



**HUNGARIAN BANKING ASSOCIATION**

*General Meeting  
April 15, 2011  
Agenda item 1.*

**REPORT**

**ON 2010 ACTIVITIES OF THE  
HUNGARIAN BANKING ASSOCIATION**

*BUDAPEST, MARCH 2011*



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## INTRODUCTION

During the past 15 years the banking sector experienced the most difficult operating conditions in 2010. Banks were hit by a series of shocks in the wake of the crisis, with customer solvency and the situation of borrowers with foreign currency home loans continuing to deteriorate, the international regulatory environment becoming more adverse in a number of areas, and measures strongly limiting banks' profitability and growth potential being imposed (bank tax, consumer protection measures). The most serious of these measures was the unexpected imposition of a bank tax. This new tax is unprecedented and flagrant in Europe, in terms of both size and the way it was imposed.

The Association's Board immediately initiated talks with the government, emphasising at all forums that such an extremely high tax would be harmful for the economy as a whole. This extra burden on banks, directly and indirectly, reduces profitability and hinders the required pick up in lending, a fundamental prerequisite for economic recovery. The European Banking Federation and six foreign parent banks wrote a letter to the Hungarian government and also turned to the European Commission and the International Monetary Fund, indicating that due to the proposed extraordinarily high extra tax they might not be able to meet the commitments they made as a condition for the IMF stand-by arrangement for Hungary.

In its action plan, the new government promised measures to help home loan borrowers in distress. In this context, the government planned to set up a National Asset Management Company, which, however, failed to materialise in 2010. Meanwhile, the government also changed the concept: Members of Parliament Antal Rogán and Lajos Kósa drafted an eight-point proposal to help debtors with foreign currency mortgage loans. The eight points originally proposed would have further aggravated the situation of banks. We started intensive talks with the government and with ruling party MPs.

During the discussions, the following compromise agreements were reached:

- the proposed restrictions will apply only and specifically to home loans;
- interest rates may be unilaterally increased for reasons to be specified in a government decree;
- a free of charge early repayment can be made only once and not earlier than the second year of the loan term, for not more than 50% of the principal amount;
- a debtor's request for an extension of the loan period will not have to be met automatically, however, such request may be rejected only for good cause;
- the MPs relinquished the proposal to introduce a walk-away and promised to rationalise notary public fees by legislation;
- the prohibition of penalty interests only applies to terminated contract - and after the 90th day following the termination of the contract.

During the consultation and in the correspondence with ruling party MPs and the competent ministry, we presented banks' own rescue schemes, pointing out that the so called "arbitrary" interest rates applied by banks are often much more favourable than the mid-rate or the MNB base rate.

The Association drafted amendment proposals to the draft law on drafting and amending certain financial laws (Draft Law No. T/581). The draft law sought to **restrict retail lending** by prohibiting the registration in the Land Registry of mortgage rights for foreign currency

home loans. Our proposals were aimed to ensure that the prohibition on the registration of mortgage rights for foreign currency home loans does not hinder the trade-off, collateral swap, assignment or transfer of foreign currency loans granted prior to enactment of the new legislation.

The damages caused by flooding, inland inundations and the red sludge disaster put additional burdens on banks. The National Disaster Management Directorate at the beginning of the summer approached the Association to seek possible ways of cooperation to provide financial help for flood victims. The government provided substantial financial support for rebuilding the damaged homes, which were also collaterals for home loans. The government reckoned that banks would relinquish the insurance amounts assigned to them by the insurance companies, and thus, these amounts could be used for reconstruction.

The National Disaster Management Directorate, on behalf of the government, and the Association on behalf of the banking community, agreed that banks would relinquish the insurance amounts due to them in favour of the state to finance the reconstruction of damaged homes. Also, the parties settled the issue of priority ranking between the state and banks in respect of the mortgage and committed to cooperating in those cases, where, after reconstruction of his home, the debtor is unable to continue the repayment of the loan, in which case the mortgagees will decide on the future of the debt.

The cooperation agreement was signed by the Minister of Interior and the President of the Hungarian Banking Association. The agreement was joined practically by all creditor banks affected. Since the conclusion of the agreement, the Association has been acting as a mediator in the data exchange between the National Disaster Management Directorate, the Association of Hungarian Insurance Companies and banks.

Under its Recommendation No. 2010/1, the Association published the Budapest Principles, a voluntary Code of Conduct similar to the London Rules. The application of the Budapest Principles is based on voluntary cooperation between creditors, aimed at avoiding bankruptcy, liquidation or foreclosure proceedings by the creditors making a proposal for restructuring the debtor company's finances. The Budapest Principles allow creditor banks and debtors to reach an out-of-court agreement, thus saving companies, jobs and working cultures. The system can be applied in cases where there are at least two creditor banks and the debtor has temporary financial or sales difficulties and shows good faith. Under the framework, the debtor is given a standstill period. During this, the company is reviewed and the potential means for its restructuring are assessed with the assistance of independent consultants.

The Association's Board addressed at several of its meetings the deficiencies in the legal framework for debt collection. Most banks try to make up for these deficiencies by putting internal policies in place and follow well-regulated, prudent and fair procedures in enforcing their claims. The same cannot be said about the practices followed by certain financial enterprises and other agents. Namely, debt collection is often performed on an agency basis by debt collection agents or auctioneer companies, outside the view of banks and the competent regulatory authorities. The Association conducted a study to survey the issue and to propose appropriate legislation. Based on the study, a concept for legislation was developed. According to the proposal, the regulation should provide debtors with guarantees against frauds, while not jeopardising payment discipline. The Association also sent the proposal to the Hungarian Financial Supervisory Authority, requesting their support. The Supervisory Authority shares

our position, including the proposal that the Hungarian Financial Supervisory Authority should be vested with the responsibility for the licensing and supervision of debt collection firms.

The various measures and regulatory changes hitting the banking sector in 2010 prompted the need for the Association to intensify cooperation with members as well as with other professional organisations, including the Hungarian Bar Association, the Hungarian Chamber of Notaries, the Confederation of Hungarian Employers and Industrialists, the Association of Bank Loan Victims and other organisations.



## I. PERFORMANCE OF THE HUNGARIAN BANKING SECTOR IN 2010

The financial intermediation sector was hit by a series of external and internal shocks in 2010. Banks weathered the severest period of the financial and economic crisis relatively well: no government bailouts were needed and liquidity strains were eased with the help of parent banks. However, the shocks hitting the sector in 2010 have significantly affected the sector's overall situation.

External shocks included the impacts of the financial crisis (liquidity and financing difficulties, deterioration of the portfolios), changes in the regulatory environment (affecting the industry in the longer-term) and the increased focus put on consumer protection issues. (At times of crisis, consumer protection comes to the forefront also for political motivations: politics uses it as a tool to neutralise the social strains caused by growing unemployment and declining incomes).

Internal shocks included the exorbitant bank tax, imposed from the second half of 2010, regulatory and other, mainly consumer protection measures affecting mortgage lending, and the dismantling of the private pension fund system. (The impacts of the elimination of the private pension fund pillar on the pension system and on the state budget will probably be a matter of debate for economists for a long time, but will undoubtedly affect banks' liquidity and profitability already in the short-term).

### 1. Assets structure

Assets in the banking sector, growing steadily in the past 10 years, declined even in nominal terms in 2010. The share of banks in the credit institutions sector continued to decrease, with more banks being transformed into branch offices. (Banks had a share of 87% in the credit institutions sector in 2010, branch offices and savings co-operatives took up 7% and 5%, respectively).

#### Credit institutions' assets at current prices (HUF billion)

Credit Institutions	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Cash and settlement accounts	689	644	491	505	782	759	765	917	673	626	693
Securities for trading	580	487	458	912	890	933	1283	2113	2570	4340	3329
Securities for investment	740	1004	1059	1534	1508	1627	1631	1831	2922	3189	3791
Total securities	1320	1491	1517	2446	2398	2560	2914	3944	5491	7529	7120
Central bank and interbank deposits	1528	1476	1445	1391	1745	2391	2681	1940	2175	2382	2275
Of which: central bank deposits		492	643	425	543	1307	1219	468	827	472	452
interbank deposits		984	802	966	1203	1084	1462	1472	1347	1910	1823
Loans (net portfolio)	4323	4905	6097	8523	9977	11935	14223	17319	20979	19791	19925
Of which: corporate loans	3076	3176	3284	4154	4772	5433	5994	6923	7456	6958	6749
Retail loans	429	677	1204	2265	2914	3712	4613	5847	7536	7519	8096
Participations	192	156	197	257	248		500	555	638	651	703
Accrued interest receivable	117	109	114	184	249	241	234	299	505	460	414
Prepayments and other assets	71	90	144	186	241	268	521	671	959	661	525
Own assets	187	169	192	268	326	404	589	688	642	591	599
<b>Total assets</b>	<b>8427</b>	<b>9040</b>	<b>10196</b>	<b>13759</b>	<b>15965</b>	<b>18850</b>	<b>22428</b>	<b>26334</b>	<b>32063</b>	<b>32691</b>	<b>32255</b>

Source: Hungarian Financial Supervisory Authority

The decline in the banking sector's performance, the weakening of the sector's role in supporting economic growth and the significant decrease in banks' assets is even more apparent when looking at the asset figures as calculated without exchange rate changes and inflation.

### Credit institutions' assets without exchange rate changes and inflation

(HUF billion)

Credit Institutions	2003	2004	2005	2006	2007	2008	2009	2010
Cash and settlement accounts	505	736	690	670	745	507	453	467
Securities for trading	912	835	845	1118	1704	1952	3164	2295
Securities for investment	1534	1417	1474	1426	1486	2207	2307	2526
Total securities	2446	2253	2319	2544	3189	4160	5470	4821
Central bank and interbank deposits	1391	1670	2183	2375	1593	1636	1713	1471
Of which: central bank deposits	425	508	1182	1063	377	628	344	311
interbank deposits	966	1162	1001	1312	1215	1008	1369	1160
Loans (net portfolio)	8523	9582	10988	12681	14352	15516	14116	12282
Of which: corporate loans	4154	4587	4996	5328	5711	5537	4980	4238
Retail loans	2265	2751	3394	4096	4832	5578	5366	4990
Participations	257	236	0	447	459	473	466	438
Accrued interest receivable	184	235	220	206	244	381	334	281
Prepayments and other assets	186	227	243	455	543	727	479	349
Own assets	268	305	365	513	556	487	431	414
<b>Total assets</b>	<b>13759</b>	<b>15243</b>	<b>17276</b>	<b>19890</b>	<b>21680</b>	<b>23886</b>	<b>23462</b>	<b>20524</b>

Sources: Hungarian Financial Supervisory Authority, MNB

These figures reveal that credit institutions' assets declined over the past two years, in particular in the corporate sector. In the past two years, *corporate loans fell to their 2004 level* and *retail loans dropped to their end 2007 - early 2008 level*.

One of the biggest strains in recent years has been the high share of FX assets in total assets. Although foreign currency-based assets have started to diminish in the wake of the crisis, this will be a long process that could be accelerated only by increasing lending activity.

The share of foreign currency loans in total loans grew from 37% in 2001 to 71% in 2008, barely decreasing by 1% since. The share of foreign currency loans in total retail loans rose over the past 8 years from 3% in 2001 to 70% in 2008, with no change in 2010. The share of foreign currency loans in total corporate loans grew over a decade from 34% to 60%.

### Share of foreign currency loans in total loans by borrowers

	2005	2006	2007	2008	2009	2010
<b>Total loans</b>	<b>50%</b>	<b>54%</b>	<b>63%</b>	<b>71%</b>	<b>70%</b>	<b>70%</b>
Non-financial enterprises (excluding associated companies)	48%	47%	53%	60%	60%	60%
Associated companies	67%	27%	22%	24%	12%	11%
Households	33%	47%	59%	70%	69%	70%
Non-profit institutions serving households	61%	59%	59%	65%	68%	61%
Central and local governments	33%	24%	29%	26%	25%	29%
Other financial intermediaries	88%	87%	87%	90%	86%	81%
Credit institutions	46%	55%	70%	75%	77%	79%
Foreigners	95%	95%	97%	98%	99%	99%

Source: Hungarian Financial Supervisory Authority

The SME sector has been a potential growth area for corporate lending in recent years, the share of SME loans in total corporate loans rose from 40% in 2001 to 53% in 2010.

### Distribution of corporate loans by business size

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
<b>Micro enterprises</b>	13%	16%	17%	16%	17%	15%	20%	17%	18%	17%
<b>Small enterprises</b>	9%	8%	9%	10%	18%	17%	16%	16%	17%	18%
<b>Medium-sized enterprises</b>	17%	19%	18%	22%	19%	22%	20%	19%	18%	18%
<b>SMES</b>	40%	43%	44%	48%	53%	54%	56%	53%	52%	53%
<b>Large companies</b>	60%	57%	56%	52%	47%	46%	44%	47%	48%	47%
<b>Total corporate loans</b>	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: Hungarian Financial Supervisory Authority

## 2. Liabilities

Banks' liabilities more than trebled, with deposits growing less than two times in the period between 2001 and 2010. The loans-to-deposits ratio doubled during the past ten years, from 82% in 2001 to 164% in 2010. (This latter figure was contributed to by the weakening of the forint exchange rate). Notably, the loans-to-deposits ratio of savings cooperatives is much better than that of banks (it was 30% in 2010) and has continued to improve in recent years.

