



HUNGARIAN BANKING ASSOCIATION

REPORT

on Activities of the Hungarian Banking Association

2nd Quarter 2016

Budapest, September 2016

Table of Contents

| | |
|--|----|
| I. Executive summary | 4 |
| II. Macroeconomic outlook, operational conditions for the banking industry | 7 |
| III. Corporate lending..... | 9 |
| Outcomes of the third stage of the Finance for Growth Scheme (FGS)..... | 10 |
| IV. Private lending | 10 |
| Delivery of opinion on the amendment of state subsidy decrees | 11 |
| Practical problems of the regulation on private bankruptcy, the decree on sale of property | 11 |
| Uniformity Decision No. 1/2016 PJE of the Curia..... | 12 |
| V. Further important regulatory events influencing the operation of the banking sector | 12 |
| Amendment of Act on Integration of Cooperative Credit Institutions | 12 |
| Amendment of the Civil Code | 13 |
| Revision of Act on Judicial Execution: the work of the Codification Committee | 14 |
| Electronic contact-keeping with courts..... | 14 |
| Issues affecting the Basel III regulation..... | 15 |
| VI. Developments with regard to the National Bank of Hungary (MNB) | 16 |
| MNB Decree on the risk-proportional NDIF (National Deposit Insurance Fund) contribution..... | 16 |
| MNB Recommendation on mortgage debtors in arrears..... | 16 |
| VII. Payments..... | 17 |
| Consultations on the introduction of an instant payment system | 17 |
| The effect of the new waste management funding on the direct debits | 18 |
| Enforcement of special treatment for disabled persons | 18 |
| Topicalities regarding payment cards | 19 |
| Establishment of PSD2 Special Working Group | 20 |
| Taking over of the tasks and management of the SWIFTNational Member and User Group (NUG) | 21 |
| Preparations for the SEPA end-date regulation | 21 |
| VIII. Taxation, accounting | 22 |
| Changes affecting the credit institutions in the taxation rules in 2017 | 22 |
| Changes in accounting legislation - Changeover to the IFRS | 23 |
| IX. Developments at the Banking Association..... | 24 |
| Board meeting 2015 | 24 |
| Money Week: Backtesting results 2016 - Preparations for 2017..... | 24 |
| Communication statistics and topicalities..... | 25 |
| International relations - V6 meeting | 26 |

| | |
|---|----|
| Working committees and working groups not mentioned above | 26 |
| APPENDIX- INTERNATIONAL OUTLOOK: REGULATION AND SUPERVISION | 29 |
| I Global regulation | 29 |
| <i>I.1 Financial Stability Board (FSB)</i> | 29 |
| <i>I.2 Basel Committee on Banking Supervision (BCBS)</i> | 30 |
| II European Regulation | 32 |
| <i>II.1 General frameworks</i> | 32 |
| <i>II.2 Capital requirement and liquidity regulations (CRR/CRDIV)</i> | 33 |
| <i>II.3 The Banking Union</i> | 34 |
| <i>II.4 Assessing the state of the Capital Markets Union (CMU)</i> | 40 |
| <i>II.5 Reviewing the Financial Conglomerate Directive (FICOD)</i> | 41 |
| <i>II.6 Documents published in Q2 by the EBA and ESA</i> | 41 |

I. Executive summary

In Q2 2016 the ***world economy*** kept on growing sluggishly, at a decelerating pace; the annual growth rate was around 1.2 per cent in the United States, 1.6 per cent in the Eurozone, 0.2 per cent in Japan, 6.7 per cent in China. In the United Kingdom, the outcome of the referendum on exit from the European Union was a surprise to the markets; it caused serious turbulences in the short term. The indirect effects of Brexit can determine money markets, primarily for the Euro, in the long term. Fears from the collapse of the Eurozone can trigger capital flight from the periphery to the core countries, which can exert pressure on the already ailing banks of the Southern countries. The European banking sector in general lives difficult times due to the weak growth outlook, the disappearing deposit interest margin, the further strengthened regulatory and capital requirement, and the unchanged level of the non-performing portfolio. These issues can be surfaced again by the strengthening capital flight. The European Central Bank might respond to the increasing pressure on the European banking sector by further easing. According to market expectations the other central banks might also respond to the weakening growth outlook and the increasing financial risks by further stimulus.

In Q2 ***the Hungarian economy*** corrected the surprisingly weak data in Q1, and grew by 2.6 per cent year on year. On the production side, growth was supported by market services, and the industry and agriculture; the construction industry's weak performance has not changed. On the consumption side, household consumption and net export were the driver of the growth. The annualised employment increased by some 140 thousand people. The lack of qualified workforce causes trouble in an increasing number of sectors. Gross and net average wage increased by 6 and 7 per cent respectively, far beyond the dynamics of the GDP. In terms of the balance indicators, the budgetary positions are still very positive; income in the most tax types grew, while the interest rate expenditure for the government debt is continuously decreasing. According to expectations, the deficit for the entire year can remain below 2 per cent. External financial stability improved further; the balance of payment surplus is supported by the external trade surplus (9 per cent of the GDP) and current transfers (3 per cent of the GDP). Inflation is slightly higher than expected earlier, around 0.5 per cent. The exchange rate of the euro fluctuated in the 310 to 318 range in Q2, apart from the market turbulences caused by the Brexit. The MNB decreased the base rate from 1.20 per cent to 0.90 per cent, in two steps.

In Q2, the aggregated balance sheet total of ***credit institutions*** decreased slightly, by 1.5 per cent in nominal term and already failed to reach HUF 33,000 billion. HUF assets decreased significantly (by nearly 10 per cent), and foreign exposures grew by nearly thousand billion HUF. The increase of the total loan portfolio stopped in essence; the gross loan portfolio grew by some half per cent only, mainly due to the release of provision. Within liquid assets, in line with the self-financing scheme of MNB, the central bank assets decrease continued, but this was not spent by the banks to finance the government debt or lending but sent abroad. Rearrangement of the domestic and foreign stocks could also be seen in the liabilities side, albeit to a much lesser extent. In addition to the HUF 579 billion decrease in domestic liabilities, foreign liabilities grew by 83 billion. The deposit portfolio is basically unchanged: government, primarily local government deposits decreased significantly; deposits from non-financial enterprises, households and foreigners increased moderately. In the declining interest rate environment a further restructuring could be observed from the fixed term deposits to current account and sight deposits. Net loan/deposit ratio of the credit institution sector grew slightly by end Q2, from 94% in Q1 to 95%. Profit developments were positive, similarly to Q1 (pre-tax profits earned in Q2 were HUF 162 billion, after HUF 199 billion in Q1). The half yearly average annualised return on assets (ROA) before tax was +2.2%, and its return on equity (ROE) +22.2%. These outstandingly good data, even compared to the "peaceful years" preceding the crisis, are partly explained by the release of provisions set aside during the loss-making years.

The decrease in **retail lending** activity in the sector is supposed to be halted by the *Housing Subsidy for Families (CSOK)* scheme. After the amendment of the relevant decrees in February, extending subsidies, the Ministry for National Economy prepared a new draft amending decree in view of Government expectations, customer needs and proposals from banks. The adoption of this amendment is delayed by the time consuming clarification of issues raised during the administrative consultations.

In the context of *FX loans* the latest resolution for uniformity by the *Curia*, published on 6 July 2016 stated that "...an FX-based consumer loan agreement is compliant with the requirements of the Credit Institution Act as effective upon the conclusion of contract if the written loan agreement sets out the loan amount in HUF (repayment currency), provided that the foreign exchange equivalent (lending currency) of the loan amount specified in this manner can be exactly calculated at the time of the conversion as set out in the agreement, or upon disbursement, taking into account the foreign exchange rate applicable at that time". This resolution for uniformity is in line with the resolutions for uniformity of civil law passed by the *Curia* in 2013 and 2014, as well as with the settlement laws and the case law based on them, and it plays an important role in maintaining legal certainty.

In the context of the application of the *MNB recommendation* issued in March on the *Handling of defaulted mortgage debtors*, burdens for the banks were mitigated by the slight decrease of the data coverage and the extension of the reporting deadline. It means an easing that the required reporting is to be submitted for transactions in default for longer than sixty days. (For defaults of 30 days the Recommendation can be applied in a more flexible manner, which is less burdensome for the banks.) For the implementation of the Recommendation the FAQ providing practical guidance is an effective assistance.

Customer demand for and interest in the *debt conciliation procedure for private individuals (private bankruptcy)* lags well behind preliminary expectations. The law was amended in April but this amendment was limited only to the extension of the time limit for the submission of the application for the procedure until 30 September 2016; a need for a comprehensive amendment/simplification is still on the agenda.

In Q2, in the context of **legislation**, the early June amendment of the *Act on the integration of cooperative credit institutions* was of particular importance for the sector. Probably the most important change for the banks is that the Integration Organisation, the Central Bank and the cooperative credit institutions are jointly and severally liable for all liabilities of each other, irrespective of the date when these liabilities incurred, i.e. from now the compensation paid by EBA for the bankruptcy of saving cooperatives can be claimed under the joint and several liability from all members to the integration. Another important development with regard to the National Deposit Protection Fund is the introduction of the *risk based fee payment*, in accordance with the EU Directive. (Upon the request from the Banking Association, the National Insurance Deposit Fund (OBA) Board set the ratio of risk based fee as 0% for the second half of 2016.)

The *amendment* to the *Civil Code* before the Government and adopted by the Parliament is much less extensive than originally intended. As a result of this review, the regulation of securities underwent a comprehensive amendment; rules on the liability of senior officers, lien agreements, security deposits, and the transfer of agreement were clarified; the concept of individual lien was re-introduced; and the nullity of fiduciary loan collaterals was restricted to consumer contracts. The re-introduction of the *independent lien* is essential for our members to reinvigorate the bank refinancing market, to clear the banks' portfolios, and to increase the safety of the mortgage bond market.

An important change in the everyday practice is the introduction of *electronic liaising with courts*, after several postponement, as of 1 July 2016. From that date, legal representatives have to submit the statement of claims, as well as any other submissions and documentary evidence electronically to the courts, via the Electronic Litigation Portal.

In the context of **payment services**, the introduction of the *prompt payment system* means a medium-term strategic change, the framework of which is intended to be established by the MNB by taking the opinion of the service providers into account to the furthest. From the events in Q2 it is to be highlighted that the Bank Association established *specialised working groups* to facilitate the transposition of the *EU Payment Services Directive (PSD 2)*, and that it took over the tasks and management of the *SWIFT national user group (NUG)*, upon the request from the entities concerned. In the bank card business the short term applicable solution for the obligation to display the card type¹ enabled to avoid the immediate and concurrent replacement of existing cards. The competent MNB department initiated consumer protection consultations on the application for a fee for barring cards. The Fraud Day organised in May focused on solutions for ATM attacks and effective protection.

The Hungarian Banking Association held its **2016 Board Meeting** with the participation of the Minister for National Economy and the VPs of the National Bank of Hungary. The Minister has highlighted the importance of the cooperation between the Government and the banking industry both in his opening speech, and in the communication published after that meeting.

In the first half of the year Slovenia hosted the **V6 Meeting**. In these meetings, in addition to the out-of-court insolvency resolution, the deposit protection schemes and resolution schemes of individual countries, the concept of private bankruptcy, and the challenges for lending in a low interest rate environment and subject to increased liquidity requirements were also on the agenda.

By the end of 2016 **global regulatory authorities** will have completed the codification of reforms decided upon in the aftermath of the crisis. As one of the last steps, in April the Basel Banking Supervision Committee launched a consultation on its paper on the *revision of leverage rate*. The final quantification of this rate will be influenced by the outcome of the quantitative impact assessment. The publication of the revised and recast version of the *Standard on the management of bank book interest rate risks* was also an important event. Under the exercise to assess supervisory consistency the Committee also examined *the extent of differences in determining risk weighted assets* by banks calculating their regulatory capital requirement for lending risk by the internal models. The draft *Manual for the prudential treatment of problematic assets* contains, in addition to the definition of non-performing and restructured exposures also the related publication requirements.

European banks are concerned that the finalisation of the Basel III regulation (many call this as Basel IV, due to the numerous amendments) will significantly increase the capital requirement for the EU banks by restricting the use of models and the introduction of minimum capital limits for individual risk types, thus influencing access to lending and the real economy growth in a negative manner. In order to avoid unintended effects EU Finance Ministers were asked to act jointly.

Amongst the pending **regulatory developments**, the establishment of a European Deposit Insurance Scheme, the application of the net stable financing ratio (NSFR) in Europe, and the introduction of the regulation on the total loss absorbing capacity (TLAC) and the related revision of the resolution-related minimum requirement on eligible liabilities (MREL) regulation are to be highlighted. Transition to IFRS 9 will make necessary to align prudential and accounting regulations, and proper management of the expected loss. In addition to the completion of the Banking Union, the Committee is engaged in an intense preparatory work for the establishment of the Capital Market Union, the commissioner in charge closely followed the establishment of the Capital Market Union. The effect of Brexit on the integration processes cannot be assessed yet.

¹ Under the European regulation, the issuer are required to display the card type (credit/debit/prepaid/commercial) on the card (visually and electronically), for the purposes of informing merchants and consumers.

II. Macroeconomic outlook, operational conditions for the banking industry

In Q2 2016 the **world economy** kept on growing sluggishly, in a somewhat more decelerating pace; the annual growth rate was around 1.2 per cent in the United States, 1.6 per cent in the Eurozone, 0.2 per cent in Japan, 6.7 per cent in China. In terms of the central bank terms in developed regions no change took place in the past months.

