containing our comments, we highlighted our main proposals, and we discussed these main points at a more restricted separate meeting before the consultation deadline with the representatives of the Ministry for National Economy.

Our final remarks summarised the key issues on which we reached an agreement, already including the outcome of these consultations:

- In listing the identification data, the act sets out a **fixed dataset**; the option for differentiation for the sector will be provided by a subsequent MNB Decree, as expected.
- The **family and given name at birth** continues to remain identification data. The **address** is inserted back to the data set; place of residence needs to be recorded only in the absence of an address. The **"mother's maiden name"** is also taken back to the data set; the validity period of the ID does not need to be recorded as new data but still needs to be verified.
- The **copying of official documents** is not an option but an obligation in the law.

- The MNB Decree will set out requirements for **online identification**.
- In the context of the nature of interest of **beneficial owners**, the MNB expects a proposal from the Banking Association for the feasible structure of data recording, taking into account the need for transmission to a central European database.
- In the future, the **verification of the entire clientele as a minimum every five years** will be an obligation, with the restriction that it will be amended for two years for customers with a high risk classification.

After the publication of the draft law, the Working Group took stock of the remaining open issues that would be reasonable to be dealt with in one of the implementing laws still under preparation, and to arrange meetings to this end with the representatives from the MNB and the Ministry for National Economy. This meeting with the MNB representatives will be held before the summer holidays, focusing on the following main issues:

- Although the new AML Act allows for online identification, online account opening can however be prevented by the requirement set out in current legislation (for example in the Hpt.) that, to be valid, contracts need to be in writing and signed by the customer. Mail delivery or even electronic signature can be a solution; however, a generally applicable and cheap solution would need to be found.
- We consider it important to clarify the expectations by the MNB on repeated customer due diligence and updating the risk assessments, and also whether the copies of documents need to be acquired retrospectively.
- With regard to the content of the beneficiary owner database, the Working Group is preparing a concept, upon the request of the MNB, for the uniform definition of the “extent and nature”.

EMIR – entry into force of the changing variation margin rules

Based on the authorisation granted in the EMIR³, regulatory technical standard (RTS) on the uniform rules for risk mitigation techniques for OTC derivative transactions not settled via a central counterparty was completed in October 2016 and approved in December 2016. This RTS provides that, as of 1 March 2017, for derivative transactions not settled by a central counterparty, concluded OTC with financial partners and above a certain threshold with non-financial partners, **a variation margin needs to be calculated and made available to the partner**.

The European Union regulation, which became effective at the same time as similar legal acts implemented globally, serves the implementation of the reforms set out by the G20 on OTC markets based on the lessons learned from the financial crisis. The entry into force of the global regulations left a **rather short preparation time** for market players, in view of the great number of transactions concluded with many partners, extensively used in the risk mitigation practice of large banks, and the complex documentation needs of contracts to be concluded with partners. To deal with the issues arising from the unfeasibly short transition period, the competent international and state supervisory authorities (for example IOSCO⁴, the American CFTC⁵ and the European ESAs⁶) reacted quickly; they issued interpretations and so-called “non-action” letters in several places, on the basis of which a **6 month grace period** is granted for financial service providers for preparation, subject to certifying the existence of certain conditions.

Referring to international developments, the Banking Association addressed a letter to the Supervisory Deputy Governor of the MNB, requesting the issue of a letter with a similar content to facilitate the undisturbed operation of the banking sector during a six months transition period. The

³ European Market Infrastructure Regulation

⁴ International Organization of Securities Commissions

⁵ Commodity Futures Trading Commission

⁶ European Supervisory Authorities

MNB sent its reply only at the end of May. In this it indicated, with reference to the above mentioned ESA document, that deadlines are due as set out in the legislation; however, it will treat the issue flexibly as suggested by the European authorities.

Practical issues with private bankruptcy, reform of private bankruptcy

The Ministry of Justice initiated consultation on the possible solutions for the amendment of Act CV of 2015 on Debt Settlement Procedure for Private Individuals, with the involvement of the Banking Association and MAKISZ. According to the Ministry of Justice, the entire procedure must be simplified in such a manner that the debtor can see in advance the degree of payment relief and the debt forgiveness. During the meetings, the Banking Association emphasized the need for a solution suitable for a wider range of non-performing customers, aligned with the tools developed by banks in recent years (real estate repossession, joint sale). In addition to partial debt forgiveness, we suggested including incentives, for example repayment subsidy, discounted enforcement expenses, tax free debt forgiveness and tax credits in the context of debt forgiveness. Consultations are ongoing and aim to develop a solution, a package product, that would significantly increase the number of customers. The reform of the legislation is expected during the autumn session.

Amendments to the Bankruptcy Act

In the autumn of 2016, the Ministry of Justice started consultations on the amendment of *Act XLIX of 1991 on Bankruptcy and Liquidation Procedures*. We received the significantly recast draft again in March 2017. The amendment aims to **collect the debtor's assets more efficiently**, and **to align it with the amendments to the Civil Code** (provisions on lien and fiduciary security). (To resolve the situation of the commission agent of the pledgee, the option registered into the Register of Loan Collateral for collateral purposes, and the beneficiary of the rights assignment for collateral purposes.) The latter are intended to be dealt with in such a manner that the collateral option and the claim assigned for collateral services can only be enforced after the initiation of the procedure only under the bankruptcy or liquidation procedure. They intended to increase the level of deduction in the context of the sale of the pledge; they intend to include the revenue from the sale of the pledge to the reimbursement of the liquidators' cost and the satisfaction of general claims. We succeeded in decreasing the envisaged level of this deduction at an oral consultation held upon our request, and our proposals on several procedural issues were accepted. The April Presidency meeting of the Banking Association reviewed the issue of this law amendment and accepted the relevant information. According to draft law No *T/15066* as submitted to the National Assembly, from the revenue received from the sale of the pledge, the expenses related to repair the pledge's state that endangers the safety of persons and property, the costs of the litigation, taxes, administrative service fees and collection costs, 1% of the net purchase price for the archiving of the debtor's records, and 7.5% as an advance for the liquidator's fee must be deducted and transferred to the Financial Office of the Metropolitan Court.

In its *decision on principles No. 4/2016*, the *Curia* decided that, in the event of a pledge established for **movables and claims to be acquired in the future**, a mortgage on property will be established when the subject of the pledge is created. If the pledger already holds the pledge subject upon the establishment of the pledge, the pledge is created upon its establishment. The dispute over practice arose in the context of whether, in the event of a pledge established on rent to be received in the future, the pledgee's claim covers the rent received after the initiation of the liquidation or it becomes part of the liquidation assets. *The amendment inserting a new paragraph (2a) into Section 49/D of the Bankruptcy Act* makes it clear that a pledge established on future claims before the initiation of the liquidation procedure covers the debtor's claims arising after the initiation of the

liquidation procedure or received by the debtor after that date. This amendment is of great significance with regard to the application of a pledge on claims as collateral. On 16 May this draft was adopted by the National Assembly.

Act on Advocacy - regulation of the status of legal counsels

Following our detailed written proposal sent out in the second half of 2016, a personal consultation took place in January between the senior officials of the Ministry of Justice and legal counsels of the Banking Association and other industry stakeholders on the regulation of the status of legal counsel. After this, in the detailed proposal sent to the Ministry of Justice, we advocated against the integration of legal counsels in a bar; however we made some proposals for improvement that make the framework of bar integration somewhat more acceptable to legal counsels and their employers. In this regard we considered as a conceptual issue **the countersigning of documents by legal counsels, the regulation of secrecy and disciplinary liability, the bar membership fee and those outside the scope of the regulation**. Focusing on the bar integration, we received a very definite rejection from the Minister of Justice. In his letter, he relied on the earlier decision on bar integration made by the Strategic Cabinet and the Government.

At the end of March 2017 we received the draft text of the law for consultation, with a very short timeline. The lengthy draft, consisting of 213 sections, considers the activities of the bar member legal counsels and trainee legal counsels as a type of lawyer's activities. With regard to **name use, the secrecy obligation and the document archiving** it is based on the characteristics of the lawyers' activities; however, **the lawyers' mandatory third party liability insurance** does not apply to a bar member legal counsel. It can be concluded that, in general, the draft fails to take into account a decisive circumstance, i.e. that **a bar member legal counsel performs his/her tasks under an employment relationship**. Remarks, including very detailed text proposals integrating the opinion of the cooperating legal advisors, were prepared linked to the draft, and the majority of these were integrated into the bill. The act will enter into force on 1 January 2018, in parallel with the new Code of Civil Procedure. The regulations on bar member legal advisors will be developed in cooperation with the representatives of the bar associations over the rest of the year.

Amendments to the Act on Enforcement

At the beginning of March 2017, MPs from KDNP submitted an individual amending motion for the amendment of *Act LIII of 1994 on Court Enforcement (draft law No. T/14298)*. This draft law was tabled to the Parliament without preliminary consultation with the professional organisations.

Under the amendment, for the forced sale of residential properties under court enforcement, **in the event of the collection of a claim based on a consumer contract, valid bids can only be made with an amount reaching the starting price (estimated value)**. If there is no such bid, the auction is considered failed.

This amendment is justified by helping non-paying debtors, with the intention of reaching higher sales prices for properties. *Act XIV of 2017*, as adopted by the National Assembly, is even stricter than the motion: if more than one year has passed since the continuous auctioning for residential properties without success, the new auction can be called at 90% of the starting price, as opposed to the proposed 80%.

