



HUNGARIAN BANKING ASSOCIATION

REPORT

on Activities of the Hungarian Banking Association

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I. Executive Summary

In the third quarter of 2016, the ***global economic*** growth continued to decelerate further. According to the latest, October IMF forecast, the annual GDP increase is expected around 1.6% in the United States, 1.7% in the euro zone, 0.5% in Japan and 6.6% in China. The globally dominant central banks continued their lax monetary policy. The continuation of the long-term slack and further easing central bank policies is also suggested by lower than expected economic growth, continued low inflation and the existing financial risks. The problems of Deutsche Bank (the unprecedented fall of the Bank's share and bond prices), the potential unfavourable outcome of the American presidential election for the financial markets and the uncertainties around Brexit are the most important ones.

The latest data confirm that the weak performance of the ***Hungarian economy*** in the first quarter was only temporary, and that the relatively dynamic growth continues. The growth in Q3 is likely to be higher than the 2.6% measured in Q2. The industrial output in August was 3.5% up on the figure reported one year ago and the decline in the construction industry output shrank significantly. According to the currently available production estimates, agriculture made a rather favourable contribution to economic growth. Numerous factors indicate that the 3 per cent GDP growth estimated for Q3 will further accelerate by Q4, so the 2.5 per cent GDP growth forecast of the Ministry for National Economy for 2016 may turn out to be too conservative and the actual figure could be closer to the 3.0 per cent, as projected by the central bank. The household consumption, which supports growth, is still backed up by favourable employment and wage indicators. In terms of the balance indicators, the budgetary positions are still very positive, the aggregated deficit of the first nine months has dropped to practically zero. By the end of the year, the state debt may reduce to 73-74 per cent of the GDP. The figures are good enough for a potential fiscal stimulus. The government bond yields are low: the yield of one-year securities is lower than 0.7 per cent, and that of 10-year securities is around 3 per cent. The annual inflation rate was 0.6 per cent, while the core inflation was somewhat higher, 1.4% in September. According to the expectations of the central bank, the 3 per cent inflation target will only be achieved in the middle of 2018. The National Bank of Hungary (MNB) did not change the interest rates in the quarter and, in line with its former announcement, the MNB limits the reference instrument portfolio: the almost HUF 1,800 billion three-month deposits will be reduced to HUF 900 billion by the end of the year. In September, the EUR/HUF exchange rate left the former band of 310-315 HUF downwards, the exchange rate strengthened until one euro was worth HUF 303 and then recovered to approximately HUF 307.

In the third quarter, ***the aggregated balance sheet total*** of the credit institutions increased slightly. The increase on the liability side was caused by the increment in the interbank portfolios and equity, and a slight increase in the deposit portfolio was another factor. The total deposit portfolio increased by just over one per cent, by HUF180 billion. The 5.4%, HUF 180 billion increment in equity was partly due to the interim profit. The expanding interbank deposits and growing loan portfolio were the major factors in the increase of the assets. The net loan portfolio was also increased by the reversal of the recognised HUF 104 billion impairment. As a result of the changes, the net loan/deposit ratio of the credit institution sector grew from 95% in Q2 to 97.3% by the end of September. In the first three quarters of 2016, pre-tax profit remained outstandingly high compared to the same periods in previous years; it almost reached HUF 452 billion. However, there are typically one-off items and factors not linked to the operation of the Hungarian banking sector behind the high profit figures (such as the releasing of impairments, the sale of Visa Europe shares by several banks and the dividends of foreign subsidiaries). In the medium term, the low yield environment will have a negative impact on the profitability of the banking sector in Hungary as well.

Preparations to comply with the mortgage funding adequacy ratio, specified by MNB in a decree, was the greatest challenge for the banks that have a large retail mortgage loan portfolio over the last

few months. In order to facilitate compliance with the ratio, the *amendment of the Civil Code* laid down the *material law rules of an independent lien* and introduced the concept of a *converted independent lien* as well as defined the *process of conversion*. In this context, Parliament approved further amendments at the end of October, initiated, amongst others, by the Banking Association; the primary objective of which was the simplification of the administrative process governing the amendment of lien. The banks reviewed their portfolios that might be considered for conversion and will most probably perform conversions on large portfolios in the forthcoming period. Apart from the existing mortgage banks, three new institutions will start operation, refinancing the portfolios with mortgage bonds.

It was an important development in mortgage lending that the long-awaited **amendment of the decrees regulating the Housing Subsidy for Families (CSOK)** was published in September, practically in the same form as the draft which represents an easement for customers, and was reviewed and supported by the banks earlier.

Still only very few people opt for a **private bankruptcy** and therefore the political party originally initiating that act now tries to have the entire act regulating the debt settlement of private individuals reviewed. The main creditor banks would also support the simplification of the process. Soon it will cause a practical problem too that despite the multiple discussions, the approval of the *government decree on the sale of property* is still delayed.

Our Association proposed to the Prime Minister's Office **amending the Public Procurement Act** back in spring but the approved solution and the concept of self-clarification suggested to the banks will only offer a difficult-to-implement solution for the exclusion of a considerable portion of the banking system from public procurement. The *procedure of exemption from exclusion* is not regulated and, according to the Prime Minister's Office, exemption can only be granted in an especially justified case. The Hungarian Banking Association also objected to the proposal for the **amendment of the Competition Law**, which would allow the competition authority to conduct an inspection on any merger, within six months from the execution of the transaction, irrespective of any threshold, which would make the extremely costly and labour intensive mergers very uncertain.

The National Bank of Hungary intends to boost corporate lending by reducing its reference instrument and extending the deadlines regulating the utilisation of the Funding for Growth scheme. Following consultations, the MNB regulatory package on credit risk management consisting of the "*MNB Decree on Customer and Counterparty Rating and on the Prudential Requirements of Collateral Valuation*", "*MNB Decree on the Prudential Requirements Pertaining to Non-performing Exposures and Restructured Debts*", and "*MNB Recommendation on the Measurement, Management and Control of Credit Risks*" was promulgated in October. In this package, the standard EU definition and data supply requirements relating to non-performing exposures and restructured debts are the most important new characteristics. Within the framework of the review of the HFSA recommendations issued prior to 1 October 2013, the *MNB Directorate of Consumer Protection* reviewed and summarised, in one document, and then distributed for consultation the *draft new MNB recommendation on the application of general consumer protection principles*. The central bank organised broad consultations on the *draft recommendation on the out-of-court restructuring of non-performing corporate loans*, developed with EBRD's professional support and also organised an international conference on the same topic with the involvement of a HBA expert. As decided earlier, the tasks of administration relating to the *BUBOR rate quoting* process will be transferred to MNB from 1 November 2016. The respective parties (MNB - Hungarian Forex Association - Banking Association) approved the co-operation agreement required for that on 12 September 2016. *The data supply requirements for 2017* will be changed significantly partly in relation to the switch to IFRS and partly because of the gradually increasing data requirements of the MNB. The central bank also

announced that from 2018 it would request the banks to prepare their COREP and FINREP reports in XBRL format but, in view of other obligations, we requested postponing that deadline.

In payments, the implementation in Hungary of the *EU Payment Accounts Directive* and the introduction of the basic account and bank account switch processes in compliance with the applicable government decrees by the required deadline were the greatest challenges. Giro Zrt. also actively participated in the development of the standard bank account switch procedure. The rearrangements of *direct debits* in relation to the universal service provider switches also required a great deal of operative contribution from the banks. The implementation of the professional and communication support plan related to the *SEPA End-date Regulation* was another important task. During the implementation of the *new Payment Service Directive (PSD2)*, the treatment of the third-party service provider will be the key factor.

The *Financial Stability Board*, which is one of the most important forum in **global regulation**, prepared its second annual report this year, according to which the new regulations adopted after the crisis were implemented steadily but not evenly. As a result of the reforms, the global financial system was in a good shape. The largest, internationally active banks are much more stable than they were prior to the crisis and comply with the capital adequacy and liquidity standards of the Basle III. regulations with continued lending to the real economy in the meantime. Nonetheless, there are still a lot to do in the construction of effective resolution regimes, resolution plans of cross-border companies, reform of OTC markets and the transformation of shadow banking activities into market financing. The *Basle Committee on Banking Supervision* is working on the finalisation of the *Basle III. regulatory package* while its most recent proposals improving the risk sensitivity of standardised methods and, simultaneously, limiting the use of internal models, were heavily criticised due to an expected increase in the capital requirement. The Committee itself intends to establish the final calibration without any consequential significant increase in the regulatory capital requirement. The BCBS published the *reviewed framework of the management of securitised debts* in July, which also contains the supervisory capital requirement of simple, transparent and comparable securitisation and was one of the last steps of the reform.

At the EU summit held in Bratislava in the middle of September, the **European** leaders issued a declaration confirming their intention to co-operate with each other after the Brexit, but the actual development trends of the EU are rather uncertain because of the forthcoming parliamentary elections and referenda in a few large Member States. In the area of **regulation**, the committee *is trying to accelerate the process of establishing the Capital Markets Union*, hoping that people will soon be able to recognise and appreciate the results. In terms of the *Banking Union*, the *Single Supervisory Mechanism (SSM)* functions according to the expectations, and the development of the *Single Resolution Mechanism (SRM)* is progressing as planned, following the formal establishment of its framework. In the latter area, the integration into the EU legislation of the global regulations on the total loss absorbing capacity (TLAC) and the amendment of the previously adopted EU legislation on the minimum requirement for own funds and eligible liabilities (MREL) in line with it are the greatest special policy tasks. The Member States and Members of Parliament have different views on the establishment of a *European Deposit Insurance System (EDIS)*. The Committee would put back on the agenda the issue of the *banking structural reform (BSR)* which already failed once in Parliament. The *public consultation opened on the macro prudential regulatory frameworks* are aimed at eliminating overlaps and inconsistency between the various components of the tool kit, the increase of efficiency and transparency, finding the right ratio of national flexibility and European co-ordination and improvement in the co-operation of authorities at national and EU level.

