



**HUNGARIAN BANKING ASSOCIATION**

**REPORT**  
**on Activities of the Hungarian Banking Association**  
**1st Quarter 2012**

**Budapest, April 2012**

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## **Executive Summary**

In accordance with the agreement between the Association and the government, the Early Repayment Act was amended on December 29 to provide, inter alia, that no later than January 30, 2012, the HUF amount of the early repayment should be paid up or a promissory note obtained from the creditor bank for the disbursement of the amount required for the early repayment. Compared to the previous regulation, the new provision shortened the time window for making the repayment.

The loss sustained by banks due to the early repayment scheme was heavier than expected. Although the number of debtors availing themselves of the scheme was around that estimated (approx. 170,000 applications), the 27% ratio of early repayments in terms of amount relative to the total portfolio (in the case of certain banks being even much higher) exceeded the estimates. At the same time, under the agreement concluded with the government in December 2011, banks can deduct 30% of their ensuing loss from the bank tax.

During the incorporation of the December agreement into law, a number of practical issues related to implementation arose, in which, in line with the spirit of the agreement, the government solicited the Association's opinion before making a decision. The compromise reached during these negotiations was acceptable for the banks. Accordingly, the legislation on Exchange Rate Cap Scheme II was adopted at the end of March, with a 3-stage implementation schedule to make the application process manageable. Basically, the only issue which was not incorporated into legislation in the first quarter in relation to the December agreement was our proposal regarding the raising of the number of real estates to be offered for purchase by the National Asset Management Company. In addition to all this, the Association continued to actively participate in the review of proposed laws affecting credit institutions.

The Association organised meetings with the national banking associations of the Visegrád countries and some non-EU member countries with a view to exchanging views and potentially developing common positions on current EU regulatory and prudential issues (Basel III, consumer protection regulations) and creating the conditions for closer cooperation.

At the beginning of the year, banks notified all customers on their data to be forwarded to the Central Credit Bureau and after data reconciliation, the initial upload of data into the Central Credit Bureau began.

The Association actively supports members' preparations for the introduction of SEPA compliant intraday settlements in July. The project (IG2) is now close to the go-live stage. The project's communications working group drafted a go-live communications plan, including the contents of communications and the expected FAQs and the relevant answers. The Association was involved in this work on an ongoing basis

The cessation of operations by MALÉV posed significant challenges for banks in relation to the refund of tickets purchased by bank card. Pursuant to the rules of international card associations, card issuer banks had to refund the purchase price of unused tickets to their customers. The collection of refund claims was managed under a uniform process developed at the consultations organised by the Association and the first refunds were made at the end of March.

The Association's scientific periodical, *Hitelintézeti Szemle* (Credit Institutions Review) published 37 studies by 44 authors in 2011. The periodical's thematic edition, addressing the theme "Risk, Uncertainty, Probability", was produced with contributions by prominent authors. The periodical is published in 1,000 copies. The Editorial Board agreed that the periodical's distribution list should be optimised. Accordingly, the share of the scientific community, savings cooperatives (paying a special contribution), the media, background institutions and fellow organisations will increase among the recipients of the periodical.

European prudential regulation in the first quarter of 2012 continued to be focused on the regulatory package related to Basel III implementation (CRD4/CRR). The EBF had several consultations on CRD4/CRR with the European Commission. It also organised a seminar (Focus Session), attended by MEPs in charge of the topic. Other focus issues addressed by the EBF included, inter alia, the revision to MiFID, the regulation of mortgage lending, the proposed introduction of a Financial Transaction Tax (FTT), preparations for compliance with the FATCA requirements, the regulatory package on retail bank accounts, the proposed legislation on Central Securities Depositories, and the Anti-Money Laundering Directive.

The EBF responded promptly to global and European regulatory developments. It extended and transformed its SIFI Working Group into a Macroprudential Oversight Working Group and, after the European Commission's setting up of a High Level Expert Group (led by the Governor of the Bank of Finland, Erkki Liikanen) on reforming the structure of the EU banking sector, the EBF set up a task force on the issue. It also created a task force to address issues related to the European Commission's Green Paper on shadow banking.

The EBF Risk Assessment Working Group developed a questionnaire on mortgage lending. The questionnaire was answered by the Association in cooperation with three member banks using the IRB approach. Our staff are actively involved in the work of other committees and working groups of the EBF, as well.

## **I. ECONOMIC ENVIRONMENT – The world economy, the Hungarian economy and performance of the Hungarian banking sector in 2011**

### **A) The world economy in 2011**

- Global GDP growth was 3.8% in 2011, 1.4% lower than in 2010. the IMF forecasts a 3.3% GDP growth rate for 2012, a 0.7% lower rate than forecast 3 months ago. (The growth forecast for 2013-ra is 3.9%, 0.2% higher than the average growth rate in the period between 1952 and 2012).
- The eurozone GDP is forecast to decline by 0.5% percentage points in 2012, growing in Germany and France by 0.3% and 0.2%, respectively, and falling in Italy and Spain by 1.7% and 2.0%, respectively.
- The EU GDP growth rate is forecast at –0.1%, GDP in the non-eurozone countries will grow on average.
- The U.S. GDP is forecast to grow by 1.8%, that of Japan and Canada by 1.7% each. Excluding these and the G7 and eurozone countries, GDP in the rest of the developing economies is forecast to grow by 2.6%. GDP is expected to grow by 1.2% in the developed countries and 5.4% in the developing world in 2012.
- GDP in the emerging European countries is forecast to grow by 1.1% in 2012, 4 percentage points slower than in 2011. This is the only developing region in the world where growth will be slower than in the developed economies in 2012. The BRIC countries are expected to do well, although some slowdown can be observed relative to 2011. (Brazil 3.0%, Russia 3.3%, India 7%, China 8.2%),
- World trade is expected to slow by 3 percentage points compared to 2011, to 3.8%., falling by 3.1 percentage points to 2.4% in the developed countries and by 2.9 percentage points to 6.1% in the developing countries. Compared to the period between 2010-2012, world trade is expected to slow by 8.9%.
- Looking at household savings in the developed countries in the past 20 years, the non-weighted average between 1992 and 2008 fell virtually linearly from 15.3% to 9.1%, to grow to 10% in 2011.
- The debt-to-GDP ratio of the PIIGS countries rose from 68% to 114% in the period between 2007 and 2011. Although still low, Spain's sovereign debt had grown since 2007 by 31 percentage points, to 67% of GDP in 2011. The debt-to-GDP ratio rose from 25% to 109% in Ireland, from 68% to 106% in Portugal and from 104% to 121% in Italy. Greece shows the most interesting path: the Greek sovereign debt grew from 50% in 1987 to 100% in 1993, to further rise from 105% in 2007 to 166% in 2011.
- In the long-term we have found that the greater the lag between gross savings and investment, the higher the growth in debt. (Twin-deficit). Looking at the EU-27, we can see that the higher the debt-to-GDP ratio and the poorer the country (and the more confused its economic policy), the higher its CDS spread. We have analysed the impact of the CDS spread on exchange rates and on the stock exchange index relative to GDP (taking the Hungarian figures between 2005 and 2011): the relationship was robust. Looking at the PIIGS data, the Greek case is a warning: the Greek CDS spread rose from 1,000 to 10,000 in a year (slightly correcting after the news on the international bailout deal). The Portuguese CDS moves around 1,000, while the others are (currently) better off: high government bond yields and high CDS spreads, inducing each other in a recessionary environment may lead to an explosion any time.
- The 30-year data series of the world economy reveal that the GDP growth rate was equivalent to about 25% of the growth rates of investment and trade, respectively. The

60-year data series show that GDP per capita moves between 1% to 3%, continuously declining after a peak in 2005. A rebound is made difficult by the fact that the customer loans-to-assets ratio in the USA (which can be considered as a macro-level LTV) has risen to 80%, thus, the 200-year-old model of GDP growth fuelled by lending does not work anymore.

- We do not know how the crisis can be solved, nor do we understand the exact reasons for it.

## **B) The Hungarian economy in 2011**

- Hungary's GDP grew by 1.7% in 2011, 0.1 percentage point faster than the EU-27 average. A comparison of the GDP growth rate to sovereign debt in the previous year in the EU-27 reveals that a high sovereign debt slows the economy. The analysis shows a closer relationship between investment and GDP growth rates, while, surprisingly, GDP growth shows no relationship with export growth.
- Exports have grown at an extremely fast pace, at an annual average rate of 10.9% since 1990. They rose by 10.2% in 2011. Investment fell by 5.4% or HUF 100 billion, contributing to the slowdown in imports and a balance of trade exceeding 10% of GDP in 2011. The evolution of the balance of trade in the period between 2003 and 2011 is well explained by the evolution of the investment rate, with an under-23% investment rate resulting in a positive balance of trade.
- Investment projects have been declining after a peak in 2005. The volume of investment projects in 2011 was 80% that of exports 160% of that in 2011, while GDP in 2011 was the same as in 2005. The GDP growth rates between 1991 and 2011 could be forecast at a 99% accuracy, based on the correlation between investments and exports.
- The relationship between GDP and the depth of financial intermediation is well-known. In the G7 countries, the stock of loans in real terms grew twice as fast as GDP in the past 50 years. In Hungary, the stock of loans declined significantly, by 13%, with corporate loans falling by 12% and retail loans by 14%.
- Employment in the age group of 15-74 has not changed in trend over the past 12 years, stagnating at 50%, an extremely low rate. (The number of those employed grew by 31,000, to 3,182,000 in 2011). By comparing the employment and development (GDP) levels of 36 countries in the decade after 2000, we can see that a higher development level goes hand in hand with a higher employment rate. The employment rates were high in the offshoot countries (USA, Canada, Australia) and in the Nordic States. They were low in the Mediterranean and in most of the post-socialist countries, with Hungary being placed in the last three.
- Looking at the Hungarian data there is a perceivable relationship between chance of employment and qualifications. Every year of schooling improves one's chance of employment by 4 to 5 percent.
- Average net salaries grew by 6% in nominal terms in 2011, at an inflation rate of 3.9%. Salaries rose by 8% in the private sector and 2% in the public sector. Looking at the salaries by economic sector, we can see that the higher the salaries were in 2010, the more their increase was in 2011. This may be a result of the single-rate personal income tax.
- Agricultural purchases rose slightly, by 0.1 percentage point, declining by 6.3% in horticulture and growing by 5.5% in animal husbandry. Agricultural GDP grew by 30% in 2011.
- Industrial sales rose by 1.5%. Export sales grew by 7.6%, domestic sales fell by 5.1%. Mid-year sales stagnated in both areas.

- Construction continued to decline, by 7.8% in 2011. However, mid-year figures show that the industry has hit its nadir, with its level being two-thirds of the 2005 level.
- In summary, with declining investments, an extremely low and stagnating employment rate, a high government debt and shrinking lending, the chances for growth built on a positive balance of trade are low, even in the mid-term.

### C) Performance of the Hungarian banking sector in 2011

- The assets of Hungarian financial institutions rose by 2.7% over 2010. (Securities, making up 22.6 % of all assets, increased by 5.2%, central and interbank deposits, representing 7.8% of all assets, rose by 14.1%, loans, taking up 59% of all assets, declined by 2%).