The amendment ignores that forced sales of properties are greatly influenced by real estate market conditions. In the capital and in certain quickly developing countryside settlements, real estates can be sold for a lot more than the estimated value, thanks to the price increases occurring in the meanwhile. However, in small countryside settlements, this amendment makes the sale of residential properties even more difficult, not only making the recovery of bank claims harder but also any other court enforcement procedures initiated on the basis of claims of private individuals

(child support, compensation, etc.). This amendment took effect as of 21 March; however it must be applied in already pending cases where no auction has been held yet. If the auction announcement is already published but no valid offer has been received, the bailiff shall increase the minimum amount that can be offered in the announcements and shall continue with the procedures accordingly.

Draft amendment to the Gambling Act

The law prohibiting payment service providers from participating in the payment of bets to operators of prohibited games and the payment of wins, was adopted at the end of 2016, as part of the action against prohibited gambling (typically online gambling).

In the issue of the implementing regulation to this law, there were several written and oral consultations since end 2016 between the Ministry for National Economy and the Banking Association. These negotiations in essence analysed **card payments and credit transfers**. In connection with card payments, it turned out that international practice knows some rare implementation opportunities, but in the current infrastructural and legal environment the effective ban cannot be applied to this form of payment.

At the same time, there is an efficient banking practice for credit transfers affecting banned accounts (black list) for blocking/filtering, but there were numerous issues to be clarified during the consultations:

- it poses a **hierarchy of legal acts issues** that the Payment Services Act provides, for credit transfers incoming to the payment service provider, immediate crediting to the beneficiary's account, to which the blocking/rejection to be regulated by the Ministry for National Economy in a decree would contradict,
- since participation in non-licensed gambling became a criminal law category, **the question of liability of the payment service provider** is raised up to the point of gaining official knowledge of the fact that the account/card holder was engaged in prohibited activities,
- which authority is competent (the banking supervisor or the gambling supervisor) to control payment service providers,
- if the black list is published on the website of the gambling supervisor, how can it be easily accessed by the banks electronically and integrated in their systems.

This consultation is still ongoing; however, the hierarchy of legal acts issue seems to be resolved by regulating the implementation details also in an act, by amending the Gambling Act. The blocking of bank cards, the feasibility of which is questioned, is still an open issue.

VI. Developments relating to the National Bank of Hungary

MNB initiative to influence the regulations on covered bonds (mortgage bonds)

The MNB raised the issue that, from time to time, a peer consultation should take place on an international supervisory/regulatory issue currently on the agenda of the European Banking Authority (EBA). It aims to enable the MNB to form an opinion on an issue by taking the deeper knowledge of potential effects on domestic market players into account. In March, for the first time, the consultation covered the topic of the **regulatory integration of European mortgage bonds**, raised under the auspices of the Capital Market Union. Originally the European Commission proposed standardizing the mortgage bond market as one of the pillars of the Capital Market Union. The EBA prepared several analyses on this issue. In addition to it, the European Parliament proposed a multi-stage integration and harmonization, in its own initiative report.

As expected, it will turn out by June whether the Commission proposal will be adopted or not, and if yes, in what form (as a Directive or as a Regulation), and with what content and timing. However, it is already certain that further consultations will take place this year on this issue, and that the potential effect of this initiative is significant for Hungarian banks. The expert discussion of the so far crystallized dilemmas and issues was on the agenda of this consultation, thus for example the possible EU timing and the alignment of the domestic legislation with the EBA report.

Draft recommendation on out-of-court company restructuring

As an important step in the joint MNB - EBRD project, it sent its *draft recommendation* at the end of January 2017. This was essentially based on the draft prepared under the EBRD technical cooperation in October 2016, and contained important earlier comments by the Banking Association; however, it represents a step back in terms of the intention to extend its scope from the earlier **2 BHUF to 1 BHUF**.

In addition to sending text proposals, in our end February reply sent to the MNB we requested increasing the threshold to the originally envisaged level. We highlighted that the recommendation continues to contain expectations, on the basis of which creditors might incur legal obligations towards the debtor, which are counterproductive and can discourage banks from the application of the procedure regulated in the recommendation. We explained that this recommendation occasionally sets formal requirements, primarily in documentation matters, the-integration of which in legislation would be possible if consumer protection reasons apply, while in view of the clientele and set of transactions subject to the recommendation (joint financing, threshold) it is not justified; it is therefore suggested to rely on the banks' internal rules. We signalled that certain technical details, for example the entry of a de facto deferral in the KHR and in the bank information requested by a debtor, need further reflection in the phase-in period.

In addition to our comments on the recommendation, we requested support from the MNB in legislative amendments that would enable, for companies in difficulties the replacement of loans secured by GHG, AVHGA surety or MFB, EXIM guarantee with a **new reorganisation loan** guaranteed by the above companies. This would not increase the obligations of the relevant institutions, while it could make the crisis management of the companies more effective.

After the receipt of our proposals, the MNB is currently working on the text of the recommendation.

Information on the meeting of the Disability Council – Recommendation No 4/2017 (III.13.) of the MNB on treatment of disabled customers

The Action Plan until 2018 of the national Disability Programme for the 2015-2025 period, as adopted by the Government, encourages, amongst others, equal opportunities of access to financial services. In order to monitor this programme, in 2016 **a Committee for monitoring legislation on improving access of the disabled to financial services in credit institutions** was established with the Ministry for National Economy in the lead, with the membership of the Ministry for Human Resources (EMMI), the National Disability Council (OFT) and the Hungarian Banking Association.

At its first meeting, the Committee discussed the **MNB report on back-testing compliance with the 2012 supervisory recommendation** and the comments on the renewed **supervisory recommendation**, as well as **the implementation of Decree 22/2016.(VI. 29.) of the Ministry for National Economy**.

According to the main findings of the **back-testing** performed by the Századvég Alapítvány, the relevant actors in civil society consider the financial sector's efforts to serve the disabled as essentially positive. In the opinion of the Banking Association, this survey was useful since it draws attention to trends related to services provided to the disabled and has started joint reflection.

In the context of the comments to the renewed **supervisory recommendation** sent out for consultation, the MNB mentioned that it sought to take them into account and, as far as possible, to integrate them. In its opinion, banks cannot be obliged to ensure they serve the disabled in all customer contact points, because it is possible that banks opt to close down rather than to invest in branches. The one-stop shop is also not possible to be implemented in general since, for example, cash handling requires a specific qualification. Requests for special products need to be addressed directly to banks, since they cannot be met via the supervisor's influence.

The MNB reported on the outcome of the implementation back-testing of Decree 22/2016 (VI. 29.) of the Ministry for National Economy. Out of the 103 institutions approached in a letter, 90 responded, and the remaining 13 savings cooperatives are integrated. Out of the respondents two institutions (in the absence of customers, and because it is a branch office) failed to prepare the strategy and policy provided for in the Decree. Out of the submitted strategies and policies, the MNB assessed seventy as appropriate and there were deficiencies in eighteen cases. Typical deficiencies: improper procedures for the assessment and internal training, non-compliance with the website-related standards. Finally, the MNB declared that it handles this matter by giving leadership rather than by force, which has so far proved to be effective.

The MNB Recommendation No 4/2017 (III.13.) on the treatment of disabled customers, entering into force from 23 July 2017, was designed by taking into account the best practices of the domestic money, capital, insurance and fund market service providers, amongst them the Banking Association's members, as well as suggestions from the association and persons representing disabled customers. During the professional consultation on the recommendation, the Banking Association signalled the sector's need, in addition to specific content proposals, for practical directives to be set as minimum requirements. The Banking Association highlighted that banks continuously work on increasing customer service standards and they are receptive to adopting directives in cooperation with regulators and representatives of the disabled.

In view of the above, the recommendation sets out the supervisory expectations that go beyond the legislation, the following of which by the supervised financial organisations and employees will contribute to the independent banking of disabled customers and their responsible financial decision-making. Furthermore, the recommendation raises awareness amongst financial organisations and their employees of the situation of the disabled and the treatment they need for their equal opportunities, as well as social responsibility. In line with the special needs of disabled customers resulting from their condition, the recommendation sets out consumer protection principles to be followed by the financial organisation when providing financial services to the disabled, proportionate expectations that also facilitate the uniform application and efficient enforcement of the relevant legislation.

Reporting

The MNB treats the **improvement** of credit institutions **reporting quality as a priority** and announced **zero tolerance** for several reports from 1 April 2017. The competent Executive Director of the MNB advised the Presidency of the Banking Association in February on the planned action, and in March, during the consultation on data cleansing, the attention of the banks' personnel in charge of reporting was drawn to it.

By confirming the banks' views, we signalled to the MNB during the consultation, and then in writing, that we consider the 1 April deadline too soon, in particular considering the usual workload in Q1, the preparation for the mandatory IFRS migration, as well as the changes containing significant transformations and more granular data requests. While agreeing with the objective to improve data quality, we requested further time for preparation. Unfortunately, the MNB did not extend this deadline; at the same time it indicated that, when imposing sanctions, it will assess the individual circumstance of credit institutions.

VII. Payment Services

Bank card market news

On the basis of MNB's 2016 data, the uptake of **contactless technology continued** at a fast rate, and so, during the previous year, nearly 63 per cent of cards and more than three quarters of POS terminals became capable of contactless payment. In addition to infrastructure, NFC technology became dominant in payment card traffic, as a result of which more than half of shopping transactions were performed in this way in 2016. This continued to be implemented in a **highly secure environment**, since in 2016Q3 the growth rate of card abuse decreased despite the increasing turnover; what is more, damage caused by issuer side abuses did not increase at all.