II. Macroeconomic outlook, operational conditions for the banking industry

In the third quarter of 2016, the **global economic** growth continued to decelerate further. According to the latest, October IMF forecast, the annual GDP increase is expected around 1.6% in the United States, 1.7% in the euro zone, 0.5% in Japan and 6.6% in China.

The **globally** dominant central banks continued their lax **monetary policy**. The FED and the ECB did not change their policies, while the Japanese central bank introduced new measures for further easement. It keeps the return on 10-year government bonds at 0 per cent and goes beyond the 2 per cent inflation target in the medium term. The BOJ did not achieve its objectives with its asset purchases and new measures and therefore is likely to introduce new instruments, e.g., the “helicopter money”. (Helicopter money means that the central bank pumps new money into the economy, e.g., by financing the budget deficit, increased specifically for such purposes, instead of buying existing bank or government securities.) The Japanese monetary policy is interesting for the whole world because it increasingly seems that the financial processes follow similar trends both in the United States and in the euro zone and the idea of helicopter money appears more and more in the thoughts of leading financial organisations and central bankers. The markets currently give more than 60 per cent chance to a FED rate increase in December, which contradicts to any further easement. However, the rate increase may turn out to be a projection that never comes true: an actual rate increase would lead to such a degree of risk avoidance and turbulence in the markets that would make the rate increase impossible. Consequently, globally the continuation of long-term lapse and further easing central bank policies is more likely. The same is also supported by lower than expected economic growth, continued low inflation (consumer price index) and the existing financial risks.

Of the **financial risks** appearing on the horizon, the following should be highlighted:

The share and bond prices of **Deutsche Bank** fell to a depth never seen before. Apart from the known difficulties, the American Department of Justice claims USD 14 billion compensation from Deutsche Bank in relation to its former activities relating to American derivative mortgage bonds. The Italian financial authorities also accused the German bank giant of having contributed to shifting the losses of certain Italian banks of the balance sheet with futures transactions. As Deutsche Bank is one of the most important actors in the global financial system, the markets assume that the authorities would intervene and bail out the bank if its share prices continued to fall or clients invaded the bank.

The **presidential elections** will be held **in the US** on 8 November. During the campaign, Republican candidate Donald Trump made a number of statements (renegotiation of the national debt, attacking the Chinese foreign exchange policy, renegotiation of the free trade agreements) which, if implemented, would bring significant changes in the US economic and financial policy. However, for the time being, the Democrat candidate Hillary Clinton is the favourite as, according to the figures of the betting offices, the chance of Clinton’s victory is higher than 80 per cent. Nevertheless, the bookmakers made a huge mistake about Brexit too, and therefore Trump may in fact have a much better chance. It is a further issue of course whether a Trump victory would in fact bring so significant changes as he suggests in the campaign.

The **final outcome of Brexit** is still uncertain. Theresa May announced that the United Kingdom will officially trigger negotiations on the terms and conditions of the withdrawal of the UK from the EU. The GBP continued to lose value and currently stands at 1.22 against the USD. Over a flash crash at night, the GBP exchange rate dropped by 6 per cent in just a few minutes (most of it was later corrected), which suggests that significant leverage was built to protect the GBP exchange rate and that the market was trying to find the new balance in exchange rates.

The latest data confirm that the weak performance in the first quarter was only temporary, **and that the relatively dynamic growth of the Hungarian economy continues**. In the third quarter, the economy expanded by more than 2.6%, which was the recorded growth for the second quarter.

The actual data of the third quarter are not yet out, but the available monthly GDP component data seem to confirm a positive outlook. In a breakdown by production: the increase in market services could most probably remain high (above 4 per cent), because the indicators that have a strong impact on, and show some overlap with, the segment reflected positive dynamism. Retail consumption is still backed by favourable employment and wage indicators. The industrial output in August was 3.5% higher than in the same month last year (according to the data without any working day adjustments). The construction industry output decline reduced. The August figure of the construction industry was “only” 9 per cent below last year’s data. Following the lowest figures reported for March, the monthly data continuously improved. The review of the breakdown by building category is a further cause of encouragement, as the construction of buildings went up by 7%, while the construction of other structures dropped by 23.9%. These figures confirm that the major decline was caused by the temporary halt in the construction projects implemented with EU support and that the performance of the whole sector could gradually improve parallel with the regular payments received currently. According to the currently available production estimates, agriculture made a rather favourable contribution to economic growth and will continue to do so throughout the year.

Numerous factors indicate that growth can further accelerate in the fourth quarter. These factors include the accelerated payment of EU support, the actual start of home construction supported with CSOK and VAT reduction (the issued construction permits suggest a dynamic increase) and the start of a few major industrial investment projects. The **GDP growth in Q3 was around 3 per cent** but could be even higher in the fourth quarter. The 2.5 per cent GDP growth forecast of the Ministry for National Economy for 2016 may turn out to be too conservative and the actual figure could be closer to the 3.0 per cent, as projected by the central bank.

In terms of the **balance indicators**, the *budgetary* positions are still very positive. Following the very good September data, the aggregated deficit of the first nine months reduced to only HUF 2.4 billion, i.e., practically zero. Although individual items relating to EU support also contribute to the record balance, in general the revenues are higher in almost all tax types and the expenditure does not go beyond the budget. The Ministry for National Economy reduced the deficit target calculated as a percentage of GDP with the EU methodology from 2.0 per cent to 1.7 per cent for this year. By the end of the year, the national debt may reduce to 73-74 per cent of the GDP. The favourable deficit and national debt figures are good enough for a potential fiscal stimulus. In August, there was a major decline in the current account surplus of the country, but the change was most likely due to single factors. The government bond yields continue to be low: the yield of one-year securities is lower than 0.7 per cent, and that of 10-year securities is around 3 per cent.

The annual **inflation** rate was 0.6 per cent in September. The external environment, low fuel prices and the reduction of the VAT rate on certain foodstuffs may continue to depress the inflation processes. The core inflation is slightly higher and currently stands at 1.4 per cent. According to the expectations of the central bank, the 3 per cent inflation target will only be achieved in the middle of 2018.

The National Bank of Hungary (MNB) did not change the central bank interest rates during the quarter. In line with its former announcement, the MNB **limits the reference instrument portfolio**: the almost HUF 1,800 billion three-month deposits will be reduced to HUF 900 billion by the end of the year. The central bank intends to make the banks use the liquidity released across the banking systems to purchase issued new HUF government bonds, whereby the liquidity could appear on the account of the state kept by the central bank in the first round. The state could use that HUF liquidity to purchase foreign exchange to be used to repay the maturing FX national debt. In the end the process may lead to further shrinking of the sterile portfolio and the central bank balance sheet.

In September, the **EUR/HUF exchange rate** left the former band of 310-315 HUF downwards. The exchange rate strengthened until one euro was worth HUF 303 and then recovered to approximately HUF 307. The current account surplus puts a continuous revaluation pressure on the HUF. However, by focusing on stimulating the economy and its own profit, the central bank is interested in weaker HUF exchange rates and therefore is likely to take further action to weaken the HUF. In the short

term, it could be achieved with a further cut in the base rate and by imposing further limitation on the volume of the reference instrument.

In the third quarter, **the aggregated balance sheet total** of the credit institutions increased slightly, by 1.93% in nominal terms (HUF 629 billion). The HUF strengthened on average by 2% against the major foreign currencies. The HUF stocks expanded by 3% both in assets and liabilities, while the currency stocks fluctuated against each other (with an overall stagnation by also including the exchange rate fluctuation).

The increase on the **liability side** was caused by the increment in the interbank portfolios and equity, and a slight increase in the deposit portfolio was another factor. The **total deposit** portfolio increased by HUF180 billion (+1.1%). It was the result of, likely temporary, increase in government, especially local government deposits (HUF 169 billion, +20.5%), in corporate deposits (HUF 82 billion, 1.4%), and the latter also included a major increase in EUR current account/demand deposits. There was a simultaneous decrease in the deposit portfolio held by foreigners (HUF -83 billion, -17%). The deposit portfolio of other client groups, including retail clients, did not change significantly. All in all, there was a major increase in **interbank funds** (7.3%, HUF 691 billion). It was primarily the result of a rise in the borrowing from the central bank and Hungarian banks (HUF 693 billion and HUF 259 billion), the impact of which was slightly reduced by the reduction in interbank deposits (placed primarily by non-GMU banks) (HUF -103 billion), and a drop in borrowing from foreign banks (HUF -106 billion). The HUF 180 billion (+5.4%) increment in **equity** was partly due to the interim profit.

The expanding loan portfolio was a major factor in the increase of the **assets**, but the increase in the interbank deposits was an even greater factor, which was slightly corrected by a decline in the balance of nostro accounts. The external exposure continued to rise (HUF +561 billion) but, contrary to former quarters, the Hungarian exposure did not decrease in the third quarter (HUF +68 billion). The aggregated net borrowing has gone up by 3.2% (HUF 503 billion), which was a greater increase than that of the balance sheet total, while the **gross borrowing** grew by 2.3% (HUF 399 billion), and therefore the reserved impairment (the recognised impairment reduced by 7.2%, HUF 104 billion) had an important role in the net portfolio increase again. In the third quarter, the gross portfolio of retail loans declined by approximately half a percentage, just like in the previous quarter. The increase in the loans to Hungarian and foreign financial organisations (HUF +434 billion) was the main factor affecting the changes in the gross loan portfolio, but the volume of loans to individual contractors (HUF +52 billion, +24%) is also rising.