On 23 June, citizens of the United Kingdom decided to exit the European Union. The outcome of the **Brexit** vote was a surprise for the markets, causing significant turbulences. The exchange rate of the British Pound was under pressure and lost more than 10 per cent from its value. The reserve currencies (USD, JPY, CHF) strengthened; and stock exchange indices started to fall in the short term. However, the initial pessimism changed quickly and stock exchange indices reached new peaks since then. According to market expectations the global leading central banks might also respond to the weakening growth outlook and the increasing financial risks by further stimulus.

The indirect effects of Brexit can be more significant for money markets, primarily for the Euro, in the longer term. The chances of further referenda in other EU Member States can grow. The exit of any Member State and the increasing likelihood of the exit in itself poses a significant and far reaching risk to the entire **European financial system**. Where depositors in the periphery countries attribute a chance for the break-up of the Eurozone, they might start to flee their capital to the core countries, mainly to Germany. However, such a capital flow can again exert pressure on the already ailing banks of the Southern countries. The European Bank sector in general lives difficult times due to the weak growth outlook, the disappearing deposit interest margin, the further strengthened regulatory and capital requirement, and the unchanged level of the nonperforming portfolio. These issues can be surfaced again by the strengthening capital flight, which further strengthens bias towards the creditworthiness of the banks in the periphery. During the two days after Brexit, bank securities suffered a record fall. The market assesses the situation of Italian banks particularly critical. In order to cool self-propelling processes the Italian Government proposes to grant an EUR 150 billion state guarantee for government bonds, however this goes against the European bank resolution rules that entered into force recently. In addition to Italian banks, the German Deutsche Bank is also in the focus of market attention. The price of the bank's shares and convertible bonds broke negative records recently. The balance sheet total of Deutsche Bank is near EUR 2,000 billion, nearly two-third of the GDP of Germany. The forward exposure of the bank is even more frightening, which is equal to the total global GDP. Thus the bank poses an extremely significant risk for the stability of the global financial system. The European Central Bank might respond to the increasing pressure on the European banking sector by further easing. It is plausible that leading global central banks will react to the increase in the global financial stability risks by a comprehensive coordinated stimulus.

In Q2 the annualised growth of **the Hungarian economy increased** by 2.6 per cent year on year, beyond the 2 per cent market expectation. On the production side, growth was supported by market services, and the industry and agriculture; the construction industry again has a mitigating influence. Industry grew by around 2%, well behind its last year's 4 per cent dynamic growth; subject to a good performance in the automotive and electronic industries. The ailment of the construction industry is related to the change in the European Union subsidy cycles. The better than expected growth data in Q2 verified the explanation that the underlying reasons for the weak Q1 performance were one-off factors such as the temporary absence of funds disbursed by the European Union and the temporary halt of one of the big automotive companies. On the consumption side, household consumption and net export were the driver of the growth.

The annualised **employment** increased by some 140 thousand people. The lack of qualified workforce causes problems in an increasing number of industries (construction, hospitality, tourism); companies are forced to raise salaries in order to keep qualified labour. The Ministry for National Economy announced that it examines the possibility to gradually decrease the charges on labour. The **gross average salary** grew by nearly 6 per cent; due to the changes in the personal income tax, the net salary grew by even more, above 7%.

In terms of the **balance indicators**, the *budgetary* positions are still very positive; income in the most tax types grew, while the interest rate expenditure for government debt is continuously decreasing. According to expectations, the deficit for the entire year can remain below 2 per cent, which can enable recovery of the economy. The *external financial stability* improved further; the country's *external financing ability* is 9 per cent of the GDP. The *balance of payment surplus* is supported by the external trade surplus (9 per cent of the GDP) and current transfers (3 per cent of the GDP). Within *government debt*, the portfolio issued in foreign exchange decreased below thirty per cent. Households dispose of nearly HUF 3,900 billion, and domestic credit institutions above nearly HUF 7,500 billion Hungarian government debt. Government bond yields further decreased, in particular on the short end of the yield curve.

Inflation can remain below the 3% target in the long and medium term; in 2016 it is slightly higher than expected earlier, around 0.5 per cent.

The Monetary Council decreased the **base rate** from 1.20 per cent to 0.90 per cent, in two steps, in April and May, respectively. While the overnight deposit interest rate remained below -0.05 per cent, the overnight lending interest rate decreased to 1.15 per cent. In July, the central bank announced that as of October it will restrict the quantities of the governing instrument, three month deposits.

The **exchange rate of the euro** fluctuated in the 310 to 318 range in Q2, apart from the market turbulences caused by the Brexit. The further easing by the central bank caused no significant depreciation of the forint.

In Q2, the aggregated balance sheet total of **credit institutions** decreased slightly, by 1.5 per cent in nominal term (HUF 496 billion) and already failed to reach HUF 33,000 billion. Compared to main currencies the forint depreciated; the quantity of euro denominated assets increased (in excess of 10 per cent, even corrected by the exchange rate changes), while the decrease of forint assets was significant (nearly 10 per cent), jointly causing the above moderate decrease.

With the **asset portfolio** the more definite increase in the foreign exposure compared to the previous quarter (HUF +981 billion), with the significant decrease of the domestic portfolio (HUF -1.477 billion) is a characteristic change. The increase of the aggregated loan portfolio stopped in essence; the *gross loan portfolio* grew by some half per cent (HUF 83 billion) only. This increase in the loan values are mainly due to the release of the provision (the recognised provision decreased by a total of 7.5%, i.e. HUF 116 billion). Within *liquid assets*, in line with the self-financing scheme of MNB, the central bank assets decrease continued (central bank deposits: -37%, current accounts: -21%, total HUF 1,167 billion), but this was not spent by the banks to finance the government debt (government bond portfolio: -2.2%, HUF 152 billion) or lending but transferred to foreign assets.

Within the **total gross loan portfolio** the HUF portfolio further decreased and the FX portfolio increased. The internal structure of the loan portfolio changed in a specific manner. The domestic corporate and retail gross loan portfolio somewhat decreased (by -1.8%, HUF 108 billion and -0.8%, HUF 45 billion, respectively, the latter could not be greatly influenced by the disbursed home subsidies for families). The net portfolio change of the relevant loans did not get into the positive, despite the improvement in the asset quality with significant corrections. In the meanwhile, foreign exposure increased (+10.8%, HUF 224 billion); mainly loans extended to foreign financial sectors increased (+23.5%, HUF 112 billion).

Rearrangement of the domestic and foreign stocks could also be seen in the **liabilities side**, albeit to a much lesser extent. In addition to the HUF 579 billion decrease in domestic portfolios, foreign liabilities grew by 83 billion.

The **deposit** portfolio is essentially unchanged (-0.01%). Deposit portfolio from the government, mainly from local governments, decreased significantly (-27%, HUF 302 billion). Contrary to this, there was a moderate increase in the deposit portfolio from non-financial undertakings, households and foreign deposits (a total of 2.1%, HUF 278 billion). It is to be highlighted that corporate deposits grew in excess of that of households. Probably due to the declining interest rate environment a further restructuring could be observed in terms of household and corporate deposits from the fixed term deposits to current account and sight deposits.

Interbank funds somewhat decreased (-3.6%, HUF -316 billion). The rearrangement between domestic/foreign funds is typical in this field. Decrease due to loans taken out from the central bank (HUF -396 billion), and funds outflowing from money market funds (HUF -79 billion) is to be pointed out. Parallel to this, as a continuation of the trend in the previous quarter, the portfolio of securities issued by credit institutions decreased (-7.9%, HUF -227 billion), mainly caused by the fall of long term bonds issued abroad (HUF -136 billion). Decrease in the mortgage bond portfolio issued continued (9.6%), probably caused by the nonrenewal of expired securities.

As a result of the above effects, the net loan/deposit ratio of the credit institution sector grew slightly by end Q2, from 94% in Q1 to 95%.

The **profit** developments were rather positive compared to similar periods in previous years, but with some decrease compared to Q1 (pre-tax profits earned in Q2 were HUF 162 billion , after HUF 199 billion in Q1). From operational revenues, net interest and dividend revenue accounted for HUF 201 billion and HUF 15 billion, respectively, while other revenues (revenue from fees and commissions and financial operations) grew to a total of HUF 159 billion. For the interest revenues the negative trends went on, i.e. that in the decreasing interest rate environment nominal interest revenues decreased more than interest expenditure. The fall in the profit of interest in derivative transactions is added to this and could not be compensated by the improving profit on interest bearing securities. Profit was greatly supported by the decrease in the net provision compared to Q1, in Q2 it was already in the negative (decreased by HUF 47 billion to HUF -36 billion). Both the improvement in the evaluation of loans and securities contributed to it. The other and extraordinary profits were essentially unchanged compared to the previous quarter.

At the end of the first half of 2016, **pre-tax profit** was outstandingly high compared to the same periods in previous years; it was above HUF 360 billion, which is HUF 205 billion higher than the profit year-on-year. The half yearly average annualised return on assets (ROA) before tax was +2.2%, and its return on equity (ROE) +22.2%, which shows a slight decrease compared to the previous quarter data (2.4% and 25.5%, respectively), however, it is still outstanding compared to recent years.

III. Corporate lending

According to the MNB lending report in May, as a result of the transactions, the corporate loan portfolio of credit institutions grew by HUF 94 billion in the first quarter of 2016, which also resulted from the drawing of credit line agreements contracted earlier. The SME lending increased by 3.4% at the end of March on an annual basis, while the aggregate corporate loan portfolio lessened by 2.4%. The disbursement of loans contracted in the second and third stages of the Finance for Growth Scheme contributed to the expansion of transaction as an aggregate with abt. 27 million forints in the first quarter of 2016.

According to responses of the banks to the Lending Survey, the conditions for corporate lending became easier; the easing was primarily manifested in the pricing conditions. The introduction of lending activity-based interest rate swap transactions (HIIRS) may remarkably promote the easing of the lending conditions. In the first quarter, banks felt primarily the acceleration in demand for forint and short-term loans, which may be followed by further expansion in demand, mainly for long-term forint loans, in the second and third quarter of 2016. The average funding cost of new contracts for corporate forint loans continued to lessen during the quarter, primarily due to diminishment of premium on large amount loans. Consequently, the average premium on loans granted in forint reached an especially low level in Hungary both in historical and international comparisons, but this result is primarily deducible to the impact of the technical structure.

Outcomes of the third stage of the Finance for Growth Scheme (FGS)

As part of the Growth Supporting Programme, at the beginning of 2016 the MNB launched the third, phasing out stage of the FGS, aimed at facilitating the changeover, in two pillars of which there is a possibility to conclude loan agreements till the end of 2016, to financing only projects.

Accepting the request of the Hungarian Banking Association, on 7 June 2016 the Monetary Council made the decision to raise the limit of the third, phasing out stage of the FFGS by 100 million forints. Thereby, the domestic micro, small and medium sized enterprises can already get loans in an amount of 400 billion forints for implementation of their projects in Pillar I (HUF pillar), while in Pillar II (foreign currency pillar) the maximum limit remains 300 billion forints.

According to the MNB Release on the FGS, the contracts covering about 125 billion forints affected 5850 transactions and 4615 enterprises in the period from 1 January to 1 July 2016, i.e. in the third stage of the Scheme. 62% of contracts established in the third stage are new project loans and 38% are new leasing transactions. Within the contracts in total amount of 100.8 billion forints concluded in Pillar I, facilitating the granting of forint loans, 62.1 billion forints were established in the form of project loan and 38.7 billion as leasing transactions. Within the contracts in total amount of 24.3 billion forints concluded in Pillar II, facilitating the granting of foreign currency loans, 15.5 billion forints were established in the form of project loan and 8.8 billion as leasing transactions. In Pillar I the average term weighted with the contract amount is 7 years, for new project loans 8.3 years, for leasing loans 4.8 years while in Pillar II 6.6 years and for the two funding forms 7.9 years and 4.1 years respectively.

Since June 2013, in the three stages of the Scheme, total 33,388 enterprises received finances in an amount of nearly 2,251 billion forints.

IV. Private lending

According to the MNB lending report in May, as a result of disbursement and repayments, the portfolio of household loans shrank by total 71 billion forints in the first quarter of 2016. Consequently, by the end of the first quarter the total loan portfolio decreased by 5.4 percent on an annual basis, but, if the basis effect of settlements and conversions to forint in 2015 were disregarded, the annual rate of portfolio shrinking would be only 4.5 percent. The volume of contracts entered into by the credit institution sector amounted to total 164 billion forints in the period under review, which represents a growth of 24 percent in annual average, compared to the same period of the previous year. The volume of new issues rose at the highest rate in the case of housing loans in the past year. According to the responses of banks to the Lending survey, the conditions of housing and consumption loans remained broadly unchanged in the first quarter and significant easing in the lending conditions is not expected for any segment in the next half year either. The total loan cost and interest premium of new housing loans remained also unchanged in the period under review. In the opinion of banks participating in the survey, even though the expansion in demand fell behind the expectations at the beginning of the year, however, prospectively a comprehensive upturn is expected. This year, the Home Purchase Subsidy for families is mainly used by big families even currently; half of the interested persons plan to borrow subsidized loan.

Delivery of opinion on the amendment of state subsidy decrees

Even after the amendment of decrees regulating the Home Purchase Subsidy (Hungarian abbreviation: CSOK) in February 2016, extending the subsidies, a number of proposals and questions arose with regard to the correct application and interpretation of the legislative provision. Therefore, the Ministry for National Economy in charge of this subject prepared a new draft amendment of the decree, taking the government expectations, customer requirements and proposals of banks submitted to it.

The draft wanted to create the possibility of state subsidization of homes in undivided common property and the original costs already paid, even retrospectively. According to the draft, the CSOK can be claimed for such new homes that, at the date of submission of the application for subsidy, have already a building permit but do not have an occupancy permit yet, and which are built by business associations for the purpose of selling to natural persons, which business associations sell the homes to natural persons for the first time. In such a case, the subsidization agreement can be signed but the home purchase subsidy can only be paid after presentation of the occupancy permit, in full amount. (Currently the existence of an occupancy permit is a requirement for submission of the application.)