In December last year the Ministry for National Economy launched a subsidy programme to **encourage the establishment of POS terminals**. Via the programme, by the end of 2017 altogether 30,200 such devices will be set up at participating merchants, so the number of card accepting devices can grow by 28 per cent, to 138,000, just by taking the effect of the subsidy into account. At the same time, so far it is rather difficult to estimate the effect of new terminals on the growth of card traffic. The proportion of POS terminals allowing contactless payment is also growing, since all new devices have this function. Under this aid scheme, the Ministry grants 80 thousand forint to merchants for the purchase and setting up of each new state-of-the-art POS terminal. The 30,200 unit volume is divided amongst six successful tenderers in the tender announced for merchants. Three participants in the scheme are members of the Banking Association.

In February the **Hungarian Competition Authority announced a sector level inquiry on bank card acquisition fees**. The Banking Association is not affected directly by the inquiry, and under a management decision it will not enter the inquiry even as coordinator or supporter, due to the lack of relevant data.

The Working Group is preparing, by active communication with MasterCard, for the launch of the ABU⁷ card company service, as provided for mandatorily for the first half of 2017. This service provides **data query possibilities for expired/ lost / stolen cards for service providers** to enable the customer to perform regular payments under existing contracts (for example subscriptions to newspapers and services) without interruption. During these consultations, the preparation of data processing and customer consent procedures, compliant with legal and consumer protection criteria, is taking place.

According to a January report from the National Police Headquarters, the **Department of the National Investigation Office specialised in bank card fraud** initiated a procedure against four Bulgarian men on the grounds of bank card fraud, i.e. acquisition of data at ATMs. In January 2017, the suspects installed data acquisition devices at a centrally located ATM of a bank in the capital. The interception took place before the acquired data were misused. The Presidency of the Banking Association showed his appreciation for this successful policing work, displaying international success for years, by way of a Golden Beehive.

Under the preparation by the OF2CEN **international cyber crime prevention and monitoring programme**, active consultations are taking place with the Italian project managers and the two

⁷Automatic Billing Updater

other participating countries. During this, the country studies facilitating project implementation, which mapped the legal environment and any eventual obstacles, were completed. In Hungary, alongside the National Investigation Office and the Banking Association, the National Police Headquarters and the National Office of Data Protection and Freedom of Information also joined the programme.

MNB Board Decision on the instant payment system

After the MNB Financial Stability Board dealt with the issues related to the design and establishment of the instant payment system in December 2016, the Board also put the issue on the agenda. The Board decided that GIRO Zrt, owned by the central bank, will establish **the central infrastructure of the instant payment system**. According to the plans, the **new payment core system** will be completed via this development by mid 2019, by joining which Hungarian payment service providers will be able to provide instant payment services to their customers. This new basic infrastructure will support the introduction of innovative services and the market entry of service providers. As a result of this development, GIRO Zrt can provide **more advanced services than today to domestic payment service providers who will have to join later on**, subject to meeting the requirement that **transactions fees cannot increase appreciably**. By using this system, it will be possible to implement transfer orders and the other innovative solutions based on it within a maximum of 5 seconds, every day of the year, 24/7. A **database for managing secondary account identifiers** will be established, through which payments can be initiated by using an e-mail address, mobile number or tax ID, without knowing the beneficiary's payment account number. This system ensures instant and final settlement of payments to customers, via which the amounts sent can be used immediately. The payment service providers must continuously ensure that the technical account of GIRO Zrt. kept by the MNB has sufficient funds at all times.

Preparation for the implementation of the EU Payment Services Directive (PSD2)

The Special Expert Group in charge of the implementation of the PSD2 Directive completed its work during this quarter. In its closing working paper:

- it described the outcome of the professional debates, essentially with a view to enable the banks' experts to use them for consultations on draft laws in the course of the implementation of PSD2,
- it communicated the proposals and questions formed to the domestic legislator in charge of the transposition of the Directive, asking for them to be taken into account when preparing the legislation.

The working paper was sent to all affected Working Groups (payments, bank card, SEPA, IT security) of the Banking Association for their opinions. The working paper, recast on the basis of the comments received, was sent, after approved by the Presidency, to the domestic authorities in charge of payment regulation, i.e. to the Ministry for National Economy and the MNB. The working paper, among others issues:

- raised the attention of the authorities to the disproportionate burdens on banks arising from **the nearly identical implementation date of the instant payment system and the PSD2 Directive**,
- highlighted the **irregular status of third party service providers** entitled to issue bank cards to bank accounts, as defined in PSD2, and their unclear relationship with the account keeper,
- explains that the **introduction of strong customer authentication (SCA)** is a serious change for customers, to which attention must be drawn in an effective campaign,
- deplores that the Directive allocates **unfair liability to banks during complaint handling** toward their customers and third party service providers.

In the working paper, concrete law text proposals are also included, on the basis of interbank consensus.

Information on the SWIFT UMG meeting

The Banking Association has performed the leadership and operational management of the SWIFT User and Member Group (UMG) since the autumn of 2016. This change not only entailed that a “neutral” player ensures the coordination of tasks implied in the operation of the UMG, but also that the professional relationships with the other Working Groups of the Banking Association can be exploited (in particular in the fields of international payments, security of IT, communication and information, money laundering and terrorist financing, and the prevention of and fight against payment fraud, as well as compliance with the regulations affecting those areas). The role of the Banking Association brought innovation also by enabling the Board to receive information directly from the regional SWIFT manager on the global activities within SWIFT and the key issues affecting domestic members.

On this year’s first regular UMG meeting and on the subsequent Banking Association Board meeting, *Ms Judit Baracs*, the Director of SWIFT responsible for Austria and the Central-Eastern European Region, and within this for Hungary, provided information on developments regarding three topics. She said that the **Global Payments Innovation** (GPI) significantly improves the transparency of the process and costs of international transfers, and helps the planning of FX liquidity; moreover, execution times will improve via the service level agreements.

In connection with the **Customer Security Programme** (CSP) she said that, in the past, the case of the Bangladesh Central Bank, drew the attention to focusing on security issues and to the systemic level, to the development of appropriate responses to be given to standing intensive cyber threats, which is embodied by the programme. SWIFT organised a roadshow to present the elements of the programme and the design and testing of practices and security solutions expected from members, the Hungarian presentation of which was held on 9 May 2017 to our members. The IT security and compliance managers of institutions were also invited to this event.

Finally she presented the **“Know Your Correspondent bank”** database related to the SWIFT compliance services. To/from this database correspondent banks can provide data freely/and request data against a fee. She mentioned that the Hungarian “large banks” already participate in the database, and she drew it to the attention of small and medium sized banks that the use of this service can also be important for them.

VIII. Taxation issues

In very early 2017, we consulted on the content of the tax declaration form related to the 2016 personal income tax authority reporting, directly with the NTCA⁸ experts. Clarification of these issues became important because the tax authority undertook to compile, as of 2017, the **personal income tax return of private individuals**, on the basis of the data received from employers and payers. Reporting by credit institutions is an important part in the calculation of the annual personal income tax of private individuals, since the tax authority acquires information from this on the annual turnover data in controlled capital market transactions managed by credit institutions, the long term saving products (TBSZ), the pension savings accounts (NYESZ-R) and the other movements of securities. This year brought significant changes and system developments for credit institutions, due to the more detailed content of the reporting and the submission deadlines becoming significantly shorter due to the central preparation of tax returns. The issues emerging during the performance of

⁸ National Tax and Customs Administration

these new types of reporting obligations were successfully resolved in time, thanks to the direct and quick assistance provided by the NTCA professionals.

With regard to the exemption of **bank card payments from VAT**, the confirmation of the 2013 Ministry position became necessary. This was justified by the fact that, since that position, the regulatory environment of payment services has changed: according to an EU Regulation issued in 2015, technical processing related to card payments can be performed by new service providers established in accordance with that regulation. We therefore requested and received confirmation from the Ministry that the change (under which choice of technical processors became possible), made with a view to opening the market for actors engaged in technical processing, does not influence the complex nature of bank cards and, under *Section 86 (d)* of the VAT Act, it continues to qualify as tax exempt financial service, if the bank card company also provides payment, transfer and technical back-office support services.

Under the Tax Working Group, we requested the position of the Ministry for National Economy for the interpretation of the rules related to the application of the discount applicable for **lending to small and medium-sized companies** under the Financial Transaction Act as applicable from 2017. The majority of the questions related to the accounting of the determination of the customer claim portfolio increase. It is unclear whether, in the calculation of the increase serving as a basis of the tax discount, the gross or net (net of impairment) claim portfolio needs to be compared, and how to treat the changes between the two periods: the differences between national accounting rules (HAS) and the IFRS methodology, the effect of the FX rate changes, the consolidation (merger) of credit institutions during the year, and the portfolio changes incurring as a result of the sales and purchase of claims.

IX. Developments concerning the Banking Association

Pénz7 - summary on the 2016/2017 school year

Nearly 160,000 pupils from nearly 1,100 schools participated in the Pénz7 (Money week) thematic week organised in March 2017, which meant more than 11,000 classes were held. More than 400 financial and entrepreneurial volunteers joined the programme. Compared to last year's results, the knowledge under Pénz7 reached 60% more pupils. It is visible that the joint work with the Ministry for National Economy, as a new professional cooperating partner, and the inclusion of entrepreneurship into financial knowledge increased the effectiveness of the programme. Nearly half of the schools and 60% of teachers joined the programme for the first time. The range of professional partners involved in the programme also increased; EMMI took over project management tasks, and integrated the Pénz7 programme into the national yearly school agenda. In addition to the Banking Association, Pénziránytű Alapítvány/MNB, the Ministry for National Economy and the JAM also worked on the successful implementation.