In the third quarter, MNB schemes did not have any relevant impact on the **liquid assets**. There was practically no change in the volume of government securities (+0.6%), although the central bank deposits expanded by HUF 86 billion. However, the deposits placed in GMU banks have gone up significantly (HUF 425 billion, +55%).

As a result of the above effects, the **net loan/deposit ratio** of the credit institution sector grew from 95% in Q2 to 97.3% by the end of September.

The profit developments were still rather positive compared to similar periods in the previous years, although a continuous decline can be observed between the 2016 quarters (pre-tax profits dropped to HUF 92 billion in the reporting quarter, following the HUF 199 and 162 billion reported in the first and second quarters. The results were also improved by the further reversal of impairment (HUF 22 billion) in this quarter too.

In the first three quarters of 2016, **pre-tax profit** remained outstandingly high compared to the same periods in previous years; it almost reached HUF 452 billion. However, there are typically one-off items and factors not linked to the operation of the Hungarian banking sector behind the high profit figures (such as the releasing of impairments, the sale of Visa Europe shares by several banks and the dividends of foreign subsidiaries). In the medium term, the low yield environment will have a negative impact on the profitability of the banking sector in Hungary as well.

III. Corporate lending

According to the MNB trends in lending report for August, in Q2 2016 the corporate lending growth rate turned into a positive figure and reached 0.3% in an annual comparison. Nonetheless, the repayments exceeded the borrowing by HUF 51 billion during the quarter. In an annual comparison, the increase in the borrowing of the SME sector reached 5 per cent at the end of June, reflecting an accelerating dynamism in the segment since the end of 2015.

On the basis of the responses of the banks to the Lending Survey, the conditions of corporate loans further eased in the quarter, which was in line with the international tendencies. Apart from greater competition, the positive economic outlook and the central bank's Market-based Lending Scheme also contributed to the same tendency. The banks taking part in the survey projected further easement in the conditions for the next six months. In the second quarter, the banks felt some acceleration in demand for long-term loans, which may be followed by a further increase in demand for investment financing in the second half of 2016. The average funding cost of new contracts for corporate forint loans decreased, primarily among the small loans used by SMEs.

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

On the basis of a Monetary Council decision of 13 October 2016, the MNB will re-distribute HUF 60 billion from the unused funds of the FX pillar in the phase-out stage of the FGS among the credit institutions, which can use the received additional funds to grant HUF and FX loans. The MNB has extended the period available for drawing down tranches under the contracts concluded during stage three of the FGS until 29 June 2018 without changing the deadline for concluding the contract, which is the end of this year. Furthermore, in order to make sure that the draw-down of the loans should not impede the implementation of investment projects that stretch across a longer period in the case of contracts concluded last year either, the MNB extends the period available for drawing down investment loans (and financial leasing) contracted in stage two of the FGS and within the framework of FGS Plus also by six months, i.e., until 30 June 2017.

According to the MNB Release on the FGS, the contracts covering about 231,8 billion forints affected 9 487 transactions and 6 890 enterprises in the period from 1 January to 30 July 2016, i.e. in the third stage of the Scheme. 68% of contracts for HUF 231.8 billion established in the third stage are new project loans and 32% are new leasing transactions. (In stage three only that type of financing can be offered, working capital financing and re-financing are not allowed.) Within the contracts for the total amount of HUF 166.5 billion concluded in Pillar I (HUF), facilitating the granting of forint loans, HUF 110.5 billion was lent in the form of project loans and HUF 56 billion in leasing transactions. Within the contracts for the total amount of HUF 65.3 billion concluded in Pillar II (FX), facilitating the granting of foreign currency loans, HUF 48 billion was lent in the form of project loans and HUF 17.3 billion as leasing transactions. In Pillar I the average term weighted with the contract amount is 7.4 years, for new project loans 8.6 years, for leasing loans 4.8 years while in Pillar II 7.3 years and for the two funding forms 8.4 years and 4 years respectively. Since June 2013, in the three stages of the Scheme, total 34 735 enterprises received finances in an amount of nearly HUF 2,358 billion.

IV. Private lending

According to the MNB Trends in Lending report for August, as a result of disbursement and repayments, the portfolio of household loans of the credit institution sector shrank by HUF 11 billion in the second quarter of 2016, and therefore the total loan portfolio reduced by 4.2 per cent by the end of June in an annual comparison. However, in June disbursements were already higher than

repayments. The volume of new contracts amounted to total HUF 258 billion in the period under review, which represents a growth of 38 percent in annual average, compared to the same period of the previous year. The biggest increase could be observed in housing loans and personal loans, where the disbursements went up by 46 and 47 per cent, respectively, over the last year.

According to the responses of banks to the Lending Survey, the conditions of housing and consumption loans have been also eased in the second quarter, and the projections indicated a further easement in the conditions of loans over the next six months too. Simultaneously, the credit demand, recognised by the banks participating in the survey, continued to expand, especially in relation to housing loans, where all the institutions reported a rise. The total average cost of new housing loans remained unchanged, but the average interest premium increased during the reviewed period in relation to the financing of more risky customers.

Amendment of state housing subsidy decrees

The long-awaited amendment of the decrees regulating the Housing Subsidy for Families (CSOK) was published in September 2016. The provisions of the legal regulation practically matched the draft prepared in spring 2016 and already reviewed by the banks, and therefore the banks also welcomed the **increase in the availability of the subsidy**. Pursuant to the amendment:

- subsidy may now be also requested for a real property which is in indivisible joint ownership (even retrospectively),
- the cost of home construction can now be reclaimed, also retrospectively, although for a temporary period,
- the regulations changed favourably for customers because subsidy is now available for constructions for which the construction permit is available, but the occupancy permit has not been issued, and
- it is no longer a requirement that the less than 25-year-old children moving together with the family should be students in higher education institutions.

The Ministry for National Economy issued a number of administrative statements clarifying the interpretation of the published decree, responding to questions submitted by various parties, including banks and the banking association.

Private bankruptcy: decree on the sale of property

Among the implementation decrees of the Private Bankruptcy Act, the government decree setting out the rules for the sale of property has still not been published. Our association conducted several reviews on the proposal for the amendment of legal regulations *on the sale of the debtor's assets in the debt settlement procedure of natural persons and on the debt settlement procedure of natural persons* in the framework of professional and administrative consultations. The regulation also sets out framework rules for the out-of-court sale of assets. In that respect, we proposed that the mortgage creditor should be entitled to take over the property within the legal framework if the attempts to sell it has failed.

In terms of the sale of property by the court we recommended that, when a number of attempts to sell the assets has failed, the property should also be sold, with the consent of the creditors, below the lowest sales price defined in the law when the creditor agrees to write off a pro rata amount from the receivables corresponding with the purchase price reduction from the debtor's debt. We made separate proposals for the sale of securities, and initiated reducing the costs of sale (EAR operator's commission, debt management fee).

Even though it does not relate to the subject matter of the regulations covered by the decree, in the same context we repeatedly pointed out that the closing of the enforcement procedures in progress was still unresolved in relation to the private bankruptcy proceedings and that the buyers making a

purchase in a private bankruptcy procedure could not obtain the ownership title free of encumbrances either.

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

Legal Working Committee seminar on the amendment of the Civil Code

On 2 September 2016, Balázs Bodzási, Deputy Minister of State of the ministry of Justice gave a presentation and held a consultation on the provisions of *Act LXXVII. of 2016 amending Act V. of 2013 on the Civil Code* that affected the activities of credit institutions.

The speaker outlined, among others, that

The modification eased the ***former prohibition of fiduciary contracts***. According to the new provision, only commitments assumed by consumers to secure a receivable, to transfer an ownership right or any other right or receivable or to establish a purchase right shall be deemed null and void, i.e., persons/organisations other than consumers can use such security. ***There has been a modification in the rules of the transfer of contracts***: with a contract transfer, the security of the right transferred to the party joining the contract will be maintained. These amended rules have been in effect since 1 July 2016. The modified provisions on pledge entered into force on 1 October 2016, but the provisions pertaining to the securities law will only take effect from 1 January 2017.

Concept of a pledge agreement has been completed with an ***independent lien***, which was re-introduced and the consumer pledge agreements must also ***specify the secured amount***. The assets eligible for a security deposit have been extended to receivables from a deposit agreement and bank account receivables. The rules pertaining to the enforcement of a pledge have also been amended. Only a financial institution can establish a re-introduced ***agreement on an independent lien*** as a beneficiary, and such a lien can only be established on a real property. The essence of the independent lien is the lack of statutory additionality, i.e., the independent lien encumbers the pledged asset irrespective of the secured claim. An independent lien may be transferred to a different financial institution even without transferring the secured receivable, which makes it marketable. The lienor is protected by the law against the double enforcement of the claim. The right of claim satisfaction is regulated in the ***collateral agreement***, the mandatory components of which are defined in the Civil Code.

The act amending the Civil Code allows for the conversion of existing mortgages and separated liens on existing properties established in a mortgage agreement into independent liens, making the, ***a converted independent lien***. The conversion takes place with a unilateral declaration issued by the lien holder financial institution to the lienor.

Following the presentation rich in content, the representatives of the banks asked a number of questions and the Deputy Minister of State promised to clarify the issues in the legal regulations or respond to the questions in writing.

Issues related to the converted independent lien

The provisions pertaining to the converted independent lien entered into force on 1 October simultaneously with the *Act on the Amendment of the Civil Code (Amended Civil Code)*, which lays down the ***material law provisions of the independent lien*** and the ***conversion process***.