**Table 1 - Banks' asset structure at current prices (in HUF billion)**

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Cash and settlement accounts	689	644	491	505	782	759	765	917	673	626	694	734
Securities for trading	580	487	458	912	890	933	1283	2113	2570	4340	3328	3407
Securities for investment	740	1004	1059	1534	1508	1627	1631	1831	2922	3189	3793	4086
Total securities	1320	1491	1517	2446	2398	2560	2914	3944	5491	7529	7121	7492
Central bank and interbank deposits	1528	1476	1445	1391	1745	2391	2681	1940	2175	2382	2275	2595
Of which: central bank deposits		492	643	425	543	1307	1219	468	827	472	452	889
interbank deposits		984	802	966	1203	1084	1462	1472	1347	1910	1823	1706
Loans (net portfolio)	4323	4905	6097	8523	9977	11935	14223	17319	20979	19791	19911	19520
of which: corporate loans	3076	3176	3284	4154	4772	5433	5994	6923	7456	6958	6745	6612
retail loans	429	677	1204	2265	2914	3712	4613	5847	7536	7519	8093	7722
Participations	192	156	197	257	248		500	555	638	651	686	777
Accrued interest receivable	117	109	114	184	249	241	234	299	505	460	427	456
Prepayments and other assets	71	90	144	186	241	268	521	671	959	661	509	864
Own assets	187	169	192	268	326	404	589	688	642	591	600	667
Total assets	8427	9040	10196	13759	15965	18850	22428	26334	32063	32691	32223	33106

- Total assets in the banking sector **net of exchange rate effects and inflation** in 2011 were at 80%, net loans at 69% of their 2008 levels (including retail loans at 67%, corporate loans at 76%); the decline compared to 2010 was 1/3 of this, with total assets being at 94%, net loans at 87% (retail loans at 88% and corporate loans at 86%) of their 2010 levels.
- The **share of foreign currency assets** in banks' total assets in the past ten years declined from 36% in 2000 to 29% in 2002, then rising to 51% in 2008 and dropping to 49% in 2011. The share of foreign currency loans in total corporate loans followed the same pattern (39%, 35%, 59% and 60% in 2000, 2002, 2008 and 2011, respectively). The share of foreign currency loans in retail loans hiked from 2% in 2000 to 68% in 2010, falling to 65% by the end of 2011 (partly due to the early repayment scheme).
- While in 2005, **banks** held 93% of total assets in the credit institutions sector, their share fell to 91% in 2008 and 87% in 2011. The share of **cooperatives** in total assets fell from 7% in 2005 to 5% each in 2008 and 2011. Banks' share in total loans fell from 95% in 2005 to 90% in 2011. The share of cooperatives in total loans declined from 5% in 2005 to 3% in 2008 and 4% in 2011. In the period between 2005 and 2011, banks and cooperatives lost 3 and 4 percentage points, respectively, in their share in retail loans.



Banks' share in corporate loans fell from 96% in 2005 to 88% in 2011, that of cooperatives rose from 3% to 5%.

- The banking sector's **gross loans to non-financial businesses** at current prices were at HUF 6,530 billion in 2011, a 0.2% increase over 2010. The ratio of 90-day past due loans increased extremely sharply: the NPL rate rose from 10.8% in 2010 to 15.4% in 2011. The distribution of gross loans by business size did not change in the past two years.
- The NPL ratio in **retail loans** was 7% in 2010. In 2011 it was 10.1%, 0.7% lower than that of loans to non-financial businesses. At the end of 2011, the NPL ratio in retail loans was 13%, 2.4% lower than that of loans to non-financial businesses. At the end of 2011, 10.1% and of the HUF 2,167 billion home equity loan portfolio was non-performing. The NPL ratio in the HUF 1,800 billion of HUF-denominated mortgage and home equity loan portfolio was 8.3%.
- In **liabilities**, the minimum capital requirement was HUF 1,409 billion, regulatory capital for risks HUF 2,372, the capital adequacy ratio 13.47%. In other words, the banking sector was adequately capitalised. Only 10.3% of total subscribed capital was in foreign ownership, the lowest ratio in 9 years. 37.5% of total liabilities were denominated in foreign currency, 26.4% from abroad (45.8% of the latter in deposits).
- The loans-to-deposits ratio of 165% in 2011 reflected a total of HUF 19,123 billion in loans and HUF 11,593 billion in deposits, a very high ratio, although declining. (The loans-to-deposits ratio was 174% in 2010 and 181% in 2008 (102% in 2002).

**Table 7 - ROA and ROE in the banking sector, 2002-2011**

	2002 audited	2003 audited	2004 audited	2005 audited	2006 audited	2007 audited	2008 audited	2009 audited	2010 audited	2011 preliminary
Net interest income	<b>4.0%</b>	<b>3.9%</b>	<b>4.0%</b>	<b>3.8%</b>	<b>3.6%</b>	<b>3.2%</b>	<b>2.7%</b>	<b>2.6%</b>	<b>3.0%</b>	<b>3.0%</b>
Interest received	8.8%	9.1%	10.4%	8.5%	7.9%	8.2%	8.2%	8.5%	7.2%	7.2%
Interest paid	4.8%	5.2%	6.4%	4.7%	4.3%	5.0%	5.5%	5.9%	4.1%	4.2%
Non-interest income (net)	<b>1.4%</b>	<b>1.6%</b>	<b>1.7%</b>	<b>1.6%</b>	<b>1.6%</b>	<b>1.6%</b>	<b>1.3%</b>	<b>1.9%</b>	<b>0.6%</b>	<b>1.0%</b>
Earnings from commissions and fees	1.3%	1.5%	1.3%	1.3%	1.2%	1.1%	0.9%	0.9%	0.9%	0.8%
Dividends	0.1%	0.2%	0.1%	0.1%	0.1%	0.2%	0.6%	0.2%	0.2%	0.3%
Net profit on financial and investment services	0.4%	0.4%	0.6%	0.8%	0.6%	0.8%	0.5%	1.0%	0.7%	0.9%
Other non-interest earnings	-0.5%	-0.5%	-0.3%	-0.6%	-0.4%	-0.5%	-0.8%	-0.3%	-1.2%	-1.0%
Operating expenses	<b>3.6%</b>	<b>3.4%</b>	<b>3.0%</b>	<b>2.9%</b>	<b>2.7%</b>	<b>2.6%</b>	<b>2.4%</b>	<b>2.0%</b>	<b>2.1%</b>	<b>2.0%</b>
Change in impairments and provisions	<b>-0.3%</b>	<b>-0.3%</b>	<b>-0.4%</b>	<b>-0.2%</b>	<b>-0.4%</b>	<b>-0.5%</b>	<b>-0.5%</b>	<b>-1.5%</b>	<b>-1.3%</b>	<b>-1.9%</b>
Profit from ordinary business activities	1.6%	1.8%	2.3%	2.3%	2.1%	1.7%	1.0%	0.9%	0.2%	0.1%
Extraordinary profit	0.0%	0.0%	0.0%	0.0%	0.2%	0.0%	0.1%	-0.1%	-0.1%	-0.3%
Pre-tax profit	1.6%	1.8%	2.3%	2.3%	2.2%	1.7%	1.1%	0.8%	0.1%	-0.2%
Tax liabilities	0.3%	0.3%	0.3%	0.4%	0.4%	0.3%	0.2%	0.1%	0.1%	0.2%
After-tax profit										
ROA	<b>1.3%</b>	<b>1.5%</b>	<b>2.0%</b>	<b>1.9%</b>	<b>1.9%</b>	<b>1.4%</b>	<b>0.9%</b>	<b>0.7%</b>	<b>0.0%</b>	<b>-0.3%</b>
After-tax profit ROE	15.5%	17.8%	23.6%	23.3%	22.7%	17.5%	11.3%	9.1%	0.5%	-3.8%
<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>-4.2%</b>	<b>-7.5%</b>

- As for the structure of ROA in 2011:
  - Net interest income was 3.0 %, the same as in the previous year. It fell from the 4% of 2002 roughly evenly to this level, which is still high compared to other countries with a greater depth of financial intermediation.
  - Non-interest income was 1.0 %, 0.4 percentage points higher than in 2010, however, the second lowest in 10 years. Earnings from commissions and fees fell by 0.1 percentage point over 2010, dividends grew by 0.1 percentage point. Net profit on financial and investment services and other non-interest income (inclusive of the special bank tax) each rose by 0.2 percentage points.
  - Operating expenses were at 2.0 %, 0.1 percentage point lower than in the previous year. Operating expenses, 3.6% in 2002, nearly halved over 10 years.
  - The change in impairments and provisions was -1.9 %, 0.6 percentage points higher than in 2010, a main factor reducing banks' ROE in 2011.
  - Profit from extraordinary business activities was -0.3 %, 0.2 percentage points lower than in 2010.
  - ROA was -0.3 %, 0.3 percentage points lower than in 2010. The 2011 ROA resulted from a) an unchanged net interest income, b) a 0.5 percentage point improvement in non-interest income and operating expenses c) a 0.8 percentage point deterioration in impairments and provisions and profit from extraordinary business activities.
- ROE in the banking sector was 3.8% ( HUF 92.6 billion) in 2011, **real ROE (ROE adjusted by inflation) was -7.5%**. (Cooperatives' profit after tax was +HUF 4.9 billion, branches of foreign banks had a pretax profit of +HUF 3.2 billion).
- *In a modestly growing economy, assets in the banking sector continued to stagnate in nominal terms and decline in real terms in 2011. The NPL rate for household and corporate loans grew by 3 and 5 percentage points, respectively. The burdens on debtors with foreign currency-denominated loans increased due to the weak forint. Banks' profitability was virtually entirely determined by the government, directly (through the special bank tax and the burdens entailed by the early repayment scheme) and indirectly (through Hungary's CDS spread), pushing banks into the red (ROE: -3.8 %, real ROE: -7.5 %). The sector's capital adequacy ratio was satisfactory (13.47%).*

## II. PROFESSIONAL ISSUES, REGULATION

### 1. Retail lending

#### 1.1 Early repayment scheme

In accordance with the agreement between the Association and the government, the Early Repayment Act was amended on December 29 to provide, inter alia, that no later than January 30, 2012, the HUF amount of the early repayment should be paid up or a promissory note obtained from the creditor bank on the disbursement within 60 days from the date of application of the amount required for the early repayment. Compared to the previous regulation, the new provision shortened the time window for making the repayment. The loss sustained by banks due to the early repayment scheme was heavier than expected. Although the number of debtors availing themselves of the scheme was around that estimated (approx. 170,000 applications), the 27% ratio of early repayments in terms of amount relative to the

total portfolio (in the case of certain banks being even much higher) exceeded the estimates. At the same time, under the agreement concluded with the government in December 2011, banks can deduct 30% of their ensuing loss from the bank tax.

### ***1.2 Exchange rate cap scheme***

To ease the burdens on debtors with foreign-currency denominated mortgage loans, a regulatory amendment to the overflow account mechanism was adopted in accordance with the 2011 December agreement with the government. Pursuant to this:

- The eased repayment (overflow account) period has been extended from 3 years to 5 years.
- The interest part of the repayment amount above the exchange rate cap shall be borne by the state and the bank on a fifty-fifty basis.
- In the event of the exchange rate levels exceeding CHF/HUF 270, EUR/HUF 340 or JPY/HUF 3.3, the entire repayment amount shall be borne by the state.
- Previous overflow account loans shall (unless disapproved by the customer) be converted into this new scheme effective July 1, 2012.
- The deadline for application for the scheme was extended.
- To reduced administrative risks, a phase-in schedule was agreed.

Public employees (who had not been able to avail themselves of the early repayment scheme) were given additional preferences:

- An overflow account interest subsidy of 3% p.a. for debtors with no child and an interest subsidy of 1% p.a. for every child for those with children.
- A one-off non-refundable support to compensate (in the form of an early repayment) for the difference between the actual repayment amount and that calculated based on the exchange rate cap, for the period between February 1 and the date of conclusion of the new overflow account loan contract.
- An earlier starting date for application.