### Loans-to-deposits ratio

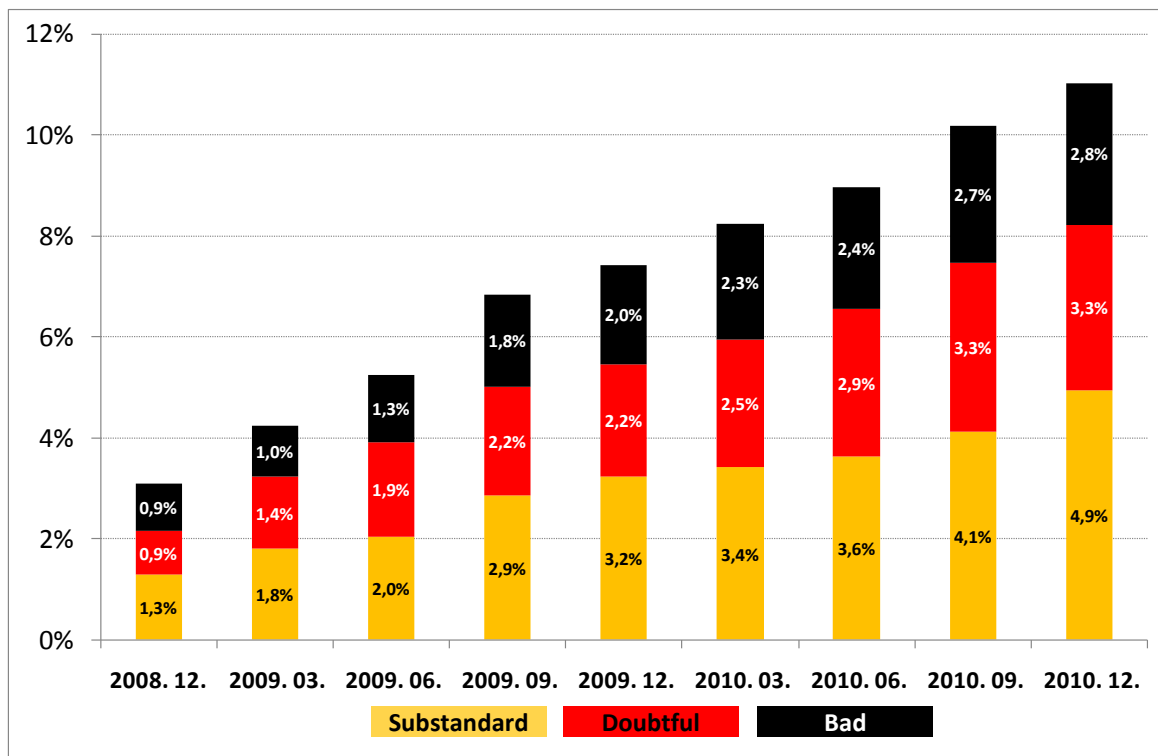
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Loans-to-deposits ratio	82%	93%	113%	122%	130%	136%	155%	166%	158%	164%
Corporate loans-to-deposits ratio	188%	161%	176%	192%	195%	176%	195%	208%	204%	182%
Retail loans-to-deposits ratio	22%	36%	52%	61%	72%	89%	105%	120%	111%	128%

Source: Hungarian Financial Supervisory Authority

### 3. Portfolio quality

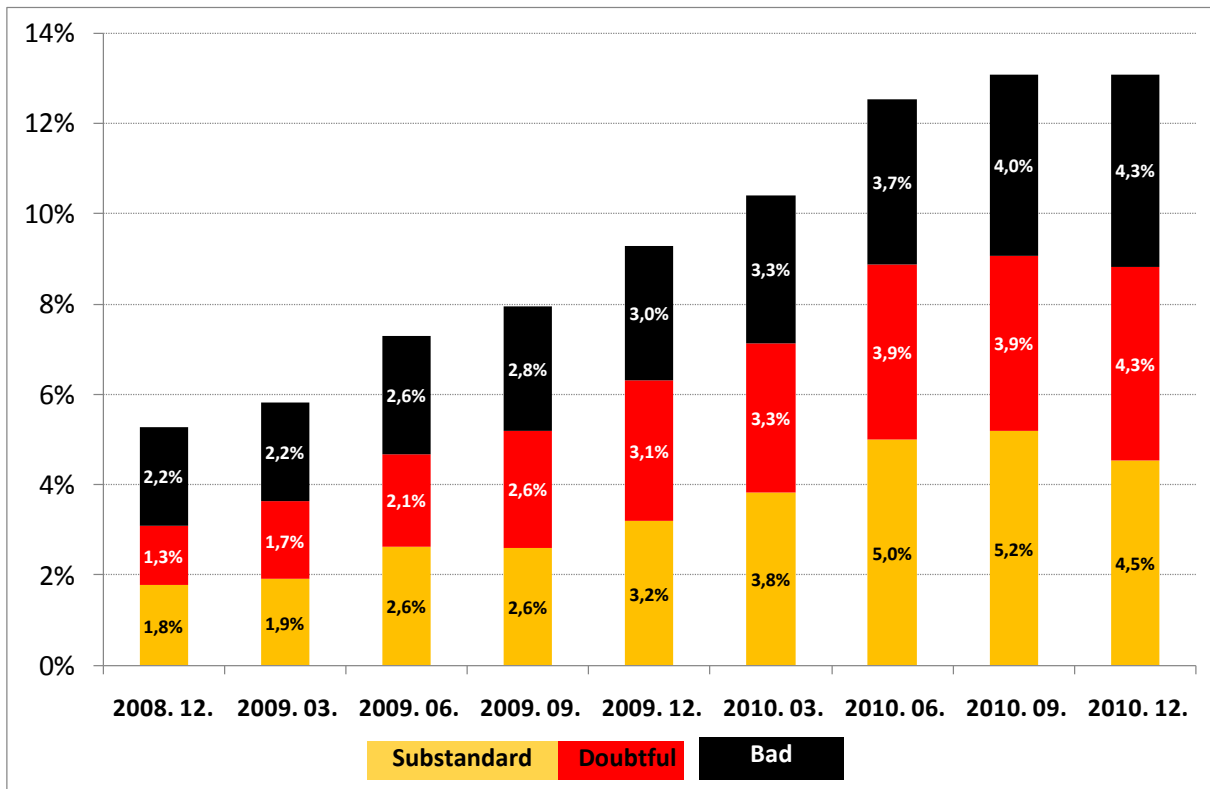
In 2008, the portfolio quality was still high, with the ratio of substandard + doubtful + bad items being 3.1% in the retail loan portfolio and 5.3% in the corporate loan portfolio. The portfolio quality deteriorated substantially in 2009 and 2010, with the ratio of substandard + doubtful + bad items rising to 11.0% in the retail portfolio and 13.1% in the corporate portfolio by the end of Q4 2010.

#### Quality of the retail loan portfolio



Source: Hungarian Financial Supervisory Authority

### Quality of the corporate loan portfolio



Source: Hungarian Financial Supervisory Authority

Notably, the deterioration of the portfolio quality, in particular that of retail loans, accelerated somewhat in the second half of 2010. This means that it may not be until the second half of 2011, at the earliest, that this deterioration stops.

#### 4. Profitability

Looking at the structure of ROA and ROE:

- Net interest income was 3.05% in 2010, 0.48 percentage points lower than the average of the last 8 years and 0.45% higher than in 2009. Interest received and interest paid both declined compared to 2009, with the latter falling at a higher rate.
- Non-interest income was 0.6% in 2010, 1.26 percentage points less than in 2009. A major part of this decline was due to the bank tax, reducing the Other Non-Interest Earnings line by 0.91%. Also, net profit on financial and investment services declined by 0.38%. (With the crisis abating, securities yields rose sharply in 2009).
- Although operating expenses did not decrease overall in 2010, banks implemented major cost reductions in the past two years, as reflected in the 10% to 12% drop in staff numbers and the closure of several branches.
- The change in impairment and provisions was 0.29 percentage points lower than in 2009.

### ROA and ROE in the banking sector

Description	2002	2003	2004	2005	2006	2007	2008	2009	2010
<b>Net interest income</b>	<b>4.02%</b>	<b>3.93%</b>	<b>3.96%</b>	<b>3.84%</b>	<b>3.64%</b>	<b>3.18%</b>	<b>2.67%</b>	<b>2.60%</b>	<b>3.05%</b>
Interest received	8.80%	9.11%	10.36%	8.55%	7.91%	8.18%	8.20%	8.47%	7.15%
Interest paid	4.78%	5.18%	6.40%	4.71%	4.26%	5.00%	5.54%	5.87%	4.10%
<b>Non-interest income (net)</b>	<b>1.40%</b>	<b>1.57%</b>	<b>1.75%</b>	<b>1.61%</b>	<b>1.57%</b>	<b>1.63%</b>	<b>1.27%</b>	<b>1.86%</b>	<b>0.60%</b>
Earnings from commissions and fees	1.34%	1.46%	1.30%	1.28%	1.20%	1.08%	0.91%	0.89%	0.90%
Dividends	0.09%	0.19%	0.14%	0.14%	0.15%	0.21%	0.61%	0.23%	0.24%
Net profit on financial and investment services	0.44%	0.44%	0.65%	0.76%	0.61%	0.79%	0.52%	1.04%	0.66%
Gains on forex trading and exchange rates	0.51%	0.48%	0.64%	0.28%	0.24%	0.20%	0.66%	0.18%	0.74%
Other non-interest earnings	-0.46%	-0.52%	-0.34%	-0.56%	-0.38%	-0.45%	-0.77%	-0.29%	-1.20%
<b>Operating expenses</b>	<b>3.55%</b>	<b>3.38%</b>	<b>3.01%</b>	<b>2.89%</b>	<b>2.74%</b>	<b>2.60%</b>	<b>2.40%</b>	<b>2.02%</b>	<b>2.09%</b>
<b>Change in impairment and provisions</b>	<b>-0.28%</b>	<b>-0.30%</b>	<b>-0.38%</b>	<b>-0.22%</b>	<b>-0.40%</b>	<b>-0.47%</b>	<b>-0.54%</b>	<b>-1.52%</b>	<b>-1.23%</b>
<b>Profit from ordinary business activities</b>	<b>1.59%</b>	<b>1.81%</b>	<b>2.32%</b>	<b>2.34%</b>	<b>2.07%</b>	<b>1.74%</b>	<b>1.00%</b>	<b>0.92%</b>	<b>0.33%</b>
<b>Extraordinary profit</b>	<b>0.03%</b>	<b>0.03%</b>	<b>0.00%</b>	<b>0.01%</b>	<b>0.15%</b>	<b>-0.01%</b>	<b>0.06%</b>	<b>-0.07%</b>	<b>-0.12%</b>
<b>Pre-tax profit</b>	<b>1.62%</b>	<b>1.84%</b>	<b>2.32%</b>	<b>2.35%</b>	<b>2.22%</b>	<b>1.73%</b>	<b>1.05%</b>	<b>0.85%</b>	<b>0.20%</b>
Tax liabilities	0.29%	0.33%	0.34%	0.41%	0.36%	0.29%	0.17%	0.13%	0.07%
<b>After-tax profit ROA</b>	<b>1.33%</b>	<b>1.51%</b>	<b>1.98%</b>	<b>1.94%</b>	<b>1.86%</b>	<b>1.44%</b>	<b>0.88%</b>	<b>0.72%</b>	<b>0.13%</b>
<b>Assets-to-equity ratio (%)</b>	<b>11.6</b>	<b>11.8</b>	<b>11.9</b>	<b>12.0</b>	<b>12.2</b>	<b>12.1</b>	<b>12.8</b>	<b>12.7</b>	<b>11.7</b>
<b>ROE</b>	<b>15.46%</b>	<b>17.80%</b>	<b>23.58%</b>	<b>23.31%</b>	<b>22.66%</b>	<b>17.46%</b>	<b>11.30%</b>	<b>9.13%</b>	<b>1.58%</b>
<b>Inflation</b>	<b>5.3%</b>	<b>4.7%</b>	<b>6.7%</b>	<b>3.6%</b>	<b>3.9%</b>	<b>8.0%</b>	<b>6.1%</b>	<b>4.2%</b>	<b>4.9%</b>
<b>Real ROE</b>	<b>9.7%</b>	<b>12.6%</b>	<b>15.8%</b>	<b>19.1%</b>	<b>18.0%</b>	<b>8.8%</b>	<b>4.9%</b>	<b>4.7%</b>	<b>-3.2%</b>

Sources: Hungarian Financial Supervisory Authority, MNB

ROA in the banking sector was 0.13%, ROE was 1.58% in 2010.

- The 0.45-percentage-point increase in net interest income offset the 0.38-percentage-point decline in net profit on financial and investment services the 0.07-percentage-point increase in operating expenses.
- The 0.29-percentage-point improvement in impairment and provisions failed to offset the 0.91-percentage-point decline in other non-interest earnings caused by the bank tax. The difference reflects the dramatic decline in profitability in 2010.
- Banks' real ROE (ROE adjusted by inflation) was in the red: -3.2%, a 7.9-percentage-point decline over 2009.

## **II. REGULATION, PROFESSIONAL ISSUES**

### **1. Legislation and measures affecting the banking sector**

#### **1.1 Bank tax**

The announcement on June 8 of an extremely high extra tax on the financial sector for a three-year period commencing 2010 shook the industry. The expected revenue from this tax was stated as HUF 200 billion, including HUF 120 billion from banks. The Association's Board immediately initiated talks with the government, emphasising at all forums that such an extremely high tax would be harmful for the economy as a whole. This extra burden on banks hinders the required pick up in lending, a fundamental prerequisite for economic recovery. The European Banking Federation and six foreign parent banks wrote a letter to the Hungarian government and also turned to the European Commission and the International Monetary Fund, indicating that due to the proposed extraordinarily high extra tax they may not be able to meet the commitments they made as a condition for the IMF stand-by arrangement for Hungary.

The detailed rules for the new tax were not consulted on in advance with the banking community. The Association presented to the Government the industry's position, as agreed at the meetings held with members' CEOs and specialists, but our efforts failed. Characterising the situation: the text submitted to Parliament was different from the concept outlined earlier and the rules for 2010 (with the first tax payment being due in September) were also changed during the short review of the proposal by the competent Parliamentary Committee during the summer. The base of the bank tax was defined as the 2009 adjusted total assets (the adjustment meaning receivables from loans, securities and investments placed with Hungarian banks being deductible), with a bracketed tax rate of 0.15% for adjusted total assets up to HUF 50 million and 0.5% above HUF 50 billion.