According to the modification, at the beginning of the process the credit institution opting for conversion informs the respective lienor on the conversion of the lien or separated lien established in the mortgage agreement. The conversion is a unilateral declaration issued by the credit institution on the basis of the law, as a result of which the position of the lienor cannot become more burdensome, and therefore the contractual effect of the conversion does not require a declaration of

consent from the lienor, i.e., it becomes effective as soon as it is communicated. Pursuant to the provisions of the Amended Civil Code, the *res judicata* effect of the conversion, i.e., the registration of the property in the register, requires the declaration on conversion, the application for registration into the property register and the credit institution's declaration indicating that the lienor has been informed of the conversion.

The conversion will be ranked in the same position as the previous lien (with the exception of the sub-lien). Temporary provisions ensure that the converted independent lien and the contracts for the former lien match each other. A converted independent lien may be registered up to an amount that does not exceed the amount specified in the former mortgage agreement.

The conversion process also triggered the need for preparing other legal regulations and normative documents. Thus amendments in the *Act on the Registration of Real Properties*¹ and other *implementation decrees* followed the amendments made in the Amended Civil Code. In this context, Parliament approved further amendments at the end of October, initiated, amongst others, by the Banking Association; the primary objective of which was the simplification of the administrative process governing the amendment of lien. MNB has prepared a ***single customer information document*** for consumer protection purposes, which contains the declaration on conversion issued by credit institutions and provides generally understandable information on the rules and consequences of the conversion.

Conversion is expected to be performed in a large number in the forthcoming period in order to comply with the provisions of the MNB MFAR Decree².

Amendment of the Public Procurement Act in Progress

Back in March, the Banking Association approached the Prime Minister's Office and proposed amending the Public Procurement Act (Public Procurement Act) by referring to a letter sent to the President of the Public Procurement Authority last November and repeating the former arguments of the Association. The amendment was initiated because as soon as the court decision adopted in the Competition Authority case Vj-74/2011. entered into force, the ground of exclusion defined in Article 62 (1) n) of the Public Procurement Act became applicable to a number of operators of the sector, and therefore ***the parties concerned were unable to submit tenders in public procurement procedures.***

Although the Prime Minister's Office proposed amending the act in response to our request, they made an alternative proposal to resolve the problem raised by us. They stressed that, in their opinion, apart from ***self-clarification***, the new procedure introduced in the act can also resolve the problem of participating in public procurement procedures. A new paragraph (5a) was added to Article 62 of the Public Procurement Act, which states that exclusion [paragraph (1) n)] does not need to be applied in the public procurement procedure if the Government ***granted exemption from its application in an individual decision*** adopted on the basis of the contracting authority's request and a proposal of the minister responsible for public procurement in order to maintain and ensure competition.

The expected consequences of the now effective amendment and the practical implementation of the cases of self-clarification were discussed with the representatives of our member institutions concerned in a meeting, in the course of which it became obvious that in most cases self-clarification suggested to the banks will only offer a difficult-to-implement solution. In most proceedings, the Competition Authority concluded that the parties did not sufficiently co-operate during the investigation, and therefore none of the parties concerned was able to satisfy the requirements of self-clarification.

¹ Act CXLI. of 1997 on the Registration of Real Properties

² MNB Decree 20/2015. (29 June) on the HUF Maturity Match of Credit Institutions

We requested further information from the Prime Minister's Office about the rules of the procedure launched by the contracting authorities according to the new provisions of the law because the procedure itself (e.g., a joint procedure or only limited to individual cases) and the time required for a potential exemption could significantly influence the applicability in practice of the new instrument, i.e., exemption from exclusion. The Prime Minister's Office informed the Banking Association that ***none of the legal regulations contain any procedural rules for the exemption procedure***, and such rules cannot be expected in the future either. They also stressed that exemption could only be granted in especially justified cases.

During the discussions currently in progress in relation to the complex amendments of the Public Procurement Act (known as the Public Procurement Roundtable), the representatives of the Prime Minister's Office also indicated that it was unlikely that the above concept or rules would be modified.

Review of the Act on Judicial Enforcement

The Codification Committee continued working on the *Act on Judicial Enforcement (Judicial Enforcement Act)* in more frequent meetings in July and August. During the consultations:

- Our Association recommended introducing a prior asset review as the first optional phase of the enforcement procedure: prior to the actual enforcement, the debtor's movable and immovable properties would be reviewed and an inventory would be prepared. The party requesting enforcement would have the right to decide, based on the inventory, whether judicial enforcement should still be requested and, if so, which property of the debtor it should concern.
- We made a number of proposals for the rationalisation of the rules relating to the order of enforcement and the distribution of cases, the increase of the efficiency of movable and immovable sales channels (continuous auction from the beginning instead of the multi-phase auction structure; using more flexible starting prices in the sales at auctions, definition of the minimum requirements for the contents of the announcements at least in a decree, use of market sales channels by allowing commissioned sales in certain cases).
- To offset the conditions impeding the sale of real properties in auctions, we recommended that the statutory usufruct right established following the registration of the mortgage should not encumber the ownership right of the auction buyer, that it should be possible to terminate a lease agreement for homes established for a definite term after the sale and that the rules of taking possession should be modified in order to protect the interests of the auction buyer.
- We proposed simplifying the rules of the sale of real properties based on an agreement of the parties out of an auction but with the same effect as that of an auction, the application of a lower rate of commission in the case of such sales and a statement indicating that the amount cancelled by the beneficiary would not be included in the basis of commission calculation for the bailiff. As a similar solution to that provided in Article 49/D of the Bankruptcy Act, we proposed that when the sales proceeds from a pledged asset are distributed, apart from the bailiff, only the pledgee's enforcement costs should be paid and the total amount of the remaining amount should be used to satisfy the claim secured by a pledge (according to the effective rules, the costs of all parties requesting enforcement must be covered from the sales proceeds).

Amendment of the Competition Act: letter to the Ministry of Justice

The Ministry of Justice published the draft amendment of *Act LVII. of 1996 on the Prohibition of Unfair Trading Practices and Restriction of Competition* on its website. According to the proposed

amendment, concentration below the limit could also be notified on the basis of a voluntary decision. A new right would be allocated to the **Competition Authority to conduct an investigation in concentration cases, irrespective of any limit**, within 6 months from the implementation both based on mandatory or voluntary reports or without a report.

The Banking Association made remarks to the draft in relation to the assessment of the concentration. In our opinion, the envisaged amendment will result in a great deal of legal uncertainty among the market operators because the extremely costly and labour intensive process of concentration between company groups will become uncertain if the Competition Authority may launch an investigation for a period of 6 months on the basis of criteria that have not been defined clearly. That is why we proposed that notification to the Competition Authority should still be compulsory only when the concentration exceeds a specific threshold but, when the concentration is below that threshold, the parties concerned should not face any legal uncertainty. We recommended **introducing a factor or a set of criteria** which could be used as the basis of voluntary notifications and the need for launching an ex officio procedure. We also recommended that the provisions of the Competition Law pertaining to onsite search (“dawn raid”) could not be applied to concentration (acquisition, merger) because the transparency of the company court procedure and the high level of documentation of any concentration case does not justify it.

Electronification of queries by authorities

Following the January consultations held upon the initiative of the Constitution Protection Office (AH), the **AH decided to communicate with the credit institutions through the GiroMail system**. This channel has been supporting the exchange of information with major banks since the second quarter.

In response to an AH proposal, we organised a consultation to discuss the experiences and problems of the start where, apart from technical issues, the most important topic was the amendment of the Act on Credit Institutions by June, specifying a 2-day deadline for response in relation to any terror risk. In that context, the representatives of AH and the Special Service for National Security (NBSZ), also attending the consultations, indicated that the amendment of the law, integrated into the legal regulations on national security and to be integrated into the Act on Credit Institutions following the analogy of the rules pertaining to electronic contact, defined in the Act on the rules of Taxation, assumed the existence of an actual electronic channel to be established by the National Security Services. The AH developed forms in order to standardise the queries and responses. The forms were distributed for review in September and were introduced from the beginning of October.

During the consultation held at the end of September, NBSZ indicated its intention to introduce an electronic solution in order to centralise the electronic queries of the other national security and, when applicable, further investigation agencies which can also support the request for and submission of historic data based on the example of already active systems of the kind (primarily the NAV system). It intended to add a function to its existing system based on which they would be informed immediately with a specific technical ID (bank account number, bank card number) of any transaction executed on the respective account.

VI. Developments relating to National Bank of Hungary

Transformation of the reference instrument of the central bank

The vice governor of MNB responsible for the monetary policy presented the purpose of further transformation of the reference asset of the central bank and the method of implementation at the

CEO consultation organised by the Banking Association in July. He explained that the central bank intends to achieve further bank adjustments, ***as a result of which an even smaller part of the excess liquidity of the financial sector will be kept in central bank deposits and instead it should be made available on the government securities and inter-bank markets primarily as the source of domestic lending.*** The central bank expects a fall in inter-bank interest rates as a secondary effect which, according to its position, may contribute to an increase in lending and reduction in the yield of government securities. He explained that they intended to implement the introduction in two phases. From August, they would hold monthly tenders instead of weekly tenders to make sure that the liquid funds maturing between the less frequent tenders could be diverted into other channels. Depending on the decision of the Monetary Council made in September, they planned to limit the volume of the reference three-month deposits from Q4. In the new regime, the central bank expects greater volatility, and thereby it will be ready and willing to support the management of surplus and missing liquidity through a flexible supply of overnight deposits and central bank credit instruments as well as HUF supplying swaps. (It has to be added that the use of such instruments entails an interest cost.)

The MNB converted the three-month deposits according to the presented schedule. The Monetary Council decided on the HUF 900 billion limit of the three tenders issued in Q4 with a major reduction in liquidity compared to the almost HUF 1,800 billion stock recorded in September. According to the Monetary Council decision, the tender has two phases: in the first phase, the participating banks may submit offers depending on their limit and then the not subscribed volume will be distributed among the candidates in the second phase.