During the several-round review of the draft legislation we managed to obtain that

- the administration of the government subsidies is regulated by law rather than by a trilateral agreement between the Ministry for National Economy, the Hungarian State Treasury and the bank,
- building society savings are allowed to be used for overflow account loan repayments,
- banks' foreclosure rights are not injured during the conversion of the old overflow account loans to the new scheme.

At the same time, we failed to obtain that

- banks are compensated for the administration of government subsidies, and that
- the preferential overflow account loans are only made available to those, who had taken the loan at a lower rate than the exchange rate cap.

### ***1.3 Partiscum XI Savings Cooperative litigation at the Szeged Court***

In its partial verdict of December 2011, the Supreme Court ordered a new proceeding in respect of certain elements of the second instance verdict in the case. The new proceeding was aimed to examine whether the reasons for a unilateral contract amendment as specified in the

savings cooperative's General Terms and Conditions were in line with the requirements set forth in the Supreme Court's verdict.

The Association provided professional assistance to the Savings Cooperative in the litigation. At Partiscum's request, our Secretary-General, Levente Kovács, University Head of Department, provided a written expert's opinion.

In its verdict, the Csongrád County Court accepted the prosecution's motion, and, citing the Civil Code, declared (ignoring the relevant sector laws and the expert's opinion) that Partiscum's General Terms and Conditions were unfair, and therefore, null and void. Partiscum did not appeal the verdict, given that the stock of contracts affected by the verdict (contracts subject to the savings cooperative's General Terms and Conditions applicable between March 1 and June 1, 2010) by now had become negligible.

#### ***1.4 Request for ruling regarding the APR cap***

At the request of member banks, the Association requested a ruling from the Ministry for National Economy regarding the statutory APR cap. In our letter, we requested the Ministry to confirm our interpretation of the relevant provision of the Credit Institutions Act that the requirement regarding the APR cap should be met at the origination of the loan. We explained that the APR only has a role before the borrowing decision is made and only serves for comparison purposes. Due to the complex calculation, it is virtually impossible to define the exact APR during the loan period.

In its response, the Ministry agreed that the primary role of the APR was indeed to provide information to help the customer's, however, it pointed out that the regulation was also aimed at limiting interests and fees. Accordingly, the APR cap should be taken into account in changing the interest and charges during the loan period. At the same time, the APR does not have to be reduced if the APR cap, pegged to the central bank key rate, decreases. Also, the APR may exceed the cap if the loan interest rate is pegged to a reference rate and the APR increase is due the increase in the reference rate.

#### ***1.5 Cooperation with the Association of Hungarian Insurance Companies (MABISZ) on property insurance related to retail mortgage loan collaterals***

The Association of Hungarian Insurance Companies approached the Association with a proposal to try to jointly improve the administration of property insurance for property provided as collateral for home loans. The divergent forms and administration procedures used by the various banks are causing significant problems to joint customers and to the banks themselves.

A joint MABISZ-HBA working group was set up. The working group agreed to follow the working method of first identifying the issues arising in the pre-contractual phase and then seeking solutions to them. The following issues were identified:

- divergent forms with divergent requirements; definition of the amount to secure the loan,
- late or no notices on defaults in the pre-contractual phase,
- insufficient information between the parties (bank and insurance company) on occurrence of damages and problems in the payout of damages.

## **2. Central Credit Bureau**

The Association's Central Credit Bureau project is aimed to promote efficient implementation of the Act on Central Credit Bureau. The project's Banking Working Group reviewed the issues related to the definitions of the Act and sought to clarify the related legal and practical issues by requesting rulings from the authorities and developing and recommending best practices. The following were clarified:

- it is not necessary to inform the customer on the contents of the data being uploaded during the initial upload (initial upload: a single-step transfer of loan contracts into the Credit Information System),
- the method for obtaining the customer's consent for data inquiries,
- the contractual data to be reported to the system.

The project's IT Working Group focused on testing before initial upload and on the implementation of the upload.

On February 17, 2012, BISZ, the operator of the Central Credit Bureau reported that it was ready to receive initial upload transactions. Participants can now send and receive data in the new structure to and from the system. The full upload of the system will take place in the second quarter of 2012.

### **3. Taxation issues**

The key taxation issues at the beginning of the year were primarily related to the banking products related to the assistance schemes for foreign currency debtors. Issues included the compensation from the bank tax of losses arising from the Early Repayment Scheme and the relevant refund process, the tax treatment of the forgiven part of 90+ days past due loans, and the growth pact stipulated in the agreement with the government. A number of questions arose in connection with the implementation of the requirements regarding the new products. It became clear that the legislation on special bank tax needed to be amended and clarified. The Association's negotiating team started negotiations with the Ministry for National Economy to address these issues. It is hoped that the taxation rules and procedures for these new products will be finalised soon.

The Association's Taxation Working Group also addressed a number of other issues, including the issue of the customer's VAT category, the procedure for certificates to be issued to private persons at year-end for the purpose of tax returns, the treatment of certificates of residence and preparations for the requirements of the U.S. Foreign Account Tax Compliance Act (FATCA).

Issues related to reporting were also addressed and solved in cooperation with the Tax Authority. In relation to the reports on private customers' annual financial and investment transactions (including preliminary pension savings, controlled stock exchange transactions and transactions related to the EU Savings Directive), due to be filed at the beginning of the year, the Working Group addressed the problem of the late availability of tax return forms and changes in the IT and technical requirements.

### **4. Accounting issues**

A response was received from the Ministry for National Economy regarding our questions related to accounting for early repayments under the Early Repayment Scheme.

Accordingly, the following were clarified:

1. Early repayments concluded in 2011 should be reported in accordance with the actual payment. The impact of early repayments carried over to fiscal year 2012, that is, concluded in January or February, 2012, should be accounted for based on the customer's application, by estimate, and an impairment should be made on the amount involved.
2. Institution that had closed their books before February 29, 2012 should report the difference between the estimated and realised loss as a 2012 item.
3. The difference between the fixed exchange rate (180 HUF/CHF; 250 HUF/EUR; 200 HUF/100JPY) and the spot rate should be accounted for as a credit loss (bad debt).

Issues related to Hungarian and international accounting rules for the new products related to the foreign currency debtor schemes were reviewed on several occasions at our meetings. The Big Four audit firms were also involved in the consultations. The objective was to ensure that the new products are reported by all institutions in a uniform manner, using the same methodology. A number of other issues related to the Early Repayment Scheme were also agreed with member banks by email.

At the beginning of the year we drew members' attention to the Chamber of Hungarian Auditors' ruling on the valuation of Hungarian and OECD sovereign bonds held for investment and corporate bonds with a similar risk classification, managed in the held-for-trading and liquidity portfolios, in the context that three rating agencies had downgraded Hungary into the non-investment grade. The Association works closely with the Chamber of Auditors' Money and Capital Markets Section and we regularly attend the Chambers' Board Meetings and professional programmes. Reviewing issues related to Hungarian and international accounting standards is useful for both parties.

## **5. Regulatory reporting (MNB, PSZÁF)**

The new EU capital regulations will significantly affect the regulatory reporting requirements for credit institutions. At the end of last year, the MNB held a presentation on expected reporting changes to be introduced from 2013 in compliance with the EU requirements and at the beginning of this year, PSZÁF sent a notification on the proposed COREP reporting framework, published for consultation on the EBA's website. A key objective of the proposed EU-level regulation is to ensure harmonised reporting in accordance with the framework established in the Capital Requirements Directive. The working document is currently only available in English, the Hungarian translation is expected to be issued by the European Commission in September. According to plans, the new reporting requirements will be implemented on January 1, 2013 and first applied to the Q1 2013 reports, to be submitted around end-May 2013. In addition to COREP, the FINREP framework will also be implemented in Hungary. According to current information, FINREP will only be applied on a consolidated basis. Accordingly, it will affect those Hungarian institutions which are file their reports with PSZÁF on a consolidated basis. It is still under discussion whether the reports, mainly built on balance sheets and P/L accounts, should be based on IFRS or non-IFRS. Harmonised frameworks are also expected to be introduced for large exposure and

liquidity reporting. PSZÁF plans to hold a consultation on the proposed new European reporting frameworks and the COREP requirements in May.

Reporting is addressed by the EBF as a priority, with a special working group designated to address the details.

## **6. Payments**

### ***6.1 Payments glossary***

The project working groups managed their operations according to a schedule set based on the size of their respective tasks:

- The working group on bank accounts, payments, cash transactions and fees started work in 2011 and met in the first quarter of 2012 on a weekly/bi-weekly basis.
- The working group on electronic banking started work in this quarter. It completed the first chapter (online and mobile banking) and is now working on the Bank Cards chapter.
- Given the relatively narrow area, the working group on documentary transactions is to start work in the second quarter.

In addition to its original task, at a request from PSZÁF, the first working group also defined the terms related to the most frequently used banking services and the related fees, for the purpose of PSZÁF's proposed bank account selector project.

To ensure that the glossary is as comprehensive as possible, the Association requested non-bank members (such as GIRO, KELER and the National Deposit Insurance Fund) to prepare the glossaries for their banking-related areas.

### ***6.2 Basic bank accounts - self-regulation***

At its March meeting, the Association's Board issued Recommendation No. 1/2012 on basic retail payment accounts. The Recommendation took effect in April. With three major retail banks and a dozen savings cooperatives already signing up, cheap basic accounts are now available nationwide. The names of the joining banks and their relevant account products are displayed on the Association's website. Interest in the basic bank account facility may be adversely affected by the government's announcement on a proposed financial transaction tax.

### ***6.4 Issues related to bank card payments***

Malév (the Hungarian national airline) suspended operations on February 3, 2012. According to the relevant communications, there were 750,000 valid bookings in Malév's system on that date. Customers who had purchased their tickets by bank card could reclaim the full ticket price through a chargeback process. According to estimates, about one-third of the affected passengers purchased their tickets by bank card.

The Association, together with specialists from member banks, promptly developed a uniform process to allow fast and coordinated administration. We issued press releases on February 7 and 14 to inform customers on actions to be taken on their part. As a major move, on February 10 we obtained a statement from the appointed bankruptcy trustee to facilitate the launch of the refund procedure by customers with tickets for later dates. Banks received and

processed thousands of refund requests, with many banks paying out the refunds in advance. PSZÁF expressed its appreciation to the Association and its members for their consumer protection attitude. At the same time, there was an ongoing settlement dispute between travel agencies and accepting banks over who is responsible for the refund. Given that the issue is regulated by the contract between the travel agency and the bank, the Association did not develop a common position on the issue. However, in our communications we continuously emphasised that the banks acted legally, in accordance with the terms and conditions of their relevant contracts with the travel agencies.

## **7. Prudential regulation**

At the beginning of March, the Ministry for National Economy drafted a proposal to amend Government Decree No. 366/2011 (XII 30) on liquidity coverage requirements for credit institutions and on the maturity mismatch of foreign currency positions of credit institutions. Pursuant to the proposal, self-issued mortgage bonds with a maturity over 30 days should not be included in the numerator of the Balance Sheet Coverage Ratio and the minimum Balance Sheet Coverage Ratio would be reduced from 0.1 to 0.05.

After an earlier consultation on the issue, PSZÁF in January issued its Recommendation No. 1/2012 (I 6) on the management of operational risks in trading activities.

In the first quarter, PSZÁF published for consultation three recommendations aimed at the adoption of the CEBS<sup>1</sup> guidelines related to the CRD. Accordingly, we reviewed the following draft recommendations:

- Recommendation on the treatment of exposures to schemes with underlying assets for the purpose of large exposures
- Recommendation on the requirements for Tier 1 capital
- Recommendations on amendments to Validation Manual II.