During the legislative process in the autumn, the rules for 2011 were changed (again without any consultation in advance): in addition to receivables from and investments in Hungarian financial organisations, receivables from and investments in debt securities and shares issued by EU-based debtors, credit institutions and financial enterprises will also be deductible from the tax base. The tax rate remains bracketed, with 0.15% up to HUF 50 billion, but now 0.53% above HUF 50 billion. Another, mainly accounting technical change is that banks may choose to pay a part or whole of the tax on a profit basis: in this case the tax base will be 30% of the bank's pre-tax profit. This tax may not exceed the amount of and is deductible from the bank tax payable on total assets. Although the legislation does not provide adequate guidance for all implementation-related issues, thanks to good cooperation with the Ministry's staff, all questions arisen thus far have been answered quickly.

The volatility of the situation is well illustrated by the fact that the draft law on the 2011 Budget includes the bank tax (although with a lower amount) also for fiscal years 2013 and 2014. Also, in the recently announced Kálmán Széll Plan, it was made public that, contrary to earlier promises, the bank tax would not be reduced in 2012.

#### **1.2 Act XC of 2010 on drafting and amending certain financial acts**

In July, the Association drafted amendment proposals to the draft law on drafting and amending certain financial laws (Draft Law No. T/581). Given that the draft law was submitted

to Parliament under an individual MP motion, we had no opportunity to comment on it. The draft law sought to **restrict retail lending** by prohibiting the registration in the Land Registry of mortgage rights for foreign currency home loans. Our proposals were aimed to ensure that the prohibition on the registration of mortgage rights for foreign currency home loans does not hinder the trade-off, collateral swap, assignment or transfer of foreign currency loans granted prior to enactment of the new legislation.

The texts provided in the Act in relation to the Act enacting the Civil Code and the Act on Land Registration could give rise to divergent interpretations. To solve this problem, we initiated consultations with the ministries involved. The required amendments to the Civil Code were incorporated in Act CLIX of 2010 amending certain financial acts. The amendments to the Act on Land registration were incorporated in Act CLIII of 2010 amending certain Acts substantiating the 2011 Budget. The purpose of these coordinated amendments was to ensure that the prohibition on the registration of mortgage rights for foreign currency home loans does not hinder measures aimed at helping debtors in distress (such as the trade-off, collateral swap, assignment or transfer of foreign currency loans) or the registration of mortgage rights due to any other amendments to the loan agreement.

### **1.3 Omnibus financial legislation (Act CLIX of 2010 on drafting and amending certain financial acts).**

The Ministry for National Economy started work aimed at transposing CRD2 and CRD3 into Hungarian legislation. Under this process, the Ministry held a consultation regarding issues related to regulatory capital, securitisation, remuneration and transposition of the Directive in general. The Association provided detailed comments on the Ministry's draft text to ensure the fullest possible consistency of the legislation with the CRD amendments. The texts for the transposition of CRD2 and CRD3 were submitted to Parliament under an omnibus legislation in the autumn.

The Association received for review the government's proposal for legislation on drafting and amending certain financial laws. Based on comments received from members, we submitted a **70-page proposal** to the Ministry for National Economy.

We provided comments on proposed amendments to the provisions on security deposits in the Civil Code, amendments to the Act on Local Taxes, amendments to the prudential provisions, the provisions on remuneration, the provisions on financial intermediaries, the provisions on qualification requirements, the provisions on the National Deposit Insurance Fund (OBA), the provisions on the issuance of electronic money in the Credit Institutions Act, and related amendments to the Capital Market Act and the Anti-Money Laundering Act.

**The Association provided comments on the draft laws on legislation and on public involvement in the drafting of legislation.** In our comments, we proposed that public involvement in the drafting of legislation be regulated under the Act on Legislation, rather than under a separate law. Regulating public involvement in a separate, simple-majority law would result in allowing the relevant rules to be changed arbitrarily. We proposed that the drafters of the legislation be mandated to report to the decision-makers the results of the review process and all essential comments received. We also made a suggestion for consultations with interest-representation organisations and pointed out that deficiencies in the legislation hinder the transparency of the legislative process. Several of our proposals were incorporated in the new acts. In relation to the Act on public involvement in the drafting of legislation (Act CXXXI of



2010), we took the necessary steps to establish the strategic partnership relations provided by the Act.

## 1.4 Helping debtors in distress

### 1.4.1 Helping debtors with foreign currency loans

In its action plan, the government has promised measures to help debtors with foreign currency mortgage loans. In this context, the government has planned to set up a National Asset Management Company. Although the brief communication issued by the government did not reveal details of the plan, it seems that the proposed National Asset Management Company would purchase from creditor banks bad loans and the related mortgaged real estate collaterals. We reviewed the potential solutions: first, the National Asset Management Company purchasing the claim, and second, the National Asset Management purchasing the real estate.

The new National Asset Management Company was not set up in 2010, and in the meantime, the government has also changed the concept. Members of Parliament Antal Rogán and Lajos Kósa drafted an 8-point proposal and, after consultations with the Association, submitted it to Parliament.

During the consultations, the following compromise agreements were reached:

- ↳ the proposed restrictions will apply only and specifically to home loans;
- ↳ interest rates may be unilaterally increased for reasons to be specified in a government decree, provided such increase is warranted by a change in the central bank base rate, change in the refinancing rates, change in money market indices, change in the creditor bank's term deposit rates, regulatory changes, or changes in credit risk, as specified in the relevant government decree;
- ↳ a free of charge early repayment can be made only once and not earlier than the second year of the loan term, for not more than 50% of the principal amount;
- ↳ a debtor's request for an extension of the loan period will not have to be met automatically, however, such request may be rejected only for good cause;
- ↳ the MP's relinquished the proposal to introduce a walk-away and promised to rationalise notary public fees by legislation;
- ↳ the prohibition of penalty interests only applies to terminated contract - and after the 90th day following the termination of the contract.

During the consultation and in the correspondence with the ruling party's MPs and the competent ministry, we presented banks' own rescue schemes, pointing out that the so called "arbitrary" interest rates applied by banks are often much more favourable than the mid-rate or the MNB base rate.

The government's concepts, including the repeated extensions of the auction and eviction moratoriums have increased the *moral hazard* and also raise capital adequacy problems. It should be noted though, that the government has in all statements emphasised that loans must be paid back and the proposed National Asset Management Company (whose role is unspecified yet) will only help in an emergency situation, and the solution it will offer may not be very attractive for those, whose willingness, not ability, to pay is missing.

### **1.4.2 Eviction moratorium**

The relevant amendment to the Act on Judicial Distraint prohibits evictions until April 15, 2010 (end of the heating season). This regulation not only prevents creditor banks from taking hold of the collateral but also hinders the enforcement of other civil claims. We have expressed our opinion on this regulation on several occasions in the media.

**Government Decree No. 12/2003 (I 30) on non-judicial sale of pledged assets was amended five times in 2010. The amendments (except for one) were drafted without any prior review** and we learned of them from the official journal. An earlier amendment to the Decree prohibited the sale of mortgaged real estates until December 31, 2010 and provided that any auction may only be announced after that date. A recent amendment to the Decree provides that until April 15, 2011, the real estate may be sold and the relevant invitation to auction published only with the debtor's consent filed in person with the tax authority.

Under the current circumstances, creditors are unable to exercise their mortgage rights. The Association on all possible occasions demanded the lifting of the eviction and foreclosure moratoriums from April 15, 2011.

### **1.4.3 Survey on the government bridging loan scheme**

The Ministry of Finance requested the Association to conduct a survey among banks to assess, with the help of a questionnaire developed by the Ministry, the effectiveness of the government loan scheme ("bridging loan") introduced under Act IV of 2009 to help debtors in distress.

In view of the importance of the issue and despite the informal nature of the procedure, we requested our members to assist in the survey. Based on the (non-comprehensive) data received, we were able to compile a fairly accurate assessment. According to this, during the roughly one and a half year since its introduction, less than some 1,300 debtors availed themselves of the loan facility. (A rather low number compared to banks' own rescue schemes, which were used by more than 150,000 debtors). The continuous relaxation of the eligibility criteria for the loan facility had a positive impact on demand for the facility (the relevant law was modified several times during 2009), banks say the number of debtors availing themselves of the facility is growing. As envisaged, the vast majority of debtors using the facility are people who have lost their jobs. Despite the low repayment amounts, the number of borrowers defaulting again is rather high (as is the case with the loans restructured by the banks).

## **1.5 Helping disaster victims**

### **1.5.1 Helping flood victim home loan debtors**

The National Disaster Management Directorate at the beginning of the summer approached the Association to seek possible ways of cooperation to provide financial help for flood victims. The government has provided substantial financial support for rebuilding the damaged homes, which were also collaterals for home loans. The government has reckoned that banks would relinquish the insurance amounts assigned to them by the insurance companies, and thus, these amounts could be used for reconstruction.

After the relevant discussions, a cooperation agreement was signed by the Minister of Interior and the President of the Hungarian Banking Association. The agreement was joined practically

by all creditor banks affected. Since the conclusion of the agreement, the Association has been acting as a mediator in the data exchange between the National Disaster Management Directorate, the Association of Hungarian Insurance Companies and banks.

### **1.5.2. Red sludge disaster**

Within the framework of cooperation and regular information exchange established between the National Disaster Management Directorate, the Ministry of Interior and the Association, banks were regularly informed by the Association on damaged or destroyed real estates previously serving as collateral. This information was crucial for banks in being able to respond quickly and determine the actions required. In turn, the government sought information from banks' on their plans in order to be able to develop the necessary financial support plans. In its response, coordinated with member banks, the Association made it clear that banks are willing to help by introducing repayment moratoriums of various lengths for various types of loans or waiving repayments for certain loans.

### **1.6 Decree on responsible lending; issues related to the new Act on consumer credit**

Certain provisions of the Decree on responsible lending and of the Act on consumer credit, taking effect in March, caused banks interpretation and implementation problems. Both pieces of legislation were adopted at the end of 2009 and it was clear that the two months time allowed for preparing for implementation would be too short.

In relation to the Decree on **responsible lending**, we organised a consultation for banks to find solutions to the issues raised. Regarding those issues where no solution could be found within the given legal framework, we submitted to the Ministry of Finance text proposals to amend the Decree.

The Ministry responded to our proposals as late as in April. The Ministry only considered some of the proposals suitable to be submitted to the government. We welcomed the Ministry's decision to submit even those proposals to the government. At the same time we drew attention that the omission of the other proposals would cause serious implementation problems.

In relation to the **Act on Consumer Credit**, no consultation could be held, given the short time left until entry into force of the Act. Hence, the Association turned to the Ministry of Finance for rulings on the issues and problems raised. In its response, the Ministry provided satisfactory solutions to most of the issues raised.

### **1.7 New regulations regarding the Annual Percentage Rate**

The EU Consumer Credit Directive has changed the provisions on APR. During the transposition of the Directive into Hungarian law, the Government Decree on APR was amended to reflect these changes.

The changes primarily related to

- the disclosure of APR;
- the inclusion in the APR of charges for additional services provided by outside service providers;
- factors to be included in the APR in advertising.

Going beyond the EU requirements, the Hungarian legislation also includes provisions on leasing products and mortgage loans. The Ministry of Finance, as the drafter of the Decree, conducted continuous consultations with the Association. Our main objective was to ensure that the new legislation is easy to implement, consumer-friendly and relies to the maximum possible extent on elements of the previous Decree to avoid disturbing the market.

## **2. Other regulatory changes**

### **2.1 New bank accounting rules**

The rules for asset valuation, in particular, receivables from loans and off-balance-sheet items under Government Decree 250/2000 on accounting rules for credit institutions were changed significantly in 2010. The changes affected the revaluation and impairment of several thousand billions of forints of contracts (capital + interest, including pending off-balance-sheet interests). The legislators' intent with the changes was to increase the level of provisioning in the banking sector, citing compliance with the IMF/World Bank loan agreement.

The Association expressed its opinion that the proposal, providing for major changes, was excessive and in many points impracticable. With the support of the Hungarian Chamber of Auditors we were able to convince the Hungarian Financial Authority (strongly insisting on the proposal) to revise the new rules and to allow for gradual implementation. The competent Ministry supported the industry's proposals. The rules contained in the enacted Decree are significantly more favourable than those initially proposed.

### **2.2 Banking opinion on IFRS 9 Financial instruments**

Specialists from ERSTE Group's headquarters in Austria organised a workshop on critical findings of an intra-group assessment of loan portfolios carried out by ERSTE in relation to the IFRS 9 chapters published thus far (classification and measurement of financial assets). ERSTE's specialists called upon the Hungarian Banking Association to join forces with other banking associations in Central and Eastern Europe to support ERSTE' initiatives with the competent international organisations (IASB, EFRAG) to amend IFRS 9.

ERSTE considers the valuation at amortised costs of certain elements of the loans portfolio as a critical point. Accounting specialists attending the meeting agreed with the arguments presented by the ERSTE specialists. The disclosure of IFRS financial data is a basic requirement for the international comparability of results.

### **2.3 Taxation issues, events**

As in previous years, banks' taxation officers continued to exchange views on major taxation issues in 2010. The Association solicited rulings on several issues from the competent ministry and the Tax Office. Our requests were aimed at simplifying the rules and reducing administrative burdens. As a major achievement, the withholding tax on interest paid to foreign organisations, raising a number of practical problems and causing excessive administrative burdens was abolished from 2011. In our efforts aimed at making the regulations more practicable, we joined forces with the Association of Securities Dealers and with the Central Clearing House, KELER. As another achievement, the complicated guidelines on the avoidance of double taxation of interest income from abroad were also annulled from 2011.