Member institutions of the Hungarian Banking Association contribute to the Money Week series with hundreds of financial expert volunteers, and with a number of fun features of the Pénz7 programme series. The Pénz7 programme is mentored on behalf of the Presidency by Board Member Éva Hegedüs. The contribution of the exceptionally active institutions is recognised with the "Ambassador of financial culture" title. In this school year, the awarded institutions are Erste Bank, K&H Bank / Vigyázz, Kész, the Pénz! programme and OTP Bank/ Fáy Alapítvány.

The outcome of the teacher and volunteer research closing the programme bears witness to the harmonious cooperation between the participants and the need for it to continue.

MRP programme, professional event

At the end of March, we organised a professional event for HR and tax experts at our member institutions on the new MRP remuneration programme applicable to credit institutions since 2016. At this meeting the senior executive of the MKB MRP scheme also participated as a speaker, in addition to the experts from the KCG Partners Law Firm and PwC Hungary that developed the compliance for legal and taxation requirements. The speakers presented the internationally measured advantages in addition to the legal and taxation aspects, and they also highlighted the main criteria experienced and to be resolved during the implementation. The audience present from member banks joined in the presentations with interest and the professional morning spent together was assessed as useful by both participants and speakers.

Future of the Money and Capital Market Standing Court of Arbitration

The Budapest Stock Exchange, the Budapest Commodity Exchange and the Hungarian Banking Association established, with effect from 30 June 2002, the Money and Capital Market Standing Court of Arbitration (hereinafter the "PTÁV"), under *Section 376 of Act CXX of 2001 on Capital markets*.

After a multi-round consultation, the draft law No *T/15361 on Arbitration* was tabled to the National Assembly on 26 April 2017, under which, as of 1 January 2018, the cases within the competence of the Money and Capital Market Standing Court of Arbitration will be adjudicated by the Commercial Court of Arbitration. Under this draft, several Courts of Arbitration will cease, including the PTÁV, effective as of 31 December 2017, and its funds will be reverted to its founders. In order to enable the Commercial Court of Arbitration to take over the cases from the courts of arbitration that are to close, the files of the PTÁV cases will be handed over to the Commercial Court of Arbitration on the day when it ceases operations.

Under this draft, the Hungarian Banking Association and the founder of the PTÁV (successor) Budapest Stock Exchange can delegate one member each to the Presidency of the Commercial Court of Arbitration, and the founders will participate in the design of the money and financial market section of the Court of Arbitration recommendation list.

Communication statistics and current issues

2017Q1 was a bit more relaxed and subdued but still an active period from the communication point of view, with average interest from the media. According to our statistics, during this quarter we were covered in online media on some 450 occasions, followed by 170 items of print coverage, then coverage in electronic media, in approximately 100 cases. During this quarter, the Hungarian Banking Association was featured and mentioned in Hungarian media on a total of 720 occasions, explaining the professional positions of the sector to the press and the general public.

The handling of delayed mortgage debtors is a regular banking communication issue at the start of the year. In addition to this, the basic account, bank switching, card and ATM security, security of mobile payments and private bankruptcy were the topic in several appearances by the competent people in the Banking Association. The conditions of the housing subsidies for families (CSOK) also attracted continuous and extensive media coverage. Looking ahead, we addressed the directions of development for the banking sector, and the apparent and likely effects of digital transformation.

In its communication, the Banking Association paid particular attention to the Money Week (Pénz7) programme series, which attracted increasing interest and even more participants. In addition to the opening event, which received media attention, we reported on the programme by means of two press releases and plenty of other coverage.

Working committees and working groups not mentioned above

- *Data Protection Working Group – Preparation for the application of the DGPR*

The **preparation for the application of the new EU 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**⁹) was the focus of the Data Protection Working Group's activity. The Working Group's meetings thematically discuss the individual chapters of the Regulation, and partly in this context we discuss the recommendation and guidelines developed by the so-called Article 29 Working Group of the EU. The GDPR is directly applicable in all Member States; no transposition by Member States is required. It has general effect and only specified cases are exempted from its scope (for example national security). In order to provide a uniform level of protection, each national data protection authority has the same rights and powers. The Regulation will be mandatorily applicable from 25 May 2018. In line with the accountability principle, data controllers are expected to develop processes within their organisation to guarantee compliance with the Regulation and they must be able to demonstrate it.

The GDPR brought **innovations in terms of the rights of the data subject**; for example the right to delete their data (right to be forgotten) for each data processing purpose, the right to data portability, or the right to object to automated data processing profiling. **Data protection standards must be applied by data controllers in each field of their activity, and processes, procedures and all data processing must be reviewed in terms of its compliance with the new standards.** The greatest challenge is the enforcement of the principle of integrated and default data protection: data controllers must implement technical and organisational measures by taking into account the scientific and technical progress and implementation costs and risks that provide guarantees in the entire process of data processing for compliance with the requirements set out in the Regulation. High risk data controlling (for example, a high number of data subjects, high volume of personal data) must be preceded by an impact assessment, and also the data protection authority must be consulted in advance. These new tasks are compensated partly by the **wider definition of the legal basis for data processing** and the release of the limits for data processing based on legitimate interest compared to the Info Act. All in all, data protection experts consider the preparation for the GDPR as a similar scale of task as the Basel II implementation. Under the GDPR, data controller and data processor companies controlling a large volume of data due to their activity must employ a **data protection officer**, directly reporting to the top management.

The GDPR sets up a **uniform system of sanctions**: an administrative fine of up to 10 MEUR, or for companies up to 2% of the entire previous year's global turnover of the business can be imposed as a rule. (The higher of the above mentioned amount must be imposed.) In serious cases, the fine can be 20 MEUR or 4% of the turnover.

Under the GDPR, a data protection due diligence of the entire activity of businesses must be performed, the related IT developments completed and forms must be adapted and internal training held. We informed the Presidency on the preparation for the GDPR and we requested its support in raising awareness of bank managers and employees that **preparation for the GDPR is not only the personal task of the data protection officer, but it affects the entire staff of the banks under the leadership and coordination of the data protection officer**, and the completion of this work requires support from the top management.

In addition to this, the Working Group dealt with the possible development directions of KHR and the data protection issues related to the AML Act.

⁹ General Data Protection Regulation

- *Working Group on Agriculture*

The Working Group on Agriculture held several meetings during Q1. At the first meeting of this year, the representative of the Prime Minister's Office held an informational presentation on the key objectives of the **2014–2020 Rural Development Programme**, on the expected launch of tenders, financial allocation, and the paying agency tasks of the Hungarian State Treasury.

At the second meeting in this year, the representatives of the Hungarian State Treasury provided information on the schedule for the reorganisation of the **Agriculture and Rural Development Agency**, and on the details of the post-transformation operation (Hungarian State Treasury, Prime Minister's Office, Ministry of Agriculture, County Government Offices), as well as the consequences of this reorganisation.

At the third consultation in this year, we reviewed and discussed, jointly with the representatives from the Ministry of Agriculture and the Research Institute of Agricultural Economics, the **results** and lessons from **2016**, and listed the **trends expected for 2017**.

In order to facilitate the **establishment of the mortgage related to the tenders of the Rural Development Programme**, we initiated with the Prime Minister's Office the issue of a publication similar to the document aiming to facilitate the establishment of mortgage in the context of the Economic Development and Innovation Operational Programme calls, taking its content elements into account. This proposal is under assessment.

The meetings of the Working Group were followed by detailed consultations and thorough discussion of professional proposals.

- *EXIM Sub-working Group*

At the Q1 meeting of the EXIM Sub-working Group, the EXIM representatives reported on the 2016 results of this cooperation, and the EXIM **strategy on the new 2017–2021 period**, focusing on facilitating access to export markets for domestic companies. In the business policy of EXIM, the optimisation of national economy benefits accessible by using the facilities offered by Eximbank and further strengthening of the set of quality criteria have been emphasised. The product range of Eximbank has been amended to ensure that a structured and transparent product range is available to serve small and medium-sized companies, a priority in national economy terms and to be supported in international market competition. On the basis of the comments made at this meeting, Eximbank developed the **updated product documentation of the competitiveness improving working capital loan**.

- *Working Group on Mortgage Banks*

The Working Group on Mortgage Banks prepared the input to the annual statistical publication of the European Covered Bond Council (ECBC Factbook), dealing with the legislative background for mortgage bonds, mortgage banks, the legal framework of collateral instruments, the definition of the loan collateral value, publication requirements and the supervisory system.

The Working Group participated in the preparation for EU legislation initiated by the National Bank of Hungary to take Hungarian characteristics into account, as well as in the development of the regulations resulting from the change in the claim qualifications.

- *KELER User Committee*

Under *Regulation (EU) No 909/2014 of the European Parliament and of the Council of 23 July 2014 on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012*, KELER must set up a user committee for the securities settlement systems it operates.

The User Committee issues opinions in the following areas:

- recovery plan (during the identification of critical functions);
- entry conditions for the KELER securities settlement system;
- service levels for the KELER securities settlement system;
- pricing structure of KELER.

Since its formation in December 2016, the User Committee has held one meeting. The Committee has seven members, of which the Hungarian Banking Association has one member as a representative of customers with a monetary account.

○ *SME Working Group*

In Q1 the SME Working Group held four meetings. At the first meeting this year the representative of the Ministry for National Economy **presented the SME strategy of the 2014–2020 Economic Development and Innovation Operational Programme** as well as the lessons learned from the tender evaluation of GINOP.