Draft decrees and recommendations on credit risk management

During the summer, the MNB organised consultations on a regulatory package related to credit risk management, requesting discussions on the following draft regulations: “*MNB Decree on Customer and Counterparty Rating and on the Prudential Requirements of Collateral Valuation*”, “*MNB Decree on the Prudential Requirements Pertaining to Non-performing Exposures and Restructured Debts*”, and “*MNB Recommendation on the Measurement, Management and Control of Credit Risks*”.

The MNB draft decree introduced only minor amendments to the customer and counterparty rating and collateral valuation regulations earlier described in the government decree, yet integrated it within the framework of prudential regulations. The draft decree on the prudential requirements for non-performing exposures and restructured receivables is based on the execution regulation of the European Commission, which defines default and forbearance and the related data supply obligations. Similarly to the former supervisory expectations, the draft recommendation on the measurement, management and control of credit risks lays down general (high-level) requirements, shifting the stress from the description of the lending process to the identification of the requirements for the control functions. The recommendation maintained a scope covering the entire financial sector, as compliance with it is expected from all institutions that have credit risk exposures. Contrary to the above, the scope of the two new MNB decrees covers only financial institutions and investment firms.

Our member banks made a lot of comments and proposed modifications for the regulatory package on credit risks, of which the following specific requests were highlighted:

- the use of rating categories by term (short, medium and long-term creditworthiness) should not be a mandatory requirement, only an option,
- the MNB should accept the documentation of the rating systems in English,
- the correlation between performing, non-performing and restructured debts should be clarified,
- the requirement for the quarterly valuation of collaterals should be omitted,

- the MNB should ensure the highest possible consistency with the European regulations and the best practices in relation to all requirements.

The MNB published the legislative package, revised on the basis of the received comments, in October; the provisions of the package must be applied from 1 January 2017.

Draft MNB recommendation for the out-of-court restructuring of non-performing corporate loans

The EBRD held a workshop, organised by the MNB at the beginning of 2016, where they presented in detail the main findings of their study prepared in co-operation by Ernst & Young and White & Case, identifying the problems that made the management of non-performing corporate loans more difficult in Hungary and making a proposal for the solutions. One of the key points included their findings concerning the review of the Budapest principles for the out-of-court restructuring (OOCR) of non-performing loans developed in Budapest and the elaboration of new methods.

Following the meeting, EBRD commissioned E&Y to identify in detail the problems of effective court restructuring and to make a proposal for a solution. E&Y completed its study by the end of July, with the involvement of 16 commercial banks, MARK Zrt. and the Banking Association. One of the key findings of the study was that the MNB should take an active role in the promotion of the broad and effective application of OOCR, and recommended to the MNB supporting the process by issuing a recommendation.

The MNB commissioned Köves and Partner Law Office to draft the recommendation and distributed it, together with the study, for a preliminary review at the end of August. At the same time, it began organising a conference presenting the recommendation to the representatives of the sector to be held at the beginning of October.

We held a meeting with the competent experts of the banks and the representative of CMS, the law office taking an active part in the preparation of the Budapest principles in order to come up with a joint position concerning the draft recommendation and to review the tasks of the Banking Association that can be undertaken in the new OOCR environment. The participants attending the meeting heavily criticised the nature of the recommendation setting a requirement for an obligatory “soft” legal instrument and the related moral risk; the method and schedule of the implementation and the scope of the recommendation. The objections and criticism were summarised in a letter, discussed with the experts and sent to the MNB at the beginning of September. Then the MNB organised a consultation for all parties concerned where it explained that it insisted on introducing the recommendation but modified its draft at several points based on the proposals of the Banking Association and the banks. The MNB stressed that it was not its intention to impose an obligation on the creditors that could be enforced under all circumstances and that it would stress the same message in the amended text.

The recommendation is likely to be introduced in December, and prior to the finalisation of the text, the central bank will organise consultations with the interested parties for a period of approximately 1 month.

Draft new MNB recommendation on the application of general consumer protection principles

Within the framework of the review of the recommendations issued prior to 1 October 2013, the MNB Directorate of Consumer Protection reviewed and summarised, with revisions, in a document, the provisions of the following consumer protection recommendations of the Supervisory Authority that were still relevant.

- HFSA Recommendation 15/2001 on the Information of Consumers by Financial Organisations,

- Recommendation of the HFSA Supervisory Board 9/2006 (7 November) on the Prior Customer Information and Consumer Protection Principles to Be Applied in Retail Lending, and
- Recommendation of the President of the Hungarian Financial Supervisory Authority 1/2011 (29 April) on the Application of General Consumer Protection Principles.

The members of the Banking Association submitted an unusually high number of comments to the draft new recommendation. Of the received remarks, we submitted the major ones to the MNB in a separate letter, while the minor ones were submitted only marked in the text.

According to the position of the Banking Association, during the consolidation of the previous recommendations, not all legislative changes approved in the meantime were taken into account in the draft (e.g., Consumer Loans Act, Act on Credit Institutions), and therefore in some points the recommendation is contrary to the provisions thereof, while elsewhere it refers to the obligations included in the legal regulations approved in the meantime as a recommended requirement. As not all legislative changes were taken on board, the draft contains a number of provisions in relation to which the additional requirement set for the financial organisations in the recommendation compared to what is included in the already existing information documents specified by law are not clear. In order to adequately apply the recommendation, we believed that it was absolutely necessary to clarify to what extent the information obligations detailed across a number of pages reflected additional requirements. Apart from proposing modifications in the text, we also gave detailed reasoning in order to assist the clarification process.

We also highlighted that it would be difficult to apply the requirements of the recommendations, including especially the requirements for information to certain services, such as debt management. In most cases, the contents of the agreement to be concluded with a debtor are determined by the willingness and capacity of the debtor to pay, and therefore in such cases it is totally unreasonable and pointless to prepare summaries and extracts.

It was on October 24 that the National Bank of Hungary (MNB) issued its recommendation No. 10/2016. (X.24.) titled Recommendation for Financial Organisations on the Application of Consumer Protection Principles. MNB expects the recommendation to be applied as of December 1, 2016.

Developments relating to BUBOR quotation

In compliance with the declaration of intent of the central bank issued at the end of March, the MNB and Hungarian Forex Association, Rate-setting Committee, prepared a draft new agreement terminating the trilateral co-operation agreement (MNB-MFT-Banking Association) of June 2014 for the quotation of BUBOR, BIRS and HUFONIA reference rates and regulating the transfer of the administration of quotations to the MNB. Pursuant to that agreement, the administration tasks will be transferred to the MNB on 1 November 2016 and MNB will perform them pursuant to the agreement until 1 November 2021. The document also defines the following main requirements set by MFT in relation to the transfer:

- The BUBOR rate can still be used free of charge. Upon the request of the Banking Association, the MNB declares in an agreement that the reference rates are public goods.
- Should MNB decide later that it no longer intends to perform the administration of the reference rates, then the task should primarily be transferred to MFT. Upon the request of the Banking Association, the agreement should state that if in such a case MFT does not wish to take over the administration of the reference rates either, then the task should be offered to the Banking Association prior to any other operators.
- The MNB involves the rate quoting banks in professional issues relating to the reference rates through consultations.

The parties approved the agreement on 12 September 2016.

The MFT Rate-setting Committee performs the tasks stated in the previous agreement until the transfer date (31 October) but, in order to facilitate a smooth transfer and adequate professional control following the transfer of the administration of the respective reference rates, the MNB established its Reference Rate-setting Committee, the inauguration meeting of which took place at the end of September. The delegates of the MFT Professional Committee and a representative of the Banking Association are also permanent guests, attending the meetings of the Committee.

Changes in data reporting in 2017

In 2017, the sector of credit institutions will keep its books according to a mixed accounting system (IFRS and national regulations), and therefore the data supplies will be transformed significantly next year. At the beginning of the year, a Banking Association working group consisting of the experts of MNB and the member banks defined the main data tables (balance sheet and profit and loss account and the related detailed loan and deposit product tables), and completed the other regular report templates by the summer.

Part of the reason for the *changes* was that *everyone should be able to complete the tables irrespective of the accounting framework* (as an example, the presentation of derivative transactions on and off the balance sheet is different in these accounting systems). The other reason is that *the MNB* also demands more new data and information in order to be able *to fulfil its tasks in monetary regulation, supervision and consumer protection*. More detailed data and new reports are requested about disbursed loans, owned securities, a detailed statement is required on cash revenues by sector, on cash fraud events and on complaint handling, just to mention a few examples.

At the beginning of the summer, the central bank also informed the credit institutions that from 2018 the EBA³ *plans to require* the ITS reports (COREP+FINREP) *in XBRL format*, and therefore it was developing its new data collection and processing information system accordingly. The introduction of the XBRL format is in line with the expectation of the European Banking Authority as it intends to improve the quality of statistical data and accelerate the data transfer by using consistent standards and technologies. In accordance with the requirements, the MNB has been using the XBRL format in its reports to the EBA and converts the data received from the banking sector into that format. As by 2018 each credit institution will have to restructure its data supply system to replace the former single-point data conversion, there will be a need for new IT development, which will trigger additional tasks and additional expenses. In addition, the deadline for the switch planned by the MNB is the same as the switch to IFRS. In order to avoid the unreasonable additional cost incurred by the sector, we recommended postponing the switch to XBRL.

VII. Payments

Transposition in Hungary of the EU Payment Accounts Directive (PAD) (basic account switch of bank accounts)

The EU approved the Payment Accounts Directive in 2014, which set a requirement for the Member States to

- include a *basic account* in the offer of their banks that provides an attractive group of services for a favourable fee (offered primarily to customers who previously did not use banking services),

³ European Banking Authority:

- introduce a “single-window” system in the banks, where a simplified **switch of banks** is offered to their customers as a service of the new bank (i.e., should not also have to also visit the old bank for the same purposes), and
- to arrange for an objective comparison of the **fees of the payments accounts of the different banks** in order to assist customers in making a decision on switching banks.