We took joint action with the Factoring Association to achieve the extension of the exemption from the provisions of Section 36/A of the Act on Taxation. These provisions substantially hinder the financing of businesses involved in public procurement tenders. In respect of the interpretation of the rules for the bank tax, questions were raised regarding the eligibility for deduction of certain balance sheet items (receivables from the central bank, revaluation reserves, accrued interest).

The Association also addressed taxation issues related to lending, including the treatment of waiver of claims, bad loans, the VAT treatment of insolvency and foreclosures, the calling of collateral options, the enforcement of mortgage rights, the option to choose between VAT taxability or VAT exemption in the case of real estates and the problems caused by the different VAT taxability of the parties. In relation to personal income tax, most of the issues raised were related to the tax treatment of controlled capital market transactions and interest income. We approached the competent ministry with issues related to the tax treatment of certain special financial products with regard to the change in the tax rate for interest income from 20% to 16% and the relevant transitional provisions. In respect of the Tax Office, we raised issues and proposals regarding payer's reporting. Also, we wrote letters to the Tax Office and the competent Administrative State Secretariat, asking for simplification of the verification process for income certificates.

We raised a number of issues and provided proposals regarding various taxation issues to the National Economy Ministry's Working Committee for Reducing Administration.

### **3. Self-regulation**

#### **3.1 The Budapest Principles**

Under its Recommendation No. 2010/1, the Association published the Budapest Principles, a voluntary Code of Conduct similar to the London Rules. The application of the Budapest Principles is based on voluntary cooperation between creditors, aimed at avoiding bankruptcy, liquidation or foreclosure proceedings against a major debtor by the creditors making a proposal for restructuring the debtor company's finances. The mechanism is practicable in cases where the debt size and debtor's willingness to cooperate facilitates such cooperation and agreement. The Budapest Principles allow creditor banks and debtors to reach an out-of-court agreement, thus saving companies, jobs and working cultures, which is a crucial interest in the current financial and economic crisis. The system can be applied in cases where there are at least two creditor banks and the debtor has temporary financial or sales difficulties and shows good faith. Under the framework, the debtor is given a standstill period. During this, the company is reviewed and the potential means for its restructuring are assessed with the assistance of independent consultants. The process could substantially reduce the time for creditor banks to obtain a clear view on the company's position and to evaluate, by taking into account each other's position, the possibilities for restructuring the company's debts. Thus far, nine banks have adopted the Recommendation.

#### **3.2 Issues arisen in connection with bank account switching due to changes in the messaging system**

Signatories to the self-regulation on bank account switching indicated that interbank data transmission, a key element of the process, is jeopardised by proposed changes to be

implemented in the messaging system operated by GIRO. GIRO's current data transmission system is functioning well and automatically, whereas the proposed new system would result in a more complicated and more costly solution, requiring substantial system development work at the individual banks. Banks proposed that the issue should be resolved through a system development to be implemented centrally by GIRO.

GIRO says the new solution is designed to promote bank account switching and is highly secure. However, it is true that achieving the former degree of automation would require system development. GIRO's representatives were of the opinion that the required development can be implemented more economically at the individual banks' level rather than centrally by GIRO, where all the many individual system needs would have to be accommodated. No agreement was reached on the issue.

## **4. Reporting**

### **4.1 Central bank reporting**

The scope of information, the reporting entities and the reporting dates for central bank reporting are regulated in a decree by the Governor of the MNB. The MNB reviews its information needs and sets the reporting requirements on an annual basis.

For the purpose of monetary policy decision-making, the MNB requires more information on securities transactions, payments, loan contract amendments and loan restructuring (occurring increasingly frequently in the wake of the financial crisis) and the rules for interest statistics reporting will also be fine-tuned. A new statistical reporting will be launched in 2011 to monitor the take-up of SEPA (Single Euro Payments Area) payment schemes. Currently, 15 Hungarian banks offer payment services under the SEPA payment schemes and more are expected to join soon. In September, the Association participated in the review of the proposed new reporting requirements for 2011. In all consultations with the central bank we are continuously emphasising the need to make the methodology guides more specific and to reduce the volume of information and eliminate redundancies, in order to ease the workload on banks' reporting units.

### **4.2 Supervisory reporting**

The 2010-reporting package for banking and investment services provided for significant changes. The issue of the relevant decree was delayed, partly due to drawn-out consultations and reviews and partly due to new reporting requirements raised by the regulators during the review process.

The short time allowed for preparations was also a challenge for the Supervisory Authority's reporting systems. The Association requested the Supervisory Authority to provide a workable implementation date. Accordingly, the new reporting requirements for investment services were only introduced from April 2010 (the deadline for consumer protection reports was July 1). We were following the issue closely with the Supervisory Authority and continuously indicated to them the problems arisen during implementation. Also, we attended several consultations in 2010 on developing the formal and content requirements for consumer-protection related reports.

On all occasions we pointed out to the Authority that the reporting requirements demand financial institutions to produce a vast amount of data on a regular basis (nearly 20 complex reports/tables on a daily basis) and banks' reporting units are stretched to the edge of their capacity in terms of both human and technical resources.

## **5. Payments**

### **5.1 Regulation of interchange fees and merchant fees**

In the wake of the Competition Office's interchange fee investigation, a regulation on bankcard transaction fees, in particular, interchange and merchant fees was adopted under a 2009 amendment to the Act on Payments. The new regulation, enacted to take effect from March 1, 2010, violated the freedom of contracting and the principles of a market economy. The Association turned to the President of the Republic, asking him to seek a constitutional test.

The new regulation, unconstitutional and questionable both technically and professionally, was changed still before taking effect, upon an MP motion, supported by the Ministry of Finance. Accordingly, the relevant section of the Act was complemented with a sub-section to provide that the rate of commissions, fees and other costs directly related to a payment made by a cashless payment instrument, charged by the financial service provider to the beneficiary may not exceed 2% of the payment amount.

### **5.2 Enhancing payment services - implementation of intraday settlements in Hungary**

Pursuant to the Payment System Council's decision of June 23, 2010, intraday settlements (InterGIRO 2 - IG2) are expected to be introduced in Hungary on July 1, 2012. The InterGIRO 2 system will allow interbank electronic credit transfers to be executed within 4 hours. Implementation of the new system will be supported by a Project Management Committee and Banking Working Group. All banks submitted their first progress reports in 2010, assessing the status of the launch of the projects, the appointment of project leaders, the adoption of the Project Document and the preparation of project schedules and project budgets.

### **5.3 Gridlock in the interbank settlement system due to shortfall of funds in customers' HUF LORO accounts; potential solutions**

The MNB has developed a proposal to eliminate gridlocks in the interbank gross settlement system (VIBER) due to shortfall of funds in customer's loro accounts. We solicited banks' opinions on the proposal. As a result of the vote at the end of June, the MNB placed an order for the enhancement of the VIBER system. In this context, the issue of transaction monitoring was raised. The MNB conducted a survey among banks in this respect. The project is now coordinated by the MNB.

### **5.4 E-money issuance - Amendment to the Credit Institutions Act**

EU Directive 2009/110/EC on electronic money institutions was transposed into Hungarian legislation through an amendment to the Credit Institutions Act. During the drafting process we indicated that to develop a position, in addition to comparing the Directive and the proposed amendment to the Credit Institutions Act, banks should be given the opportunity to review the underlying system of electronic money issuance at the concept level.

## **5.5 Proposed EU legislation on cross-border cash transport**

The Ministry for National Economy requested the Association's assistance in the review of the proposed EU legislation on cross-border cash transport.

Currently, national borders and divergent national laws are a barrier to designing optimal cross-border transport routes. The proposed legislation does not aim to ensure full law harmonisation but rather, to provide a transparent operational framework, while respecting national regulations.

The Association involved in the review the most affected banks (for example, those banks active in the border area with Austria), the competent officer of the Hungarian SEPA Association and major CIT companies.

At the meeting with the Ministry we requested the Ministry to make sure that the proposed legislation does not make the current practice for cross-border cash transport impossible and the government starts as soon as possible work to develop a regulation on cash transport based on the proposed EU legislation.

## **6. Regulation of debt collection practices**

The Association's Board addressed several times the deficiencies in the legal framework for debt collection. Most banks try to make up for the deficiencies by putting internal policies in place and follow well-regulated, prudent and fair procedures in enforcing their claims. The same cannot be said about the practices followed by certain financial enterprises and other agents. Namely, debt collection is often performed on an agency basis by debt collection agents or auctioneer companies, outside the view of banks and the competent regulatory authorities. The Association conducted a study to survey the issue and to propose appropriate legislation. Based on the study, a concept for legislation was developed. Participants in the discussion emphasised that the regulation should provide debtors with guarantees against frauds, while not jeopardising payment discipline. We communicated our ideas and proposals to the former Ministry of Finance and the Hungarian Financial Supervisory Authority. The Supervisory Authority shared the Association's position that the Hungarian Financial Supervisory Authority should be vested with the responsibility for the licensing and supervision of debt collection firms. No progress that we know of has been made on this issue.

## **7. Practical issues related to the rules for compensation provided by the National Deposit Insurance Fund (OBA)**

The new provisions on deposit insurance under the Credit Institutions Act (Act CXII of 1996), effective from January 1, 2010, entail substantial extra tasks for both banks and the National Deposit Insurance Fund (OBA). The implementation of the new rules raises a number of questions on the part of banks. It took a lengthy consultation process and amendments to the legislation to have the formal and content requirements for reporting to the Fund made practicable. As a major achievement, a satisfactory solution was reached through the cooperation of KELER, the MNB and the Hungarian Financial Supervisory regarding the method of reporting on bank-issued securities deposited with other custodians in Hungary or abroad.



The requirements provided by the National Deposit Insurance Fund's Board regarding mandatory customer information effective from 2011 impose disproportionately high extra costs on banks. Banks do not share the Fund's view that the proposed customer information guide to be issued with a standard text would increase confidence in the financial sector. Banks do not see any use of this information obligation under the current circumstances.

After several discussions, based on our proposals, the customer information requirements were simplified: the completed template will not have to be mailed to the customers: it will suffice to let the customers know, through the commonly used channels (bank account statements, the bank's website), that the relevant customer information is available and can be collected in the bank's branches. The Association also held a meeting for banks to ensure consistent implementation. The meeting was useful: participants, competitors in the market, were able to agree on a number of points regarding the required customer information. On still pending issues, the Association solicited the OBA's position.

### **III. ASSOCIATION COMMITTEES AND WORKING GROUPS, ASSOCIATION RELATIONS, EVENTS**

#### **1. Association committees and working groups**

##### **1.1 Bank Security Committee**

###### **1.1.1 IT Security Working Group**

A key task for the Bank Security Committee's IT Security Working Group in 2010 was the drafting of a proposal to revise the Hungarian Financial Supervisory Authority's Recommendation on Internet Security with a view to maintaining customer confidence in using electronic banking channels.

The Working Group drafted a proposal for amendments to the Operational Rules of the Bank Security Committee. Several banks participated in the COMEX 2010 drill. The Working Group met with the competent associate of the Data Protection Ombudsman to discuss the possibilities for information sharing between banks on suspicious cases (for example, exchange of photos and video recordings). Namely, the Data Protection Act does not allow for such information exchange. This is a major obstacle to detecting and intercepting frauds. It would be a solution if specific regulations were provided in the law regulating the area in question (for example, for banks, in the Credit Institutions Act).

###### **1.1.2 Human and Physical Security Working Group**

Bank robberies were a key issue addressed by the Working Group in 2010. Cooperation and information exchange between banks and the Police (in particular, in the transfer of surveillance camera recordings) has improved, however, the number of bank robberies continues to remain high (which is also attributable to increasing livelihood problems).

As another key issue, the Working Group also addressed the dangers in hostage situations during bank robberies. Participants were divided over the probability of tiger kidnapping incidents in Hungary.

The Working Group addressed security issues related to human risk: a significant part of bank frauds is attributable to employees. The Working Group discussed a letter from the Police criticising banks' practices regarding the line-up of security guards in bank branches.

###### **1.1.3 Anti-Fraud Working Group**

The Anti-Fraud Working Group reviewed experience of the e-Post system operated by the Hungarian Chamber of Bailiffs. The system is currently used by five banks. The number of inquiries has doubled since the installation of the system. 24,000 persons are inquired on monthly. 85% of the answers are negative. The discussion on the most frequent types of fraud revealed that, as is the case in other countries, a major part of frauds in Hungary start from inside the bank. Fraud is also facilitated by the fact that for customer convenience, banks' systems allow changing certain data without the customer being present in person.

The Fraud Forum, addressing bankcard frauds, is a good example of how bankcard frauds can be prevented through cooperation between banks. The Working Group agreed to meet on a monthly basis to exchange information on the various types of frauds they have learned of.

## **1.2 Anti-Money Laundering and Anti-Terrorism Working Group**

The Working Group reviewed the report on Moneyval's 4<sup>th</sup> round mutual evaluation of Hungary. Moneyval is a committee of experts from EU member states that are not members of the Financial Action Task Force (FATF), the international anti-money laundering and anti-terrorist financing organisation established by the OECD. The report established that Hungarian banks are committed to combating money laundering and are aware of the customer due diligence requirements and record-keeping obligations related to transfers of funds. Deficiencies were identified in the areas of legislation and implementation of the law. The government does not plan to revise the Anti-Money Laundering Act until CRD3 and, possibly, CRD4 are adopted.

## **1.3 Payments Working Group**

The Association's Payments Working Group meets on a monthly basis. The working group reviewed practical issues arisen during implementation of the relevant laws. Members of the working group consider these meeting as important in developing best practices for the issues arisen. In cases where the legislation is not clear enough, the Working Group can turn to the regulators for clarification or ruling.