In its second meeting, the representatives of BISZ Zrt. reported on the present and future opportunities of BISZ Zrt and its currently available services, as well as on its PD calculator. The KAVOSZ representative presented the Széchenyi Card Programme and the Agro Széchenyi Card, as well as the KAVOSZ customer qualification system facilitating risk management. Currently this latter is used by two credit institutions, and as a result of this consultation they are negotiating with a further two credit institutions.

At this third meeting, consultations took place with the MNB representatives on the **model certificate for the verification of the existence of natural foreign exchange collateral to secure EUR borrowings** under Pillar II of the third stage of the FGS.

At the fourth meeting, the representatives of the European Investment Bank and the European Investment Fund presented in general their 2016 activities as well as the available product range of the EBB Group. In 2017Q1 the European Investment Fund and UniCredit SpA InnovFin signed an SME guarantee facility agreement in order to improve access to funding for innovative SMEs and small mid-cap companies, including those in Hungary.

○ *Working Group on Leasing*

In Q1 the Working Group on Leasing had several meetings. The representatives of BISZ Zrt. reported on the present and future opportunities of BISZ Zrt. and its currently available services, as well as on its PD calculator. Furthermore the KAVOSZ representative presented the customer qualification system used by KAVOSZ for risk management purposes.

The **Office of Government Issued Documents Sub-Working Group** on Leasing developed a template private document in connection with the recording of vehicle data in the vehicle register, the registration of the transfer of title and the registration of the lessor customer's operator right, published by the Central Office for Administrative and Electronic Public Services (KEKKH), and available from this year for each government one-stop shop. The Working Group discussed the practical experience of the application of the private document, as well as details of the tender procedure for state aid for electric cars.

○ *Working Group on Litigation*

In Q1 the Working Group on Litigation held two meetings. **Preliminary ruling procedures** pending at the European Court of Justice were on the agenda of these meetings. In one of these cases, the judge made questions in connection with the relationship between Section 37 of the Settlement Act and EU law. We also discussed the order made by the Budapest High Court of Appeal initiating a

preliminary ruling procedure and wishing to find out whether allocating exchange rate risks to customers as an unfair contractual condition can be examined or not, and whether the related information fulfilled the requirements of clarity and comprehensibility.

We also reviewed the material of the September 2016 meeting of the Curia consultation body dealing with FX loan cases, as well as the material of the official FX lending meeting held in the Pécs High Court of Appeal on 8 April 2016.

We studied the guiding judgments of the German and Austrian Supreme Courts in the matter of handling fee and disbursement commission.

- *Treasury Working Group*

The set-up meeting of this working group was held at the end of January, then it approved its Rules of Procedure electronically and elected Krisztián Kovács (OTP) as its chairman; his appointment was approved by the Board in its March meeting.

In Q1 the main aim of the Working Group is to facilitate the implementation of new capital market legislations MiFIR/MiFID2). For this purpose, it appointed six major topics (incentives; cost transparency; governance and organisational issues, focusing on product management, identification of target markets, as well as standards on investment consulting; best execution of orders; systematical internalisation and pre and post trade transparency; as well as documentation and reporting issues) at its founding meeting; these are planned to be processed by the working group, subject to moderation by a bank expert. In addition to it, the working group consulted with experts from other institutions on certain special issues. In March we negotiated with ÁKK on the incentive rules' aspects in the context of government bond trade commissions.

I. Global regulation

I.1 Financial Stability Board (FSB)¹⁰

In 2017, the presidency of the FSB is held by Germany. Mark Carney, the chair of the organisation, set out the following priorities for the German presidency:

1. Transforming shadow banking into resilient and flexible market-based finance, mitigating structural vulnerabilities in asset management;
2. Making derivatives markets safer by progressing the post-crisis reforms to OTC derivatives markets, and adopting the coordinated guidance on central counterparties recovery and resolution;
3. Supporting full and consistent implementation of post-crisis reforms, including the development of a structured framework for post-implementation evaluation of the effects of reforms;
4. Addressing new and emerging vulnerabilities, including misconduct risk, as well as those stemming from the decline in correspondent banking and from financial risks related to climate change.

The FSB set up the comprehensive framework for reviewing and regulating **shadow banking activities** in 2011, and the G20 leaders adopted the corresponding schedule in 2013. Since then, the toxic forms of shadow banking activities, such as large funding mismatches, huge leverages and opaque off-balance sheet agreements, have been driven out to a significant degree, and they no longer pose a risk to global stability. Money market funds and repo markets are now under effective supervision, and the significance of asset management has increased rapidly. In January, the FSB laid out its proposals addressing the structural weaknesses and liquidity mismatches in asset management activities. These are being operationalized by IOSCO until the end of 2017 with respect to the liquidity mismatches in open-ended funds, and until the end of 2018 with respect to the development of consistent leverage measures. While finishing the work, the FSB has not identified new global risks related to shadow banking activities; however, the FSB's member authorities must share the relevant data and monitor the risks continuously. Finance ministers and central bank governors are requested to confirm the FSB's proposals regarding the mitigation of the risks linked to asset management activities, in the spirit of transforming shadow banking activities into safe, market-based finance. For the Hamburg summit, the FSB

- assesses the post-crisis development of shadow banking activities and the related financial stability risks, as well as the adequacy of the measures taken and monitoring of them, and
- reports on the operationalization of the proposals regarding asset management.

The **comprehensive renewal of OTC derivatives markets** was put forward at the 2009 Pittsburgh summit in order to reduce systemic risk, improve transparency and prevent abuses. Since then, substantial headway has been made in certain areas, and the proportion of centrally cleared OTC derivatives has soared. In other areas, such as the margin requirements for non-centrally cleared OTC derivatives or the reporting requirements of derivative transactions, progress has been slower. Efforts are ongoing to remove legal barriers to reporting and improving data quality by creating Unique Transaction Identifiers and Product Identifiers. **Central counterparties (CCPs)**¹¹ play a central role in reducing systemic risk. CCPs are closely regulated and supervised by the authorities, and their

¹⁰ The highest-level international financial regulatory body

¹¹ Also known as central clearing counterparties

resilience has improved considerably since the crisis. Their **resolvability** is also key from the perspective of financial stability. For the Hamburg summit, the FSB

- gives a comprehensive report on the reform of the OTC derivatives market, and
- publishes the final guidance on the recovery and resolution of CCPs. The guidelines by CPMI¹² and IOSCO containing the detailed rules will also be drawn up for the summit.

With respect to **post-crisis reforms**, before the Hamburg summit, the FSB

- is finalizing its guidance on internal TLAC,¹³
- is publishing its third annual report on the implementation and effects of the financial regulatory reform,
- is developing a framework for evaluating the effects of the introduced reforms.

Among **new and emerging vulnerabilities**, the FSB is focusing on misconduct risk, and has prepared an action plan. The action plan uses preventive measures to reduce misconduct risks and includes (i) the improvement of financial institutions' governance and compensation structure, (ii) the enhancement of the global standards of conduct in the fixed income, commodities and currency markets, including codes of conduct and regulatory and enforcement tools (iii) and the reform of major benchmarks in order to mitigate the risk of manipulation. For the Hamburg summit, the FSB

- is preparing a report for the G20 leaders on the measures taken in order to manage misconduct risk in line with the action plan and the recommendations on managing this risk,
- is publishing a consultative paper on using compensation (remuneration) tools to address misconduct risk.

In connection with curbing correspondent banking and remittances, which mainly impact developing and emerging economies, the FSB devised a four-point action plan in March 2016. At the Hamburg summit, it

- reports on the results in implementing the action plan and the further steps.

The agenda of the meeting also includes

- the final report of the task force responsible for financial disclosure obligations related to climate change,
- and the report on the impact of fintech innovation on financial stability, also touching upon regulatory and supervisory aspects.

In line with the priorities outlined above, the FSB published the following documents in the first quarter:

Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities

Report on re-hypothecation and collateral reuse

Non-cash Collateral Reuse: Measure and Metrics

Consultation on the Guidance on Central Counterparty Resolution and Resolution Planning

Consultation on the Unique Transaction Identifier

With respect to the cooperation in global regulation, it does not bode well that, at the meeting of finance ministers and central bank governors in Baden-Baden in March, the USA blocked the points on free trade and climate change.

¹² BIS Committee on Payments and Market Infrastructures

¹³ Total loss-absorbing capacity

I.2 Basel Committee on Banking Supervision (BCBS)

I.2.1 Finalizing the Basel III regulation

In early March, the Basel Committee reaffirmed its commitment to the Basel III reforms decided after the crisis. The Chairman of the Committee, Stefan Ingves, stated that:

- The Basel Committee has made further progress towards the finalization of the Basel III reforms.
- The members of the Committee reiterated their support for the key features of these reforms, including the risk-weighted asset framework, the leverage ratio regulation and the output floor. The differences, where they remain, have narrowed, and the work continues to reach an agreement.
- While the finalization of Basel III will take longer than expected, the Committee remains determined to reach agreement on the remaining elements, and recognizes the importance of providing clarity and certainty to all market participants.

I.2.2 Consultation on the draft guidelines on identification and management of step-in risk

After December 2015, the Basel Committee initiated the second consultation on addressing step-in risk in March. The Committee's proposal is part of the G20 regulation initiative aimed at regulating the shadow banking system and mitigating systemic risk. The regulation seeks to reduce the potential spillover risk posed by shadow banking entities to banks.

According to the definition in the document, step-in risk is the risk that a bank may provide financial support to an entity that it has ties to beyond its contractual obligations or capital commitments or even in the absence of any contract, should the entity experience financial stress. In order to capture and address such risks, those unconsolidated partners to whom the bank may provide financial assistance to avoid the reputational risk arising from its ties to them have to be taken into account.