The final recommendations are expected to be issued in the second quarter to take effect shortly after that.

## **8. Proposed regulations affecting credit institutions**

### ***8.1 New Civil Code***

The draft of the new Civil Code covers the full range of civil and family law relations, with 1600 articles on nearly 400 pages. Our reviews were primarily focused on the provisions of related to lien law, contract law, bank contracts and securities law. The most critical issues identified by banks' legal counsels included the abolition of independent lien and floating charge and the prohibition of fiduciary collaterals (option to buy, assignment).

Apart from sureties, the draft Code regulates lien as the exclusive collateral in rem. Pursuant to the draft Code, lien is an additional right: it is related to a secured claim, it is in favour of the beneficiary of the claim and its extent is also aligned to the claim. The draft Code only regulates mortgages and pledges, in a strict and closed logic. The only special types of lien recognised by the draft Code are consumer lien contracts, and in certain cases, sureties. Instead

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<sup>1</sup> Committee of European Banking Supervisors (ceased to exist in December 2010). It was the predecessor of the EBA, the European Banking Authority.



of independent lien, the drafters propose the establishing of a lien on the underlying debt and the mortgage securing it, thereby solving the issue of refinancing.

Regarding the prohibition of fiduciary collaterals (option to buy, assignment [even a brief explanation of these instruments would exceed the boundaries of this report]), we proposed that the Code should at least allow for another law to provide in certain cases otherwise, since these collaterals are commonly used in certain securities transactions. A categorical prohibition would be against several EU laws and the relevant Hungarian laws transposing them.

We also expressed our concerns in relation to the contract types used by banks, the terms and conditions for payments and the regulations on securities. We submitted proposals to solve these issues, as well.

Also, we initiated that the one-year transitional period until the entry into force of the legislation should commence on the day when all the relevant amendatory laws have been promulgated, given that the adoption of the new Civil Code will entail the need to revise the entire legal system and law appliers could only start preparing themselves for implementation when all the relevant new laws are in place.

After mutual consultations, the Association submitted its position jointly with the Hungarian Leasing Association, the Hungarian Factoring Association, the Association of Securities Dealers, the Association of Hungarian Mortgage Banks the Association of National Savings Cooperatives (OTSZ) and the Interest-Representation Association of Savings Co-Operatives (TÉSZ).

We sent our comments and proposals to the Ministry of Administration and Justice, the head of the Civil Law Codification Committee, Professor Lajos Vékás, the Ministry for National Economy and the Hungarian Financial Supervisory Authority, requesting their support and the opportunity for consultations.

## ***8.2 Review of decrees related to the implementation of the Bankruptcy Act***

In the first quarter, we reviewed the following draft decrees related to the implementation of the Bankruptcy Act:

- Draft Government Decree amending Government Decree 237/2009 (X 20) amending Government Decree 226/2000 (XII 19) on detailed rules for the public sale of the debtors' assets in liquidation proceedings and on accounting tasks related to liquidation.
- Draft amendment to Administration and Justice Ministry Decree No. 36/2010 (V 13) on electronic appointment of liquidators and bankruptcy trustees,
- Proposal and Draft Government Decree on electronic sale of the debtors' assets in liquidation proceedings,
- Justice Ministry Draft Decree amending Justice Ministry Decree 38/2009 (VIII 31) on formal and content requirements for the notice specified in Article 40 of EU Regulation 1346/2000/EC on insolvency proceedings.

- Proposal and Draft Government Decree amending Government Decree 114/2006 (V 12) on Registry of Liquidators.
- Administration and Justice Ministry draft decree on content elements of court certificates.

During the reviews, we made proposals to improve creditor protection and accountability of the liquidation procedure.

### ***8.3 Amendments to the Company Registration Act***

We reviewed the proposed amendment to the Act on Public Company Information, Company Registration and Winding-Up Proceedings (Act VI of 2006) in the context of implementation of the task set in the Simplification Programme of the Magyar Program regarding signature specimens.

We proposed a provision to provide that apart from a personal ID document, a party in an administrative proceeding (whether initiated by the party or launched ex officio) should not be required to submit any extra document to certify particulars that are available in the Companies Registry. In other words, apart from the cost of the signature specimen, the initiation of an administrative proceeding should not entail any other additional administrative burdens and costs.

We proposed that Company Registry data and scanned copies of the specimen signature should be made available to market players free of charge under the same terms and conditions as those applicable to the organisations specified in the Act.

In the long-term, we proposed that as an alternative to attestation by a lawyer, the attestation of the signature specimen by a legal counsel should be accepted. This may be provided for under a proposed comprehensive revision to the regulation on legal counsels.

### ***8.4 Proposal for amendments to the Act on the right to personal information; data protection consultations***

In relation to the new provisions regarding registration with the data protection registry of Act CXII of 2011 on right to personal information and freedom of information (Privacy Act), we initiated the removal of the requirement to report data processing based on customer relations and the narrowing of the reporting requirement to those cases where the person involved cannot exercise his or her right to personal information. We also initiated the removal of the requirement to report data processing based on regulation, or at least the narrowing of the definition of "mandatory" data processing to those cases where, due to the nature of the data processing, the person involved cannot be directly informed as provided by Section 20 of the Act, as distinct from other cases where he or she can and, by law, must be directly informed when applying for particular financial services. We requested a consultation with the National Agency for Data Protection and Freedom of Information regarding the interpretation and amendment of the Privacy Act.

### ***8.5 Proposal for amendments to the Act on Chambers of Commerce***

Act CLVI of 2011 amending the Act on Chambers of Commerce requires entities subject to registration in the Companies Registry to register with the Chamber of Commerce. Applications for registration had to be filed by February 28, 2012. The registration fee is currently HUF 5,000 per annum. The stated objective of this law is "to ensure the further development of the system of voluntary chambers of commerce by providing for the mandatory registration of business organisations, with a minimal annual fee of HUF 5,000, as a contribution to the chamber's performance of public functions". Upon a proposal from one of our members, we initiated with the Ministry for National Economy and PSZÁF an amendment to the law to provide that this fee should not be applicable to organisations supervised by PSZÁF, given that in their cases, the objective of the Act regarding registration is fulfilled. Neither the Ministry, nor PSZÁF supported our request.

### ***8.6 Consultation of the regulatory concept of the Act on debt collection***

PSZÁF is working on the re-regulation of debt collection activities. The supervisory authority sees a need to change the consumer protection regulations related to debt collection and to provide for clear conduct and customer information rules.

The objective is to specify minimum rules for fair debt collection proceedings, mindful of the customer's legitimate interests, in order to ensure that the debt is recovered through cooperation between the parties and responsible decisions based on information relevant to the customer. We held a consultation with PSZÁF on the proposed concept.

### ***8.7 Proposal for amendments to the Gaming Act***

The president of the National Tax and Customs Administration (NAV) initiated a consultation with the Association to review issues related to the implementation of payment-related provisions of the Gaming Act. We held several meetings with the NAV's Gaming Supervision Department. The meetings were also attended by members of the Association's Payments Working Group. As a result of these meetings, we submitted a proposal to make the Act's provisions regarding unauthorised online gaming more clear-cut. The NAV supported our proposal and forwarded it to the Ministry for National Economy.

## **9. Other issues**

### ***9.1 Bank Security Committee and working groups, elections***

The Association's Bank Security Committee amended its rules in January. Accordingly, the term of office of the chair and deputy chairs (the latter also acting as heads of the Committee's working groups) was set at three years and the Committee's election rules were made more specific. The new officers were elected in accordance with the new rules. Péter Jakab (MKB) was re-elected as chair of the Committee and György Fialka (Budapest Bank) as deputy chair of the Committee and head of the Human and Physical Security Working Group. New leaders were elected for the Anti-Fraud Working Group (Gábor Sweissmüller, Citibank) and the IT Security Working Group (György Pávlicz, AXA).

### ***9.2 Human Physical Security Working Group***

In the first quarter, activities of the Human and Physical Security Working Group were focused on the proposed amendment to the provisions on remote alarm services of the Act on personal and property protection (Act CXXXIII of 2005). The new provisions may result in a 6-month suspension, without the option of consideration, of the licence of the security company providing the remote alarm service in the case of multiple false alarms to the Police. This implies significant risks, because due to the high number of lines connected to a particular security company and the fixed installation requirements, switching security companies is costly and slow.

Given that there is no technology solution that can fully eliminate false alarms, the Working Group requested the Minister of Interior in a letter in April to initiate an amendment to the relevant provisions of the Act.

The appearance of homeless people in banks' 24-hour ATM zones was a main issue during the winter. To solve this issue, the Working Group's head met with police leaders, who undertook to cooperate with banks' banking security units to keep homeless people away. Consultations on the issue are also being conducted with the National Police Headquarters.

### ***9.3 Participation in the development of financial training courses under the new National Training Register (OKJ)***

Following the consultation with fellow associations on the proposed new vocational training structure under the new National Training Register (OKJ) in October 2011, the Association's Human Resources Working Group proposed that the Association should participate in the development of professional and examination requirements for certain training courses affecting the financial sector. Accordingly, we indicated this intention to the Ministry for National Economy in November. To support this work, a 4-member task-force was set up from training officers from member banks. At the end of February 2012, the Ministry requested the Association to coordinate the development of the professional and examination requirements for certain training courses, with an extremely short deadline of two weeks. The work was made even more difficult by the fact that the Ministry was unable to furnish the proposed final training structure. Therefore, the requirements had to be drafted for two potential structures. The proposal was submitted to the Ministry by the required deadline (March 19) and copied to the Hungarian Chamber of Commerce and Industry, the organisation coordinating the restructuring of the OKJ vocational training system. Inter-ministerial reviews of the new system are underway. The new training system is planned to be introduced on April 30, 2012.

### ***9.4 Proposed project for an electronic system for data requests from authorities***

For the purpose of this section, data requests/inquiries mean requests from eligible authorities for information or data that are subject to bank secrecy. After 2005, there have been several attempts to "electronify" these inquiries, however, thus far, the only the solution that can be considered as workable has been the system created at the initiative of the Hungarian Chamber of Bailiffs. The standardisation and electronic processing of administrative inquiries has been a constant demand of members. Furthermore, in December, GIRO also indicated its intention to participate in the development and operation of an appropriate system. Accordingly we started preparing a project.

As a first step, we conducted a survey between mid-February and mid-March to quantify and assess the importance of the issue, and to get the views of specialists from member banks regarding a potential project to be set up. Although the data provided by members are not accurate enough to assess the figures at the sector level, by conservative estimate it can be said that the issue causes banks an extra cost of more than HUF 700 million. Specialists from member banks unanimously support the project. A proposal is now being drafted for approval by the Board.

### ***9.5 Financial and Insurance Training Forum***

The Financial and Insurance Training Forum was set up as an informal consultation forum at the end of December 2011. Participants in the forum include the Hungarian Banking Association, the Association of Hungarian Insurance Companies and training organisations and other associations interested in the training of financial and insurance intermediaries. The forum discussed the PSZÁF's plan to issue a decree on official training for financial and insurance intermediaries. Based on previous experience, participants decided to write a joint letter to PSZÁF's President, requesting involvement in the drafting process. The letter was drafted and sent to PSZÁF the end of February.

## **III. INTERNATIONAL RELATIONS, ASSOCIATION EVENTS, COMMUNICATIONS**

### **1. European Banking Association**

#### ***1.1 EBF Executive Committee***

The EBF Executive Committee (ExCo) held two meetings in the first quarter. Key issues addressed by the Committee included measures aimed at the development of a new strategy and the prioritisation of tasks as initiated by the ExCo's new Chair Wim Mijs and activities related to the review of and lobbying on proposed EU regulations.