In the opinion of the Banking Association sent to the Ministry we welcomed the trends of changes but we made some comments at the same time. Among other things, we called attention to the fact that

- with regard to the undivided common property it is not unambiguous whether the regulation applies to purchase, construction and extension of homes equivalently,
- the data protection rules are missing from the building society regulation,
- clients benefited by the retrospective effect should only be eligible for a second procedure free of charge if they paid the fees to the bank at the first occasion.
- as regards homes acquired through a subsidy, the period in which only the subsidized person can acquire an exclusive ownership should be limited to the period of ban for sale and encumbrance due to the State.

The Ministry for National Economy welcomed our comments but it informed us that, during negotiations with other ministries, a number of other problems arose and their time-consuming clarification may delay the acceptance of the amendment.

Practical problems of the regulation on private bankruptcy, the decree on sale of property

The legislation on debt settlement procedures for private individuals, commonly known as Private Bankruptcy Act, was amended in April, but the changes were only limited to the extension of deadline for submission of applications for the procedure to 30 September 2016. The submission of a more lengthy proposal was postponed to the second half of 2016, in view of more urgent draft laws. (On the other hand, no amendment of law is included in the legislation schedule of the second half of the year.)

We have collected and sent the practical problems relating to the application of the Act to the Ministry of Justice and at the same time we initiated a trilateral consultation with involvement of the Family Bankruptcy Protection Service. At the negotiation on 8 June the following issues were on the agenda: simplification of the submission documents, review of the eligibility to initiate the proceeding, the electronic contact-keeping, the remedy of deficiency, the obligation to collate data, the initial date of using the repayment subsidy, problems relating to preparation of an environment study, the display of announcements on website, the searching possibility, etc. We managed to find solutions to most of the problems raised; the Office of Justice will issue methodological recommendations on them in agreement with the Banking Association.

The draft government decree *on the sale of the debtor's assets in a debt settlement procedure for natural persons* was also consulted with the experts of the Hungarian Banking Association. In the course of consultations we initiated that the mortgage lender should have the possibility to accept real estates in an out-of-court procedure as well, we proposed the approaching of sales limit prices to the market conditions, and made a number of technical, legislation-editing proposals.

Uniformity Decision No. 1/2016 PJE of the Curia

Because a new law interpretation issue arose in respect of the foreign exchange loans, on 6 May 2016 the Head of Civil Department of the Curia initiated the conducting of a uniformity procedure in order to get a response to the following legal question: "Is a contract considered to be a valid consumer loan contract, in which the loan amount to be disbursed in HUF is indicated in forint and the foreign currency amount of the contract is contained in a separate document (such as disbursement notification, repayment schedule), which document was prepared after the contract was signed and, according to the agreement between the parties, forms part of the contract?"

The *Uniformity Decision No. 1/2016* of the Curia, published on 6 June 2016, took up the position that a foreign currency-based consumer loan contract complies with the provisions, in effect at the time of signing the contract, of the Credit Institution Act even in the case that the contract put down in writing states the amount of the loan in forint (payment currency), provided that the equivalent expressed in foreign currency of the loan amount (stipulated amount) stated in this way can be calculated exactly at the date of conversion laid down in contract or at the date of disbursement, taking the rate of exchange prevailing at that time into consideration. A contract containing the number and amount of repayment instalments and the repayment dates also complies with the provisions of the Credit Institution Act. The amount of instalments can be considered calculable if the contract contains at least the information and the calculation method on the basis of which the instalment amounts can be exactly determined at the later date of conversion as fixed in the contract or, in lack thereof, at the due date of payment of the instalments. If the contract contains the above-mentioned information, a unilateral legal statement (such as disbursement notification, repayment schedule, payment schedule) communicated after the signing of the contract is regarded as information given by the financial institution to the consumer, which does not affect the coming into force or the validity of the contract.

The Civil Uniformity Decision is in conformity with the civil uniformity decisions made by the Curia in 2013 and 2014, the settlement acts (Act XXXVIII of 2014 and Act XL of 2014) as well as the judicial practice developing under them, and plays an important role in keeping legal certainty.

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

Amendment of Act on Integration of Cooperative Credit Institutions

On initiation of the Ministry for National Economy acting in the name of the Government, on 7 June 2016 the Parliament amended the Act on Integration of Cooperative Credit Institutions and Amendments to certain Economy-related Laws in a procedure of exceptional urgency. Among other things, the amended Act affirms the role of the MNB as supervisory authority, extends the powers and competences of the Integration Organization, and extends the joint and several liability of the Integration to liabilities towards the OBA.

As a result of the amendment, the auditing power of the Supervisory Authority (MNB) is wider, from now on the Supervisory Authority is entitled to follow up the observation of obligations of the Integration Organization, the head and members of the board of directors of the Integration Organization, furthermore that of the Central Bank of the Integration as well as the heads and members of the board of directors and supervisory board of the former. In case of suspicion of violation of laws, the MNB may oblige the Integration Organization to conduct a comprehensive audit. If a grave or repeated breach of duties occurs, as a supervisory measure, the MNB may levy a penalty or withdraw the operating license of the cooperative credit institutions in breach of duties. The MNB was provided special powers for supervisory measures (stipulation to reorganize the capital structure, to sell assets, etc.) for the case that the adjusted capital of the cooperative credit institution abates Pursuant to the amendment, the board of directors of the Integration Organization may decide (only upon the preliminary approval of the Supervisory Authority) to admit the cooperative credit institution to or to exclude it from the Integration Organization.

The amendment considerably strengthened the competence of the Integration Organization of Cooperative Credit Institutions (IOCCI) against Takarékbank that acted as Central Bank in the past. The codifier curtailed the functional monopoly of Takarékbank even by introduction of the term "Central Bank", since, according to its definition, the central bank is a credit institution that performs its tasks together with the IOCCI. (On the other hand, the Act also provides that, until the power is withdrawn, Takarékbank Zrt. is the central bank of the Integration.) The mandatory policies concerning the members will be accepted by the Integration Organization in the future. Pursuant to the amendment, the list of policies will be extended as from the summer, and thus, the approval of policies on IT requirements will also be the competence of the Integration Organization. The activity of the Central Bank performing the functions in relation to the cooperative credit institutions' integration will be controlled by the Integration Organization. In order to operate in compliance with the laws, the directives defined by itself, the issued policies as well as with the earlier instructions, the Integration Organization gives mandatory instructions to the cooperative credit institutions and the Central Bank. If, in the opinion of the Integration Organization, a cooperative credit institution or a group of credit institution is in a critical situation, the IDCCL may decide to suspend the position of the executive officers of the cooperative credit institution, to suspend the cooperative membership or, with the preliminary approval of the Supervisory Authority, to exclude the member.

Maybe the most important change affecting the banking sector is the widening of the scope of responsibilities of the Integration Organization and the termination of unreasonable limitations that were in effect earlier. Pursuant to the amendment, the Integration Organization, the Central Bank and the cooperative credit institutions are jointly and severally liable for each others' all obligations, irrespective of the date of their arising.

Amendment of the Civil Code

The draft amendment of the Civil Code sent by the Ministry of Justice for opinion in April in the framework of administrative reconciliation had a fairly long content. The proposal contained the clarification of rules relating to legal persons, forfeiture, collateral register as well as the amendment of regulation of account contracts, factoring contracts and financial leasing agreements; however, these proposals were not included in the *draft law no. T/10528* negotiated by the Government and then submitted to the Parliament.

In the phase of administrative reconciliation, the Banking Association made observations primarily regarding the issues directly affecting the banks; inter alia, we made additional textual and clarifying proposals in relation to the consumer mortgage contract, the collateral, for a new regulation releasing the voidness of fiduciary collaterals, regarding the consumer guarantee and the financial

leasing contract. Overall, we welcomed the amendment because the draft aimed at the solution of a number of law interpretation problems and codification inaccuracies.

The Act adopted by the Parliament has much shorter content than planned originally. The regulation on securities was comprehensively amended; the rules regarding the responsibilities of executive officers, the mortgage contract, the collateral and the contract transfer were made more precise; the legal institution of independent mortgage was restituted; the voidness of fiduciary collaterals became limited to consumer contracts.

The restitution of the institution of independent mortgage is extremely important for our member banks for the purpose of recovery of vividness of the bank refinancing market, the cleaning of banking portfolios and the increase of safety of the mortgage market.

Act LXXVII of 2016 amending the Civil Code entered into force on 1 July but the amendments affecting the mortgage are in effect only as of 1 October 2016 and the securities rules as of 1 January 2016.

Revision of Act on Judicial Execution: the work of the Codification Committee

The Codification Committee that was established for the revision of Act LIII of 1994 on Judicial Execution continued its work in the second quarter; in addition to the officials and experts of the Ministry of Justice, the Chamber of Hungarian Public Notaries, the MAKISZ (professional organization of debt managers), the National Court Office, the MNB, MARK Zrt., the National Office for the Judiciary, the Chamber of Bailiffs and the Banking Association also participated in its work. In order to perform the work in due time, the Hungarian Banking Association (HBA) initiated the more frequent meeting. The experts of the Banking Association made a detailed proposal for regulation of execution for pecuniary claims as well as for movable and immovable assets. In agreement with the MAKISZ, they elaborated a textual proposal for re-introduction of preliminary audit of assets. The purpose of this proposal was that the new act should make the enforcement of claims calculable, reduce unreasonable administrative and cost burdens and should ensure that during the execution proceedings an auction could be reached within one year from the initiation. In order to make the sale of movable and immovable assets more efficient, we would find necessary

- the continuous auction instead of a multistage auction;
- the application of a more flexible up-set price than that applied currently;
- the inclusion of minimum contents of announcements in legislation;
- the use of market sales channels; and
- the supporting of voluntary sale of assets by ensuring the priority of satisfaction of mortgagees.

For the purpose of easier sale, we proposed that after registration of the mortgage, the usufructuary right should not encumber the ownership of the auction buyer as well as that it should be possible to terminate a lease agreement entered into for a limited period after the sale. In order to strengthen the protection of interest of the auction buyers, we also made proposal for rationalization of the rules of occupation.

Electronic contact-keeping with courts

After several postponements, as from 1 July 2016 the use of electronic way in contact-keeping with courts is a requirement for clients proceeding with legal representatives and business associations with seats in Hungary, including banks. The amended rules can be read in *Act III of 1952 on the Code of Civil Procedure* (hereinafter referred to as *Civil Procedure Act*) as well as in *Government Decree 83/2012.(IV.21) on the regulated electronic administration services and services to be provided by the state*. The regulation of contact-keeping with courts built on the customer portal system that ensures

the contact-keeping with the administrative authorities and which are already in operation. For business associations and partnership law offices, the contact-keeping with courts is provided by an e-litigation portal. Legal representatives have to submit the statement of claim and any other petitions, documentary proofs to court in electronic way, using the *form submission supporting service*. For use of the e-litigation portal, access to the customer portal and a live internet connection is necessary, furthermore the so-called *General Form Filling Programme* (hereinafter referred to as the *ÁNYK*) must be downloaded from the website of the NAV (National Tax and Customs Administration). The forms standardized by the court are available on the website www.birosag.hu. For instalment of the forms, also the *ÁNYK* programme is necessary. To foster the preparations, we have set up an ad hoc working group and attended several consultations in the Ministry of Interior, the National Office for the Judiciary and in the Hungarian Lawyers Association.

Issues affecting the Basel III regulation

- *Letter to the Minister for National Economy in relation to finalization of the Basel III*

The current phase of the international regulatory processes is the finalization of the Basel III rule system. The proposals written in the published consultation documents of the Basel Committee with regard to the open regulatory fields would bring to action such far-reaching changes in the operation of credit institutions that the amendments are mentioned as Basel IV rule system among experts. The European Banking Federation (EBF)² as the most significant interest group of the European banks regularly calls the attention of international and EU regulators to the effects of the still open issues of Basel III with regard to the finalization that are unfavourable for the banks. In June the EBF requested the competent minister of Slovakia who holds the next presidency in the second half of the year to place this issue on the agenda of the July meeting of the ECOFIN.

Joining the initiation of the EBF, in the middle of June we contacted the Minister for National Economy presenting the areas where the changes in the international regulations would affect the Hungarian banking system the most unfavourably through the presumable additional capital requirements and due to the Hungarian specificities. One of these areas is the planned transformation of determination of the capital needs of credit risks by the IRB method to the direction of the standard method which would be detrimental to our banks that are active internationally even. Another important regulatory initiation would stipulate the recording of sovereign risks and, connected to them, a capital requirement that shall be other than zero. This would represent a particularly unfavourable change for Hungary because, as an effect of the self-financing program of the MNB, a significant government debt exposure developed at the banks.

- *Imputation of mortgage bond exposure in the high risk limits*

Upon initiation of the member banks we checked with bank experts of the issue whether the mortgage bond exposure, which will be extended due to implementation of the JMM (mortgage compliance indicator) rules soon, needs to be taken into consideration for the calculation of high risk limits. Due to the mortgage bond exposure which is typically against one issuer, large number of banks would be required to meet the additional capital requirement if the high-risk stipulation were applied.

In the opinion of experts, until the end of 2028 Section 302 of the Credit Institutions Act provides exemption from the requirement to take the mortgage bond exposure into consideration in the high risk limit if the affected portfolios and the practice of the bank completely comply with the

² European Banking Federation

requirements specified in Section 129 Subsection (1), (3) and (6) of the CRR (Capital Requirement Regulation).