Inadequately assessed step-in risk that becomes material may adversely influence a bank's capital and liquidity position. Nevertheless, the proposal does not stipulate additional Pillar 1 capital and liquidity requirements for covering step-in risk. Banks need to analyse and assess (unconsolidated) entities that have ties to them, as well as the related risks, on an individual basis. The supervisory reports required in the topic are vital to the concept. The differentiation between primary and secondary indicators in the previous consultative document was left out of the assessment methodology for step-in risks.

After the two-month consultation period, the Committee will finalize the guidance, the framework of which will become effective from the end of 2019.

I.2.3 Progress report on banks' implementation of the principles for effective data aggregation and reporting

The Basel Committee published its latest status report on banks' application of the Principles for effective data aggregation and risk reporting at the end of March. The Principles issued in January 2013 sought to bolster G-SIBs'¹⁴ risk data aggregation and risk reporting practices in order to improve risk management, decision-making and resolvability. The Principles had to be fully implemented by banks identified as G-SIBs in 2011 and 2012 from January 2016.

The report was prepared based on the self-assessment of the authorities in charge of the supervision of the G-SIBs. It found that although some progress has been made, the majority of G-SIBs have not fully implemented the Principles, and adherence to the Principles is inadequate. Based on the poor results, the Committee added the following proposals to the Principles:

¹⁴ Global systemically important banks

- Banks should develop clear roadmaps to achieve full compliance with the the Principles, and to comply with them on an ongoing basis.
- Supervisors should (i) communicate the assessment results to their banks and provide the necessary incentives to achieve full compliance with the Principles; and (ii) continue to refine- their techniques to assess banks' compliance with the Principles.

The Committee expressly recommends that national supervisory authorities require domestic systemically important banks (D-SIBs) to adhere to the Principles as well, after a three-year preparatory period.

1.2.4 Regulatory treatment of accounting provisions

At the end of March, the BCBS published details of the interim regulatory treatment of accounting provisions and standards for transitional arrangements. These measures are warranted by the forthcoming entry into force of the international accounting rules on provisioning, which contain the transition to the forward-looking estimation of credit losses. (IFRS 9¹⁵ will be effective from January 2018, although earlier implementation is allowed. In the US, the current expected credit loss (CECL) model will be compulsory for banks operating as public entities from 1 January 2020 and from 1 January 2021 for the other banks, and earlier implementation is allowed from 2019 for all banks.)

The Committee supports the introduction of ECL accounting, even though it will probably impact regulatory capital, since the new model radically overhauls banks' provisioning practices. As there is very little time left until the implementation of IFRS 9, the Committee temporarily maintains the treatment of the provisions in the Basel framework (for a maximum of five years after the introduction of ECL). The interim period provides an opportunity for the Committee to consider the method for the long-term treatment of the provisions carefully. Jurisdictions may employ temporary measures to smooth the significantly negative effects on regulatory capital.

Due to the short timeline until the implementation date, the provision of CRR2 introducing the interim period (Article 473a) has to be decoupled from the November banking regulation package and fast-tracked.

1.2.5 Enhancements to the Pillar 3 disclosure framework

The Committee has also prepared the consolidated and enhanced framework for the Pillar 3 disclosure requirements. The new document is the revised version of the requirements published in January 2015. The Pillar 3 disclosure requirements seek to promote market discipline. The revised, enhanced version contains three main elements, as compared to the previous one:

- it consolidates all existing disclosure requirements stipulated by the Basel Committee into the Pillar 3 framework,
- it introduces a dashboard of banks' key prudential metrics, and compiles the new disclosure requirements that describe prudent valuation adjustments, and
- it reflects the ongoing regulatory reforms (TLAC, revision of market risk framework)

During the formulation of the revised requirements, both comments from users and from those preparing the report were taken into account. The implementation deadlines for the reports were determined individually, in line with the entry into force of the relevant regulation. The new disclosure requirements for the existing reports should typically be applied from the end of 2017.

1.2.6 Revisions to the global systemically important banks assessment framework

At the end of March, the Committee published a consultative document on the assessment framework of G-SIBs. The aim of the G-SIB regulation is to reduce the probability of failure through

¹⁵ International Financial Reporting Standards

stipulating higher loss absorbency (HLA). The G-SIB identification methodology assesses institutions' systemic risk using 5 categories and 12 indicators. Simultaneously with the introduction of the assessment methodology, the BCBS decided that the methodology has to be reviewed every three years in order to keep it consistent with the original goals despite the structural changes, and to enable the introduction of new dimensions for capturing unexpected systemic risks.

As a result of the review, the Committee requested comments on the following changes:

- Removal of the cap on the substitutability category;
- Expansion of the scope of consolidation to include insurance subsidiaries;
- Amendments to the definition of cross-jurisdictional activity;
- Modification of the weights in the substitutability category, and the introduction of a "trading volume" indicator;
- Revisions to the disclosure requirements;
- Further guidance on bucket migration and the associated HLA surcharge;
- A proposed transition schedule.

The Committee also requested feedback on the introduction of the indicator for short-term wholesale funding, presenting a corresponding impact assessment based on end-2015 data.

1.2.7 Report on the introduction of Basel III – Assessing the introduction of the Basel III reforms

In line with the established practice, in the first quarter the Committee published a quantitative report assuming full implementation. The figures show that the capital adequacy, liquidity and TLAC values have all substantially improved as compared to the data from half a year ago.

Based on the reports of the jurisdictions concerned, the Committee also published a compilation that demonstrates the extent to which the jurisdictions have corrected the deficiencies identified during the December 2015 RCAP¹⁶.

II European regulation

II.1 General environment

II.1.1 Legislative priorities for 2017

In December 2016, for the first time in the EU's history, the presidents of the European Council, the European Parliament and the European Commission officially agreed on next year's legislative priorities, about which they issued a joint declaration and which they seek to implement before the end of the year if possible:

- By strengthening the European Fund for Strategic Investments (EFSI ***giving a new boost to jobs, growth and investment***), and continue to build the Banking Union and the Capital Markets Union.
- ***Addressing the social dimensions of the EU***, bolstering initiatives aimed at youth employment, improving social security coordination and access to services, and creating a European- Solidarity Corps.
- ***Better protecting the security of EU citizens*** through a better protection of external borders, tighter controls on purchasing and owning firearms, fighting money laundering, terrorism and terrorist financing and through information exchange on third-country citizens.
- In the spirit of responsibility and solidarity ***reforming the EU's migration policy***, reviewing asylum regulation and improving investment in third countries aimed at addressing the root causes of migration locally.

¹⁶ Regulatory Consistency Assessment Programme

- **Implementing a connected Digital Single Market**, notably through the EU telecoms and copyright reforms, allowing the use of the 700 MHz band, preventing unjustified geo-blocking, reviewing the Audiovisual Media Services Directive and modernising common data protection rules.
- **Establishing the Energy Union and developing a forward-looking climate change policy**, adhering to the Paris Agreement, i.e. the clean energy requirement, in all European projects.

According to the declaration signed by the three presidents, progress also needs to be made in maintaining common European values, tackling tax fraud and preserving the principle of free movement of workers, and reinforcing Europe's role in strengthening stability, security and peace.

II.1.2 White Paper on the Future of Europe

In March, the European Commission published a White Paper, outlining the potential scenarios for the future of the 27-member EU until 2025. The aim of the *White Paper* is to trigger a broad debate in the next months across the whole continent, with the involvement of the European Parliament, national parliaments, regional and local governments and the whole civil society. The debate will focus on **“more or less Europe”, the implementation of “federalist or nation-based integration”**. On the basis of these questions, the Commission laid out five possible scenarios, which were described by the following headings:

- **Carrying on** (The EU focuses on delivering of its positive reform agenda.)
- **Nothing but the Single Market** (The EU is gradually re-centred on the Single Market.)
- **Those who want more do more** (The EU allows willing member states to do more together in specific areas.)
- **Doing less more efficiently** (The EU focuses on delivering more faster in selected policy areas, while doing less elsewhere.)
- **Doing much more together** (The EU decides to do much more together in all policy areas.)

(The basic assumption in all scenarios is that the 27 Member States carry on together, within the framework of the EU.)

Drawing on the public debate, President Juncker will take the ideas forward and present his personal views on the future of Europe in his State of the Union Speech in September 2017. Based on all this, the European Council can draw its first conclusions by the end of the year, and decide in time about the next steps to be taken until the European Parliament elections in June 2019.

II.2 Priorities of the Maltese Presidency

On 1 January 2017, for the first time after its accession in 2004, Malta assumed the Presidency of the European Council. The Maltese Presidency continues economic policy coordination in line with the revised European Semester. Accordingly:

- **The future architecture of the EMU** has to be discussed based on the Commission's White Paper.
- The implementation of the tasks laid down in the **Capital Markets Union Action Plan** has to be strengthened, including the common rules on securitisation and the review of the European venture capital and social entrepreneurship funds;
- Progress has to be made on the **legislative proposals on banking**, including the amendments to the Capital Requirements Directive and Regulation, the Bank Recovery and Resolution Directive and the Single Resolution Mechanism Regulation, which include the EU's implementation of international standards;
- The work has to be continued on the **legislative proposals on central counterparties**, and the review of the European Market Infrastructure Regulation (EMIR) has to be initiated.
- The constructive, technical-level work on the **European Deposit Insurance Scheme (EDIS)** has to be continued, while progress has to be made in the proposals reducing banking risk.

- Several **taxation files have to be reviewed**, including the amendment of the Anti-Tax Avoidance Directive, an initiative on dispute resolution mechanisms, the renewed discussion on the Common Consolidated Corporate Tax Base as well as the proposals on e-commerce and the reduced rates on e-publications.
- The negotiations on the **4th Anti-Money Laundering Directive** have to be concluded.