The key priorities and focus points in the EBF's review and lobbying activities are currently the following:

1. CRD4/CRR („ongoing” – under discussion by lawmakers)
2. MiFID („ongoing” – under discussion by lawmakers)
3. Mortgage lending („ongoing” – under discussion by lawmakers)
4. FTT („ongoing” – being discussed by Member States and the Council)
5. FATCA („ongoing” – seeking a pan-European solution)

The following issues are expected to come up in the near future and may be added to the above priorities (their current status indicated in brackets):

6. Central Security Depositories (draft legislation submitted)
7. Shadow banking (consultation in process)
8. Retail bank accounts (consultation on a common regulatory package starting in April).
9. SEPA and EPC governance (to be agreed by June 2012)
10. Ring-fencing/structural market reforms (Liikanen High Level Expert Group to present report by September 2012).

11. Crisis management & resolution (decision postponed by September 2012)
12. Deposit Guarantee Schemes (to be discussed subject to the proposal on crisis management resolution)
13. Packaged retail investment products (discussion to begin in April 2012)
14. Undertakings for Collective Investment in Transferable Securities (UCITS) V (discussion expected in Q3 2012)
15. Anti-Money Laundering Directive (final proposal expected to be submitted in Q4 2012)

The communications strategy, an integral part of the ExCo's strategy, was also completed. The communications strategy includes the following key elements: a Statement Book, containing the EBF's positions, a Quick Response Strategy to address new issues, EBF Key Messages related to key priorities and a Media Profile strategy to enhance media relations.

### ***1.2 EBF Economic and Monetary Affairs Committee analysis on economic and financial forecasts for 2012***

The Association is actively involved in the work of the EBF Committee on Economic and Monetary Affairs. A major task of the Committee is to monitor and analyse economic and monetary forecasts for the EU. At its last meeting in March, the Committee adjusted the 2012 GDP growth forecast downward. There was consensus in the Committee that GDP growth in 2012 was expected between 0 and 0.5%, which means stagnation. From Hungary's point of view, a major negative development is the expected economic slowdown in Germany, with the German GDP growth rate dropping from the previous year's 3% to 0.5% in 2012. In terms of threats, Greece, Ireland, Italy, Portugal and Spain were the focus points. There was agreement in the Committee - and this view was also shared by the Deputy Governor of the ECB - that the firewall built to prevent a domino effect from Greece or Italy must be reinforced.

### ***1.3 EBF Banking Supervision Committee***

European prudential regulation<sup>2</sup> and accordingly, activities of the EBF Banking Supervision Committee in the first quarter of 2012 were focused on Basel III implementation (**CRD4/CRR**<sup>3</sup>). The European Commission published its proposal in June 2011, followed by the EU rapporteur's report in December. The Danish presidency put forward three compromise proposals in the first quarter. Although there are still differences in opinions in several points, decision-makers are determined to have the regulatory package adopted by the European Parliament and the Council still in the first half of 2012. The EBF fully supports this endeavour, while emphasising that the original objective of a Single European Rule Book should not be conceded for the sake of compromise.

The EBF had several consultations on CRD4/CRR with the European Commission. It also organised a seminar (Focus Session), attended by MEPs in charge of the topic. In March, the EBF organised a meeting for the Visegrád countries with officials of the European Union, members of the European Parliament and the financial attachés of these countries. The EBF's Risk Assessment Working Group assists CRD4/CRR implementation by reviewing risk assessment methodology issues. The Working Group developed a questionnaire on mortgage

<sup>2</sup> For details, see the Annex to this report.

<sup>3</sup> Capital Requirements Directive 4, Capital Requirements Regulation

lending. We completed the questionnaire in cooperation with three member banks using the IRB approach.

The EBF responded promptly to global and European regulatory developments. It extended and transformed its SIFI Working Group into a **Macprudential Oversight Working Group** and, after the European Commission's setting up of a High Level Expert Group (led by the Governor of the Bank of Finland, Erkki Liikanen) on **reforming the structure of the EU banking sector**, the EBF set up a task force on the issue. It also created a task force to address issues related to the European Commission's Green Paper on shadow banking.

#### *1.4 New communications strategy*

The EBF's Board and Executive Committee have had new leaders since the end of the last year. In view of this and the economic and financial situation in the EU, in particular in the eurozone, the EBF's supreme decision-making bodies agreed that there was a need to develop a new mid-term communications strategy for the EBF. The EBF Communications Committee was commissioned to develop the new strategy. The Communications Committee's Chair presented the concept for the new strategy in February. The concept includes a mid-term vision for the EBF, setting the targets to be achieved in the next three years, including the key priorities, and the main focus points for the Federation's communications. The EBF's key mission is to efficiently represent the banking industry and to contribute to restoring competitiveness and stability. It was also agreed that in addition to key technical and regulatory issues, the EBF should give more emphasis to advocacy in political and economic policy decision-making.

#### *1.5 EBF Payments Systems Committee*

The EBF's Payments Systems Committee addressed to issues :  
Participant expressed serious criticism of the European Commission's Green Paper on electronic payments (online, mobile and card payments), in particular the Commission's plan to impose regulatory constraints on these, popular and highly efficient, payment methods, as this could paralyse and set back innovation. In the area of bank cards, it has taken decades to develop the best structures. The majority of the Committee would incentivise e-payments by increasing the fees for cash transactions.

Participants agreed over the need to renew SEPA governance: the SEPA project has been developed by the European banking industry upon the expectation of the EU authorities, as a self-regulation, through a major effort of the industry, and it has been a bitter experience for the industry to see the EU authorities challenging SEPA citing competition law or partial stakeholder accusations. It must be ensured that banks can have their own forums and workshops to formulate their interests and efficiently represent these interests at the top forum of SEPA.

## **2. International relations, consultations**

### *2.1 Regional consultations - Visegrád countries, Serbian Banking Association*

The Association seeks to establish cooperation in the European Banking Federation with the banking associations of the Czech Republic, Poland and Slovakia. The financial

intermediation systems, the structure of the banking sectors and banks' ownership structures are in many respects similar in these countries, hence, it is expedient and useful for these countries to exchange experience and develop common positions, strategies and advocacy positions at the EU level. The proposed Visegrád-type cooperation is aimed to achieve these objectives. We took up the matter with the three countries' banking associations and a first meeting took place in Bratislava.

From among the neighbouring countries, the development of cooperation under the auspices of the EBF with the Serbian Banking Association, an associate member of the EBF, is in process. The first meeting took place on March 8 and 9 in Belgrade.

## ***2.2 International inquiries, information requests***

Several inquiries and requests for consultation meetings were received from major international analysts and investment firms and from foreign embassies in Hungary. The inquiries were focused on the economic developments of 2011 and the forecasts for 2012. In relation to the banking sector, the questions were focused on banks' profitability in the context of the regulatory environment and the expected outcome of the early repayment and exchange rate cap schemes.

## **3. Communications, press relations**

### ***3.1 Communications challenges and tasks in the first quarter***

Until mid-March, media attention had primarily been focused on the early repayment scheme. Then, the extended exchange rate cap scheme, entering into force on April 2 came to the forefront. Several inquiries were also received regarding the situation of more than 90-day past due debtors, social policy measures, the fate of real estate's subject to forced sale, the launch of the National Asset Management Company and the related conditions, and regulatory changes regarding government subsidies for home construction, purchase and renovation. Already in the first quarter, several questions were received regarding the new laws on transparent pricing and on APR, taking effect in April.

### ***3.2 Media appearances, statistics***

The Association appeared in the media on a regular basis in the first quarter: we had 960 mentions and appearances in the various media on issues affecting the banking community. In terms of frequency, the online media top the list, followed by the print and the electronic media. Our media communications were managed in a way to ensure that they promote members interests, while also being informative and helpful for the customers.

### ***3.3 Communications related to the IG2 project***

The project for the introduction of SEPA-compliant intraday settlements (IG2) is close to the go-live stage. The project's communications working group drafted a go-live communications plan, including the contents of communications and the expected FAQs and the relevant answers. The Association was involved in this work on an ongoing basis.



### ***3.4 Hitelintézet Szemle (Credit Institutions Review), special edition***

At the first quarter meeting of the periodical's Editorial Board, the main statistics of the 2011 editions were reviewed. In 2011, the periodical published 37 studies by 44 authors. The periodical's thematic edition, addressing the theme "Risk, Uncertainty, Probability", was produced with contributions by prominent authors.

The periodical is published in 1,000 copies. The Editorial Board agreed that the periodical's distribution list should be optimised. Accordingly, the share of the scientific community, savings cooperatives, the media, background institutions and fellow organisations will increase among the recipients of the periodical (through somewhat increasing the number of copies and using the Association's inventories). The Editorial Board decided that the theme for the 2012 thematic edition will be macroprudence. It also decided that another thematic edition in 2012 will be dedicated to doctoral essays on financial and economic topics.

Accordingly, we sent an invitation for essays to the heads of 15 doctoral schools and took up the matter with the coordinators, who forwarded the invitation to the doctoral students. Students' publication materials are invited by end April. The studies will be reviewed by the Editorial Board and the selected studies will be published in a special edition in the summer (subject to the quality of the studies and the number of studies received).

## ANNEX

### INTERNATIONAL DEVELOPMENTS: REGULATION, SUPERVISION

## I. European Union

### I. 1. Capital and liquidity requirements: CRD4/ CRR

European prudential regulation in the first quarter of 2012 continued to be focused on the regulatory package related to Basel III implementation (CRD4/CRR). The European Commission published its proposal in June 2011, followed by the EU rapporteur's report in December. The Danish presidency put forward three proposals in January, February and March, providing for more room for national discretions.

The ECON<sup>4</sup> is scheduled to vote on the CRD4/CRR package on April 25 and the package is planned to be adopted by the EU in early June. While the European Commission and the Parliament continue to propose a Single Rule Book, the Council supports a more flexible approach that would give member states more room for manoeuvre.

#### *I.1.1 EU rapporteur's report*

In his preliminary report (Explanatory Statement), the EU rapporteur, Othmar Karas, highlighted the following:

- The application of the "substance-over-form" approach is key to assessing the quality of capital. Member states should avoid any diverging or front running regulations impacting or weakening the principle of maximum harmonization of Pillar 1.
- In relation to liquidity standards, the European Commission proposed a thorough investigation before finally setting the ratios. The rapporteur calls on all stakeholders to co-operate with the European Banking Authority (EBA) and the Commission so that essential data elements can be assessed. Unitary reporting formats should ensure the observation period is meaningful.
- The leverage ratio is a useful, simple and hard-to-manipulate backstop against the building of excessive leverage and excessive risk. The leverage ratio should serve as a backstop mechanism under Pillar II and not be disclosed before a final decision on its introduction has been taken.
- The requirements for the management and capitalisation of counterparty credit risk, including the authorisation and recognition requirements for Central Counterparties by the competent authorities should be aligned with the relevant EMIR provisions.
- Work related to the treatment of Credit Value Adjustment (CVA) is being conducted in the Basel Committee with regard to methodological and technical issues. An observation period until 2013 would allow taking into account the work being undertaken by the Basel Committee and ensure consistency.

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<sup>4</sup> The European Parliament's Economic and Monetary Affairs Committee.