The deadline of implementation of the first two objectives was the middle of September 2016. The ministry responsible for implementation began consultations on the regulations that required a lot of preparation time and bank development only at the end of July and the relevant decrees were only published at the end of August. (Our Association warned the legislator urgently, and they recognised that the original deadline could not be maintained, and therefore the implementation deadlines specified in the legal regulations were extended to the middle/end of October.)

The Government also set a target to introduce a **basic account free of charge** but postponed the decision on the conditions of the social account to January 2017.

Similarly to other EU Member States, there have been self-regulations at the Banking Association for the basic account and bank switch for years. In order to avoid any duplication, the Board of the Banking Association revoked them as the decrees entered into force.

Following the publication of the government decrees, the Banking Association organised a consultation for its members and invited the experts of the Ministry for National Economy responsible for the topic. It also requested a position statement from the Ministry on the issues left open. In the course of the consultations, joint solutions were found to numerous issues but many problems continued to exist. The most important disputed items were as follows:

Basic account

- How does the cash withdrawal option specified in the decree on the basic account relate to the two cash withdrawals free of charge provided in the Payment Services Act? (According to the Ministry they are independent from each other.)
- How can a bank satisfy the requirement to compare the basic account to the other accounts offered by it with sufficient detail and documentation?
- What fees can the bank charge to the services associated with the basic account (e.g., text message or limit amendment for the bank card), which are not parts of the basic account? (According to the Ministry, the banks should provide those services free of charge.)

Switching accounts

- The two basic services transferred from the former bank to the new bank are not defined clearly (direct debit and direct credit), which may cause problems during the implementation.
- The Ministry did not deem it necessary to define a list of bank technical reasons preventing the bank switch, which may lead to different banking practices.
- The Ministry did not find a legal solution to a disturbing provision of the directive which is contrary to the provisions of the Payment Services Act, according to which the old bank must refuse a credit to be made on its customer’s account after a specific date defined by the customer.

The discussions on the open issues with the GIRO and the Ministry were still in progress when the report was prepared. It is great help in the practical implementation of the bank switch that GIRO Zrt. agreed to automate part of the process and standardise the interbank messages.

Curia decisions concerning the transaction levy

A Curia decision in January 2016 concluded a case brought to court in 2014. The case involved the review of an administrative resolution adopted by MNB in its consumer protection competence.

With this decision, the MNB prohibited the transfer of the financial transaction levy to consumers and ordered the refund of any excess fee to the consumers as well as impose a consumer protection fine. Following a decision of the Budapest Court of Public Administration and Labour, the case was transferred to the Budapest Capital Regional Court and then to the Curia with a request for review.

I. The judgment of the Budapest Capital Regional Court concerning the **alteration of the fee calculation method** was favourable for the account manager and was based on the following arguments:

- The legislator does not prohibit the transfer of the transaction levy to customers. The transaction levy is a budget revenue but it is added to the cost charged by the credit institution on the amount of funds moved according to the customer's order; consequently, the transaction levy relates to the customer's order and therefore **the transaction levy is payable by the customer**.
- The introduction of the transaction levy is a lawful reason why the credit institution should take this cost component into account when it establishes the fee for its services.
- The total applied fee increase cannot be higher than the transaction levy and cannot generate in any additional income for the credit institution.
- The fixed+% fees applied instead of a fixed fee reflected only the transaction levy and the customers did not have any disadvantage beyond that.

II. Concerning **the increase of the HUF 0 transaction levy**:

- A credit institution can provide any service free of charge for any reason (free of charge, free, for HUF 0, etc.).
- Without any statutory obligation, credit institutions cannot be expected to assume any duty payable by other parties free of charge (see point I.: the levy is payable by the customer) that occurs outside the scope of its operation, following the conclusion of the contract. Consequently, the increase of the HUF 0 fee by the rate of the transaction levy is not the same as the introduction of a new fee.

The Curia decision adopted in the review procedure maintained the effect of the second instance judgment of the court and dismissed the MNB request for a review.

Direct debit tasks resulting from universal service provider switches

The Banking Association has an active co-ordinating role in the switch of universal service providers in how to manage issues relating to direct debit. While earlier changes in the gas and electricity service providers triggered tasks, recently major changes occurred in the organisational framework of waste management and there was another large switch of service providers in the gas supply (TIGÁZ-FŐGÁZ). Our objective was to provide an adequate legal and information background and to make sure that in relation to such services **the banks of the thousands of customers paying their bills with direct debit should amend the direct debit authorisations** for the new service providers, thus avoiding any unnecessary burden imposed on the customers.

Within the framework of the consultations between the various parties:

- we talked to old and new service providers on the legal background of the switches and on a schedule acceptable for both parties,
- we had discussions with the account managing bank of the new service provider on the message format to be used for the transfer of the data required for changing the direct debit authorisations to the account managing banks of the retail customers paying with direct debit,
- our Association also took part in the organisation of the data traffic test between banks,

- during the finalisation of the schedule, we paid special attention to make sure that the account managing banks of the customers have enough time to amend the authorisations in large numbers.

We had the switch schedule prepared according to the above criteria reviewed by the experts of the Payments Working Group and then distributed it to our members requesting due and professional implementation.

Latest news on Bank cards

○ *General card market data*

According to the MNB data, in Hungary **the number of bank card payments** executed with contactless cards exceeded the number of traditional card payment transactions first in Q2 2016. The share of contactless cards is 59 per cent. This fast and comfortable contactless payment is available on approximately 70 per cent of the POS terminals. Nearly 9 million payment cards have been issued in Hungary, within which approximately 85 per cent are debit cards; these proportions have practically not changed over the recent period. The dynamic increase in **card purchase transactions** observed in the last few years continued in the second quarter of the year. This increase in the turnover primarily stems from the broad distribution of contactless payments and the increasing popularity of online purchases. The almost 120 million purchase transactions executed in the Hungarian acquiring network with cards issued in Hungary was more than 21 per cent and the approximately HUF 819 billion involved in those transactions was more than 25 per cent higher than the figures recorded in the same period of the previous year.

○ *Fraud events*

According to the current statements of the MNB, the number of **payment card frauds** went up by 60 per cent and their value increased by approximately two thirds (HUF 270 million) at the card issuers in Q1 2016 in comparison with the same period of the previous year. However, within the total purchase turnover, the ratio of frauds is less than 0.01 per cent in volume and 0.04 per cent in value, which figures are very good even in a European comparison. The largest number of fraud events continue to relate to transactions not requiring the physical presence of the card (CNP⁴): 79 per cent of the cases and more than 74 per cent of the consequential losses resulted from such transactions. In terms of the direction of the transactions, the cross-border traffic was affected mostly as the ratio of fraud relating to international traffic was higher than 80 per cent both in the number of transactions and in the damage caused. Unfortunately, the frequency of **fraud events relating to prize games by phone** has increased over the last few months. With this type of fraud, the perpetrators call customers in the name of Szerencsejáték Zrt., a bank or a mobile service provider and, by referring to a prize game organised by the respective companies, encourage them to pay money onto specific mobile numbers through an ATM by using their bank cards. According to the statistics submitted to the Banking Association by our members, the perpetrators deceived hundreds of people in the first half of the year, after which these customers complained to their banks (301 complaints, tens of HUF millions total loss). According to expert estimates, the actual number of (unreported) cases could reach a thousand, and the total loss could be around HUF 100 million. The Banking Association organised a number of complex discussions with the involvement of the fraud experts of its member banks, the National Police Headquarters, the mobile phone operators and the competent members of staff of Szerencsejáték Zrt. Our Association also approached the Ministry of Interior requesting administrative actions in order to handle the problem.

⁴ Card not present

- *Business cards workshop*

We organised a workshop on 7 September where speakers from NGM gave presentations on the regulatory updates on business cards and reviewed the options of broader encouragement of the use of business cards (prizes, new product features, regulatory support, etc.).

- *Equal treatment - Managing disabled customers*

A decree requiring equal treatment in the financial services to disabled customers (22/2016. NGM Decree) was published at the end of June. The decree set a requirement for credit institutions to develop a strategy for more deliberated and caring services to disabled customers. Apart from the Payments Working Group, the Bank Cards Working Group also supported the implementation of the provisions of the decree and the preparations of the banks. In future, the “best practices” will be shared in this topic within the framework of the activities of the Disability Committee organised by the Ministry for National Economy.

Implementation of the Payment Services Directive (PSD2)

The effective Payment Services Directive could not regulate the innovations of the last few years which related to primarily to e-commerce. Over the last ten years, three activities developed, within which a third party payment provider (TPP) cuts into the payment chain as a new actor between the customer and the payment service provider managing the payment account. The purpose of the service of this third party provider is that the customer (the payer or the beneficiary initiating the payment) contacts the account manager for the payment initiation service (PIS), the query for the aggregated account balance (AIS⁵), or to make the payment with a payment card issued by the TPP through the intermediation of the TPP. During these transactions, the customers are required to reveal their personal security codes to third parties.

The PSD2 had to introduce rules for the liability and, equally importantly, security requirements for such services that were previously not included in the legal definition of payments and their service providers as well as the interconnection between the latter providers and the payment service providers keeping the payment account. Considering that the security of payments is a key issue in this changed payment chain, the European Banking Authority was authorised to develop the detailed rules in the PSD2 (regulatory technical standard) (RTS)). The RTS focuses on customer authentication (**strong customer authentication** (SCA) will be a basic requirement from 2018) and **secured communication** (SC) between payment service providers. The EBA released the RTS draft for public consultations in August with a deadline for responses in October.