The Working Group reviewed the proposed amendment to the relevant MNB Decree due to the introduction of intraday settlements in Hungary effective from July 1, 2012 (currently, the settlement date is T+1 day). The issues arisen were clarified at a consultation with the MNB.

## **1.4 Work-Out Committee**

The Association's Work-Out Committee held several meetings to address issues related to the interpretation of new provisions in the Bankruptcy Act, application of the new provisions, issues related to the appointment of liquidators and the need to amend certain provisions of the Act.

The Committee held a special meeting to address issues related to the enforceability of guarantees. The Committee provided a proposal for complementing Garantiqa Creditguarantee's business terms and conditions with procedures to be applied in the case of liquidation proceedings.

The Committee heard a presentation on the London Rules, a self-regulation model aimed at dealing with companies in financial difficulties. The presenters reviewed the advantages of a voluntary cooperation and agreement between creditor banks versus a bankruptcy or liquidation proceeding.

The presenters emphasised that a self-regulation such as the London Rules is also warranted in view of the insolvency moratorium provisions of the new Bankruptcy Act, leaving banks defenceless due to bankruptcy protection. The Association set up an ad hoc Working Committee from representatives from the initiating organisations and banks supporting the concept. The Working Committee developed a proposal for the procedure.

### **1.5 Intermediaries Working Group**

In relation to the new regulations on intermediaries, taking effect in January 2010, the Association worked actively on drafting the relevant implementation decrees. We provided proposals for the implementation decrees on intermediaries' liability insurance, fees and qualification system. Our elaborate and mature proposals largely contributed to the timely enactment of these decrees.

A number of interpretation issues arose during preparations for the new licensing system. The Association organised consultations and attended conferences on the issue. We also requested rulings from the Hungarian Financial Supervisory Authority. We participated in the preparations for the training and qualification process and reviewed the curriculum and tests for authority exam. Based on practical experience, we initiated amendments to the Credit Institutions Act's provisions on intermediaries. Most of the changes proposed were incorporated in the Credit Institutions Act through the omnibus legislation adopted in the autumn.

### **1.6 Taxation Working Group**

The Association's Taxation Working Group formulated a number of proposals and requests aimed at promoting implementation of the various tax laws. The Working Group's proposals were sent to the Ministry for National Economy. We reviewed the new proposals published on the Parliament's website in the fourth quarter and provided comments and proposals for adjustments to them. We held several consultations with a view to making the rules for the bank tax imposed in 2010 more practicable and on issues related to the accounting of the extra tax (immediately reducing profits) and the possibilities for its deferral and for shifting to a classical profit-based tax. The Working Group analysed several alternatives, but none of the solutions received unanimous support. The Working Group was not involved in the review and drafting of the legislation.

### **1.7 SME Working Group**

We organised several consultations with the Hungarian Development Bank and other banks involved on certain changes in the terms and conditions for SME loan schemes made available by the Hungarian Development Bank. During the consultations, agreement was reached regarding the implementation of the changes.

There were several consultations held between banks and Garantiqa Creditguarantee Ltd. on changes in Garantiqa's General Business Terms and Conditions. In addition to other issues, the discussion was focused on whether the changes were in line with the Basel II requirements. Banks were of the view that the changes eliminate the advantage of a zero capital charge for loans counter-guaranteed by the state.

At Garantiqa's request, the Association agreed to take steps with the government to increase the rate of government counter-guarantees from 70% to 85%. At the same time, we considered the increase of Garantiqa's guarantee fees untimely: in a financial crisis, the state's task should be to flatten the cycle and promote, through various tools, SME financing. The Association is of the view that short-term losses should be covered from Garantiqa's accumulated funds. In the long-term, the Association sees room for a risk-proportionate fee.

## **1.8 Agricultural Working Group**

At banks' request, the State Secretary of the Ministry of Agriculture held a consultation on the system of and changes in agricultural support in 2010. The meeting was attended by a representative from the Agricultural and Rural Development Agency. At the meeting, the Deputy CEO of the Hungarian Development Bank (MFB) briefed banks on changes in the MFB's terms and conditions for agricultural loans in 2010.

In the middle of the year, the Association organised an information-exchange meeting with the competent leaders of the Ministry of Rural Development. At the meeting, banks' representatives provided information on the situation of agricultural lending, pointing out that due to disaster losses, there has been little interest shown in the available subsidies as yet.

## **2. Conferences, round-table discussions**

### **2.1 Conference on IFRS 9 Financial Instruments reporting standards**

The Association, in cooperation with KPMG, organised a conference at the beginning of the summer on the IFRS 9, a new standard to replace IAS 39. The conference was aimed to brief banks' accounting, IT and risk management specialists on main characteristics of the new standard, planned to be introduced from 2013. The conference was attended by more than 100 participants.

### **2.2 Conference on 2011 tax changes**

As in the previous years, the Association in December organised a one-day conference (Tax Forum) for banks' taxation officers on tax law changes affecting the sector. Presenters at the conference included representatives from the Finance Ministry, involved in the drafting of the new tax laws. An audience of 50 heard presentations on main tax changes taking effect in 2011 (personal income tax, corporate tax, bank tax, social security contributions).

Participants made active contributions to the Forum and gave positive feedback on the event.

## **3. Consultations**

### **3.1 Discussions with the Minister for National Economy**

The Association's Board held discussions with the Ministry for National Economy in November as well as in December. At the meeting in November, the Association's President pointed out that the measures introduced by the government in recent months (the imposition of a bank tax, the eight-point plan of FIDESZ MPs, the trebling of the contributions to the National Deposit Insurance Fund, the freezing of private pension fund contributions, the temporary suspension of the Budapest Transport Company's operating licence) have damaged banks' operating conditions and Hungary's standing in the international money markets. He considered it crucial to develop a more favourable economic environment and to take measures to improve Hungary's ratings. The bank tax should be reduced in 2012, as promised, and subsequently, the system to be introduced in the EU should be adopted in Hungary.

The Association's President emphasized the need to find an early solution to problems of home loan borrowers through the proposed National Asset Management Company.

The **Minister for National Economy** said he considered the meeting as a new beginning and regarded the Hungarian banking community as his most important ally. The concept of the proposed National Asset Management Company has been changed to specifically address social problems. He welcomed the proposal to extend the credit guarantee system and said the Ministry will support the proposal.

**Leaders of the Association** pointed out that restoring Hungary's credibility and the confidence of investors (apart from that of banks' shareholders) is a fundamental interest for banks. It is crucial to abolish the eviction moratorium and to restore the conditions for mortgage lending. A further tightening of banking regulations would be unbearable. SME financing could be improved by making the criteria for the Széchenyi Card Scheme more flexible. Addressing debtors in default can no longer be delayed. The treatment of mortgage loans is a ticking bomb in the banking system.

In response to the issues raised by leaders of the Association, the **Minister for National Economy, György Matolcsy** said that the government will meet the budget deficit targets, and the next step will be to prove its political strength to carry out structural reforms. The government supports restoring the conditions for mortgage lending. The Minister emphasised the importance of cooperation and regular meetings between the banking sector and the government.

At the invitation of the Minister for National Economy, another meeting was held in **December**. The Minister for National Economy shared that the first stage in the new Government's operations, focused on stabilising the budget will be concluded by the end of the year and a new stage will begin in January 2011. At the end of February, the government will announce its stabilisation and growth programme, which will be focused on increasing competitiveness. The banking sector will have a crucial role to play in this programme; hence, the government considers the sector as a key ally. Accordingly, the government would like to conclude an agreement with the Banking Association in the first half of 2011, to set out the key elements of long-term cooperation. The government's stabilisation and growth programme will include a budget expenditure cut of HUF 600 billion to 800 billion, in the implementation of which the cooperation of the banking sector may also be essential.

The Association's President gave a brief outline of the practical issues and problems that would require cooperation between the government and the industry, including the addressing of the problem of mortgage loan debtors (in particular, those with debts denominated in Swiss Francs), the lifting of the eviction moratorium, the difficulties in enforcing government guarantees, amendments to the Bankruptcy Act, the definition of the roles of the National Development Bank and Eximbank, and regulatory issues.

### **3.2 Consultation on current issues affecting the Finnish and Hungarian banking sectors**

Representatives from the Hungarian Banking Association and the Federation of Finnish Financial Services in March held a consultation on current issues affecting the banking sectors of the two countries. The meeting was held at the invitation of the Finnish Federation and organised by the Hungarian Embassy in Helsinki. An important conclusion of the meeting was that smaller EU member states should act in a coordinated manner in major issues (proposed regulations, directives) affecting their banking sectors, as their interests are often not taken sufficiently into account.

### **3.3 Consultation with the Hungarian Financial Supervisory Authority on consumer protection issues**

At the initiative of the Compliance Committee, we initiated a consultation with the Hungarian Financial Supervisory Authority's consumer protection officers. At the consultation, the Supervisory Authority's officers presented their plans, the main changes and proposed consumer protection legislation. In certain cases, the Supervisory Authority may launch investigations upon reports filed by non-natural persons. In these cases, it is not the person of the complainant, but the contents of the complaint that will determine the nature of the proceeding. If the contents of the complaint may affect consumers, then a consumer protection proceeding may be instituted. Overall, it could be concluded from the discussion that the Supervisory Authority will interpret the regulations as broadly as possible when it comes to cases involving consumer protection issues or found by the Authority to be of that nature.

### **3.4 Consultation on current issues related to the legislation on intermediaries**

The Association's Intermediaries Working Group held a meeting with the Hungarian Financial Supervisory Authority's Managing Director for Licensing and Legal Enforcement and his associates. In relation to the secondary school qualification requirement, the Authority shares the Association's opinion that the relevant definition in the Credit Institutions Act is inaccurate. Regarding the **rating of qualifications**, the Hungarian Financial Supervisory Authority regularly requests rulings from the National Institute of Vocational and Adult Education.

### **3.5 Presentation on auditor's reports**

In his presentation, held for banks' lending and risk management officers and attended by 300 professionals, the President of the Hungarian Chamber of Auditors reviewed the contents of the various items of the balance sheet and profit and loss account, highlighting the potential risks. Going item-by-item, he reviewed the main financial transactions, inadvertent errors and signs of potential fraud.

The presentation, illustrated with a number of practical examples, was found interesting and useful and was followed by additional presentations in view of the great interest shown in the topic.

### **3.6 Meeting with leaders of the Hungarian Bar Association**

Signatories to the Code of Conduct on Retail Lending have, inter alia, committed to drawing the attention of third party contributors to loan agreements that they may not participate as purchasers in any purchase of the receivables initiated by the creditor or in a potential liquidation proceeding at a later stage. Given that third party contributors mainly include legal counsels and notaries public, at the proposal of the Hungarian Financial Supervisory Authority, we wrote a letter to the Chambers of the two professions, drawing attention to this conflict of interest. The Bar Association initiated a meeting on the issue. At the meeting, we explained the importance of the Code of Conduct and reviewed some other current issues.

## **4. Meeting of the EBF Financial Markets Committee in Budapest**

In the half-year preceding the new EU presidency, the European Banking Federation's Financial Markets Committee holds its meeting in the country taking over the EU presidency.

Accordingly, the Association hosted the Financial Markets Committee's Meeting on October 14-15, 2010 in Budapest.

At the meeting, the State Secretary responsible for financial policy at the Ministry of National Economy briefed participants on the Hungarian presidency's legislative plans regarding financial and investment services.

Opening the second day, Mihály Patai, in his capacity as Vice-President of the Budapest Stock Exchange, gave a presentation on current issues related to the Hungarian money and capital markets, the situation of the banking sector and the, unfounded, anti-bank sentiment, which, as in other countries, is present also in Hungary. He reaffirmed that foreign banks in Hungary think on a long-term basis and do not plan to abandon the market despite the seriously negative (hopefully, exceptional) measures affecting them.

Finally, the EBF Secretariat briefed participants on the general decision-making mechanism in the EU and on the status of proposed pieces of legislation affecting the industry.

### **5. Foreign Bankers' Club**

At the Association's Foreign Bankers' Club's meeting, the Association's president gave a briefing on activities of the Association. At the end of the meeting, foreign CEOs proposed that further consultations and coordination should be held on the issues addressed. The Club's rotating chair, the CEO of K&H Bank, Mr Hendrik Scheeling was requested to manage this task. The meeting was attended by Ms Irina Ivaschenko, Head of the IMF's Budapest Office.

Mr Scheeling reported that following the Club's meeting he had bilateral meetings with foreign CEOs. Based on these meetings, a summary was compiled on the proposals made by foreign CEOs to make the Association's work more efficient. Also, foreign CEOs requested to be given the opportunity to participate more actively in the Association's decision-making processes.

### **6. Meeting between banks' communications officers and financial and business journalists**

At the end of February, the Association organised, for the third time now, a meeting for banks' communications managers and prominent financial and business journalists, in the form of a dinner. The event was aimed at strengthening our media relations and offered the opportunity for journalists for an informal exchange with banks' communications officers. An attendance of 40 participants shows the popularity of the event. The dinner was attended by spokesmen of the Ministry of Finance and the Hungarian Supervisory Authority.

### **7. Pre-Christmas dinner for CEOs**

The Association held its traditional pre-Christmas dinner for CEOs on December 6. The dinner was attended by the Governor of the MNB and the President of the Hungarian Financial Supervisory Authority.

Before the dinner, we held a meeting for CEOs, where the Association's President gave a briefing on current issues, regulatory changes and actions taken by the Association in relation to various government measures affecting the industry.



## **8. Cooperation with the Association of Hungarian Travel Agents and Tour Operators**

The Association's Secretary-General was invited to attend the Board Meeting of the Association of Hungarian Travel Agents and Tour Operators (MUISZ), addressing issues related to payments, online sales and bankcard acceptance. To tackle the issues arisen, the Association and the MUISZ in February organised a technical meeting to seek specific solutions to the issues raised. At the Association's proposal, specialists from MUISZ and Giro Bankcard Ltd. met to review new opportunities regarding the operation of POS terminals operated at travel agents' offices.