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

MNB Decree on the risk-proportional NDIF (National Deposit Insurance Fund) contribution

The amendment of the Credit Institution Act carried out as one of the phases of adaption of the Directive on the European deposit-guarantee scheme authorized the MNB to define the detail rules of risk-proportional NDIF contribution. The Credit Institutions Act and the European regulation provided for the entering into force of the relevant MNB Decree as of 31 May 2016.

The Decree was prepared by the NDIF and the Supervisory Authority Division of the MNB in knowledge of recommendation of the European Deposit Insurance Scheme (EDIS) on determination of risk-proportional fees. The officials of the Banking Association and the IDCCL were involved in the preparations of the legislation in March 2016, presenting the elaborated concept and detailed methodology. According to the concept, the MNB Decree contains only the basis frame rules and delegates the annual calibration of weighting the factors to be taken into consideration in determination of the risk-proportional deposit insurance fees (capital position, liquidity and funding position, quality of assets, business model and strategy plan) to the competence of the board of directors of the NDIF.

In the course of negotiations, the HBA expounded that, in its opinion, the NDIF fee payment obligation of any group of institutions and guarantee community can be stated in a consolidated way if the relevant laws exclude the possibility that the NDIF has to pay compensation to the depositors without involvement of the group or community in the case of bankruptcy of any individual institution belonging the group. (That is, it supported the consolidated fee payment in the case of the Banking Association and the IDCCL if the Act on integration of cooperative credit institutions is amended so that it should not give rise to exclusion of certain members from the IDCCL.) Furthermore we requested that the introduction of risk-proportional contribution should not affect the NDIF fees planned for 2016.

Pursuant to the MNB Decree entered into force on 31 May, the deposit insurance fees had to be determined individually also in the case of institutions of the IDCCL. However, the Decree was amended within a month in the manner that it allowed the consolidated NDIF contribution for the cooperative credit institutions. Even though the IDCCL Act continues to provide the possibility to exclude the savings cooperatives, but the NDIF will be entitled to claim the compensation paid to depositors for a bankrupt cooperative under joint and several guarantee from the Integration.

The fee payment for 2016 has not changed: the Board set forth the proportion of risk-based portion of the contribution as 0% for the second half of the year.

MNB Recommendation on mortgage debtors in arrears

In March the MNB issued a Recommendation, in which it stipulated for the banks with mortgage loans in arrears to try to find an acceptable solution for the non-paying debtors in a complicated, cost and time-consuming process. In the second quarter the Banking Association urged the mitigation of burdens arising from the Recommendation, the rationalization, simplification and the making of the duties incumbent on the banks unambiguous on a number of forums, using all means available to it.

- On the forum held for the bank experts with the participation of the representatives of the National Data Privacy Authority, the competent executives of the MNB presented in details

and interpreted the provisions of the Recommendation. The consultation has largely contributed to the fact that the FAQ³ issued by the MNB later, serving practically as a guide, means a real assistance to the organizations implementing the Recommendation.

- Connected to the implementation of the Recommendation, the MNB ordered extraordinary data supply containing very detailed information. On the effect the comments of the banks, it extended the time limit for the data supply and somewhat narrowed its content as well.
- The Presidency also discussed the tasks arising from the Recommendations with the competent deputy governor of the MNB. The Deputy Governor announced that the data supply obligation has to be fulfilled only in the case of transactions with longer arrears than sixty days. (Accordingly, in the case of 30 day arrears, the Recommendation can be applied more flexibly, in a way less burdening the banks.)
- Upon request of the Deputy Governor, the Banking Association collaborated in a data survey initiated by the MNB, which reviewed the date and modalities of contact established between the banks and the debtors with the goal that MNB should help the solution of common problems of the banks and the debtors through a central communication.
- The Banking Association made a number of proposals in letter as well. For example, it achieved that the complicated process set forth in the Recommendation can be left if the parties can manage to find an acceptable solution already at the time of the first contact establishment.

VII. Payments

Consultations on the introduction of an instant payment system

The Financial Infrastructures Division of the MNB prepared its medium term development concept under the title *“The possibility of implementation of an instant payment service in Hungary”*, which was discussed and sent for professional consultation by the Financial Stability Board.

Based on its preliminary researches, having regard to the international development trends and the expectations of the European Central Bank and the ERPB⁴, the MNB feels expedient to establish such a constantly operating payment system, the member of which is all Hungarian payment service providers and which enables any time to implement electronic financial transactions immediately between the payer and the payee (beneficiary). The structure (construction) and operating principles of the infrastructure of the system support innovative payment solutions on the long run. Its services can be used with low costs and low technical limits both for the payers and the payees (beneficiary) and at the same time they replace those payment situations where the use of cash is typical currently.

In possession of the accepted concept, the MNB requested the Banking Association and the banks to take part in the most significant development of the forthcoming years that fundamentally transforms payments. As first step of the cooperation, the MNB presented the concept of instant payment system in the Payment Services Working Group of the HBA and later on (after it) it conveyed a sector-level forum for the precise and uniform interpretation of the concept. The Central Bank emphasized from the beginning on that the opinion of the affected parties is of special importance in taking (making) final decisions.

In addition to the material describing the concept, the MNB sent those question sets as well that apply to the various aspects of the system to be established, request the HBA members to check and answer them in details. The instant payment system affects a number of fields of the banking

³ Frequently asked questions and replies

⁴ Euro Retail Payments Board: the body of small amount euro payments

operation; for this reason the divisions in charge of development of household and corporate payment services, the implementation of payment transactions, the liquidity management, the IT systems, and of the operation of electronic banking services and payment services also took part in the elaboration of the answers. It was a further request from the MNB that those fintech companies with whom the banks cooperate should also be involved already in this phase. (The answers to the sets of questions had to be submitted to the MNB by 31 June.)

The MNB also conducted bilateral consultation with the banks, in the course of which fundamental conceptual issues, such as issues related to the accounting of the transactions, the compliance with requirements for account statements, the suitability of account-keeping systems used by the members, the opening and closing hours of the business day, the compliance with the maintenance requirements during the continuous operation, the possibility to withdraw transactions and to the possibility to insert orders requiring special investigations were put in the focus.

The participants of the consultation also made proposals for simplification of the “initial” features of the system. In the opinion of many participants, the use of secondary account identification codes could be neglected in the beginning; the system should manage only the credit transfers from the possible payment methods; and the payments should be started with well-defined “low” initial limits.

The effect of the new waste management funding on the direct debits

Under the scope of reorganization/centralization of the public utility services, the waste service was also reorganized. From banking aspect, this affects the direct debits because several hundreds of thousand authorizations had to be changed to the favour of the new beneficiary. In the case of replacement of the former service providers (gas and electricity), law made possible to transfer the authorization to the favour of the new service provider, but in case of waste management, the new central organization appointed by law has not taken over the service itself from the old service providers; it was only authorized by law to collect the and allocate the fees.

In order to avoid that the change of authorization should take place individually, the Banking Association conducted discussions with the new central organization and its account-keeping bank about the possibilities of the expedient implementation. Because of the gap in the law, as a transitory solution the Ministry for National Economy laid down in its resolution that it finds acceptable to transfer the authorizations by the banks to the favour of the new beneficiary in the case of waste management.

Enforcement of special treatment for disabled persons

Government Decree No. 1653/2015 (IX. 14.) contains the Action Plan of implementation of the National Disability Programme for the period of 2015-2018. Within the scope of the Action Plan, the Ministry for National Economy is responsible for the legal framework providing the safe accessibility with equal opportunities to the services of financial institutions. The *“Decree No. 22/2016 (VI.29.) of the Minister for National Economy on the rules providing for access with equal opportunities to the financial services for disabled persons in credit institutions”* came force in the light of this. The Decree, generally, provides the obligation to the service providers (including the banks) to ensure equal treatment to their disabled customers in an efficient and humanistic way.

Pursuant to the Decree, for the purpose of providing equal treatment the banks are required:

- *To elaborate a strategy* promoting the possibility of access to the financial services under equal treatment, including the specification of the range of services providing access and the method of access. (For example, the strategy must cover the possibility of free withdrawal of cash twice in situations where the bank does not issue a debit card for its disabled customers.)

- To include the strategy in a regulation.
- in order to inform the disabled customers, to publish at least the *information* described in the Decree item by item *on their websites* in a separated, well-visible place with easy accessibility.

The enforcement of equal treatment in the practice is further enhanced by the fact that a committee was set up in the meantime to monitor the rules for the improvement of accessibility for disabled persons in credit institutions, in which committee the Hungarian Banking Association was given two seats.

Topicalities regarding payment cards

According to the data of MNB, the increase of electronic payment turnover continued in first quarter of 2016, in the framework of which a growth exceeding 30 percent of the payment card turnover was the mostly noteworthy. The paypass technology continued to gain ground in the payment card acceptance network, at POS terminals. The more than 7 percent expansion of the number of online acceptance sites can be considered similarly considerable.

In the second half of the year, the Bank Card Working Group specially addressed the following topics:

- *Adaption of the EU MIF rules*

Regulation 2015/751/EU of the European Parliament and of the Council adopted in April 2015 imposed a number of administrative tasks on the European banking sector in addition to regulating the interchange fees. The provisions of the regulation which had to be applied as from 9 June 2016 required comprehensive preparations from both the issuing banks and the acceptors and therefore, they consulted with the MNB, the card companies and the plastic manufacturers both in Hungary and at regional level.

The EU Regulation provides the possibility for the traders not to accept any card type/brand for payment with cards. For this reason, in order to give information to the consumers, the issuers were required to display the type of the payment cards (credit/debit/prepaid/commercial) on the card (visually or in electronic form). Due to the international nature of card use, the text must be indicated in English. The ensuring of electronic identifiability of cards already in circulation, issued earlier - as expected by the MNB - raises considerable professional difficulties, since the placing of new information on plastic cards could have been executed only with total replacement of nearly 9 million cards in circulation. This problem must be managed even at European level; the EPC⁵ recognized that the implementation of the requirement of the Regulation to indicate the electronic type by due date meets very significant difficulties; therefore it issued an urgent, extraordinary professional paper offering short-term solution (application of BIN tables) to the problem. (The long-term compliance is provided by the new data element of EMV chips.)

The HBA prepared a customer information document on the changes entered into force, which it published in the Bank Card Working Group and also made public on its website, and sent to the Consumer Protection Division of MNB.

- *Consumer protection discussion with MNB on application of card stop fee*

Upon request of the Consumer Protection Directorate of MNB, we surveyed the current practice of our member banks in respect of application of a card stop fee. According to the picture resulted, the practice of banks regarding the payment card stop fee is currently not uniform at all, it shows

⁵ European Payments Council

considerable differences both in legal and technical/procedural terms. The differences can be explained by operational and risk management solutions preferred by the banks. Discussion are currently underway with the experts of the Consumer Protection and Financial Infrastructures Directorates of MNB regarding the practice expected by the Supervisory Authority which is also feasible.

- *Provision of bank card payment method for vending machines*

On 12 and 19 April the management of the Bank Card Working Group attended the shareholder's meeting and the trade event with the title "Cashless solution in the vending branch" of the Magyar Ital- és Áruautomata Szövetség (MIÁSZ) (Hungarian Vending Association), where it held lectures. Currently, about 30 thousand beverage machines are in operation in Hungary and the codifier is likely to extend the obligation of connecting them to the tax authority (NAV), similarly to the online cash register. In a situation where vending machines should be developed anyhow, the operators may be open to make preparations for the machines to accept payments by card. On the above-mentioned forums we provided general information to the MIÁSZ members and summarized the conditions how to provide card payments.

- *Fraud events and other topics*

In mid-May we organized a *Fraud Trading Day* again, where the solutions for attacks against ATMs and the successful protection were put in the focus. This time the technology service providers have also summarized their knowledges in additions to the experts of MNB, of the Europol from the Hague and of the National Bureau of Investigations (NNI) from Budapest, with the aim that the banks should be as successful as possible in the smooth operation of the ATM network.

The first *CEPOL*⁶ training was held at the end of May in the Cyber Crime Laboratory established jointly with the International Training Centre of the Ministry of Interior. The course organized with the view of efficient prevention of payment card and online crimes was attended by leading experts of authorities of 24 EU countries. In addition to providing assistance to furnishing the Laboratory, we supported the event with professional lecturers.

Connected to fraud events, during the quarter the HBA organized several wide-ranging trading reconciliations in the issue of the increasingly spread mobile phone *upload/online betting frauds*. We support the suppression of this type of fraud through prevention, information to customers and investigation work of the police, using multilateral professional communication and cooperation.

The Working Group, in cooperation with the Payment Services Working Group, also discussed and processed the issues of *overall provision of the possibility to withdraw cash twice*, and the expectations of MNB to develop the proper practice of *immediate crediting*. At the end of May, several of our working group members attended the *E-money Conference* in Bratislava.

Establishment of PSD2 Special Working Group

The Payment Services Working Group was of the opinion that it would be important for the codifier to know and utilize the ideas and proposals of the banking sector with regard to the Directive already when the Directive on Payment Services is adopted. The management of the competent department of the Ministry for National Development notified that they welcome the preliminary contribution of the Banking Association.

⁶ European Police College

Accordingly, a special working group was established within the Payment Services Working Group with the view to make proposals and provide aspects for the adoption of the PSD2, using the working papers of the European Banking Federation (EBF), taking the criticism of the EU with regard to this working paper, and with the approval of the Payment Service Working Group and the SEPA.

The Special Working Group, in which six banks delegated their experts, has held its inaugural meeting and made a resolution on the method of processing the Directive, the allocation and scheduling of the task among each other. During the period of its operation, the Special Working Group shall regularly render account to the Payment Services Working Group and the SEPA Committee.