The report provides several proposals (amendments, deletions and supplementary proposals) to Recital section and other provisions of the CRR. The most important of these include the following:

- It should be ensured that European banks are not put at a competitive disadvantage in the global market. Therefore, the Commission should identify, by March 2012, the provisions of the Regulation that should not be implemented in the EU without simultaneous implementation in the USA.
- Trade finance exposures are small in value and short in duration. They have an identifiable source of repayment and their inflows and outflows are usually matched. Therefore, they should be subject to special treatment in terms of capital requirements and liquidity standards.
- The Commission should align (before the adoption of the Regulation) the proposed capital requirements with the recommendation of the EBA to require major banks in the EU to establish an exceptional and temporary buffer so that the core Tier 1 capital ratio reaches a level of 9 % by the end of June 2012.
- The counter-cyclical buffer should be focused on periods of excessive credit growth only. Systemic risk arising from other factors should be captured by other macro-prudential tools, which have yet to be developed.
- The sovereign debt crisis has demonstrated that a 0 % risk weight for government bonds no longer corresponds to economic reality. The Commission should submit a report to the European Parliament and the Council proposing options to adjust that risk weight accordingly as soon as possible.
- The EBA and the Commission should ensure that the draft regulatory technical standards and requirements developed by the EBA can be applied by all institutions concerned in a manner that is proportionate to the nature, scale and complexity of those institutions and their activities.
- The EBA and the Commission should also start developing their reporting requirements on liquidity requirements and leverage, as soon as possible.
- The definition for interconnected customers and groups should be fine-tuned.
- Institutions should be allowed to offset tax assets against tax liabilities.
- A guarantee provided by a rated guarantee provider should be accepted irrespective of the guarantee provider's rating.
- Amendments and clarifications regarding the recognition of liquid assets and reporting requirements. Differentiated weights for credit risk adjustment for off-balance-sheet items (20%, 50%, 100%).
- The removal of national discretions regarding the level of own funds, the recognition of unrealised gains and the recognition, for a transitional period, of capital instruments issued before the cut-off date
- In certain cases, deletion of the requirements for the EBA to draft regulatory standards, or extension of the deadline for their submission.

In relation to the EBF's amendatory proposal (Top 10 priorities<sup>5</sup>), the report contains three similar proposals:

- The report supports the EBF's proposal that Tier 1 capital held by a subsidiary should receive a wider recognition in minority interest.

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<sup>5</sup> See our 4th quarter 2011 report

- In relation to the EBF's proposal for corporate deposits to be eligible for an outflow factor lower than 75%, the report proposes that the EBA should assess and define the calibration of deposits to non-financial customer.
- The report supports the proposal that the European Commission should produce a report on the impact of the own funds requirements on SMEs, but it proposes that this should be done before the entry into force of the regulation (instead of 24 months after its entry into force).

In relation to CRD4, the rapporteur highlighted the importance of harmonised supervisory practices and the incorporation in supervisory decisions of the principle of free flow of capital. In relation to supervisory colleges, he emphasised the need to ensure a common and aligned working programme and harmonised supervisory decisions. The decisions of supervisory colleges should be binding for all group members as well as for home and host supervisory authorities. Cooperation between home and host supervisor should be strengthened through a higher degree of transparency and information sharing. Competent authorities must not only be able to effectively supervise institutions, they must also have the power to impose strict sanctions and prevent future violations.

### *1.1.2 Compromise proposals of the Danish presidency<sup>6</sup>*

The Danish presidency put forward compromise proposals, aimed to integrate the EU rapporteur's report with opinions received from member states. The proposals would give countries wider scope to apply tougher capital thresholds and greater flexibility in deciding the level of capital requirements and the relevant application dates. In addition to the capital conservation and counter-cyclical buffers, member states could impose a systemic risk buffer from 0.5% up to 3%, to be met with Common Equity Tier 1 capital. In addition, member states would be able to apply tougher requirements, if they identify changes in the intensity of macroprudential risk posing an imminent risk to financial stability member, and if the European Commission agrees and such measures do not harm the fiscal and budget situation of other member states. Thus, the level of the capital conservation buffer could be increased without limit. Also, the European Commission would be authorised to adopt temporary measures in relation to own funds, risk weights, large exposures and disclosure requirements.

In addition, the Danish presidency added the following remarks in relation to the explanatory notes:

- Citing the de Larosi re report and the need to ensure financial stability, the Danish presidency reiterates the importance of a Single European Rule Book and a framework for macroprudential supervision.
- CRD4 and the CRR provide several instruments for preventing and reducing macroprudential and systemic risks. It is important to ensure the consistency, transparency and control of these instruments.
- If the national authorities of two or more member states identify a similar change in macroprudential risk, they may send a joint notification to the Commission, the Council, the ESRB<sup>7</sup> and the EBA.
- The Commission should review the appropriateness of macroprudential regulation and its compliance with international standards.

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<sup>6</sup> From the three compromise proposals, here we present the key points of the third one, now being under discussion.

<sup>7</sup> European Systemic Risk Board

- Member states may introduce the liquidity standards and leverage ratio before their implementation dates (2015 and 2018, respectively).
- Minority interests may, under certain conditions, be recognised in CET1 at the consolidated group level.
- Institutions should be encouraged to use the Advanced Measurement Approaches. However, before using the more risk-sensitive approaches, they should meet the relevant conditions for their application.
- The supervisory monitoring of certain intra-group exposures will be given more emphasis.
- Securitisation positions should not be deducted from capital if there are other ways to determine a risk weight reflecting the actual risk of the position.
- The Commission should by December 13, 2013 review the large exposure regime and make a proposal on whether to uphold the exemption from the large exposure regime as a national discretion, or to generalise it, or to abolish it.
- To ensure liquidity management at the group (subgroup) level, an exception from the application of the liquidity standards at the solo level may be given if certain stringent conditions are met and if all of the national supervisors involved agree at the individual level.

The proposal would broaden the scope of instruments eligible and reportable as liquid assets and uphold the extension of the Basel floors until 2014. From a Hungarian point of view it should be mentioned that the compromise proposal does not envisage a review of the zero weighting of sovereign bonds and the proposal would in many respects broaden the powers of host supervisors.

The Danish presidency's proposals regarding the CRD would overall strengthen supervisory powers and cooperation and broaden the scope and tools for supervisory measures and sanctions. Information exchange between authorities would include supervisory inspections, the preventive and curative treatment of failing institutions, and emergency situations. To ensure transparency of the internal banking market, supervisors should publish information in a way which allows for meaningful comparison of the manner in which this Directive is implemented.

## **I.2 High Level Expert Group on reforming the structure of the European banking sector**

After measures adopted in the USA and the U.K. to restrict banks' activities, the issue has been put on the agenda in the EU as well. A High Level Expert Working Group has been set up to look into the possible reforming of the structure of the European banking sector. Michel Barnier, the Commissioner for Internal Market appointed Erkki Liikanen the Governor of the Bank of Finland, formerly a member of the European Commission, as chairman of the Group. The Group is charged with giving recommendations to:

- reduce the risks of the banking system as a whole,
- reduce the risks that individual firms pose to the financial system,
- reduce moral hazard by making market exit a viable option also for the largest and most complex institutions and thereby reduce government guarantees,
- promote competition, and
- maintain the integrity of the internal market.

The Group includes former bankers, regulators, consumers of banking services and economists with expertise in banking, financial markets and financial regulation. The Group will present its final report to the Commission by the end of summer 2012.

The European Banking Federation has also set up a task force from members of its various committees, to follow, mirror and, if necessary, influence the work of the High Level Expert Group.

### **I.3 Shadow banking**

In March, the European Commission published for comments a Green Paper on the risks involved in shadow banking and possible measures to address these risks. The Green Paper aims to define the shadow banking system and to identify the organisations engaged in shadow banking. (By launching this consultation, the European Commission joins the Financial Stability Board's global work on the issue).

The Commission proposes to focus on the following:

- Money Market Funds and other types of investment funds or products with deposit-like characteristics,
- Investment funds, including Exchange Traded Funds (ETFs) and hedge funds, that provide credit or are leveraged,
- Finance companies and securities entities providing credit or credit guarantees, or performing liquidity and/or maturity transformation without being regulated like a bank,
- Insurance and reinsurance undertakings which issue or guarantee credit products,
- Securitisation and securities lending and repo.

The Green Paper analyses the risks and benefits related to shadow banking, the challenges for regulatory and supervisory authorities and the regulatory measures applying to shadow banking in the EU. Comments are invited by June 1, 2012.

The EBF set up a Task Force from members of its Banking Supervision and Capital Markets Committees to develop a position on the Green Paper. The Task Force is tasked to provide a critical analysis of shadow banking, presenting the threats shadow banking poses to banks and the systemic risks it entails. The Task Force should also analyse the impacts of overregulation, presenting proposals for the relaxation of the regulatory constraints that have led to the evolution of shadow banking.

## **II. European Banking Authority - European Supervisory Authorities (ESAs)**

### **II. 1 EBA Work Programme 2012**

2012 will be the second year of operation for the EBA as a full-fledged EU Authority. Accordingly, the EBA's Work Programme for 2012 will continue to give special emphasis to the overall development and strengthening of the EBA's institutional capabilities. At the same time, there are significant new legislative proposals in European banking regulation which will have a major impact on the amount and priorities of specific tasks for the EBA. The main objectives and priorities in the EBA's Work Programme for 2012 include the following:

### Regulation

Playing a leading role in the creation of the single rule book for the EU banking system.

- Developing Binding Technical Standards (BTS<sup>8</sup>) under the new CRD4/CRR framework (76 regulatory and 32 implementing standards). Key areas: capital and capital buffers, liquidity, remuneration and leverage ratio.
- Crisis prevention and resolution arrangements. (Once the European Commission's proposals are available)

### Oversight

Delivering an independent and high quality analysis of EU banks and the EU banking sector in the following areas:

- Risk assessment
- Reporting and transparency (COREP, FINREP)
- Home-host cooperation in supervisory colleges.

### Consumer protection

Promoting transparency, simplicity and fairness in the market for consumer financial products.

### Policy analysis and coordination

Providing a legal analysis of the policy and supervisory documents prepared by the regulation and the oversight clusters (technical standards, guidelines, supervisory recommendations, dispute resolution, peer review etc).

### Operations and institutional capabilities

Completion and further enhancement of the internal control environment in a period of intensive build-up and growth of the recently established EU institution. Full implementation of the EU Internal Control Standards.

The Annex to the Work Programme includes 320 tasks, one third of which is assigned Priority 1, which is a rather ambitious plan.

## **II.2 Regulatory and implementing technical standards**

### ***II.2.1 Priorities***

The European Banking Federation requested its members to comment on the proposed Binding Technical Standards specified in the EBAs Work Programme for 2012. Based on the comments received, the EBF made a proposal to change the priorities assigned to certain BTSs by moving some Priority 2 items to Priority 1, while reducing some other items from Priority 1 to a lower priority and deleting some other items. In its letter to the EBA, the EBF pointed out the importance of allowing sufficient implementation time.

### ***II.2.2 Regulatory technical standards for own funds***

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<sup>8</sup> Binding Technical Standards (BTS) are important implementation instruments for the proposed Single European Rule Book. They include two types of standards: Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS).

The EBA standing committee on own funds is currently working on the drafting of 15 Binding Technical Standards (BTS). (The drafting of an additional 20 BTS has been postponed by mid-2012). The 15 Binding Technical Standards currently under drafting are scheduled to be adopted by the EBA Board of Supervisors in April. This will be followed by a 3-month consultation. Then, the standards will be finalised and submitted to the European Commission for adoption. If all goes according to schedule, the BTS on own funds will be published in January 2013.