## IV. INTERNATIONAL RELATIONS

### 1. EBF Committees

#### 1.1 Fiscal Committee

Tightening the regulations on banking supervision is a central issue at the EU level. There is a debate on proposed measures aimed at building reserves in the banking sector to avoid similar crises in the future and on punishing those institutions responsible for the crisis and recovering the public funds provided for bailouts.

The EBF's committees are investigating the issue of imposing a tax on banks. The industry accepts that the global financial system needs to be stabilised. At the Pittsburgh summit, the G20 leaders reviewed the proposals mooted by the U.S. government to consider the **imposition of a bank tax** or the setting up of a **Resolution Fund**.

Based on an analysis of potential options, the IMF proposed the imposition of two new taxes: a Financial Stability Contribution (FSC) and a Financial Activities Tax (FAT).

**A major objection to the IMF's proposal** is that a tax on the financial sector would lead to market distortions, reduce banks' competitiveness and could not be applied on a general basis, given the different sizes of bailouts provided by the governments in the various countries (with no bailouts at all in some countries).

The EBF is of the view that there is a need for a crisis management framework that would enable member states to offer banks in distress solutions that are based on the criteria of preserving financial stability and confidence in the banking sector.

At the same time, it would be expedient to explore **what kind of special measures could be adopted by national and EU-level supervisors to manage/prevent bank crises**.

To this end, measures adopted by member states to compensate for the public funds spent should be reviewed, as they may vary within a wide range.

The EBF is divided over the proposal for a European resolution fund and sees a need for further work and consultations on the issue. The EBF is of the view that the guidelines for crisis management now under development should extend to all financial institutions. The European Commission and Parliament envisage the guidelines to be initially applied to cross-border deposit taking institutions and later extended to all financial market players. An alternative to application by institution type would be application based on the same business/same risks/same rules principle.

The Fiscal Committee gives special attention to the Foreign Account Tax Compliance Act (FACTA) enacted in the U.S. in March 2010. The purpose of this Act is to monitor payments made to foreign accounts to evade federal tax. Data protection issues related to the reports are unclear and the development of the required reporting systems and processes will pose a major challenge for financial institutions.

Financial institutions and their organisations, including the EBF, are making special efforts at the international level to make the provisions of the FACTA more practicable. The International Banking Federation (IBFed), whose members include the banking associations of the USA, the EU, Canada, Australia, Japan, China, India and the Republic of South Africa, turned in a letter to the IRS and the U.S. Treasury, drawing attention to key issues related to the implementation of the Act. While expressing its agreement with the U.S. government's objective (that is, for all U.S. citizens to pay taxes on their real incomes), the EBF pointed out that managing tax liabilities on a worldwide scale would be an excessive task for banks as well as for the IRS.

## **1.2 Consumer Affairs Committee**

The EBF Consumer Affairs Committee expressed its regret over the European Commission's shift of focus to consumer protection issues rather than focusing on promoting the integration of financial markets in Europe. This shift is to some extent understandable after the financial crisis; however, it may lead to missing the desired vision.

The EU authorities would like to enforce the principles of responsible lending by imposing higher (risk proportionate) capital requirements and by regulating individual lending. European banks consider the proposed measures excessive and overly stringent.

The main topic of the Committee's meetings was the proposed EU legislation on responsible mortgage lending and borrowing. The proposed legislation aims to extend the Consumer Credit Directive, adopted two years ago, to mortgage credits. The industry has, both verbally and in writing, drawn the attention of all competent EU forums to the risks in the proposed concept, including overregulation and shifting the responsibility for consumer decisions to banks.

The industry agrees that lending by financial enterprises and credit agencies should be regulated more tightly, but the relevant regulations should be developed at the national level.

The Committee reviewed the EU self-regulation initiative aimed at facilitating the comparison of deposit products. The industry responded to the EU Commissioner's letter with a cautious rejection, given that the practice proposed by the EU is already applied in some member states. However, the European Commission insists on a self-regulation.

## **1.3 Anti Money-Laundering and Anti-Fraud Committee**

The EBF's Anti-Money Laundering and Anti-Fraud Committee addressed the Third Anti-Money Laundering Directive. (An assessment report on the Directive is underway, the report may serve as a basis for the Fourth Directive). The application of sanctions is inconsistent due to divergent national interpretations of the sanctions. Consistent interpretation at the EU level would be needed.

At their Pittsburgh summit, the G20 established that 2.7 billion people in the world have no basic accounts. The G20 committed themselves to making financial services accessible for the poor (*financial inclusion*). The U.S. goes as far as saying that financial exclusion is a factor increasing the threat of terrorism. Among the reasons for financial exclusion are the strict customer identification rules imposed for anti-money laundering considerations. Adequate methods should be developed to identify those customers that have no ID documents, for examples the masses of immigrants. The tools for financial inclusion may be different: in

underdeveloped countries, mobile payments, while in the developed regions, basic accounts are more preferred.

Consistent anti-money laundering actions are hindered by some data protection rules. Hence, the EBF should be involved in the review of the Data Protection Directive. In view of the Hungarian presidency, at the Association's invitation, the EBF Anti-Money Laundering and Anti-Fraud Committee will hold its 50<sup>th</sup> Meeting in June 2011 in Budapest.

#### **1.4 Physical Security Working Group**

The Physical Security Working Group reviewed the EU's bank robbery statistics of 2009. The number of bank robberies in the EU decreased in 2009, with a substantial improvement in Italy, where the number of bank robberies has been one of the highest in recent years. The improvement is mainly attributable to better use of the available technical facilities (in particular, video cameras) and successful arrests. The statistics of Central-European member states (Poland, Slovakia, Hungary) deteriorated, basically due to a dramatic drop in living standards and some people feeling hopeless and resorting to crime in the wake of the financial crisis. The number of bank robberies rose substantially in Poland, while in Slovakia, the number of assaults on ATMs increased sharply. The Physical Security Working Group reviewed the latest trends, crime methods and prevention techniques in the various member states. Public sentiment in the wake of the crisis has led to violence against banks in some countries, banks should brace themselves for this.

#### **1.5 Legal Committee**

The Legal Committee adopted the action plan for the Committee and its Sub-Committees for 2010. Members proposed that the Committee give more attention to the issue of responsible lending.

In relation to the Securities Law Directive (SLD), the Committee had the view that the crisis has created a new situation and investor interests should be given more emphasis in the new legislation. Participants heard a briefing on the February meeting of the working group on netting agreements. In the context of crisis intervention and intra-group asset transfers, the Committee heard a briefing on the proposed reform of the European financial supervisory system and on the EBF's evolving stance on the issue. The EBF basically supported the proposals for the creation of the European Systemic Risk Board and the three European supervisory authorities. However, it emphasised that there were a number of issues that still needed clarification.

The Committee addressed issues related to responsible lending, bank account switching, the Directive on consumer's contractual rights, the Anti-Discrimination Directive and the proposed revision of the Data Protection Directive.

The EBF published its position on the European Commission's approach on personal data protection in the European Union. The EBF's ultimate goal in data protection is legal certainty. Data protection policies should protect not only individuals but also companies. The EBF highlighted the need for IT security measures to prevent frauds. The EBF supports the European Commission's endeavours to clarify the existing provisions on applicable law for cross-border data processing, as there are currently many inconsistencies between the provisions of the national legal systems in member states. The EBF welcomes the proposal for

a clear legal framework to govern data controllers' obligations and responsibilities. The EBF drew attention to some provisions in the Third Anti-Money Laundering Directives that are too general and give rise to inconsistent interpretation, thus causing legal uncertainty.

The CEBS plans to compile a set of guidelines on corporate governance to ensure consistent implementation of internal governance rules. The guidelines address the areas of transparency of the corporate structure, the functions and responsibilities of supervisory authorities and the role of IT security systems. The EBF's competent working group will prepare a comparison of existing national regulations and solutions. The purpose is to convince the European Commission that potential changes to the EU framework should be implemented through high-level legislation. The Association will also provide information for the analysis.

## **1.6 Communications Committee**

The Communications Committee collected arguments that could help restore confidence in the banking sector in the wake of the financial crisis. The Committee reviewed the draft proposal compiled based on experiences and comments received from national banking associations regarding the proposals to be made by the Committee to the EBF Executive Committee in relation to the EBF Secretariat's communications approach. The main message of the proposal was that as the crisis abates and the first signs of recovery begin to show, stronger communications, better supporting the interests of the banking community are needed. The Committee requested its Chairman (János Müller, Chief Adviser of the Hungarian Banking Association) to revise and finalise the proposal. The Committee's Chairman presented the revised proposal at the meeting held for the presidents and secretaries general of associate members of the EBF on December 9.

## **1.7 Banking Committee for European Social Affairs**

The Committee reviewed its activities over the past 10 years, giving special emphasis to national assessments conducted on impacts of the financial crisis on employment and social benefits. The Committee also discussed the role of social dialogue at the time of recession. Members of the Committee disagreed with the proposal to set qualification requirements in the banking sector and to set up a committee on this issue, given that qualification expectations are largely determined by the employment culture in the country in question.

## **1.8 Payments Systems Committee**

The Payment Systems Committee meets on a quarterly basis. The Committee decided to brief the Executive Committee in writing on the most important issues addressed at by the Committee, including the setting of a SEPA end date, migration to the SDD Scheme, the issue of application of Multilateral Interchange Fees for payment card transactions, the latest developments in the areas of innovative payment methods and electronic invoicing, the proposed SEPA Council and its role, data security issues arisen in connection with SWIFT transactions, and the increase in cash payments in the wake of the financial crisis and the costs and benefits of cashless payment methods.

The drafting of a major piece of legislation, similar in significance to the Payment Services Directive, is underway. The proposed legislation, inter alia, will set an end date for SEPA migration. The Payments Regulations Expert Group (PREG), providing legal support to the Payments Systems Committee, is tasked to follow the drafting process and to make proposals

for any necessary amendments to the proposed legislation. The Payment Services Directive allows for the creation of payment institutions (a competition to banks). The Payments Systems Committee compiled a table showing whether or not payment institutions can be banking association members in the various member states. There are different approaches in the various members states to the issue.

## ANNEX

## Annex 1

## INTERNATIONAL REGULATION, SUPERVISION

The international and EU bodies responsible for financial regulation and supervision (the Financial Stability Board, the Basel Committee on Banking Supervision, the IMF, the European Commission, the CEBS, etc.) continued work aimed at a more stringent regulation of the financial sector based on the decisions adopted by the political decision-makers, in particular, the G20. The regulatory endeavours were focused on strengthening banks' capital and liquidity standards, improving supervisory cooperation, tackling bank crises and systemically important financial institutions, corporate governance, including remuneration policies and practices, and the regulations on central counterparties and on OTC derivatives.

The Association's annual report is not the forum for presenting all the many regulatory initiatives and proposals in detail. (We sought to present them in detail in the annexes to our quarterly reports). In this report we will only focus on the most important ones.

## 1. Strengthening banks' capital and liquidity standards

### 1.1 Basel III

The Basel Committee made further progress in developing and refining the details of the proposed regulation aimed at **strengthening banks' capital and liquidity standards**. The Basel Committee's oversight body, the Group of Central Bank Governors and Heads of Supervisors, in their press releases in July and September published the agreements reached in relation to key elements of the Basel III package.

The July agreement addressed the **definition of capital**, the treatment of **counterparty credit risk**, the **leverage ratio** and the **global liquidity standards**. In relation to liquidity standards, the Committee relaxed the December 2009 proposal in several points.

Two consultative documents and two impact studies were published during the summer in the process of finalisation of the proposed Basel III framework. The Financial Stability Forum and the Basel Committee published two reports in August. The reports addressed the long-term macroeconomic impacts of the regulatory package published in December and will serve as inputs for final calibration. According to the assessments, the new regulation will have a clear net economic benefit, because the security and stability of the global banking sector will improve, and the probability of financial crises and the output losses concomitant with them will be reduced. The benefits stemming from this clearly override the output costs incurred as a result of the stricter capital and liquidity requirements. However, the study undertaken by the European Banking Federation (EBF) in cooperation with the IIF regards the potential negative consequences of the Basel III regulation as more significant.

The Basel Committee issued a separate consultative document on the countercyclical buffer. National authorities are to prescribe the setting up of countercyclical buffers if they think that the excessive credit growth is resulting in a build-up of system-wide risk. The countercyclical buffer to be introduced internationally (globally) would serve the same purpose in every

jurisdiction and guarantee the appropriate protection of the banking sector against future potential losses.

Another consultative document of the Basel Committee published in August made a proposal *to ensure the loss absorbency of regulatory capital (of SIFIs) at the point of non-viability*. The consultative document makes a proposal about how to ensure the write-off or conversion of the non-common share elements of equity in the interest of sharing the losses incurred prior to assisting an institution through non-market instruments. Pursuant to the proposal, all non-common Tier 1 instruments and Tier 2 instruments at internationally active banks must have a clause that requires them to be written-off or converted on the occurrence of a trigger event.

At its September 12 meeting, the Basel Committee decided on the timetable for implementation of the new framework. In its press release of September 12, the Basel Committee announced a substantial strengthening of the current capital requirements: the minimum requirement for common equity will be gradually increased from the current 2% to 4.5% by January 1, 2015. The Tier 1 capital requirement will increase from 4% to 6% over the same period. The minimum total capital requirement will remain 8%. Capital instruments that no longer qualify as non-common equity Tier 1 capital or Tier 2 capital will be phased out over 10 years beginning January 1, 2013. The required deductions from common equity will be implemented in steps of 20% in the period between 2014 and 2018. As announced in December 2009, banks will be required to hold a capital conservation buffer. The capital conservation buffer will be calibrated at 2.5% and will have to be built from common equity. It will have to be replenished to the target level in steps of 0.625% over four years from January 1, 2016. National authorities would have the power to require the building up of countercyclical buffers up to 2.5%. This buffer may consist of common equity or other fully loss absorbing capital.