Furthermore, the European Fund for Strategic Investments 2.0 and the establishment of the EIB External Lending Mandate are priorities regarding which the Presidency cooperates with the Parliament in order to reach a political agreement. The Maltese also wish to work out an agreement on the Structural Reform Support Programme Regulation as well.¹⁷

II.3 The Commission's proposal on the amendment to the Comitology Regulation

In line with President Juncker's State of the Union speech in September 2016, the European Commission proposed to amend the Comitology Regulation in February. The amendment seeks to increase the transparency and accountability of the procedures aimed at the implementation of EU legislation.

The package contains four targeted amendments, bolstering the transparency of Member States' views, enabling a more powerful political guidance and ensuring greater accountability in the decision-making process. The elements of the package are as follows:

- **changing the voting rules** in the last phase of the comitology procedure (appeal committee) by only taking into account the votes for or against the given legal act (this will reduce the number of abstentions and the situations where the appeal committee is unable to adopt a position, therefore the Commission is forced to make a decisions without clear guidance from the Member States);
- **involving national ministers**, so that the Commission can refer the issue to a second, ministerial-level appeal committee if the national experts do not adopt a position (this ensures that sensitive decisions are discussed at the appropriate political level);
- **increasing voting transparency** in the appeal committee by disclosing the votes of Member States' representatives;
- **ensuring political input** by enabling the Commission to refer the issue to the Council of Ministers for comments if the appeal committee is unable to adopt a position.

The above proposal is one of the key new initiatives of the Commission's 2017 work programme, aimed at avoiding the situations where the Commission has to make a decision without clear guidance from the Member States.

II.4 Public consultation on the operations of the European Supervisory Authorities (ESAs)

In March, the European Commission launched a public consultation on the operation of the European Supervisory Authorities. The European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) have been the cornerstones of the reforms introduced after the financial crisis. They are crucial in ensuring that financial markets are well-regulated, robust and stable all across Europe. Since their establishment, the ESAs have contributed to the preparation of the Single Rule Books for financial services, the convergence of supervisory practices, the creation of the robust financial framework of the Single Market and the founding of the Banking Union.

The consultation aims to identify the areas where the ESAs' utility and efficiency can be strengthened and improved. Increasingly coordinated and integrated supervision will have ever

¹⁷ On 8 February 2017, the Presidency agreed with the MEPs on a programme that helps Member States introduce structural reforms. The programme will be in effect from its launch until 31 December 2020, with a budget of EUR 142.8 million.

more significance in the future, especially in the development and integration of European capital markets and the establishment of the Capital Markets Union. The consultation ended on 16 May, **and covered the (i) tasks and powers, (ii) governance, (iii) structure and (iv) financing of supervisory authorities**. Taking into account the received responses (as well), the Commission will make a proposal about the appropriate amendment to the ESA regulations by the end of this year.

II.5 Banking Union

II.5.1 The Single Supervisory Mechanism (SSM)

2016 annual report

In November 2016, the SSM celebrated the second anniversary of its formal existence. In the **introductory interview** of the 2016 annual report on the ECB's supervisory activities, **Daniele Nouy**, the Chair of the Supervisory Board of the SSM, pointed out the **effective tackling of non-performing loans, the continuous strengthening of the solvency of the euro area's banking sector and the harmonisation of banking supervision** as the chief achievements in the past year. Within the harmonisation of supervisory practices, the uniform application of national options and discretions in the euro area (which was regulated by the ECB in a regulation and a guidance) and the standardisation of the Supervisory Review and Evaluation Process (SREP) were highlighted. As a result of the harmonised application of the SREP, the Pillar 2 capital add-ons match banks' unique risk profile much better. Nonetheless, banking activities are still partly regulated by directives, the concrete implementation of which may vary across Member States. This creates an uneven playing field, reduces the efficiency of banking supervision and makes it more costly. Therefore if policymakers are serious about the Banking Union, they must further harmonise the rules. This also has to be applied during the discussion about the Commission's November banking regulation package.

Supervisory priorities for 2017

The SSM department of the ECB has surveyed the risks threatening the banking sector in cooperation with the national competent authorities. During this, it used the information received from the Joint Supervisory Teams, the ECB's macro and microprudential analyses and reports from international bodies. The identified risk drivers were as follows: the excessively low/negative interest rate environment; high levels of non-performing loans and the sluggish economic growth in euro area countries; the geopolitical uncertainty in the EU; the reactions of banks and markets to new regulation; a potential reversal of risk premia in financial markets; the situation of emerging market economies; EU fiscal imbalances; cases of misconduct by banks; developments on the real estate lending markets; cybercrime and IT disruptions; and non-bank competition. These factors exert the greatest impact on two risk categories, the risks linked to the business model and profitability and credit risk.

The supervisory priorities for 2017 identify three key areas for the inspections in the given year:

1. **Business models and profitability drivers**

- The assessment and thematic review of business models and profitability drivers,
- The analysis of the impact of Brexit on supervised banks,
- The potential risks linked to the emergence of "fintech" and other non-bank competition;

2. **Credit risk, with a focus on non-performing loans and concentration**

- The further measures linked to non-performing loans (NPLs) (guidance to banks, supporting Joint Supervisory Teams),

- The assessment of the preparedness for the upcoming introduction of the IFRS 9 financial instruments accounting standard,
- The examination of the excessive concentration of certain asset classes (shipping loans, real estate lending);

3. **Risk management**

- Compliance with the BCBS principles for effective risk data aggregation and risk reporting,
- Targeted review of internal models (TRIM),
- ICAAP¹⁸ and ILAAP¹⁹,
- Outsourcing.

As it can be seen from the above, several supervisory initiatives are launched for all three priorities, the complete implementation of which may take more than a year in certain cases.

Targeted review of internal models (TRIM)

The ECB launched the TRIM project at the end of February with a conference held for the banks concerned and the publication of a relevant guide. (Banks could comment on the latter until 13 April.) The TRIM guide details **how the ECB interprets the relevant EU rules on the internal models for credit, market and counterparty risk and model use in general** (CRR/CRD4, the Commission's delegated and implementing regulations, RTSs and EBA guidelines and the ECB's supervisory manual and guide). The aim is the harmonised interpretation and implementation of the existing legal framework and the rapid adaptation to the pending changes in the regulation. With respect to the unwarranted variability in risk-weighted assets (RWAs), the gaps identified in the regulation are addressed taking into account benchmark calculations.

In connection with the TRIM guide, the ECB expected feedback on the areas that require further clarification or further reflection on specific principles. The draft guide is fine-tuned based on the comments received, on-site inspections, horizontal expert assessments and the developments in regulation. Before finalisation, a formal, public consultation will be held for all risk types.

Final guidance on tackling non-performing loans

After the consultation that ended in November 2016, the ECB published its guidance helping the tackling of non-performing loans (NPLs) in March, which

- outlines the **measures, processes and best practices** aimed at the tackling of NPLs by banks,
- calls on banks to implement realistic and ambitious **strategies aimed at the reduction of NPLs**,
- serves as the basis for the **dialogue between banks and supervisory authorities**, and also discusses corporate governance topics.

Even at the end of 2016 Q3, NPLs of significant banks under the direct supervision of the ECB amounted to EUR 921 billion. The high proportion of NPLs curbs banks' lending and takes up too much of executives' energy. Therefore the ECB urges the appropriate and determined management of the problem, and calls on governments to establish a legal and judicial framework that facilitates the reduction of the NPL ratio for banks.

2017 ECB stress test on the interest rate risk in the banking book

The 2017 stress test of the ECB analyses the interest rate risk in the banking book (IRRBB). The supervisory authority collects information on the **interest rate sensitivity of banks' assets and liabilities and the development of the net interest income in the banking book**. The sensitivity

¹⁸ Internal Capital Adequacy Assessment Process

¹⁹ Internal Liquidity Adequacy Assessment Process

analysis is conducted based on the scenarios pertaining to the six interest rate shocks outlined in the April 2016 IRRBB standard of the BCBS. The results of the stress test will be used in a non-mechanical way, in the Supervisory Review and Evaluation Process (SREP) 2017, while prescribing the Pillar 2 capital requirement.

Reporting: Review of supervisory reporting requirements linked to the IFRS transition

On 17 February, the ECB announced a public consultation on the amendment to supervisory reporting requirements. The review of the ECB regulation introduced in December 2015 is primarily warranted by the **introduction of the IFRS 9 standard**, however, a few other changes (the reporting of certain FINREP tables on an individual basis, the imposition of reporting requirements on subsidiaries operating in non-Banking Union Member States or in third countries) were also put forward. Accordingly, the reporting tables used by banks will also be adjusted.

Reporting: AnaCredit

The EBIC²⁰ requested that the ECB extend the AnaCredit reporting deadline by another six months by lengthening the test period. The ECB has not accepted the proposal yet, therefore banks will need to perform the first non-trial reporting on the September 2018 data about individual loans in November 2018.

II.5.2 The Single Resolution Mechanism (SRM)

The Single Resolution Board (SRB) has been the resolution authority with full responsibility for the 129 significant institutions supervised by the ECB in the Banking Union and another 15 cross-border banking groups since January 2016. (The SRB staff has not expanded to the planned number yet: at the end of 2016, the headcount was 171, which is sought to be increased to 350 by the end of 2017.) In 2016 national resolution authorities **contributed more than EUR 10 billion to the Single Resolution Fund (SRF)** by paying the 2015 portion (EUR 4.3 billion) subsequently in January, and by paying the 2016 fee (EUR 6.4 billion) in June. The 2017 contribution will amount to EUR 6.5 billion. On 8 February 2017, the SRB announced that it had concluded, with all 19 Member States participating in the Banking Union, the **loan facility agreements (LFA)** that provide bridge financing when necessary to the tune of all the provisions in the SRF, i.e. EUR 55 billion.