### ***II.2.3 Industry associations' joint letter on ESA timeframes***

In January, European industry associations (EBF, ISDA<sup>9</sup>, AFME<sup>10</sup> and other associations) wrote a letter to the EU Internal Market Commissioner, the Danish Finance Minister, and the Chairman of the ECON on the timeframes set for the European Supervisory Authorities (ESAs). The letter points out that the ESAs would be required to draft an extremely high number of technical and implementing measures at a time of great economic difficulty, while the ESAs were still in the process of building staffing levels and resources to full strength. In relation to EMIR and CRD4/CRR, the industry associations recommend that timelines for level 2 implementation, as set out in level 1, should not be defined in absolute date-specific terms, but by specifying a period for ESA drafting, starting from the date when the level 1 measure is adopted or enters into force. This period should not be less than 12 months. The industry associations also suggest that a principle of prioritisation be incorporated in the level 1 mandates and the European Commission should be given the power to extend the implementation deadlines.

In his response, the EU Internal Market Commissioner agreed that a public consultation was indispensable in drafting the implementing standard. He stressed, however, that the Commission had set clear priorities for the ITS, only providing short deadlines in those cases where the standards were indispensable for the functioning of key elements of the regulation, while the rest of the standards are to be implemented at later dates. The Commission would follow closely the developments until the conclusion of the co-decision process, to allow ESAs sufficient time to draft the standards and to prevent deadlines from becoming unmanageable due to any delay in legislation.

### ***II.3 Consultation on Implementation Technical Standards on supervisory reporting requirements for Large Exposures (CP51)***

In February, the EBA published its proposed Implementation Technical Standards for supervisory reporting requirements for large exposures. The ITS sets large exposure reporting requirements, in accordance with Article 383 of the proposed CRR and complementing the ITS for general supervisory reporting requirements provided in CP50<sup>11</sup>. Uniform reporting requirements are aimed to ensure fair conditions of competition between comparable groups of credit institutions and investment firms and will lead to more efficiency for institutions and more convergence of supervisory practices. The proposed ITS covers compliance-related information and information needed to analyse concentration risk.

The scope and level of application of the proposed ITS follows the scope and level of application of the CRR. The ITS would take effect simultaneously with the CRR on January 1, 2013. Institutions will have to submit a first set of data related to the reference date to national authorities by 13 May 2013. The EBA intends to finalise the draft ITS and submit it

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<sup>9</sup> International Swaps and Derivatives Association

<sup>10</sup> Association for Financial Markets in Europe

<sup>11</sup> See our 4th quarter 2011 report.



to the Commission by June 30, 2012. The proposed submission date assumes that a final CRR will be available beforehand.

In their joint response to the consultation paper, the EBF and the AFME pointed out the following:

- The first-time adoption of the ITS should be January 1st, 2014, at the earliest.
- More clarity is needed regarding the application of the NACE sector codes and counterparty identification codes. It is a concern that the latter would proceed independently from the FSB<sup>12</sup> work on common legal entity identifiers.
- The EBF and AFME understand that the Large Exposure reporting requirements and COREP reporting will not be affected by current accounting regimes, otherwise a transition period of two to three years would be needed for implementation of the new large exposure and COREP reporting requirements.
- COREP reports and Large Exposure reports use the same database because they are interconnected. Therefore, the period between the reporting reference date and the submission date should be the same as the period set in the COREP framework.
- The geographical and sector information is already covered under the Pillar 2 framework.
- The reporting required under European regimes (for COREP, FINREP and Large Exposures) should be aligned with the FSB's data template for G-SIBs. These reporting requirements contain overlapping data that would be duplicative and unnecessary. Definitions and data fields should be aligned to the greatest possible extent.
- The introduction of an additional reporting threshold of EUR 150 million would be a dramatic, disproportionate and sudden increase in reporting requirements for many banks. Furthermore, it is not covered by the EBA's mandate and must therefore be rejected.
- The Large Exposure reports should not, and cannot, be used for the supervisory monitoring of concentration risk.

#### ***II.4 Standing Committee on Financial Innovation (SCFI)***

The regulation establishing the European Banking Authority (EBA) requires the establishment of a Committee on Financial Innovation (Article 9). The main objective of the EBA's Standing Committee on Financial Innovation (SCFI), established in May 2011, is to assist the EBA in fulfilling its mandate in the areas of financial innovation and consumer protection. From 2012 onwards, the EBA will publish a yearly report, prepared by the SCFI, identifying areas of concern in both the consumer protection and financial innovation areas of the banking sector and areas where these two intersect. This will include recommendations to the EBA's Board of Supervisors, to national supervisory authorities, or to the European Commission (e.g., for regulation).

The SCFI's 2012 report addresses issues related to indebtedness and responsible lending, financial literacy and education, complex savings products, bank account fees and charges, unnecessary sales, the impact of technology, and comparison websites.

A key task is to identify financial innovations that might be potentially harmful from a consumer protection perspective, analyse such products in depth and assess the risks they raise and take or recommend further action, if necessary. In 2012, the SCFI will also analyse, inter alia, collateralised commercial paper, contracts for difference and convertible bonds. An annex to the report provides a detailed review of Exchange-Traded Funds.

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<sup>12</sup> Financial Stability Board

## ***II.5 EBA Guidelines on AMA extensions and changes (GL45)***

These Guidelines provide institutions with guidance on how to communicate AMA extensions and changes to the competent authorities and on how to define internal policies for AMA changes in line with supervisory expectations. The Guidelines do not contain requirements regarding modelling or the risk management of institutions. Changes to the AMA will have to be categorised according to their materiality as 'significant', 'major' or 'minor' change. (The classification criteria for the various categories are provided in the annex to the Guidelines). This classification is important because while extensions and 'significant' changes require a prior approval, 'major' and 'minor' changes only need to be notified to the competent authority (major changes in advance, minor changes only subsequently).

## ***II.6 First aggregate assessment on banks' capital plans***

In February the EBA's Board of Supervisors made a preliminary assessment of banks' capital plans submitted in response to the EBA's Recommendation on recapitalisation<sup>13</sup>. The review highlights that, in aggregate, the shortfalls are expected to be met primarily through direct capital measures and these would not have a negative impact on lending into the real economy. The EBA Board of Supervisors also agreed that the next EU-wide stress test would be undertaken in 2013. The EBA Board of Supervisors undertook a preliminary overview of the proposed measures highlighting the following:

- The planned actions give a capital surplus of approximately 26%, creating some leeway in case some actions do not materialise.
- 77% of the actions focus on direct capital measures (covering 96% of the capital shortfall). The majority of these are capital raising, retained earnings and conversion of hybrids to common equity. The remaining 23% of the actions relate to risk-weighted assets (RWAs).
- Taking into account the measures arising from EU state aid decisions on banks' restructuring or other country programmes, the impact of actions reducing lending into the real economy would be less than 1%.

National supervisors, in close cooperation with the EBA, assessed banks' capital plans in February and banks received a feedback on their plans in early March. National supervisors all signalled their commitment to using their supervisory powers to ensure implementation by banks of the actions required.

## **II.7 Discussion Papers on technical standards for EMIR<sup>14</sup>**

### ***II.7.1 ESAs' joint discussion paper***

In early March, the ESAs published a joint discussion paper on draft Technical Regulatory Standards on risk mitigation techniques for OTC derivatives not cleared by a CCP<sup>15</sup> under the

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<sup>13</sup>Following the ECOFIN's decision on measures to restore confidence in the banking sector, the EBA issued a communication on October 26, 2011, announcing that banks' Core Tier 1 capital ratio should reach 9% by June 30, 2012. (See our 4th quarter 2011 report).

<sup>14</sup> European Market Infrastructures Regulation

Regulation on OTC derivatives, CCPs and Trade Repositories (EMIR). The EMIR Regulation, adopted in September 2010, delegates powers to the Commission to adopt the required Regulatory Technical Standards (RTS). The ESAs are expected to jointly develop draft RTS and submit them to the Commission by September 30, 2012. The RTS should include collateral and capital requirements, segregation requirements and operational processes for intragroup exemptions. The ESAs invited stakeholders' opinions and data for a cost-benefit analysis by April 2. A consultation paper on the issue is expected to be published during the summer.

### ***II.7.2 EBA discussion paper on regulatory technical standards for capital requirements for CCPs***

Simultaneously with the ESAs joint discussion paper, based on the authorisation provided by the EMIR regulation and with the same deadline, the EBA published a discussion paper on draft regulatory standards (RTS) for capital requirements for CCPs. The discussion paper analyses possible options that the EBA is currently considering. The EBA's preliminary view is that the capital of a CCP, including retained earnings and reserves, should be at all times at least equal to the higher of the following two amounts:

- the CCP's operational expenses during an appropriate time span for winding-down or restructuring its activities; and
- the capital requirements for those risks that according to the Regulation must be covered by appropriate capital.

A consultation paper on the issues is expected to be published during the summer.

### **II.8 Regulatory requirements regarding exposures to SME**

At a request from the European Commission, the EBA is expected to submit by September 1, 2012 a report on the appropriateness of the treatment of exposures to SMES and on the possibility to reduce the applied risk weights. The EBA requested the EBA to provide data and analyses for the report.

Irrespective of this report, the EBA is widely lobbying for the introduction of an SME Supporting Factor (76.19%).

## **III. European Banking Federation - IBFed<sup>16</sup>**

### **III.1 CRD4/ CRR**

#### ***III.1.1 Letters to the Danish presidency for a Single European Rule Book***

The European Banking Federation has long been of the view that the regulation of the European market based on a Single Rule Book was indispensable. However, the Danish presidency's compromise proposals would provide for more national discretions, citing the need for national

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<sup>15</sup> Central Counterparties

<sup>16</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).

flexibility. This seriously jeopardises the objective of a single market of financial services. The EBF turned to the Danish presidency on three occasions to object these proposals.

In its first letter, the EBF expressed its objections to the compromise proposal allowing national authorities to

- introduce the capital conservation and counter-cyclical buffers from January 1, 2013 instead of a phase-in implementation from January 2016, and
- set a higher minimum exposure-weighted average LGD for exposures secured by residential property collateral.

In the EBF's opinion, even the Commission's original proposal provides too wide a scope for national discretions, such as the extension of national authorities' powers to impose additional capital requirements under Pillar 2 and the flexibility in the phasing-in schedule, which are not in line with Basel III. The EBF does not support the introduction of new national discretions, nor the retention of existing discretions, as they would increase the risk of an unlevel playing field and lead to legal uncertainty and regulatory arbitrage, jeopardising growth and lending to the real economy.

The Danish presidency's second compromise proposal, published on March 2, further diverged from the concept of a single European rulebook by proposing allowing national authorities to impose a systemic risk buffer of up to 3%, to be built from CET1 capital under Pillar 1. Objecting to this proposal, the EBF wrote a letter to Danish presidency, the EU Commissioner and the EU rapporteurs, suggesting that

- important parts of the Basel Accord, such as the minimum capital requirements, should not be subject to national discretion;
- systemic risk should be subject to a separate regulation, in accordance with the FSB global standards, as agreed by the G20 leaders in November 2011.

The EBF responded to the Danish presidency's third compromise proposal in a letter defending the Single European Rule Book. The letter was copied to the EU Internal Market Commissioner, the EP rapporteurs and the financial attachés. The letter pointed out that the compromises taking shape could set back growth in three respects:

- The flexibility package is a significant turn away from a Single European Rule Book. The powers granted to authorities (the right to impose additional capital requirements) point far beyond the original intent.
- The proposed national discretions might be a barrier to the development of common crisis resolution frameworks.
- The proposal for the treatment of systemic risk pre-empts the solution to be developed by the FSB.