The monitoring period for a non-risk based leverage ratio begins in January 2011; parallel application will extend from 2013 to 2017, while the disclosure requirements concerning the ratio and its components will have to be met from 2015. Following appropriate review and calibration, the leverage ratio will have to be applied under the Pillar 1 from 2018.

The Committee also agreed on the timetable for the introduction of the liquidity coverage ratio. After an observation period beginning in 2011, the liquidity coverage ratio (LCR) will be introduced on January 1, 2015. The revised net stable funding ratio (NSFR) will become a minimum standard by January 1, 2018. The Committee will put in place rigorous reporting processes to monitor the ratios during the transition period and will continue to review the implications of these standards for financial markets, credit extension and economic growth, addressing unintended consequences as necessary.

The proposed final versions of the Basel Committee's reform package were published in December. The Basel Committee reaffirmed the implementation dates announced earlier and fine-tuned the proposal, based on comments received and results of the impact studies. In the rules for short-term liquidity, the Committee introduced a new limit: the amount of inflows that can be offset by outflows over a thirty-day period is capped at 75% of total expected cash outflows. This requires that a bank must maintain a minimum amount of stock of liquid assets equal to 25% of the outflows. In relation to the documents on strengthening the resilience of the banking system, the Basel Committee issued guidance *for national authorities operating the countercyclical buffer system*.



In December, the Basel Committee also released the results of the *comprehensive impact study* conducted in 2010. Assuming full implementation as of December 31, 2009, the average common equity Tier 1 capital ratio (CET1) was significantly higher than the new minimum requirement of 4.5%.

As a final step in the reform to raise the quality of regulatory capital, the Basel Committee in the middle of January 2011 defined the trigger events for the write-off of non-common Tier 1 and Tier 2 capital or their conversion into common equity to absorb losses prior to any government assistance.

## **1.2 CRD revisions (CRD3, CRD4)**

The Basel Committee's global capital and liquidity decisions are implemented (with a certain delay) at the EU level through amendments to the Capital Requirements Directive. The first major CRD revision, CRD2 (affecting large exposures, hybrid capital instruments, supervisory cooperation and the treatment of securitised positions) had to be implemented by October 31, 2010 and first applied from December 31, 2010. Work in the first half of 2010 was focused on developing and adopting CRD3, addressing the capital requirements for the trading book and for re-securitisations (highly complex securitisations), the disclosure requirements for securitisations, and remuneration policies and practices. Also, a proposal for CRD4, complementing the Basel III framework with a Single Rule Book, was published in February 2010.

During the consultation on *CRD3*, the definition and weighting of highly complex securitisations and the proposals for the regulation of remunerations were the most debated issues. Market players also disagreed with the extension of the Basel I floors until December 31, 2011. As for remuneration policies, the text adopted under the co-decision mechanism basically corresponds to the Financial Stability Board's high-level principles, even surpassing them in certain points. The implementation date for the provisions on remuneration in CRD3 was December 31, 2010, the rest of the provisions will have to be implemented by July 1, 2011.

The consultative document on CRD4 was published in February 2010. The proposal basically corresponded to the Basel Committee's consultative documents published in December 2009. The document provided regulatory proposals for liquidity management, raising the quality of capital, the introduction of a leverage ratio, the treatment of counterparty risk, the clearing of OTC derivatives through central counterparties, improving the countercyclical nature of the regulatory framework (capital buffers, dynamic provisioning), the introduction of additional rules for systemically important institutions and provisions for the introduction of a single rule book. The European Commission held a public hearing on CRD4 to assess the European specificities that should be brought to the Basel Committee's attention, as the Basel Committee's proposal would have more adverse consequences for the European economy than for other economies.

*The European Parliament's Economic and Monetary Committee (ECON)* in September *adopted a resolution on the transposition of the Basel III capital framework into EU legislation*. The resolution provides that a comprehensive assessment should be undertaken to assess the cumulative impact on banks and on the real economy of the proposed new regulations. The proposed eligibility criteria for core Tier 1 capital in CRD4 should be reviewed. Also, European specificities in corporate financing should be taken account of. In

relation to the new rules adopted in the U.S.A., the ECON called on the European Commission to act proactively in the review of the Basel capital framework to ensure that European specificities are taken account of in the new regulations. Providing for a level playing field and avoiding regulatory arbitrage are key to ensuring that European banks are not put at a competitive disadvantage.

In October, the European Commission issued a consultative document on countercyclical buffers. The proposal complements the Basel Committee's July consultative document with some key issues regarding European banking groups. The document addresses the role of the European Systemic Risk Board (ESRB) and the European Banking Agency (EBA) in determining countercyclical buffers. As a second key point, the document addresses the question of how bank-countercyclical buffers should be calculated for EU banks that have established branches in other EU member States.

The European Commission's proposal for CRD4 is delayed and expected to be completed by June 2011. The proposal gives special attention to European specificities, such as the definition of capital (there is no commonly agreed definition in the EU for common equity), the home/host aspects in the liquidity framework, and grandfathering. The results of the quantitative impact study assessing the GDP impacts of the proposed regulatory package will be published together with the proposal. According to current plans, the final text of CRD4 is expected to be agreed by the end of 2013.

### **1.3 Industry opinions**

The European Banking Federation broadly agrees with the tightening up of the regulation. However, it considers that as a combined impact of the new regulations, the supply of credit, and as a consequence, economic growth, would drop significantly. The stringent capital requirements published in September are very demanding and banks will require significant fresh capital to meet the new requirements. The appropriate treatment of covered bonds is especially important from the point of view of export and trade finance in Europe.

As for the liquidity buffers proposed by the Committee, the EBF strongly opposes building buffers by restricting banks' managements' ability to set the dividend payout policy. While understanding the problems associated with procyclicality, the EBF is highly critical of the details of the proposal put forward in the document and considers that the proposal should be thoroughly reviewed.

In agreement with the idea that systemically important financial institutions should not have access to state rescue without the holders of non-common equities taking a share of the losses incurred, the EBF objects to the Committee's stipulating a particular proposal instead of a comprehensive approach. It believes that the problem should be handled within the framework of international crisis management. According to the EBF, it would be more suitable even within the dimension stipulated by the Committee if not all capital elements other than common shares would have to be made convertible, but contingent capital would be included in the existing capital structure as a new element.

## 2. Systemically important financial institutions (SIFIs) - Bank resolution framework

### 2.1 Systemically important financial institutions

The Institute of International Finance (IIF) in May published a report on systemic risk and systemically important firms. The report reviewed the characteristics of systemic risk and the benefits of systemically important firms and presented industry proposals for addressing systemic risk.

The report pointed out that systemic risk is a complex phenomenon. It is related to any institution, not just large systemic firms. It also has to do with interconnectedness. Smaller firms can also be a source of systemic risk. Proposals to limit the size of firms or to apply surcharges on large firms are unlikely to succeed in limiting systemic risk. The response to systemic risk should be complex, multifaceted and integrated. It requires an ongoing combination of enhanced regulation, sound industry practices, such as corporate governance and risk management, strong supervision and macro-prudential oversight, and effective market mechanisms and infrastructure. In addition, *a cross-border crisis resolution regime* is required, based on the principle that no firm should be considered too big to fail. Firms must have comprehensive recovery and resolution plans.

The Basel Committee in August published a consultative document on a *proposal to ensure the loss absorbency of regulatory capital at the point of non-viability*. The Basel Committee is expected to publish its comprehensive study on SIFIs in mid-2011, after sending it to the FSB.

The G20 leaders at the Seoul Summit endorsed the Financial Stability Board's policy framework for reducing the moral hazard of systemically important financial institutions (SIFIs). The framework calls for actions in five areas:

- ↳ A resolution framework and other measures to ensure that all financial institutions can be resolved safely, quickly and without destabilising the financial system and exposing the taxpayer to the risk of loss;
- ↳ A requirement that SIFIs and initially, in particular global SIFIs (G-SIFIs), have a higher loss absorbency capacity to reflect the greater risks that these institutions pose to the global financial system;
- ↳ More intensive supervisory oversight for financial institutions which may pose systemic risk;
- ↳ Robust core financial market infrastructures to reduce contagion risk from the failure of individual institutions;
- ↳ Other supplementary prudential and other requirements as determined by the national authorities.

The FSB has identified 24 banks and six insurance companies as global SIFIs.

The G20 leaders endorsed the policy framework and timelines proposed by the FSB to address the too-big-to-fail problem and the requirement for G-SIFIs to have recovery and resolution plans.

The European Commission's position is that the regulation of systemically important financial institutions should be addressed under the crisis resolution framework by strengthening supervision (with on-site inspections). The European Commission is not convinced that

imposing an additional capital requirement is the right answer. The issue is still being debated at the international level.

## 2.2 Bank resolution framework

The Basel Committee works closely with the Financial Stability Board on developing a proposal for *a cross-border bank resolution framework*. This work is aimed to provide assistance to national authorities in implementing the required reforms in crisis management, promoting convergence in crisis management practices and better cooperation between home and host authorities, a prerequisite for effective cross-border crisis management. At their November summit, the G20 leaders reaffirmed their commitment to national-level implementation of the Basel Committee's cross-border resolution recommendations. The proposal will be accompanied by a *global cumulative impact study*, assessing the cumulative effects of the proposed new deposit guarantee rules, the proposed crisis resolution framework and the implementation of the Basel III capital framework.

Parallel with - and in many respects ahead of - the work going on at the global level, work aimed at the development of a *common crisis management framework* under the concept of a single European market is in full gear in the *European Union*. The European Parliament responded to the European Commission's October 2009 communication on a cross-border bank resolution framework in an own report, published at the beginning of the summer. The Commission published a proposal for reorganisation/protection funds in June and a communication on the proposed crisis management framework in October.

The European Parliament's report provided recommendations in four areas: creating a European crisis management framework, addressing systemic banks, creating an EU Financial Stability Fund and establishing a Resolution Unit.

In line with the European Parliament's recommendations, the European Commission issued a communication, proposing that the EU establish an EU network of *bank resolution funds*. The funds would be financed from contributions from banks on an ex ante basis and exclusively used for bank resolution. In the case of large and very complex financial institutions, resolution funds would be complemented by recovery and resolution plans, debt-to-equity conversions and haircuts imposed on holders of subordinated debt. The Commission will revisit the issue of an EU Resolution Fund in 2014, the date foreseen in the proposed EBA Regulation for reviewing the new supervisory system.

In relation to the proposed resolution funds, the EBF considers it important that the contributions are levied on the same base, same rate and at a harmonised target level, by taking into account other risk mitigation factors (stronger capital framework, stronger supervisory framework).

Based on the results of the relevant consultation, *the CEBS provided the European Commission with further advice on specific issues relating to cross-border crisis management*. The advice focused on the following issues:

- General principles for the minimum common toolbox
- The minimum common toolbox and conditions for use
- Financing the implementation of the tools
- Recovery and resolution plans.

The European Commission in October 2010 issued *a new communication on the proposed EU framework for crisis management in the financial sector*. The Commission proposed a toolbox of measures, including:

- a requirement for institutions and authorities to prepare recovery and resolution plans;
- powers for supervisors to require the replacement of management, or to require an institution to divest itself of activities or business lines that pose an excessive risk to its financial soundness;
- resolution tools, such as powers to transfer assets and liabilities of a failing bank to another institution or to a bridge bank;
- identifying resolution authorities to exercise the resolution powers (prevention, crisis management);
- the European Supervisory Authorities (ESAs) should be given a coordination and support role;
- establishment of national resolution funds.

The European Commission will publish a report on the further harmonisation of insolvency regimes (Insolvency Framework) by the end of 2012.

In its response to the Commission's communication, the EBF pointed out that resolution frameworks should be introduced globally to ensure a level playing field, and the proposed European crisis management framework should focus on both preventative and early intervention tools and resolution mechanisms.

### 3. Financial supervision

Efficient supervision is key to effective crisis prevention and crisis management. Accordingly in addition to post-crisis measures, a reform of the system of financial supervision is of key importance. It is essential that this is done by taking due account of *macroprudential risks*.

#### 3.1 Supervisory colleges

Since the introduction of the Basel II framework, supervisory colleges have been played an increasingly important role in enhancing cooperation and coordination between supervisors. The Basel Committee in March published a consultative paper on good practice principles for supervisory colleges, aimed at supporting the G20's and the Financial Stability Board's objective to strengthen supervisory cooperation and supplementing the guidance issued by the Basel Committee on cross-border cooperation and information sharing. The Committee outlined eight principles in relation to college objectives, governance, information sharing, communication channels, collaborative work, interaction with the institution, crisis management and macroprudential work.

Following the Basel Committee's consultative paper, the CEBS, in response to the relevant requirement set forth in the revised capital requirements directive (CRD2), also published its guidelines for the operational functioning of colleges of supervisors. The guidelines are aimed to provide guidance for the different tasks to be performed by the supervisors involved within a college, including the process of setting up the college, the exchange of information among college members, communication with managements of the supervised institutions, the voluntary sharing and delegation of tasks and the adoption of joint decisions on the permission

for the use of internal models and on the adequacy of own funds held by the group and its entities. Supervisors within colleges are also provided with guidance for taking due account of macro-prudential risks and for the planning and coordination of activities in emergency situations.

The **industry** is of the opinion that the CEBS's guidelines encourage convergence of supervisory practices and help creating a level playing field. The industry welcomes the strengthening of the role of the consolidating supervisor and supports the coordination of information requests to the supervised institution and the submission of ICAAP reports in a coordinated and synchronised time frame. The industry also welcomes the flexible approach of the guidelines allowing for taking account of experience gathered during implementation.