Taking over of the tasks and management of the SWIFT⁷ National Member and User Group (NUG⁸)

Upon request of the National User Group of SWIFT, the range of activities of the Hungarian Banking Association was extended with new functions after the HBA approved a field of interbank cooperation belonging to the scope of self-organization from the beginning on. Prior to the decision the HBA ascertained whether the internal rules of SWIFT allow for the representatives of banking associations to hold the chair position of the national user groups, and weighed up, what the implementation of tasks attached to the management and operation of/operating the group imposes on it. (As from its establishment in 1983 to 2006, the chair position of the Hungarian Member and User Group was held by the executive officials of the Foreign Exchange Division and the Payment Services Division of the Central Bank and then, as from 2006 by the representative of OTP Bank.)

Following the resignation by chairperson and her deputy, the NUG members decided unanimously that they want to delegate the chair position and the tasks relating to the management of the SWIFT Group to the competence of the Hungarian Banking Association. The taking of the role by the HBA was supported by the fact that it disposed of the required personnel, and the management and activity of the SWIFT Group fits to the payment service profile of the HBA, primarily supplementing the scope of domestic (forint) and euro (SEPA) payments with international foreign exchange payments .

Preparations for the SEPA end-date regulation

The SEPA Working Committee continued the implementation of its preparatory plan, complied in the autumn of 2015 for communication of the SEPA end-date regulation⁹ and wishing to promote the preparations by both the payment service providers and the customers. In this period two practical actions took place; a *new electronic press communication* and the sending of a *second questionnaire following up the status of the preparations*.

The article published on *potfolio.hu* portal discussing the new SEPA gave general information, addressing the wide public, on the purpose of the single euro payments area and on the obligations of non-euro zone member states, which are due after 31 October 2016, i.e. after the so-called end-date. The article discussed with special emphasize the obligation that affects not only the payment service providers but the customers (primarily the enterprises) as well, and pursuant to which the so-called bundled (batch) payment orders can only be submitted and the payment service providers can only accept such orders according to the SEPA standards *ISO 20022 XML*).

Preparation by non-euro zone member states is monitored by the ECB as well through regular reports of members of the European System of Central Banks. Upon request of and cooperating with the MNB, the HBA compiled a *questionnaire consisting of two parts*, out of which already the second

⁷ SWIFT: Society for Worldwide Interbank Financial Telecommunication, a company engaged in financial messaging services incorporated in Belgium and operating in cooperative form on the basis of the Belgian law, its seat is i La Hulpe

⁸ National (Member and) User Group

⁹ Regulation No 260/2012/EU of the European Parliament and of the Council (14 March 2012) establishing technical and business requirements for credit transfers and direct debits in euro and amending Regulation No 924/2009/EC

was sent in June. The questions related to the offers of euro payment services by the payment service providers (credit transfer and two debit types), the status of preparations with regard to them and the information on the services. The answers are expected to be processed at the beginning of the autumn.

VIII. Taxation, accounting

Changes affecting the credit institutions in the taxation rules in 2017

At the beginning of May 2016 the legislative package containing the changes in taxes in 2017 was submitted to the Parliament, which was reviewed by the Taxation Working Group of the Banking Association and sent comments regarding several points thereof to the Ministry for National Economy preparing the legislative changes

The most important thing for the credit institutions is that the special bank tax rule (Act LIX of 2006) changed in several points: the credit institution contribution was abolished; the special bank tax rate changed (above an adjusted balance-sheet total of 50 billion forints it will be 0.21% in 2017 and 2018 and below 50 billion forints it remains 0.15; the special tax base will no more be the balance-sheet total of year 2009 applied since its introduction but from the next year on, it will be the figure of accounting statement of the second tax year preceding the relevant tax year. As a special rule, a new special tax called *special tax on financial leasing activity* was introduced, the application of which raises several problems. In our opinion, the income-based taxation rule treating the leasing activity separated does not fit to the “basic” special tax that was based on balance-sheet total. The legislative rule is not sufficiently concrete in the respect, how the special tax levied on leasing activity must be taken into consideration for the special bank taxes: whether the receivables from leasing activity can be deducted from the balance-sheet total or the profit from leasing activity from the annual profit of the bank, or the tax of the leasing can be deducted from the “basic” special tax. For the purpose of unambiguous application, the above questions must be clarified; we informed the competent ministry thereof.

The change in the legislation also affected the *financial transaction levy*. Against the earlier inconsistent approach, it became unambiguous that financial transactions implemented between a private individual acting as an individual entrepreneur and his bank account used as a private individual are not encumbered with levy payment obligation, furthermore, that financial institutions granting credit or cash loan not qualifying as payment service have to pay financial transaction levy on loan repayments effected by cash.

The taxation of securities transaction has also changed. It is an important factor that the return of investment units issued by alternative investment funds qualify as a dividend type income as well as the fact that the data supply to be sent to the tax authority on controlled capital market transactions will be more detailed than earlier.

Due to the repealed European Savings Directive¹⁰, the legislative package also addressed the new tax proceeding rules to be applied to interest income of non-resident private persons: accordingly, as from 1 September 2016, the payer must basically apply the rules of agreements on double taxation to interest income.

¹⁰ Savings Directive No. 2003/48/EC is no more effective as from 10 November 2015

An important requirement affecting those who change over to the IFRS that, in case an institution submits an application for [conditional tax assessment ruling](#), to its application it must attach the expert opinion on rating of the bookkeeping accounts of the Hungarian Chamber of Auditors.

Changes in accounting legislation - Changeover to the IFRS

- *Postponement of the mandatory changeover to the IFRS*

It is an important change affecting the accounting regulation that the mandatory changeover to the IFRS in individual level accounting processes is postponed from the earlier accepted 1 January 2017 by one year, to 1 January 2018 for credit institutions and financial undertakings subject to equivalent prudential regulation, in the manner that the introduction can be brought forward to 1 January 2017 at their own discretion. In addition, several accounting terms and accounting rules were made more unambiguous during the law amendment: for example, the rule for returning from the IFRS to the Hungarian standards, the term of accumulated profit reserve according to the IFRS, the management of modification of contracts and certificates affecting the closed years and the definition of negative business or company value, the settlement of subsidies.

- [Trade meeting Workshop](#) on the changeover to IFRS - with the participation of consultants from PwC

In the issue of changeover to IFRS the Banking Association organized a [trade meeting workshop](#) for the accounting, taxation and data supply experts of the member banks with participation of consultants from PwC with the view that the consultant, promoting the preparations by the bank, share their experiences in IFRS changeover projects managed by them and call attention to the scheduling of the key tasks. The representatives of Divisions Regulation, Supervisory Authority and Statistics of MNB were also invited to the meeting. The two day [trade meeting workshop](#) was conducted with active collaboration of the members and we received favourable feedbacks regarding the usefulness of the event.

According to legal regulations, for changeover to IFRS *the preparedness must be confirmed by an auditor* and the report thereon shall be submitted to both the MNB and the National Tax and Customs Administration 90 days prior to the changeover. When issuing the report, the auditor must check whether the credit institution applies IFRS accounting policy, has any professional with IFRS qualification and whether comparative data according to IFRS 1 are available for the business year preceding the first year of changeover.

The preparation for individual application of the IFRS involves wide-ranging tasks for bank groups reporting according to the IFRS at consolidated level (there is 8 such bank groups), because usually they have not established such an internal system (process control and technology) with the help of which they can properly manage (evaluate and display) the business events in the moment of accounting according to the IFRS methodology.

The deadline for changeover postponed by one year represents usually an easement; on the other hand, there are several banks who plan to implement the changeover as of 1 January 2017. It is a special challenge that the IAS 39 standard affecting the financial instruments within the IFRS will be replaced by a new-approach standard, called IFRS 9 as from 2018. However, in the opinion of advisors, only for this reason it is not reasonable to introduce the changeover in 2018. It is worth of applying the IAS 39 in the beginning where the IFRS methodology is learned only now, because this provides a good basis for the IFRS 9.

The changeover represents a comprehensive change for the purpose of the whole of the banking operation; in addition to the accounting compliance, *the aspects of taxation and the reports regularly sent to the Central Bank* shall also be taken into account. Beside the Accounting Division, the

divisions performing the above-mentioned two duties must make decisions in a number of methodological issues. The major rules of both the taxation and the reports to the MNB were developed in connection with the IFRS, however, during the preparations, more and more such questions arise, for the reason of which the position to be taken by the regulator and the adjustment of the legislation is indispensable. The bank trading issues collected before the discussion and addressed to the participants mainly affected the taxation and the data supply.

IX. Developments at the Banking Association

Board meeting 2015

The Hungarian Banking Association held its ordinary board meeting on 8 April. This time the participants of the event were hosted by Erste Bank Hungary and the guests invited included Mihály Varga, Minister for National Economy and the deputy governors of the National Bank of Hungary, Ferenc Gerhardt, Márton Nagy and László Windisch. In his opening exposé, the Minister for National Economy emphasized, inter alia, that

- the Government and the banking sector are important partners of each other in giving swing to the economic growth and in fostering the development of households, and the Government strives to maintain this partnership.
- the economy developed favourably in the recent period through disciplined management of the state budget which was supported by the control of economy and as a result, the consolidation was implemented in the manner that it did not hinder the growth factors.

The minister mentioned the stable capital position and the improving profitability of the banking sector as a favourable circumstance, however he also referred to the difficulties affecting the banking sector and the major challenges in 2015: the settlement and conversion to forint of the household mortgage loans and other foreign currency-based consumer loans.

In his report on the developments of the past year and tasks of this year, Mihály Patai, President of the Hungarian Banking Association emphasized that most likely, the banking sector is over of its hard period, however the return of the development tendencies that preceded the crisis cannot be expected in the same form.

In addition to the usual agenda items (reports on the activity and business management as well as the acceptance of plans for 2016), this was the first time that the Supervisory Board established a year ago has rendered an account, offering the acceptance of documents audited by the SB. In accordance with the traditions, the Aranykaptár Awards (Golden Beehive Awards) were also allocated at the Board Meeting. In 2016, the awards recognizing the eminent professional work made for the sector were given to dr. József Baki (FHB Bank), dr. Bálint Csere (OTP Bank), Zoltán Horváth-Szladek (Erste Bank), Gabriella Kárpáti (Eximbank), Péter Tóth (Budapest Bank) and dr. Vanda Toma (CIB Bank).

Money Week: Backtesting results 2016 - Preparations for 2017

The *research documents summarizing the opinions of teachers and volunteers of banks* with regard to the Money7 event week of spring 2016 were completed. According to the questionnaires filled up by 708 teachers and 125 volunteers, the Mone7 program was outstandingly successful (besides 98% general satisfaction, 95% were those who found the selection of the topic excellent or good, and

more than 90% were satisfied with the programs and the organization). The teachers and the voluntary financial experts were able to cooperate excellently, not only in external opinions but also in according to own judgment, with the aim to make the financial knowledges evident and comprehensible for the pupils and students.

Supported by the Board as a part of the European Money Week project, based on the favourable feedback and including the experiences gained from the earlier events, we started the preparation for the Money7 of 2017.

The trade partners participating in the project (Pénziránytű Foundation/MNB, Ministry of Human Resources, JAM) have also assessed the program to be successful, therefore we plan to continue it jointly in the future. The circle of organizers will also be extended with the Ministry for National Economy; Minister Mihály Varga will provide lectures regularly, voluntarily; he wishes to extend and diversify the topics by adding business management knowledges.

Further information on the preparations for next year:

- The Ministry of Human Recourses (EMMI), inserting the Money7 program in the national curriculum, publishes the event for the following date: Financial Consciousness and Management Week 6 to 10 March 2017;
- The EBF will likely set the period of 27-31 March 2017 for the European Money Week 2017 (thus, according to the plans, Hungary will open the international project);
- Together with our co-organizer, the Pénziránytű Foundation operating with the MNB, we have started preparations for a long-term cooperation agreement.

As its main task, the HBA will carry out the central coordination and elaboration of the frames of the Money7 program as well as the control and coordination of the communication. In addition, it will organize the opening ceremony of the week and the participation of voluntary financial experts in the school training. At the same time, our member banks will have the opportunity to join to the Money7 program series under uniform joining conditions, in a non-branded way, financed by themselves.

Communication statistics and topicalities

In the second quarter, the press focused on the first experiences of use of the Family Housing Allowance (CSOK), on the reduction of bank tax, the current changes in the ownership structure of banks, the penalty imposed by the Hungarian Competition Authority on the HBA, the institution of private bankruptcy and the changes in lending to SMEs.

Following the Board Meeting, we summarized the most important events, affecting the Hungarian Banking Association and the banks, of the past year and the position taken by the sector, at the first time in the history of the HBA, in an official press release, in form of a so-called "Communiqué". According to the Communiqué, the restitution of confidence in the financial system is a key duty, as part of which a transparent and calculable financial regulation must be provided to the customers, the investors and the market operators. The credit institution sector is an integral part of the economy, the success of one of them results in the success of the other. The HBA assessed favourably that the agreed reduction of taxes imposed on the banks, introduced as part of the crisis management, began in 2016. On the other hand, it stated that, as a result of an annual payment of 600 billion forints, the sector remains the larger taxpayer in Hungary. The Family Housing Allowance, the SME lending, as regards the international events the possible exit decision by the Brits (Brexit) and the names of persons to whom the Aranykaptár Award was awarded were also mentioned in the communiqué.

The activity of the Hungarian Banking Association was accompanied by an intensive press interest in the second quarter of 2016. The somewhat lower number of publications was explained by the

beginning of the summer period on the one hand, and by the intensive sporting events on the other hand. The online press communicated news about the sector on 381 occasions, the number of our appearances in the printed press amounted to 140, while we could be seen in the electronic media 117 times. As an aggregate, the press and the public could get news about the opinions of the banking sector on 640 occasions during the quarter. In addition to the Communiqué issued on the Board Meeting, we informed the public on special topicalities by three major press releases: on the increase of the FGS, the bank robbery at Oktogon square and the Brexit.