- *EBF Payment Systems Committee meeting*

At its latest meeting, the European Banking Federation Payment Systems Committee discussed the following main topics in relation to the application of PSD2:

- The competent unit of the European Commission reviewed and, with a few remarks, practically approved the **guidance** of the **EBF** expert group established specifically for such purposes for the **interpretation and implementation of PSD2**, applicable from 2018. (The Banking Association also received that professional paper and the Secretariat of the Payments Working Group sent it to each working group member.)
- In Europe, one of the main issues to be resolved is the introduction of the “Application Programming Interface” (API). This **interface** will support communication, involving confidential data and secrets between the key party of e-commerce, the third party provider

⁵ Account Information Service

(TPP) and the account managing bank of the account holder customer making a purchase in an e-commerce transaction. Obviously, the PSD2 lays down only the theoretical basis of this data transmission/communication. EBA, which is responsible for the details, also developed detailed requirements, a range of interpretation and guidelines, which still left a broad area for technical implementation (which therefore can/should be disputed). It is not clear whether a single pan-European solution can be found or interconnectable national solutions will be adopted. No decision was made either on whether the process of resolving this issue would be driven only by banks, or jointly by banks and TPPs, or by the authorities.

- It is obviously a problem that the EBA standards cannot be implemented any sooner than July 2018, yet the provisions of the directive must be applied from January 2018.
 - *Review of the EBA standard assisting the implementation of the directive*

Three working groups of the Hungarian Banking Association (Card, Payments and IT Security Working Groups) have competence in relation to the draft standard, and therefore they jointly processed the RTS draft. In the first step of the process, the HBA asked the MNB Directorate of Financial Infrastructures (which was involved in the drafting of RTS) to summarise and present the contents of the future standard and to give some guidance concerning the right interpretation of the definitions and requirements in a professional discussion attended by a large number of the member banks.

After the discussion, the experts of our member banks drafted their written responses to the EBA questions included in the draft. Most questions related to the SCA application, the protection of the personal authentication components, the interface(s), the requirements of secured communication and identification and the authorisation of the activities of enterprises engaged in payment services. In relation to the prepared responses, we held another consultation with the MNB experts on the interpretations to be confirmed and on the open issues to be submitted to the EBA. The HBA finalised and submitted the opinion of the Hungarian payment service providers related to the RTS draft by the deadline, by using the information referred to above as input.

SEPA⁶ developments

- *Implementation of the professional and communication support plan related to the SEPA End-date Regulation*

The SEPA Working Committee prepared in the summer and launched in the autumn of 2015 its professional and communication support programme for 13 months. The programme had a dual objective; to provide professional support to the payment service providers in preparing for the satisfaction of the requirements included in the SEPA End-date Regulation⁷ and to satisfy the information obligation specified in the regulation: to inform the general public and, more specifically, the retail and corporate customers of payment service providers on the changes in euro payments, effective from 31 October 2016.

The working committee began supporting the professional preparations of payment service providers proactively, by publishing an **Information Booklet**, also available on the HBA website, at the beginning of October 2015, and later it presented in detail to the payment service providers in the **professional meeting**.

The standard document distributed to the payment service providers with the aim of informing corporate customers and managing the issue of standard conversion also intended to assist payment service providers in the preparation; similarly, the **questionnaire-based survey** that consisted of two

⁶ Single Euro Payment Area:

⁷ REGULATION (EU) No 260/2012 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euro and amending Regulation (EC) No 924/2009

parts (conducted in Q2 and Q3 2016) focusing on the topics of the Information Booklet (joining payment models, managing corporate batched orders, IBAN-only and customer information) was also aimed to serve the same purpose.

Articles were published in the written and electronic press to provide information for the general public and retail and corporate customers according to a planned quarterly schedule: It is time to prepare for SEPA (VG); An important deadline is coming – Hungarian companies should prepare themselves (portfolio.hu); Good news for the customers of banks (Privátbankár.hu, *in publication*). Apart from the articles providing information, the fourth issue of Gazdaság és Pénzügy (Economy and Finance) (Hungarian abbreviation GÉP) also presented the last 15 years of the development of the euro and SEPA.

- *New providers joining the SEPA Schemes*

One of the main rules of the SEPA End-date Regulation is that after 31 October 2016, euro payment orders may be executed only by using the standards and rules of the regulation even by payment service providers of Member States not part of the euro zone. In practice that means that any payment service provider intending to take part in the European payment turnover must register itself in the SEPA payment schemes (credit transfer from 2008 and the direct debit core and direct debit business to business scheme from November 2009) which were developed, and are operated and managed by the European Payments Council (EPC).

In each Member State, the registration process of the payment service providers must be supported by the NASOs⁸. This is the responsibility of the NASO Working Group of the HBA SEPA Working Committee, which took over this task from the Hungarian SEPA Association in 2014. Most of the Hungarian payment service providers registered as soon as the schemes (primarily the credit transfer scheme) was launched; in Q3 2016, another minor registration wave could be observed in the framework of the preparation for the end date (presumably, in relation to the registration deadline, set by the EPC for the end of September). According to the EPC data valid as at 14 October, **24 Hungarian members joined the SEPA credit transfer scheme and two Hungarian organisations joined the direct debit scheme.**

SWIFT annual global conference (SIBOS)

In the history of SWIFT, which goes back to the 1970s, this year's SIBOS was the 39th, and the third event held in Geneva, accompanied with the usual great interest; the event was attended by more than eight thousand participants and two hundred exhibitors, including a number of fintech enterprises. It was the first occasion when the National Member and User Group was represented by a HBA delegate.

The organiser managed again to select a topic that concerns the financial community most, which is ***the place of finances in the changing ecosystem***, and put it in the focus of the event under the title of "Transforming the Landscape". The title that suggests a strong change presented the challenges caused by digitisation, various innovations and financial crimes and the extremely strong impacts of challenges on the competition to which the operators of the official financial world must respond from four main aspects. The four main aspects were banking services, compliance with the regulations, culture of banking services and securities, each of which served as the main topic of a day. Most reputable experts summarised their experiences during the plenary sessions, occasionally outlining the best practices for managing the arising problems. Apart from innovations, such as the blockchain and closely related distributed ledger technology; the distribution of instant payment schemes, the mobile telephony effect of replacing the bank (branch) system in large regions with an

⁸ National Adherence Support Organisation

extensive population but without infrastructure, the ***prevention and management of cybercrime was covered most extensively of the four topics***. Perhaps the best known direct reason for that is the central bank of Bangladesh, which fell victim to hackers through the bank's SWIFT connection as a result of inadequate security equipment and procedures. Based on that event, SWIFT developed and announced its customer security programme (CSP), the implementation of which was recommended to all members and users by the SWIFT CEO and security manager. (The CSP will also be a major task for the Hungarian National Member and User Group from next year.)

Apart from the main issue of security, the most important message of SIBOS was that SWIFT will continue representing (as before) its main values, i.e., professional excellence, value and potential manifested in its membership as a community and innovation in the global digital environment that presents increasingly versatile challenges.

VIII. Taxation, accounting

HBA proposals for the amendment of the tax laws

In Q3 2016, the Taxation Working Group held a number of discussions on the following main topics and prepared numerous proposals for the amendment of legal regulations:

- For the amendment of the tax laws and regulations related to the switch to IFRS in order to assist applicability in
 - Act *C. of 1990 on Local Taxes*, we made two new alternative proposals for a simpler definition of the IFRS local business tax net sales revenue category component in the part pertaining to the local business tax (*Article 40/D*).
 - Our proposals prepared for Act *LXXXI. of 1996 on Corporate and Dividend Tax* were aimed at not introducing major differences in the tax liabilities due to the differences between the account methods (IFRS or the Hungarian Accounting Standards (HAS)) and the different optional switching dates (1 January 2017 or 1 January 2018).
- The purpose of our proposal for the clarification of *the provisions on the corporate tax rule relating to the Settlement Act* was to make it clear, also in the law that the outcome of a settlement made with a consumer according to the MNB methodology also applies to the calculation of the related tax refund.
- Our Associated asked for position statements in relation to numerous issues of the *regulations on the banking surtax* relating to the taxpayer's investment service activities and leasing activities, because the provisions of the law are unclear in numerous points and represents a tax risk at the parties applying the regulations. In addition, we also proposed reducing the special tax of financial enterprises in a competition neutral manner, at the same rate as the bank tax or at least to maximise it because the disproportionate tax rate was a hindrance in the cleansing of the significant non-performing loan portfolios, also urged by the regulators.
- We proposed correcting *the rules pertaining to long-term investment agreements (LTIA)*; we requested an investor friendly option to continue part of the investment under favourable conditions when expiring LTIA's were extended.
- We also submitted questions/proposals to the tax authority and to the competent Ministry for National Economy in relation to the procedures and reporting obligations required in the *international taxation data exchange process*.

Method of notification of the switch to IFRS in 2017

Pursuant to *Article 114/C of Act C of 2000. on Accounting*, credit institutions must notify the central bank and the state tax authority of their switching to financial statements prepared according to IFRS at least 90 days in advance. Thus credit institutions which will prepare their annual report according to the International Accounting Standards from 1 January 2017 had to submit a notification on their decision for the switch by 30 September 2016. The MNB Credit Institutions Supervision Directorate waited for the notifications about the switch prepared in the form of official letters and sent by post, together with an audit report required under the law. They also had to register at NAV by completing the form generally used for reporting changes and indicating the start date of the application of IFRS.