The letter also draws attention that according to a report published by the Basel Committee recently, the implementation of Basel II.5 and Basel III in the USA will be delayed, putting European banks at a competitive disadvantage.

### ***III.1.2 EBF position regarding trade financing instruments***

As is known, Basel II and the European framework implementing it fails to sufficiently take into account the low risk in these instruments<sup>17</sup>. During the consultation, MEPs submitted amendment proposals for the preferential treatment of short-term trade finance instruments. The EBF is of the view that this preferential treatment should be extended to include medium and long-term trade finance instruments.

To support lobbying on the issue, the EBF's working group in charge of the issue prepared a review on possible government tools to promote trade finance in member states. From a liquidity point of view it is imperative that, following the U.S. example, trade finance instruments are recognised as central bank eligible assets.

### ***III.1.3 Legal issues***

The EBF Legal Committee reviewed Chapter IV of the CRD, addressing supervisory powers, supervisory sanctions and the rights of appeal. The Legal Committee welcomed the introduction of sanctions, as this would promote legal certainty and a level playing field. The Committee also supported the approach that the sanctions should be efficient, proportional and deterrent. However, it pointed out that the proposed sanctions were inconsistent with the principles of subsidiarity and proportionality as set forth in the EU Treaty. In relation to the principle of subsidiarity, the size of the sanction should be regulated at the member states' level. The size of sanction proposed by the European Commission (10% of total annual revenues) cannot be considered as proportional: it significantly exceeds the normally applied rates (the maximum sanction applied by some EU member states is EUR 100 million. In the USA, the maximum sanction for corporate entities is USD 10 million). The sanctions should be aligned with the rates provided by other Directives.

### ***III.1.4 Liquidity management***

At the expert meetings held between the EBF and the European Commission, several technical issues related to liquidity management were addressed, including the definition of SMEs, the treatment of corporate deposits, the exemption from individual application and reporting, operational requirements related to liquidity buffers, conditional and unconditional credit lines, the classification of off-balance-sheet items, the treatment of sight deposits and other issues.

### ***III.1.5 EBF Focus Session with Members of European Parliament***

At the beginning of February, the EBF organised a seminar (Focus Session) on CRD4/CRR. The meeting was sponsored by the EU rapporteur Othmar Karas and attended by MEPs and their assistants in charge of the topic, the ECON Secretariat and representatives from the EBF. At the meeting, the EU rapporteur emphasised that the CRD4/CRR were not simply a response to the crisis, but the objective of the framework was to enable the European banking sector to restore growth and jobs in Europe. The rapporteur highlighted the most important points of his report, stressing the importance of avoiding any goldplating.

The EBF supported the approach of putting the emphasis on the substance rather than on the deadlines. Participants from the banking industry emphasised that the introduction of liquidity standards would entail serious real economic consequences. The impacts in Europe would be more serious than elsewhere and might lead to disintermediation.

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<sup>17</sup> See our 4th quarter 2011 report.

### ***III.1.6 Meeting of the Visegrád countries with lawmakers***

In March, the EBF organised a meeting for the Visegrád countries (the Czech Republic, Hungary, Poland and Slovakia) with officials of the European Union, members of the European Parliament and the financial attachés of these countries to review CRD4/CRR issues that are of particular importance from a CEE point of view. The meeting was focused on the following issues:

- Application of the CRD4/CRR on a consolidated and individual basis, the role of host supervisors,
- the treatment of small and medium-sized businesses, application of an SME supporting Factor,
- the treatment of minority interests, and
- the application of liquidity standards.

### ***III.1.7 Risk Assessment Working Group – Questionnaire on residential mortgage lending***

The Risk Assessment Working Group assists CRD4/CRR implementation by reviewing risk assessment methodology issues with a view to ensuring an as accurate as possible risk weighting. The Working Group developed a questionnaire to survey the characteristics and differences between the various IRB approaches in mortgage lending. The survey is aimed to assess

- how the approaches used by the various institutions capture the risks in the market;
- what and how big the differences are;
- which are the areas where there are differences and whether those differences are warranted;
- which are the areas where the differences are unwarranted.

The questionnaire was answered by the Association in cooperation with three member banks using the IRB approach. The results are expected to be published by end May.

## **III.2 EBF, AFME joint response to the EBA consultation on ITS for supervisory reporting requirements for institutions (CP50)**

The key points of the joint response are as follows:

- The industry fully supports the European Commission's aim to achieve a Single Rule Book. The national discretions that the proposals seek to introduce need to be removed.
- The industry has serious concerns about the magnitude of the changes that are being proposed. Pragmatic and workable solutions should be found to satisfy the information needs of the ESRB in dialogue with the industry.
- The proposed timing for the implementation of the proposal and the proposed remittance dates need to be reviewed. (In the industry's view, the new framework should be applicable only from January 1, 2014). At least 45 working days will be necessary for submitting FINREP reporting on a consolidated level to ensure the quality of the reporting data. The COREP remittance date should be set at 50 days.
- The proposals are flawed from a legal point of view: the use that the Consultation Paper proposes to make of the principle of proportionality does not respect some basic principles of EU Law nor established jurisprudence of the European Supervisory Authorities.

- The FINREP requirements should be applied to institutions preparing their consolidated financial statements on the basis of IFRS. Furthermore, the FINREP requirements and should be aligned with the IFRS.

### **III.3 EBF response to the consultation on Credit Rating Agencies<sup>18</sup>**

In the consultation on proposed amendments to the EU Regulation on Credit Rating Agencies, the EBF made the following key points:

- A rotation of rating agencies as proposed by the European Commission would decrease the competitiveness of the European financial market and the ability of banks to raise long-term funding.
- Reducing overreliance on ratings is an important issue for the regulation of financial markets. However, rule makers should inform markets participants of which alternatives will be feasible in future. Internal rating models will only be used by a small fraction of market participants.
- Subject to appropriate drafting, alignment with member states' legal principles and a potential cap on the liability, the EBF in principle supports a common EU-level principle of civil liability for credit rating agencies with respect to "gross negligence and intent".
- In the short-term, the EBF encourages decision makers to push ahead with measures aimed at improving the provision of rating services to users, such as ending practices like the non-recognition of the ratings and methodologies of other agencies.
- The EBF believes that there would be market interest in the emergence of a privately run European CRA if it increased the overall quality of ratings. To gain credibility in the market it would have to be funded privately and be free of political involvement.
- Greater scope for comparison between ratings is always useful for banks and investors. Further clarification would be necessary on how the proposed EURIX scale would add value and work alongside existing scales that are already well established.
- Proposals concerning sovereign ratings must form part of a coordinated European solution to the sovereign debt problem.
- The EBF is of the opinion that while the covered bond market would gain from less dependence on CRAs, the current proposal creates probably more problems than it solves.

The EBF made specific comments and amendment proposals regarding the mandatory rotation of rating agencies, rating methodologies, the use of internal rating models and civil liability.

As a major development, the three big credit rating agencies have applied for the registration of their third-country ratings. The European Securities and Markets Authority (ESMA) has announced that it considers the regulatory frameworks for credit rating agencies of the United States of America, Canada, Hong Kong and Singapore to be in line with European rules. Accordingly, European financial institutions can continue using for regulatory purposes credit ratings issued in these countries after April 30, 2012. The EBF plans to take steps for the recognition of ratings of CRAs registered in emerging countries such as Brazil, Chile, Mexico or South-Africa.

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<sup>18</sup> For details on the European Commission consultation on proposed amendments to EU Regulation 1060/23009/EC on Credit Rating Agencies, see our 3rd quarter report.

### **III.4 SIFI Working Group transformed into Macroprudential Oversight Working Group (MAPOWG<sup>19</sup>)**

At its November meeting, the EBF Banking Supervision Committee decided that it was necessary to enable the EBF to develop positions on macroprudential issues. To achieve this, the Banking Supervision Committee agreed to extend its SIFI Task Force and transform it into a Macro-Prudential Oversight Working Group. The Working group is charged with providing comprehensive analyses on macroprudential policy developments, developing EBF positions, drafting EBF responses to consultations and lobbying at the European and global levels.

### **III.5 IBFed response to the Basel Committee proposals for new capital disclosure requirements<sup>20</sup>**

The IBFed supports the overall endeavour to develop comprehensive, transparent disclosures which meet the needs of market participants, but it has reservations over the approach proposed to meet the objective. There is a growing perception that Pillar 3 has not fulfilled its early promise. This may be partly due to the issue of lack of comparability, which the Basel Committee proposal seeks to address. However, in the IBFed's opinion, one of the main reasons explaining the lack of interest in Pillar 3 disclosures is that the complexity and level of detail of the information needed by supervisors does not match the information needs of market participants. The granularity of the data requested by authorities may lead to disclosure overkill, which would not be in line with the original objective of enhancing transparency.

In addition to the above general remarks, the IBFed made critical comments regarding the Basel Committees proposals for

- common reporting templates,
- the reconciliation of the regulatory versus accounting consolidation
- the disclosure template during the transition phase, and
- the disclosure frequency.

The IBFed also proposes that the Commission should confirm explicitly that the proposed disclosure requirements will apply at a consolidated level only and the first date for disclosure will be after January 1 2013, that is, coinciding with either the 2013 Interim Report or the 2013 Annual Report, depending on which of these is first audited.

### **III.6 IBFed response to the Basel Committee consultative document on principles for the supervision of financial conglomerates**

1. The IBFed welcomes the flexibility of the proposed supervisory framework. However, it points out that the identification of the group-level supervisor should rely on objective, written criteria which are determined at the global level.
2. The IBFed agrees with the approach that the responsibility of the Group-level Supervisor is to focus on group-level supervision and to facilitate coordination, while the other supervisors are responsible for the specific regulated components. However, this distinction becomes blurred in the document and there are many instances where the consultation paper fails to

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<sup>19</sup> Macroprudential Oversight Working Group

<sup>20</sup> For details on the Basel Committee's consultations, see our 4th quarter 2011 report.



clearly allocate the appropriate responsibilities. This is not likely to foster effective supervision, particularly keeping in mind that the supervisors involved may come from differing backgrounds and supervisory cultures (banking, insurance and securities regulators).

3. The IBFed supports the use of a Pillar 2-type approach, while pointing out that the capital requirements which are being imposed on a financial conglomerate should be determined first and foremost on the basis of a capitalisation by risk type, determined by confidence levels set at sectoral levels. There may be instances where the capital requirement for a financial conglomerate as a whole may be higher than the sum of the capital requirements for its component parts. However, for a more balanced approach, the possible diversification benefits realised by financial conglomerates from having operations in various sectors should be taken into account.

4. The IBFed shares the view that supervisors need to take into account double or multiple gearing in assessing the capital adequacy of a financial conglomerate.

5. Requests for information to the financial conglomerate should be coordinated by a central point of contact, with common reporting formats, requirements and deadlines. The IBFed draws attention that the consultation paper fails to pay sufficient regard to the need for confidentiality.

6. The consultation paper calls for a legal framework to ensure that supervisors are protected from liability for acts taken in good faith. The final version of the paper should elaborate on this issue.

### **III.7 IBFed response to the Basel Committee consultative document on internal audit**

The IBFed is of the view that the proposed measures in the consultative document are overly prescriptive and represent a shift from recommendation to mandatory regulation. It sets specific requirements in several areas where it is primarily the role of bank management to make key decisions (operations, employees, the relationship between supervisor and bank). The document is focused on large internationally active banks and does not sufficiently take into account the differences in asset size, business model, charter type, and cost effectiveness. The IBFed recommends changing the consultative document to allow national supervisors to make appropriate recommendations for smaller and less risky banks.