International relations - V6 meeting

The host of V6 meeting held on 2-3 June with the participation of the Czech Republic, Croatia, Poland, Hungary, Slovakia and Slovenia was Slovenia in the first half of the year, consequently, the characteristics, risks and challenges of the *Slovenian banking system* was discussed in more extensive details. The liquidity and capital position of the 15 commercial banks and 3 savings banks being present on the Slovenian market is satisfactory, on the other hand, the lending declined, as main reason for which we identified the decrease in demand. As expected, the improving economic environment and the favourable interest rates have positive impact on the loan demand. After the earlier stagnation, the risks (profitability, funding, exposure) show a decreasing tendency but the interest rate risk is increasing. The other countries reported similar lending risks and expectations. Speaking about the restitution of the economy, the experiences of the "*Slovenian principles*" and the "*Prague rules*" were mentioned, the application of which are undertaken by the banks and other creditors voluntarily. The *out-of-court method of crisis management* has not spread in the Czech Republic, the reason for which is, inter alia, that it cannot be applied for companies that are large at system level, and they mentioned the lack of intercommunication between the banks and creditors as a hindrance. In Croatia a "reorganization law" adopted in 2012 is applicable "instead" of the standards mentioned above, which law introduces the institution of the so-called pre-bankruptcy. Despite fact that the Croatian law aiming at the closing of the reorganization process regulates both the financial operation and the supervision of the institution, its application has not spread. The participation in the pre-bankruptcy process preceding a judicial procedure on the basis of the Croatian law remains voluntary, similarly to the standards developed in other countries. The procedure is initiated by the debtor and a council monitors the process.

Along the adoption of the EU directives, the *deposit protection funds and the regimes of reconstruction of the individual countries* were also presented at the meeting. In addition, the characteristics of the *institution of private bankruptcy* were also analysed. The private bankruptcy is a legal institution existing in all V6 countries but its application has not spread as expected preliminarily.

Lending in an environment of low interest rate and under increased liquidity requirements provides challenges to the credit institution. There was an understanding in the respect that lending in such an environment has a negative impact on the credit institutions. An interest rate approaching zero or a negative interest rate may cause problems not only for the depositors but also for the pension savings.

Hungary will be the host of the next V6 event, likely in November.

Working committees and working groups not mentioned above

- *Data Protection Working Committee*

The Data Protection Working Committee of the Banking Association invited the Chairman of the National Authority for Data Protection and Freedom of Information (NADPFI), Attila Péterfalvi for an

informal professional consultation, which took place on 1 June. The discussion dealt with two issues: the implementation of *recommendation of the NADPFI on the requirements of preliminary data protection information* in the banking sector, and preparations for changes in legislation that became necessary after the *new data protection regulation of the EU* enters into force. In respect of this latter, the Chairman of the NADPFI informed us that he initiated the establishment of a Codification Committee for the preparation of internal codification tasks in relation to the EU regulation directly effective as from 2018 at the Ministry of Justice.

The implementation of the recommendation for preliminary data protection information caused many difficulties in the banking sector, on which the members of the Working Committee rendered detailed account to the representatives of the NDPFI. Attila Péterfalvi proposed that, taking the sectoral legal regulation and the specificities of the bank sector as basis, the Banking Association shall elaborate a sector-level recommendation connected to the NDPFI recommendation which, upon request, would be audited by the NDPFI within the limits defined in the Information Act, according to the prescribed fee schedule.

The Board supported the preparation of the recommendation and after it is ready, the request for audit. The Working Group has completed the recommendation and sent it to the NADPFI for auditing with the view that following the audit, the Banking Association shall offer the recommendation to the member organizations to join to it. The Chairman of the NADPFI informed the Banking Association that its colleagues started to study the document.

○ *Agricultural Working Group*

At the second quarter meetings of the Agricultural Working Group, the National Land Fund Management Organization gave information on the rules of procedure of the *“Land to Farmers!”* Program to be applied by banks, and the Ministry of Agriculture on the expected specific values of the production-linked subsidies in 2016. The Working Group consulted with the State Supervision of Public Warehouses and the Hungarian Public Warehousing Association on the major trends of modernization of public warehousing several times. The related talks will presumably continue in the rest of the year as well.

○ *EXIM Sub-Working Group*

In the second quarter, within the scope of Credit Program for the Improvement of Competitiveness of Eximbank, the EXIM Sub-Working Group received information on the detail rules of loan redemption, the financeability of real estate projects and on introduction of current asset refinancing credit line. Based on the comments expressed at the meetings, Eximbank elaborated the individual investment refinancing credit line agreement introduced in the framework of Credit Program for the Improvement of Competitiveness..

○ *Void FX loan contracts Working Group*

At the meeting of the Void FX loan contracts Working Group held in the second quarter, the following issues were put on the agenda:

- experiences relating to the application of legal consequences in actions for terminating execution procedures,
- in case of nullity because of deficiencies in the risk disclosure statement concerning exchange rate risks, experiences relating to the application of Section 37/A of the Accounting Act,
- conformity procedure initiated by the Curia.

○ *Mortgage Bank Working Group*

The Mortgage Bank Working Group is a permanent working group created for the purpose of integrating the tasks taken over from the Hungarian Mortgage Bank Association into a working group to be operated within the framework of the Hungarian Banking Association. The Working Group forms an independent unit within the Banking Association, to which mortgage credit institutions can delegate representatives and the experts of other affected banks may receive invitation to the meetings if the topic requires that. It is a two-tier Working Group: the Main Committee consists of the CEOs of mortgage credit institutions holding a Banking Association membership, while the Subcommittees consisting of experts delegated by the mortgage credit institutions hold their sessions in professional formations.

A priority objective of the Working Group to enforce the interest at domestic and EU level and to foster the exchange of experiences among the member institutions, adhering the legislative rules of competition.. Since its creation, the Working Group has played an active role in the elaboration of the rules on restructured individual liens and other related rules for ensuring conformity with the mortgage compliance indicator stipulated by the National Bank of Hungary.

- *Leasing Working Group*

The Leasing Working Group has held meetings in the second quarter several times. It negotiated *the draft amendment of Act V of 2013 on the Civil Code and the proposal on the loan collateral registration and the amendment of certain related acts* with involvement of the Legal Working Committee, and sent its relevant comments to the Ministry of Justice.

The members of the Working Group have shared their experiences with respect to execution of the property item provided as collateral for financing the leasing if the leasing agreement was terminated.

The Working Group consulted with the Ministry for National Economy about the new Sections 69 (4a) and 73 (3a) inserted in *Act CCCXXXVIII of 2013 on Credit Institutions and Financial Enterprises by Act LIII of 2016 on the Amendment of Certain Acts affecting the financial intermediary system*, which new Sections apply to the extension of content of intermediary fees.

The Office of Government-issued Documents *Sub-Working Group* operating within Leasing Working Group has held its inaugural meetings in the second quarter. The purpose of the Sub-Working Group is to compile a proposal package for standardization of the administration work in the Office of Government-issued Documents, because the practical rules of procedure and requirement of the so-called “government windows” (one-step administration service), each differing from the other and changing from day to day, cause serious problems when motor vehicles financed by financial leasing are registered from one name to the other. At the inaugural meeting the Working Group started the compilation of its concept with regard to the topic.

I Global regulation

I.1 Financial Stability Board (FSB¹¹)

In the second quarter, the Financial Stability Board mainly focused its activities on *Regional Consultative Groups* (RCG). In these groups, the FSB member and non-member countries of individual regions, in addition to reviewing the 2016 work programs, identify risks and vulnerabilities that apply globally as well as to given areas. In addition to this, the *RCG for the Americas* covered the reasons for the decline in correspondent banking services and issues relating to asset management activities, while the *RCG Europe* discussed cooperation on cross-border regulation and crisis resolution as well as private pension schemes resilience and *RCG for Asia* exchanged views on challenges concerning information technology and cyber security.

In May, the FSB announced that the *Enhanced Disclosure Task Force* would be disbanded. The task force published three progress reports on the implementation of frameworks after its Principles and Recommendations on Risk Disclosures; the last one was published in December 2015. The fourth report was not completed because no significant improvement is expected concerning the risk disclosure of big banks.

In May, the FSB published a thematic peer review on the *implementation of the policy framework for shadow banking entities*. In June, it published its *guidance for developing effective resolution strategies and plans for systemically important insurers*.

Also in June, the FSB announced a public consultation on the *Proposed Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities*. The consultative document sets out 14 recommendations to address the following structural vulnerabilities from asset management activities that could potentially present financial stability risks:

- redemption terms and conditions for fund units and liquidity mismatch between fund investments;
- leverage within investment funds;
- operational risk and challenges in transferring investment mandates in stressed conditions; and
- securities lending activities of asset managers and funds.

The International Organization of Securities Commissions (IOSCO) simultaneously issued a *policy recommendation on addressing data gaps related to asset management activity*.

Comments on this document are welcome until September 21, 2016. The FSB intends to finalize the policy recommendations by the end of the year, many of which will be operationalized (formulated into concrete regulation) by IOSCO.

¹¹ The highest international body of financial regulation

1.2 Basel Committee on Banking Supervision (BCBS)

The Regulatory Consistency Assessment Programme (RCAP): Risk-weighted assets (RWAs) in credit risk in the banking book

The Basel Committee on Banking Supervision published a second report on risk-weighted assets (RWAs) in the banking book, as part of its Regulatory Consistency Assessment Programme (RCAP) to ensure full and effective implementation of the Basel III framework. The study examines the variability of RWA in banks that use internal models to calculate their credit risk regulatory capital requirements. While the Committee's 2013 report on the same topic found considerable variation in average RWAs, the current report extends that analysis in two respects:

- Data were collected from 35 major internationally active banks on their retail and SME lending portfolios. When averaging across banks in the sample, the report finds a reasonable relationship between estimates of probabilities of default and actual default rates. A weaker relationship is observed between loss outcomes and other parameters estimated by credit risk models (such as loss-given-default - LGD). At an individual bank level, there is much greater variation between parameters estimated using credit risk models and actual outcomes. As retail business is predominantly local, these variations are partly explained by differences in local circumstances.
- The report also evaluates the variability in estimates of exposure at default (EAD) for all asset classes, using data from 37 banks. These reveal wide variation in bank practices, which can contribute materially to overall RWA variability. It was also found that some of the estimates used in internal credit risk models lack empirical support. Further, some data relating to one asset class have been used to support estimates for unrelated asset classes.

The report also describes sound practices relating to banks' independent model validation functions. These practices apply to the governance, methodology and scope of banks' validation functions, as well as to the role of validation across different phases of model development and implementation.

Revisions to the leverage ratio

The Basel Committee on Banking Supervision released a document on revisions to the leverage ratio for a three-month period of consultation. The Basel III framework introduced a simple, transparent, non-risk-based leverage ratio to act as a supplementary measure to the risk-based capital ratio. This revised document proposes a set of changes to the BCBS standard released in January 2014. The proposed changes to the framework are an important element of the regulatory reform program that the Basel Committee has committed to finalize by end-2016. The document proposes revisions in the following issues:

- to measure derivative exposures, the Committee is proposing to use a modified version of the standardized approach for measuring counterparty credit risk exposures instead of the Current Exposure Method (CEM);
- to ensure consistency across accounting standards, two options are proposed for the treatment of regular-way purchases and sales of financial assets;
- clarification of the treatment of provisions and prudential valuation adjustments for less liquid positions, so as to avoid double-counting;
- alignment of the credit conversion factors for off-balance sheet items with those proposed for the standardized approach to credit risk under the risk-based framework;
- additional leverage ratio requirement applicable to global systemically important banks (G-SIBs).

The final design and calibration of the proposals will be informed by a forthcoming comprehensive quantitative impact study.

To promote consistent global implementation of the Basel standards, the Committee periodically reviews frequently asked questions (FAQs) and publishes answers. The Committee simultaneously published the current set of FAQs that relate to the Basel III leverage ratio framework.

Reviewing the introduction of the Basel III standards

The Basel Committee released its progress report on the introduction of the Basel III standards for the tenth time. The tenth progress report updates the Committee's previous progress reports which have been published on a semiannual basis since 2011. According to data from March 2016, all 27 BCBS member jurisdictions have final risk-based capital rules, LCR regulations and capital conservation buffers in force. Further, 24 member jurisdictions have issued final rules for the countercyclical capital buffer and 23 have issued final or draft rules for their domestic systemically important banks framework (D-SIBs). With regard to the global systemically important banks framework (G-SIBs), all BCBS members that are home jurisdictions to G-SIBs have the final framework in force. Member jurisdictions are now turning to the implementation of other Basel III standards, including the leverage ratio and the NSFR.

Draft guidelines on the prudential treatment of problem assets - definitions of non-performing exposures and forbearance and their disclosure criteria

In April the Committee also published its draft guidelines on the prudential treatment of problem assets. At present, banks categorize problem loans in a variety of ways and there are no consistent international standards for categorizing problem loans. The definitions proposed by the Basel Committee aim to foster harmonization in the measurement and application of two important measures of asset quality and thereby promote consistency in supervisory reporting and disclosures by banks.

- The definition of *non-performing exposures* introduces criteria for categorizing loans and debt securities that are centered around delinquency status (90 days past due) or the unlikelihood of repayment. It also clarifies the consideration of collateral in categorizing assets as non-performing. The definition also introduces clear rules regarding the upgrading of an exposure from "non-performing" to "performing" as well as for the interaction between non-performing status and forbearance.
- *Forbearance* refers to concessions, such as a modification or refinancing of loans and debt securities, that are granted as a result of a counterparty's financial difficulty. The proposed definition sets out criteria for when a forborne exposure can cease being identified as such and emphasizes the need to ensure a borrower's soundness before the discontinuation.