The CEBS in October published its second report on the functioning of supervisory colleges. The report presents the outcome of the review carried out between April 26 and June 8, 2010 on colleges' activities in the areas of information exchange, risk assessment and planning and coordination. According to the general findings of the report, the majority of supervisory colleges achieved considerable progress in the application of the relevant requirements and guidelines. Further progress is needed in the areas of common planning, identification, assessment and mitigation of risks.

### 3.2 New European supervisory architecture

Work aimed at developing a new financial supervisory architecture in Europe continued in 2010. The *European Systemic Risk Council (ESRC)* and the *European System of Financial Supervision (ESFS)* were created to commence operations on January 1, 2011. The **European supervisory authorities (ESAs) for the banking, securities and insurance and occupational pensions sectors: the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA)** were set up through the transformation of the former three Level 3 Committees. Under a co-decision process, an *omnibus directive* was adopted to incorporate the new supervisory architecture into the sector regulations.

Under the relevant Regulations, the new European Supervisory Authorities (ESAs) will have the power to intervene if divergences from Community law are not remedied by the national supervisor. This power will promote the removal of barriers to convergence and the development of a *Single Rule Book*. Disagreements between supervisors will be settled by the ESAs under own initiative procedures launched by the ESA. The new supervisory authorities will have the power to prohibit or restrict operations if financial stability is jeopardised. The ESAs will also have the task to develop technical standards. These standards may only be altered by the European Commission after consultations with the competent authorities (as a rule, Level 3 regulations will be formally adopted by the Commission). Proposed regulations and standards will be submitted by the ESAs to public consultation and impact assessment before being adopted.

*If the orderly operation of the financial system or financial markets is jeopardised*, the new authorities may require national supervisors to take emergency measures. It will be the Council to decide on a state of emergency following a request by the ESAs, the ESRB or the Commission. A common toolset, including financing mechanisms, will have to be developed with a view to ensuring convergence of crisis resolution and crisis prevention practices.

*Supervisory colleges* will have a key role in ensuring consistent supervision of cross-border groups.<sup>1</sup> As full members of the ESAs, supervisory colleges will contribute to streamlining information exchange and promoting convergence. ESAs will have an important role in the harmonisation of deposit, investor and insurance guarantee schemes. Tasks of the ESAs will include initiating and coordinating EU-level stress tests in cooperation with the ESRB. As a rule, the ESAs will collect the information needed for their operations from the national supervisors. However, in exceptional, warranted cases, the ESAs may solicit information directly from the financial institutions.

#### 4. Corporate governance, remuneration policies

In line with the political decision-makers' intentions, corporate governance, and in particular, remuneration policies continued to be given special emphasis in the legislative work in 2010. A number of consultative documents were published on these issues in the EU as well as at the global level.

The *Basel Committee* in March published a consultation document *on principles for enhancing corporate governance* at banking organisations. The document gives an overview of corporate governance and provides principles for the key areas of focus, including board practices, senior management, risk management and internal controls, complex or opaque corporate structures and disclosure and transparency. Supervisors have a critical role in ensuring that banks practice good corporate governance. They should establish guidance or rules requiring banks to have robust corporate governance strategies, policies and procedures. Commensurate with a bank's size, complexity, structure and risk profile, supervisors should regularly evaluate the bank's corporate governance policies and practices as well as its implementation of the Committee's principles.

At the European level, the three Level 3 Committees conducted a stock take on and analysis of *on cross-sector convergence of corporate governance principles*, identifying those areas requiring further harmonisation.

The European Commission launched a public consultation on a Green Paper on corporate governance and remuneration policies in financial companies. The EP rapporteur pointed out that the area of corporate governance is constantly evolving and is therefore ill suited to a prescriptive approach: a flexible "comply or explain" approach in the form of codes of best practice would be more appropriate. The European Banking Federation emphasised that corporate governance rules should reflect the different national structures and business models and the principle of proportionality should be applied.

The CEBS in October published its consultation paper on the Guidebook on Internal Governance, aimed at *enhancing and consolidating supervisory expectations* with a view to improving the sound implementation of internal governance arrangements.

The Basel Committee published a document on *compensation principles and standard assessment methodology*, aimed to help supervisors assess a firm's compliance with the Financial Stability Board's Principles for Sound Compensation Practices and related implementation standards.

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<sup>1</sup> The previous proposal for the EBA to directly supervise systemically important financial institutions and groups was dropped. The new text does not contain any specific reference or provisions for systemically important financial institutions (SIFIs).

The Committee's consultation report analyses the methods used by banks for incorporating risk into bonus pools and individual compensation schemes.

The CEBS drafted a set of *guidelines* on remuneration practices and policies under CRD3. In drafting the guidelines, the CEBS took into account work carried out by the Financial Stability Board and the European Commission, its own high-level principles and the implementation study carried out by the CEBS in the first quarter of 2010. Also, the CEBS published a report on the on the implementation of the high-level principles at the institutions and supervisory authorities.

## 5. Other regulatory developments

In the wake of the financial crisis and in light of the need to bailout banks from state/taxpayer funds, the imposition of *a levy on financial activities* has become a key issue in European and global regulation. The *IMF* compiled a *report for the G20 group*, analysing the potential options for a bank tax. The analysis extended to three forms of contribution from the financial sector: a Financial Stability Contribution (FSC), a Financial Activities Tax (FAT) and a Financial Transaction Tax (FTT). The report concluded that this third option, the Financial Transactions Tax did not appear well suited for the specific purposes set out in the mandate from the G20 leaders.

Bank taxes were imposed in a number of member states in 2010. The base of the tax varies (total assets, certain types of liabilities, profit, etc.) by country and so does the tax rate. This contradicts the principles of a level playing field.

Another key issue in *EU legislation* is the regulation of *Credit Rating Agencies*. The European Commission put forward a proposal to amend the 2009 regulation and launched a public consultation on CRAs in relation to a number of issues not addressed by the regulation. Also, the European Parliament made some own initiative proposals for the further regulation of credit rating agencies. The CEBS revised its guidelines on the recognition of ECAIs<sup>2</sup> (CP37) and provided technical advice to the European Commission on the recognition of ECAIs. The rules under which EU-based credit rating agencies may endorse ratings issued in third (non-EU) countries were also reviewed.

Regulatory initiatives included the European Commission's public consultation and legislative proposal for the clearing and risk mitigation of *OTC derivatives*, requirements for *central counterparties* and reporting obligation and requirements for *trade repositories*, proposals for amendments to the *Credit Guarantee Schemes Directive* and the *Investor Compensation Scheme Directive* and the Commission's *Green Paper on Audit Policy*.

2010 activities of the CEBS (from January 2011: the European Banking Authority) were governed by the priorities set out in the CEBS's work programme. In addition to the standards and guidelines already mentioned, the CEBS issued the following *Level 3 regulations*:

- ↳ High-level principles for risk management;
- ↳ Revised guidelines on supervisory disclosure;

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<sup>2</sup> External Credit Assessment Institutions



- ↳ Principles for disclosures at times of stress testing, reflecting the lessons learnt from the financial crisis;
- ↳ Guidelines on instruments referred to in Article 57 (a) of the CRD.

Also, the CEBS published a *consultation paper* on

- ↳ changes in the Advanced Measurement Approach in determining the regulatory capital charge for operational risk.

In addition, the CEBS provided advice to the European Commission on a Single Rule Book and an analysis on the scope of full harmonisation in the CRD. It coordinated and assessed the 2010 European level stress tests and the European impact study (EU-QIS) on Basel III. It prepared a report on the functioning of supervisory colleges, assessed the implementation of disclosure requirements for 2009 and launched a public consultation on its proposed amendments to the Guidelines on Common Reporting (COREP).

## 6. EBF lobbying

The *European Banking Federation* was actively involved in the European and - primarily through the IBFed<sup>3</sup> - the global standard setting processes. Commensurately with the importance of the proposals, the EBF provided comments on all consultation papers issued by the various regulatory committees. It actively participated in the impact assessment on Basel III and, where necessary, took proactive action to promote regulatory proposals favourable for the industry and against proposals detrimental to the industry.

Perhaps the most marked comments of the EBF in 2010 related to the Basel III framework and the imposition of bank levies. In relation to the proposed regulatory package, the EBF pointed out that any further decisions should only be made after a comprehensive impact assessment of all elements of the regulatory package. It also emphasised that the new measures, affecting banks' capital requirements and liquidity and the capital market as a whole, will reduce the supply of credit, and as a consequence, set back economic growth to a much larger extent than that shown in the impact studies conducted. In relation to the bank taxes imposed in the various countries, the EBF primarily objected to the distortion of a level playing field. In addition, the tax is levied at a time when capital accumulation would be crucial for banks to meet the increased capital requirements.

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<sup>3</sup> IBFed: International Banking Federation. (Founding members of the IBFed include the American Bankers Association, the Australian Bankers Association, the Canadian Bankers Association, the European Banking Federation and the Japanese Bankers Association. Associate members of the IBFed include the China Banking Association, the Indian Bankers Association, the Korea Federation of Banks, the Association of Russian Banks and the Banking Association of South Africa).

**BOARD MEETINGS****Agenda****January 11, 2010**

1. Briefing on the Hungarian Supervisory Authority's proposed circular on additional provisioning requirements
2. Proposal regarding the regulation of interchange fees and merchant fees
3. Proposal for amendments to the Association's Rules
4. Status report on the drafting of the Association's CSR programme
5. Briefing on the Basel Committee's proposed new capital and liquidity standards
6. Miscellaneous

**February 1, 2010**

1. Proposal for a "London Rules" type self-regulation
2. Briefing on proposed legislation on construction trusteeship
3. Report on the financial management of the Hungarian Banking Association in 2009 based on preliminary figures
4. CRIF Zrt.'s application for membership
5. Miscellaneous

**March 2, 2010**

1. Briefing on the proposed new European financial supervisory architecture
2. Briefing on the preparation of implementation decrees for the legislation on intermediaries
3. Draft submission to the General Meeting on the 2010 budget of the Hungarian Banking Association
4. Proposal for amendments to the Association's Rules
5. Nomination for Chairman of the Ethics Committee
6. Miscellaneous

**April 9, 2010**

1. Review of potential areas of cooperation with Garantiqa Creditguarantee Ltd.  
Presenter: Dr. György Radnai, CEO, Garantiqa Creditguarantee Ltd.
2. Report on 2009 activities of the Hungarian Banking Association (document for the General Meeting)
3. Proposal for amendments to the Association's Rules (document for the General Meeting)
4. Proposal for updating the Association's Membership Fee Rules
5. Proposal for the 2010 budget of the Hungarian Banking Association (document for the General Meeting)
6. Report on the financial management of the Hungarian Banking Association in 2009 (document for the General Meeting)
7. Briefing on the situation regarding the customer information guide on compensation from the National Deposit Insurance Fund

8. Update on the implementation decrees for the legislation on intermediaries
9. Briefing on amendments to the regulations on out-of-court sale of pledges
10. Miscellaneous

### **May 2010**

1. Board Recommendation on the Budapest Principles
2. Work Programme of the Hungarian Banking Association for 2010 (document for the General Meeting)
3. Letter from EON on the registration of electrical lines in the Land Registry and on related banking issues (collateral rating, mortgage, registration, etc.)
4. Miscellaneous

### **June 7, 2010**

1. Proposal for issues to be raised to the new government
2. Documents for the first half 2010 press meeting
3. Briefing on the Association's financial management in the first half of 2010
4. Miscellaneous

### **July 23, 2010**

1. Proposed government measures to help home loan borrowers in distress
2. Mandatory exchange rate for foreign currency loan repayments
3. CRIF Zrt.'s application for membership
4. Miscellaneous

### **September 6, 2010**

1. Briefing on the Hungarian banking sector in the first half of 2010
2. Proposal on constitutional objections to new regulations
3. Proposal on the Széchenyi Card Scheme
4. Proposal for participation in the Financial Navigator Programme
5. Report on the Association's financial management in the first half of 2010
6. Briefing on the Data Protection Commissioner's proposal concerning the Central Credit Information System
7. Miscellaneous

### **October 8, 2010**

1. Main directions of the development of European Credit Guarantee Schemes in the medium-term  
Presenter: András Fekete-Győr, Managing Director, National Deposit Insurance Fund
2. Report on the possible legal judgement of a potential constitutional complaint on the bank tax
3. Miscellaneous

**November 8, 2010**

1. Preparations for the 2011 General Meeting
2. Proposal for issues to be raised at the meeting with leading government officials (György Matolcsy and Mihály Varga)
3. Proposal for a CEO meeting - issues to be raised
4. Report on the Association's financial management in Q1-Q3 2010
5. In the context of the Hungarian presidency: Briefing on the European Commission's Work Programme for 2011
6. Briefing on the new Act on the Hungarian Financial Supervisory Authority
7. Briefing - Assessment of implementation of the self-regulation on bank account switching
8. Briefing on the Interior Ministry's proposal regarding the management of the red sludge disaster

**December 6, 2010**

1. Proposal for issues to be presented at the December 6 CEO meeting
2. Miscellaneous

### **Report of the Ethics Committee of the Hungarian Banking Association**

The new Code of Ethics has defined the composition of the new Ethics Committee. Accordingly, the Ethics Committee consists of a Chair elected by the General Meeting and members delegated by member institutions.

Here is my report on the Ethics Committee's activities in the past two years:

- No ethics procedures were initiated by members against each other; accordingly, no such ethics procedures were instituted in the period in question.
  
- During the same period, a number of requests were received from customers (both corporate and retail) for an ethics procedure. In the vast majority of these cases, after establishing contact between the customer and the bank in question, the customer, by mutual agreement with the bank, dropped the request. In some cases, the customers took note of the fact that the Ethics Committee has no jurisdiction over financial disputes and such matters should be referred to a court.

Miklós Pulai  
Chair of the Ethics Committee

**DRAFT RESOLUTION**

The General Meeting adopts the Report on 2010 Activities of the Hungarian Banking Association.

Budapest, April 15, 2011