In the past year, the SRB **developed the reports necessary for resolution planning** in cooperation with the banks:

- Banks' liability data template (LDT),
- The critical functions template, and
- The reporting on access to the financial market infrastructure.

In addition to laying the groundwork for resolution reporting, the other major task was the establishment of the **minimum requirement for own funds and eligible liabilities (MREL²¹) for each bank**. The document presenting the SRB's approach and the future steps was published in February 2017. While determining the MREL values for 2017, the SRB applied a preliminary, mechanical and simplified approach, providing informative target values that are not enforceable or challengeable. The informative target value for the subordinated instruments in the case of G-SIIs²² was determined as the sum of 13.5% of the risk-weighted assets (RWAs) and the combined buffer requirement²³ (-125 bp), while no guidance was provided for the other banks.

²⁰ European Banking Industry Committee

²¹ The TLAC and MREL requirements ensure that in the case of a potential resolution, institutions have enough bail-in-able funds. TLAC requirements set by the FSB apply to G-SIBs, and MREL requirements in line with EU regulations apply to all European banks.

²² Global systemically important institutions

²³ CRD, Article 128

In 2017, the SRB will set a **consolidated, compulsory MREL value** for the major banking groups, which has to be achieved after an appropriate interim period. In 2017–2018, the **individual MREL values** will also be determined, taking into account the risk profiles. The **internal MREL values** within resolution groups will be started to be determined as well, and a special methodology will be developed for the multiple point of entry strategies. Progress will also be made in **managing the cross-holding of MREL instruments** and in the field of **subordinated instruments**.

With respect to the issuance of MREL instruments, it is essential that the Commission treat the **regulation on the harmonisation of the creditor hierarchy to be applied in the case of an insolvency** separately, as a high priority during the amendment of the BRRD.²⁴

The SRB organised **dialogue** with the representatives of the industry at the end of January, for the **fifth** time. The event attracted more than 100 stakeholders (EU officials, national banking associations, resolution authorities, banks, the European Commission, the European Parliament, the ECB).

II.5.3 The European Deposit Insurance Scheme (EDIS)

In the first quarter, no breakthrough was achieved with regard to the European Deposit Insurance Scheme. **The technical details were further discussed** in the Ad Hoc Working Party (AHWP) set up to strengthen the Banking Union. According to the result of the survey conducted after the publication of the European Commission's impact assessment in October, Member States deem further analysis necessary in the following areas:

- irrevocable payment commitments,
- temporary high balances (payments after deposits temporarily exceeding the insurance limit),
- the payment obligation for deposits held at institutions not subject to the CRR and those held at branches in third countries,
- the possibility for alternative and preventive EDIS measures,
- the aspects to be taken into account in risk-based fee payment.

In addition to the impact assessment, the influence on the internal market and competition, the fragmentation in Member States' insolvency regulation, the interaction between EDIS and the other two pillars of the Banking Union and the aspects related to the introduction of a common financial support also have to be carefully considered while developing the EDIS.

It is important to note in connection with the Banking Union that the **EBA's relevant website will be an information hub regarding crisis prevention, liquidation and resolution**, showing the data obtained from the competent authorities. This also enables the compilation of EU-wide data on **DGS payments** and the use of the funds.

II.6 The Capital Markets Union (CMU)

In January, the European Commission **announced a consultation on the mid-term review of the Capital Markets Union Action Plan planned for June 2017**. The goal of the mid-term review is to strengthen the political framework aimed at the development of the capital market by revising the proposed actions and integrating the supplementary measures. The mid-term review:

- assesses the progress in the implementation of the CMU Action Plan;
- reformulates the necessary actions in the light of the work so far and the recent market developments; and
- supplements the CMU Action Plan with new measures, giving an effective and proportionate response to basic challenges.

²⁴ Bank Recovery and Resolution Directive

During the consultation, feedback and proposals based on evidence and concerning the medium-term agenda were expected from all stakeholders until 17 March. In the consultation, issues such as:

- financing for innovation, start-ups and non-listed companies;
- making it easier for companies to enter the market and raise capital on public markets;
- investing for long term, infrastructure and sustainable investment;
- fostering retail investment and innovation;
- strengthening banking capacities to support the wider economy; and
- facilitating cross-border investment

were covered.

In its response to the consultation, the European Banking Federation stated that European banks fully support the objectives laid down in the CMU Action Plan, i.e. the strengthening of the capital markets and the elimination of the obstacles to cross-border capital flows.

The EBF primarily proposes the following for the success of the CMU:

- The Commission should provide strong leadership and technical expertise during the STS securitisation dialogue in order to create solutions that will revive securitisation markets;
- Taking the interests of both debtors and creditors into account in a balanced manner, the proposal on bankruptcy proceedings should be revised, thereby contributing to the solution of the issue of non-performing loans;
- The Commission has to play a more central role in the European development of financial education, empowering entrepreneurs, consumers and investors, so that individuals and companies better understand financial opportunities and the available sources of finance.

On 27 February, the ***European Commission published its report entitled “Accelerating the capital markets union: addressing national barriers to capital flows”***. The Commission pointed out in the report that the success of the Investment Plan for Europe depends largely on whether the Member States and the Commission can work together to eliminate the barriers to cross-border investment. The report mentions three types of barriers (ex ante, in itinere and ex post) that hamper cross-border transactions for investors.

In order to accelerate the establishment of the Capital Markets Union, the Commission called on the Member States to develop a ***joint roadmap*** for eliminating the national barriers to capital flows.

In early March, the European Banking Authority announced that within the framework of the so-called ***Vienna Initiative, a special working group was established headed by the European Commission*** in order to ***examine the obstacles to the realisation of the Capital Markets Union***. The working group focuses on the opportunities for development on the capital markets of the Central, Eastern and South-eastern European (CESEE) region and the conditions necessary for that, and the majority of its members are the representatives of the region’s Member States. In order to assist the work of the working group, the Commission has compiled a survey, expecting Member States’ problems and potential solutions.

II.7 Relevant EBA’s and ESAs’ documents in Q1

Guidelines

EBA publishes final guidelines on LCR disclosure (EBA/GL/2017/01)

Consultation papers

ESAs’ consultation on the establishment of central contact points to strengthen fight against financial crime (JC/2017/08)

Consultation on procedures for complaints of alleged infringements of the PSD2 (EBA/CP/2017/01)

Consultation on specification of an economic downturn (EBA/CP/2017/02)
Consultation on the coverage of entities in banking group recovery plans (EBA/CP/2017/03)

Recommendations

Updated recommendation on the equivalence of supervisory regimes (EBA/REC/2017/01)

Opinions

EBA expresses dissent over the EU Commission proposed amendments to technical standards under the IFR²⁵ (EBA/OP/2017/01)

ESAs warn on money laundering and terrorist financing risks affecting the EU financial sector (EBA/OP/2017/07)

Opinion on transitional arrangements and credit risk adjustments due to the introduction of IFRS 9 (EBA/OP/2017/02)

Opinion on improving the decision-making framework for supervisory reporting requirements (EBA/OP/2017/03)

Opinion on measures to address macro-prudential risk (EBA/OP/2017/04)

ESAs welcome European Commission's public consultation on their operation

Regulatory and implementing technical standards

Final draft technical standards on exclusion from CVA of non-EU non-financial counterparties (EBA/RTS/2017/01)

Draft Regulatory Technical Standards on Strong Customer Authentication and common and secure communication under Article 98 of Directive 2015/2366 (PSD2) (EBA/RTS/2017/02)

Draft Regulatory Technical Standards on disclosure of encumbered and unencumbered assets under Article 443 of the CRR (EBA/RTS/2017/03)

Reports and other documents

Risk Dashboard Data as of Q3 2016

EBA and ESMA call to clarify margin requirements between CRR and EMIR (EBA/201/82)

EBA publishes DPM and XBRL taxonomy 2.6 for remittance of supervisory reporting

Report on high earners

ESAs publish statement on variation margin exchange

EBA updates on the 2018 EU-wide stress test timeline

EBA publishes results of the CRDIV-CRR/Basel III monitoring exercise as of end June 2016

EBA Recovery planning - Comparative report on recovery options

EBA report Results from the 2016 market risk benchmarking exercise

Revised list of ITS validation rules

Notifications on resolution cases and use of DGS funds

EBA updates list of OSIs²⁶ in the EU

EBA report on functioning of supervisory colleges in 2016

II.8 The change of the EBA's headquarters

Due to the United Kingdom's Brexit decision has to be made on the change of the London headquarters of the European Banking Authority and to appoint a new headquarters.

To enable Budapest to become a successful applicant, the Hungarian Banking Association prepared a letter under the European Commission's public consultation aiming to reflect on the operation of the EBA. We have sent this letter, listing the reasons in favour of a headquarters in Budapest, to the

²⁵ Interchange Fee Regulation

²⁶ Other systemically important institutions

Government, several non-eurozone banking associations and to the domestic associations, requesting a wide range of participation in public consultations, as well as support.

When appointing the new headquarters, we considered important the principle, how to allocate the EU supervisory authorities. We believe that the concentration of authorities in Member States and the relocation of the EBA to the Eurozone would not be reasonable. In view of the developed banking environment, Budapest, as the second largest capital outside the Eurozone, can be a suitable candidate for the headquarters of the EBA.