The proposed definitions complement the existing accounting and regulatory framework in relation to asset categorization. They are intended to be used, in both the supervisory monitoring of a bank's asset quality and by banks in their credit risk management, as well as part of their internal credit categorization systems.

Management of interest rate risk in the banking book

In April, the Basel Committee on Banking Supervision issued its standards for Interest Rate Risk in the Banking Book (IRRBB), a reviewed and revised version of the previous document (issued in 2004).

As opposed to the options included in the 2015 consultative document (which preferred a pillar 1 approach versus pillar 2) these standards set out supervisory expectations for the identification, measurement, monitoring and control of IRRBB under a pillar 2 approach.

The key enhancements to the 2004 Principles include:

- More extensive guidance on the expectations for a bank's IRRBB management process in areas such as the development of interest rate shock scenarios, as well as key behavioral and modelling assumptions to be considered by banks in their measurement of IRRBB;
- Enhanced disclosure requirements to promote greater consistency, transparency and comparability in the measurement and management of IRRBB. This includes quantitative disclosure requirements based on common interest rate shock scenarios;
- An updated, more risk sensitive standardized framework, which supervisors could mandate their banks to follow or banks could choose to adopt; and
- A stricter threshold for identifying outlier banks (banks who do not meet interest rate risk criteria), which has been reduced from 20% of a bank's total capital to 15% of a bank's Tier 1 capital. As an additional criteria, interest rate risk exposure must be measured by the maximum change in the economic value of equity under the prescribed interest rate shock scenarios.

The revised standards reflect changes in market and supervisory practices since 2004, which is particularly pertinent in light of the current exceptionally low interest rates in many jurisdictions. The revised standards must be implemented by 2018 (initially, according to data from December 31, 2017).

Statement on capital arbitrage transactions

The Basel Committee on Banking Supervision issued a statement on capital arbitrage transactions. According to the statement, transactions that are designed to offset regulatory adjustments employ a variety of strategies. For example, these may include: (1) the issuance of senior or subordinated securities with or without contingent write off mechanisms; (2) sales contracts that transfer insufficient risk to be deemed sales for accounting purposes; (3) fully-collateralized derivative contracts; and (4) guarantees or insurance policies. These types of transactions pose a number of risks. They can be complex, artificial and opaque. They can include legal risk and be untested in their ability to fully address the underlying rationale for the regulatory adjustment. Furthermore, they can have the effect of overestimating eligible capital or reducing capital requirements, without commensurately reducing the risk in the financial system, thus undermining the calibration of minimum regulatory capital requirements. Banks should therefore not engage in transactions that have the aim of offsetting regulatory adjustments. Any such transactions will be subject to careful supervisory scrutiny in the evaluation of risk transfer and the assessment of capital adequacy.

II European Regulation

II.1 General frameworks

We have yet to see the effects of the British referendum of June 23, 2016 on the European Union, where British voters voted to for the United Kingdom to leave the Union. In order to ease the money market turbulence that came about as a result of the referendum, the European Banking Federation immediately issued a press release, in which it stated that the sector continues to be dedicated to cross-border cooperation within Europe and that banks will continue to provide their retail and business services in the same manner as before. The European banking sector will do everything in its power to minimize the effects of Brexit on markets and the entire European economy.

Donald Tusk, the president of the European Council, emphasized the importance of preserving unity among the remaining 27 member countries of the Union in his press release. He recommended that leaders of member countries consider the Union's future from a broader perspective. He assured

that there would be no legal vacuum after the decision and that EU rules (rights and obligations) would apply to the United Kingdom until the point of exit. He admitted that the past few years have been the most difficult in the history of the Union, but also referred to a quote from his father: “What doesn’t kill you, makes you stronger.”

Jonathan Hill, the commissioner delegated by the United Kingdom responsible for financial stability, financial services and the Capital Markets Union, resigned following the outcome of the referendum. The European commission president regretfully accepted his decision and the portfolio will be passed over to Valdis Dombrovskis, the commission vice-president.

II.2 Capital requirement and liquidity regulations (CRR/CRDIV)

Members of the European Banking Federation are justly worried that the finalization of the Basel III regulation (the regime also called Basel IV) will considerably increase the capital requirement of EU banks, have a negative influence on credit accessibility and the growth of the real economy through limiting model use and introducing minimum capital limits for individual risk types. Therefore the EBF wrote a letter in the subject to the Slovak minister of finance (Slovakia holds the presidency in the second half of the year) that EU financial ministers should take action in the Basel Committee so that the finalization of the post-crisis regulation package will not present disadvantages to European banks. (Modifications made during the finalization process present a disadvantage to Europe as the ratio of bank intermediation is much higher; Europe is in the lead, together with Japan, on risk-sensitive modeling experience; and the Basel rules must be applied to all of Europe’s banks).

II.2.1 Implementing the NSFR in the EU

In May, the European Commission announced a one-month consultation period on the European implementation of the Net Stable Financing Ratio (NSFR) to complement the EBA’s¹² assessment in the same topic as well as its own call for evidence from September 2015. The Commission asked for as much data, information and proof as possible on how and to what extent the NSFR (approved by the Basel Committee) influences the financing of economic actors, the breadth of its unintended consequences, and if there are certain European specificities that need to be taken into account in the European implementation of the NSFR. The Commission is also examining separately whether derivative transactions or short-term transactions with financial institutions should be treated specially during the introduction of the NSFR, as well as if the principle of proportionality corroborates that certain types of institutions be exempt from the NSFR. The Commission asked respondents to provide thorough justification for when divergence from global NSFR regulation is warranted due to European specificities, what kind of management they would recommend instead in these cases; and to provide numerical data for impact wherever possible.

In its response, the European Banking Federation highlighted that the NSFR regulation would be highly detrimental to the development of the Capital Markets Union, as it is overly penalizing towards capital market activities. Management of secured claims (e.g. mortgages) is disadvantageous as well. For activities such as trade and export finance or factoring, which are and will most probably remain bank intermediated in the long term, the NSFR would make those activities more expensive for customers.

II.2.2 Interaction of the accounting and prudential frameworks (managing expected loss, and impact on capital)

¹² European Banking Authority

Due to the obligation of provisioning, the IFRS 9 will reduce stakeholders' equity and the common equity tier without any corresponding change in banks' level of risk taking, risk appetite, strategy or actual losses. (The increase in provision balance is due to the fact that IFRS 9 incorporates expected loss instead of actual loss. At the same time, prudential regulators have declared previously not to focus on further significant increase of overall capital requirements.) Banks can adjust to higher capital requirements by raising fresh capital (which, taking a look at recent efforts of European banks does not seem feasible) or by decreasing their activity, which would have a negative impact on the real economy. In order to avoid this, it is necessary to modify the prudential regulation, since frameworks created in the wake of the crisis already offered a solution to the problem, which on the part of accounting is only managed by IFRS 9. IFRS 9 and prudential regulation result in "double counting", while expected losses are taken into account in different time horizons.

The European Banking Federation held a professional consultation with the relevant department of the European Commission in order to manage this problem. It made a proposal to amend the prudential regulation in such a way that is based on internal qualification, is applicable in the case of the standard method, and is consistent with the overall prudential framework, which relies on a 12-month time horizon. In case the Commission would wait for the coming about of a global solution, the EBF recommends a 3-year "freeze-in period", during which the life time expected credit loss provisions and one year expected credit loss provision is added back to the common equity tier.

II.3 The Banking Union

As is well known, in November 2015 the European Commission made a proposal to the Parliament and Council to establish the European Deposit Insurance Scheme and issued a statement on the completion of the Banking Union. In reaction to this initiative, member states agreed that related work had to be organized and coordinated at the appropriate level. Therefore they established an Ad Hoc Working Party (AHWP), which met 9 times during the Dutch presidency. After having reviewed its work during the half year, the Presidency submitted a progress report on the finalization of the Banking Union in mid-June, based on the roadmap. After having presented their achievements so far, the Council asked the Commission to: create a proposal for the implementation of TLAC regulation and the relevant review of MREL by end-2016 the latest; propose amendments to the CRR/CRDIV (a review of options and national discretions granted to member states, and the finalization of the leverage ratio and the NSFR); to create a legislative proposal for minimum harmonization for effective insolvency law in the context of the Capital Markets Union; and to conduct further work on examining whether harmonizing moratorium tools can contribute to stronger stabilization. Member states of the Banking Union must ratify the bridge financial agreements that support the Single Resolution Fund by September, at the latest. For the regulatory treatment of sovereign exposures, the Council will await the outcomes of the Basel Committee. The Council reaffirmed that the discussions on measures relevant to all member states continue to take place at the level of all 28 EU member countries to ensure that the Banking Union remains open to all member states and in view of preserving the single market within the EU.

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

Managing national options and discretions (NODs) – Part II

In May the European Central Bank made a proposal for complementing the Addendum to the Guidelines for managing national options and discretions. The proposal complements the guidelines and regulation published on March 24, 2016, which applied to 115 NODs with the management of further 8 NODs. The consultation concerning the above lasted little over 1 month (from May 18th to June 21st). The recommended additions concern (among others), capital waivers, exclusion of intragroup exposures from the calculation of the leverage ratio, use of IFRS for prudential purposes, considering intragroup exposures during the calculation of risk-weighted exposure amount, and the cap of liquidity inflows.

ICAAP¹³-ILAAP¹⁴

The European Banking Authority published its draft guidelines on ICAAP and ILAAP information collected for the Supervisory Review and Evaluation Process (SREP) back in September 2015. The guidelines have since been modified based on consultations and will have to be implemented by European banks from June 30, 2016. At the same time, in January, the ECB published SSM expectations for ICAAP and ILAAP processes and information collection on its website. Banks under the direct supervision of the ECB have to implement these starting from the date of publishing. In relation to the above, the European Banking Federation held the following views:

- It welcomed that the guidelines recognize that the ICAAP and ILAAP are internal bank processes. It emphasized the need to maintain the ability for banks to have a flexible approach to their capital and liquidity planning.
- There should be a single guideline for ICAAP-ILAAP and SREP (including stress tests).
- “Gold-plating” on the part of ECB in addition to EBA requirements should be avoided. A level playing field should be ensured for SSM and non-SSM banks.

ECB guidance on the review of qualification of capital instruments as AT1¹⁵ and T2¹⁶ instruments

The ECB issued public guidance on the review of the qualification of capital instruments as Additional Tier 1 and Tier 2 instruments. The guidance lays down the procedure which the ECB will follow in reviewing the qualification of capital and specifies the information that significant banks under its direct supervision should provide. Institutions will qualify their instruments based on the aspects provided by the ECB. Following this, the ECB may review these qualifications anytime. Institutions may consult with the relevant JST¹⁷ before they issue individual instruments.

SSM supervisory report on the governance and risk appetite frameworks of euro area banks

The SSM (as set in its priorities) examined in particular the governance and risk appetite of the significant institutions (SIs) it supervises during its Supervisory Review and Evaluation Process (SREP). An in-depth assessment of the institutions management bodies was conducted, concentrating on activities and suitability. The review covered 113 bank groups – those with very particular business models and those who were in the process of ceasing their activity were not considered.) The report, published in June 2016, assesses industry practices in the areas of internal governance and risk appetite frameworks (RAF), highlighting both shortcomings and good practices. The report outlines supervisory expectations and concludes that many Eurozone banks need to improve in both areas to achieve international best practices, thus:

¹³ Internal Liquidity Adequacy Assessment Process

¹⁴ Internal Capital Adequacy Assessment Process

¹⁵ Additional Tier 1: additional primary capital

¹⁶ Tier 2: secondary capital

¹⁷ Joint Supervisory Team

- Most banks need to improve the quality of debate on the board and its capacity to independently challenge the management;
- Many banks need to boost their board's collective knowledge, strengthen its independence and have a clearer allocation of responsibilities;
- Most banks need to implement more robust and comprehensive risk appetite frameworks, which should be consistent with their overall risk profile.

In addition to the above, the ECB also calls on banks to develop and establish a comprehensive risk appetite framework to help strengthen risk awareness and support a sustainable business model. Such a framework should define the level of risk tolerance a bank is willing to take in relation to both financial and non-financial risks. Banks' managements should deploy risk metrics and limits more consistently, closely monitor them and report back to the board regularly. The risk appetite framework also needs to be aligned more closely with the business plan, strategy development, capital and liquidity planning, and remuneration schemes of banks.

Anacredit¹⁸

On May 18th the Governing Council of the ECB adopted the AnaCredit regulation, which will serve as a basis for establishing the dataset for loans granted by credit institutions in the Eurozone. A dataset containing detailed information on individual bank loans is a basic innovation and it is the ECB's intention that it would provide support for the European System of Central Banks's tasks (in the fields of monetary policy, financial stability, risk assessment, the supervision of banks, scientific research and developing new statistics). AnaCredit's thorough preparation is visible through the fact the ECB already announced it in 2011, while data collection is scheduled to start only in September 2018. At first, banks will only report information to the common dataset of credit institutions of the banking union on loans to corporations and other legal entities. The ECB's Governing Council will decide if it will extend the AnaCredit project at a later stage to private households (which would be reported anonymously). The main users of the dataset will be: the ECB, central banks of member countries, national and European supervisory authorities, national and European resolution authorities, the European Systemic Risk Board (ESRB), the European Commission and to some extent, reporting agents. Some users will only have access to part of the dataset at an aggregated level to ensure confidentiality.

The ECB issued a feedback statement (compiling the experience gained at its consultation held in December 2015) together with the Regulation. The feedback statement shows the modifications that have been made since the draft regulation factually.

To aid the implementation of the AnaCredit regulation, the ECB will create and publish a Manual, which will add further detail to the reporting obligations set in the regulation. The aim of the Manual is to support a unified reporting practice through implementation guidance and by clarifying data reporting requirements. The first edition of the Manual will likely be issued in the autumn of 2016, and will gradually be improved. The ECB published a draft manual in early summer and is awaiting comments from the institutions concerned.

ECB workshop on recovery planning and crisis management

At its workshop held in mid-June, the ECB presented its experience so far in recovery planning. The ECB considers it its task to develop a consistent methodology for its directly supervised banks or the assessment and benchmarking of recovery plans. The ECB will adopt a staggered approach in this field.

¹⁸ Analytical credit datasets

The initial benchmarking exercise (based on recovery plans completed by August 2015) had two main caveats: the sample was small (21 plans) and the key areas were limited to a few areas only (options, scenarios and indicators). The benchmarking had the following main conclusions:

- Institutions should provide more complete, comparable and up-to-date data;
- The section on options often lacks detail and 23% of options were not assessed as credible;
- Institutions generally complied with the EBA requested number of scenarios;
- There is different calibration of indicators across plans;
- The benchmarking confirmed the need for more guidance and structure for recovery plans in the next rounds, including the structure of plans.

II.3.2 Single Resolution Mechanism (SRM) – The Bank Recovery and Resolution Directive (BRRD)

The Single Resolution Board's official consultation with the representatives of the sector

In May, the SRB organized a meeting with the representatives of the banking sector – the third such meeting since it commenced its operations. It brought together 70 stakeholders, including representatives from EU-level and national banking federation from banking union countries, representatives from national resolution authorities, the European Commission, European Central bank and the European Banking Authority. The following issues were part of the agenda:

- Work plan for 2016 resolution planning, and the main elements of the resolution plan
- Simplified obligations for less significant institutions
- The Single Resolution Fund (SRF and Administrative contributions for the SRB

SRB workshop on the calculation on SRF contributions

At the workshop on contributions to the Single Resolution Fund in June, SRB representatives noted that the SRB is limited by the calculation methodology mandated within the delegated and implementing act. It therefore can only work on transparency with regard to the calculations but has to be cautious to guard confidentiality of individual results. In January 2016, national resolution authorities transferred EUR 4.3 billion of ex-ante contributions to the SRF, and a further EUR 6.4 billion by June 30, 2016. (The Fund needs to be filled by 2023, up to 1% of the insured deposit portfolio. In 2016 the Fund received contributions from 3,762 institutions from 19 banking union countries.) At the workshop SRB representatives compared 2016 vs 2015 for resolution contributions, presented the main components of the annual contribution and illustrated all of these with calculation data.

Introducing the total loss-absorbing capacity (TLAC) regulation in Europe and the relevant review of MREL¹⁹

Introducing the TLAC regulation and in Europe the associated MREL review present European regulatory authorities with a challenging task. Based on the BRRD the MREL regulation (in force in the Union) does not meet the TLAC requirements elaborated by the FSB and adopted globally in November 2015 (to be implemented from January 2019). Thus MREL requirements must be modified in 2016 for the sake of compatibility.

Key differences are:

- The TLAC standard will only have to be implemented by the 30 global systemically important banks (G-SIBs)

¹⁹ Minimum Requirement for own funds and Eligible Liabilities

- TLAC prescribes a Pillar 1 requirement in proportion to risk-weighted assets (16%, then 18%) and full exposure (6%, then 6.75%), in which capital buffers cannot be included.
- The MREL regulation does not set a minimum requirement; required MREL levels are set by the competent authorities for individual banks under Pillar 2. Capital buffers may be included in these.
- At the same time, the BRRD includes a burden-sharing clause, under which all shareholders and investors contribute an 8% bail-in to crisis management, before an external sources (thus the SRF) is available.

In order to harmonize the regulations the European Commission recommended that during the modification of the CRR/CRDIV the capital requirement of EU-based G-SIBs be raised from 16% to 18% and to alter the definition of Tier2 capital, introducing a new element, which complies with the FSB's approval criteria.

In May the Commission set the methodology and criteria of MREL definition for individual institutions in a delegated regulation²⁰. Naturally, this regulation did not yet consider regulation amendments needed for TLAC implementation.

A number of undecided issues concerning TLAC implementation remained:

- Should TLAC implementation be achieved through the modification of CRR or BRRD or is a rewrite of the MREL RTS enough?
- Should there be a TLAC like Pillar 1 applied in MREL to non-GSIBs i.e. O-SIBs²¹?
- Should a Pillar 2 element of the TLAC/MREL requirement be left to the discretion of resolution authorities or be mandated by legislation?
- In terms of eligibility is it possible to agree on a harmonized form of subordination (contractual, statutory or structural) or is it preferable to allow flexibility?
- Should buffers generally sit on top of the MREL/TLAC requirement?

According to currently available information, the Commission is expected to publish a new proposal in October.

BRRD regulations

In early June, the Official Journal published *regulation (EU)2016/860 specifying further the circumstances where exclusion from the application of write-down or conversion powers is necessary under Article 44(3) of Bank Recovery and Resolution Directive*.

Also in June, the Official Journal published *commission implementing regulation (EU) 2016/962 laying down implementing technical standards with regard to the uniform formats, templates and definitions for the identification and transmission of information by competent authorities and resolution authorities to the European Banking Authority according to the BRRD*.

In addition to the above, *commission delegated regulation (EU) 2016/1075 supplementing the BRRD with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges* was also published.

II.3.3 The European Deposit Insurance Scheme (EDIS)

Status report from the Dutch presidency on the European Deposit Insurance Scheme

²⁰ The Council or the Parliament may reject the regulation within the next three months.

²¹ other systemically important institutions

The progress report compiled by the presidency states that member states had greatly differing opinions in connection with EDIS. Some member states treated the implementation of a third pillar of the banking union as a priority and therefore welcome the proposal concerning EDIS. According to some, the proposal should be more ambitious in terms of timing and its entry into force, thus they supported the faster conversion of the deposit insurance funds into a mutual European (banking union) fund. Other member states strongly object to the proposal and its timing and contest the necessity and appropriateness of the proposal.

In addition to a number of specific issues, the main fundamental questions raised during the debates were:

- The link between further progress on risk sharing (including the EDIS and the setting-up of a common backstop for the SRF) and on a number of measures aimed at reducing risks in the banking sector;
- The absence of a specific impact assessment; several member states were of the opinions that such an assessment was needed to discuss the necessity, appropriateness and possible structures of EDIS;
- The suitability of the legal basis.

In its progress report, the Dutch presidency recommended that additional, more focused, detailed, quantitative analyses should be elaborated by the Commission, extending its scope to the different EDIS stages, and examining possible alternative options. As for legal background (following the example of the Single Resolution Mechanism), well-framed Intergovernmental Agreements (IGA) are a possible solution. The concrete provisions were put into three main categories: those considered as provisionally accepted, provisions in need of further refinement or consideration, and provisions which require a more fundamental debate due to lack of detail. Accession and departure of member states to EDIS, the mutualization process of the funds, the monitoring of insolvency procedures, risk based ex-ante contributions, and alternative measures belong to this last category.

EFDI/EBF Briefing Session on the European Deposit Insurance Scheme

The European Forum of Deposit Insurers (EFDI) and the European Banking Federation organized a briefing session entitled “How can a European Deposit Insurance Scheme strengthen the Banking Union?” to discuss opposing opinions (which range from high expectations to strong reservations) in connection with EDIS.

The working document of the Committee on Economic and Monetary Affairs (ECON)

In June, ECON published a working document about EDIS (rapporteur: Esther de Lange – European People’s Party). According to the working document members of the European Parliament are just as divided as member states concerning their judgment of the proposal for EDIS. Agreeing in this highly sensitive topic will require the right balance in terms of timing, conditionality and content. This task is further complicated by the lack of proper impact assessment. Ensuring as much as possible cost-neutrality for the banking sector and a level playing field between banking union member states and non-banking union member states will be two key elements to finding a compromise.

The rapporteur recommended the following steps:

- An impact assessment from the European Commission;
- Concrete steps in the area of risk reduction;
- More clarity on the calculation of the risk-based contributions;
- Finding a broad majority position in both the Council and Parliament on the concrete timing of the phasing of the EDIS, the conditionality of the risk reduction, and the content/design of EDIS.

According to preliminary timing, the draft report will be presented on September 26th and the deadline for the submission of amendments will be October 6th. The ECON vote will be held on November 28-29.

II.4 Assessing the state of the Capital Markets Union (CMU)

In April, Jonathan Hill, commissioner for financial stability, financial services and the Capital Markets Union assessed the current state of the CMU at a joint conference with the European Central Bank and the European Commission. The first status report on the CMU was also disclosed during his speech. The status report determines which steps need to be taken in order to create a single market for capital in Europe and reports on the states of the process. (The Status Report will be updated and published every six months from now on²².)

The report found that while the overall global economic environment remains uncertain, Europe's capital markets are more promising. Companies have been diversifying their sources of funding, turning to the corporate bond and stock markets to finance themselves, and to alternative financing instruments (crowd funding, private placement) though this only makes up a small share of their financing, despite an increase.

Fulfillment of the CMU Action plan can be assessed based on the responses to the following questions:

- Is funding increasing for start-ups and non-listed companies?
- Has it become easier for companies to raise money on public capital and money markets?
- Is long term investment increasing, particularly in infrastructure?
- Do retail and institutional investors have more options?
- How well is investment flowing throughout the EU?

The answers to these questions will show whether the right measures have been taken, if they are working as intended, and where some processes may need to be modified.

The commissioner talked in particular about *private pension funds*. This was justified by the fact that in fifty years' time there will only be two people in work for every person over 65, instead of the current four. This will present a huge demographic challenge happening, while the state wishes to reduce its role in more and more countries. Therefore encouraging the development of private pension funds gains extra importance and it will have a positive effect on the development of capital markets. Only a few European countries (Denmark, Finland, the United Kingdom, the Netherlands, Ireland) have large private pension markets. Elsewhere these markets are relatively small, which would indicate that the CMU Action plan prioritize these areas. In June a consultation was launched on promoting the development of European private pension markets and on identifying the obstacles to this at European and national regulatory level.

Among other developments in 2016, the commissioner also discussed the *adoption of the Solvency II regulation*, which supports infrastructure investments by insurers. The report on *crowd funding* was published in April. This new form a financing has a massive potential for growth – especially in the case of startups. It is therefore extremely important in these cases to open up the European markets and meanwhile not regulate too soon or too intensively and thus stifle innovation. The *passporting system for investment funds* will also be reviewed, while proposals for strengthening *European venture capital funds* will be submitted to the Commission, and proposals will be brought forward by the end of the year to reduce the differences between national *bankruptcy and insolvency regimes*.

Out of those of the last six months, the commissioner highlighted the following achievements: the initiative to restart Europe's securitization markets; the proposal for *simple, transparent and*

²² The status report will be available in the 2016 edition of the Economic and Financial Stability and Integration Review (EFSIR)

standardized securitization (STS); the overhaul of the Prospectus Directive to create a simpler, faster and cheaper regime; and the Green Paper on financial services from the perspective of the consumer.

II.5 Reviewing the Financial Conglomerate Directive (FICOD)

In June, the European Commission launched its consultation to review Directive 2002/87/EU on the supplementary supervision of credit institutions, insurance undertakings and investment firms in financial conglomerates (FICOD). The Commission is conducting the consultation as part of its REFIT program²³ (which is part of the “Better regulation” agenda). The aim is to assess the performance of FICOD in terms of effectiveness, efficiency, coherence and relevance compared to its stated objectives. The Commission sees practical experience with FICOD as very important and also awaits responses from institutions not currently subject to FICOD, but also from those whose operations may be influenced by it. In addition, the Commission is examining any problems FICOD may cause, as well as improvements that could be made. Responses to questions posed during the consultation process must be submitted by September 10th.

II.6 Documents published in Q2 by the EBA and ESA²⁴

Guidelines

Final Guidelines for disclosing confidential information under the BRRD (EBA/GL/2016/03)
Final Guidelines on stress tests for deposit guarantee schemes (EBA/GL/2016/04)

Consultation papers

Draft Regulatory Technical Standards on credit valuation adjustment (CVA) proxy spread (EBA/CP/2016/04)
Draft RTS on Key Information Documents for retail investors in the EU (JC/2016/21)
Draft RTS on disclosure of encumbered and unencumbered assets (EBA/CP/2016/05)
Draft Guidelines on LCR disclosure (EBA/CP/2016/06)
Draft Guidelines on disclosure requirements for the EU banking sector (EBA/CP/2016/07)

Opinions

Report on securitisation risk retention, due diligence and disclosure (EBA/OP/2016/06)
Opinion on the application of customer due diligence measures to customers who are asylum seekers from higher-risk third countries or territories (EBA/OP/2016/07)
Opinion on additional collateral outflows (EBA/OP/2016/08)
Opinion on Commission amendments to the EBA ITS on benchmarking of internal approaches (EBA/OP/2016/09)
ESAs’ opinion on technical standards on the credit quality steps for ECAs credit assessments (ESAs/2016/41)

Regulatory and implementing technical standards

Final draft technical standards on specialised lending exposures (EBA/RTS/2016/02)

Reports and other documents

Risk Dashboard Q4 2015
Risk and vulnerabilities affecting the EU financial system (JC/2016/17)
End of term office report of the EBA’s Banking Stakeholder Group

²³ Regulatory Fitness and Performance Programme

²⁴ European Supervisory Authorities (EBA, ESMA, EIOPA)

List of O-SIIs in the EU 2015

Corrections to XBRL reporting taxonomies and reference dates

Discussion paper on innovative uses of consumer data by financial institutions (EBA/DP/2016/01)

Guidance for computing Financial Soundness Indicators (FSIs)

Report on unsolicited credit ratings for determining institutions capital requirements (EBA/DC/2016/151)

Decision on data for supervisory benchmarking (EBA/DC/2016/156)

Annual Report 2015

Consumer trends report 2016