IX. Developments at the Banking Association

MoneyWeek - Preparation, plans for 2017

and involving nearly 30 European countries in 2015 and, for the second time, in 2016, with a great deal of success and outstanding results. Owing to the supportive decision of the Board adopted on 4 July, the HBA began to make preparations for the 2017 event series. Important information, new components:

- Commissioned by the Ministry of Human Capacities (EMMI), the financial programme of the MoneyWeek will be organised by the Hungarian Banking Association and the Financial Compass Foundation.
- In 2017, enterprise development information will also be added to the topics, in relation to which the NGM and JAM⁹ will be co-organisers.
- In 2017, the topic weeks will be included in the official curriculum of the academic year and therefore, compared to the previous years, schools have already expressed increased interest.
- The schedule for the academic year was distributed by EMMI in August, and therefore instead of the 4 months, available previously, we must support the programme sooner, with a 7-month co-ordination period. (15 September 2016-15 April 2017.)
- The financial topic of the 2017 MoneyWeek is defined as “Bank Smartly” and summarises the information on payments (bank account, bank card, netbank) for different age groups among the students.

The main responsibilities of the banking association include central co-ordination, organisation of the opening event, recruitment and training of voluntary assistants from banks. The HBA invited its member institutions to join the MoneyWeek programmes with supplementary events implemented according to standard terms and conditions. Sponsor of the programme from the Board: Éva Hegedüs, Board member. Manager in charge of operational control: Levente Kovács, general secretary.

Communication statistics and recent news

The online press communicated news about the sector on 690 occasions. The number of our appearances in the printed press amounted to approximately 250, while the Hungarian Banking Association was covered in electronic media on approximately 170 times. Throughout the entire quarter, the Hungarian Banking Association had over 1,110 appearances in Hungarian media, which indicates a rather intensive period.

In the course of this quarter, we raised attention to the actual issues and problems affecting the sector in a number of declarations, interviews and professional statements made by the general

⁹ Junior Achievement Hungary Education and Enterprise Development Foundation

secretary. Main topics covered in the declarations and interviews of the general secretary: process of re-establishing contact with mortgage loan customers in default, expectations and experience related to the use of private bankruptcy, development trends of the banking sector and visible and estimated effects of digitisation. In our interviews we also covered information related to the SEPA requirements and relevant for corporate customers, the regulation and practice associated with the basic account, the integration of the reduction of commission of real property agents and we also issued a number of information declarations on online banking and card security, as they were appropriate in the summer.

Working committees and working groups not mentioned above

- *Data protection working committee*

Following a visit of the NAIH president to the Banking Association, the Data Protection Working Committee prepared the first draft of the data protection information. Then we requested a consultation with the head of the Audit Department concerning the audit procedure. The possible ways of developing the document were identified during the consultation. A detailed discussion was held about it at the September meeting of the Working Committee, which was followed by the revision of the document.

Upon a proposal of the Working Committee, we sent a letter to the Ministry for National Economy describing data protection issues related to the implementation of the *Decree No. 22/2016. (29 June) of the Minister for National Economy on the rules of providing access with equal opportunities to the financial opportunities to the financial services for disabled persons in credit institutions.*

- *Agricultural Working Group*

In the third quarter, the Agricultural Working Group had several meetings and held its first Technical Day. During the Technical Day, speakers from Szentistváni Mezőgazdasági Zrt., the Poultry Product Council, Bigecs Farm Sertésenyésztő Kft. and the Dairy Inter-sectoral Organisation and Product Council gave presentations on the present and future situation of the poultry sector, the tendencies of the pig sector and the current issues of the dairy sector. Following the meeting, the participants visited the fodder mix plant and drying, cleaning and storage facilities of the hosting farm.

The Working Group established its position on the draft decree of the Ministry of Agriculture on temporary support to certain agricultural sectors in an unfavourable position of the market provided within the framework of the Agricultural Széchenyi Card Instruments.

The Working Group consulted with the State Supervision of Public Warehouses and the Hungarian Public Warehousing Association on the major trends of modernisation of public warehousing. The discussions on that topic are likely to continue in the forthcoming quarters too.

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

- *Mortgage Bank Working Group*

The task of the Mortgage Bank Working Group is to identify and represent the joint professional interest of mortgage credit institutions and to promote the success of the mortgage bonds on the capital market. This Working Group operates on two levels. The Senior Committee is responsible for the strategic decisions, while the following sub-committees are responsible for the professional activities and detailed work on the various topics.

Based on the membership of the Hungarian Banking Association at the European Mortgage Federation and European Covered Bond Council a close cooperation has been set up between the

WG and these organizations. On the occasion of the invitation of secretary of EMF, ECBC Mr. Luca Bertalot the Senior Committee laid down the framework of EU cooperation, on which the expert Sub-committees have started the professional work.

The rules on converted independent liens entered into force on 1 October, in relation to which the **Legal Sub-committee** made proposals for *the amendment of the Act on the Civil Code, the Act on Real Property Registration, the Act on Fees and Charges and the implementation decrees*. The legislation on burden reduction related to the mortgage conversion had been promulgated on the 4th November. The sub-committee was also involved in the drafting of the standard customer information (declaration and booklet) related to the conversion elaborated by the MNB.

In the 3rd quarter, the **Valuation Sub-committee** focused on the discussion of experience of the statistics-based valuation specified in the *Decree of the Minister of Finance on the methodology principles of establishing the collateral value of real properties other than arable land*.

The main objective of the **Capital Market Sub-committee** is to take part in the drafting of the EU Mortgage Bond Directive, and therefore in the third quarter it reviewed the preparatory document prepared by the European Banking Authority in the early stage of legislation. The Sub-committee also reviews the international (EU) experience of soft bullet final repayment mortgage bonds and the credit rating practice relating to mortgage bonds.

- *Establishment of a small and medium-bank forum*

At the beginning of September, a small and medium-bank forum was established within the Association upon the initiative of the respective members. The Forum is led by Éva Hegedüs, a member of the HBA Board elected from small and medium banks. The Forum invited Dr. László Windisch, MNB deputy governor responsible for supervision to its first meeting. In his presentation, the deputy governor outlined the current role of small and medium banks in the banking sector. Concerning the potential future strategies, he believed that small and medium banks with less than HUF 500 billion balance sheet total could be successful primarily as specialist banks. The costs of banking operation (relating e.g., to compliance with the increasing expensive regulations or IT development) are increasing, and therefore minor institutions can fund their costs only if they can find the gaps on the market and are able to provide high-quality services. During the consultation after the presentation, the potential instruments with which the supervisory authority could assist the small and medium banks (e.g., distribution of model regulations) and the areas of potential co-operation of the respective banks (e.g., IT development) in order to improve efficiency were also discussed.

- *SME Working Group*

During its meeting held in the third quarter, the SME Working Group received information on the Széchenyi Grant Advancing Loan (SZTM) and Széchenyi Own Funds Supplementing Loan (SZÖK) products from the representatives of KAVOSZ Zrt. During the meeting, the speakers presented the main terms and conditions of the SZÖK and SZTM loans, and then the questions raised at the meeting were discussed.

The Working Group had a discussion in writing with the Prime Minister's Office on the issues concerning the implementation of EU schemes and submitted proposals to the Prime Minister's Office for the amendment of *Government Decree 272/2014. (5 November)* which relates to those issues.

In relation to the verification of the natural currency of EUR loans taken within the framework of Pillar II. of stage three of the Funding for Growth Scheme, the Working Group had a meeting with the MNB and the Hungarian Chamber of Auditors.

In addition it also held consultations in writing with the Public Procurement Authority on numerous occasions in relation to *Act CXLIII. of 2015 on Public Procurement*.

- *Leasing Working Group*

The Leasing Working Group involved the Legal Working Group in the discussions on the package of proposals for the amendment of Articles 69 and 72 of the Act on Credit Institutions concerning the regulation of the intermediary fees during the third quarter. The order of the Curia on a pledge established on future receivables issued under No. Gfv.VII.30.086/2016/8. was also on the agenda. According to the order and pursuant to Article 49/D. (1) of the Bankruptcy Act, the rent relating to the period prior to the start date of liquidation is encumbered by a pledge, while the creditor no longer has a pledge on any rent originating after the start date of liquidation because it is part of the assets to be involved in the liquidation.

The Working Group discussed the position statement of BISZ Zrt. concerning Article 11 (1) of Act CXXII. of 2011 on the Central Credit Information System, which relates to the mandatory date of indication in the KHR of the date of default with the date when the outstanding debt reaches the currently effective minimum wage, and the 90 days of default must be calculated from that date.

The Working Group received information from the Ministry for National Economy concerning Article 223 of Act LXVII. of 2016 on the Foundation of the Central Budget of Hungary for 2017, according to which *the draft government decree on complaint handling and the obligation of the intermediary to provide prior information* will be prepared soon, and will enter into force on 1 January 2017.

The **Government-issued Documents Sub-working Group** of the Leasing Working Group had a number of meetings in the third quarter. The main responsibility of this Working Group is to prepare a proposal package for the standardisation of the administration work in the Office of Government-issued Documents, because the different and frequently changing practical procedures and requirements of the “government windows” (single-window administration service) are causing problems during the re-registration of vehicles financed with financial leasing every day. The members of the Working Group prepared a three-page document template, presenting the main content components of a financial lease agreement and a sale and purchase agreement.

- *Macroeconomic Working Group*

We made a proposal in July to extend the discussions conducted earlier on the current status of the macro economy and the expectations of the members by inviting senior macro economists from the MNB and NGM for consultations. The experts of the authorities accepted the initiative and, in agreement with our members, supported the idea of organising such a meeting every six months. The experts had their first meeting on the extended scale in the middle of September. All the participants agreed that the short-term outlook of the Hungarian economy was fundamentally positive even with the reviewed external and Hungarian risk factors and that the main factor leading to the current situation was that, apart from the net exports, internal consumption was becoming a more dominant driving factor of the economic growth.

- *Anti-Money Laundering Working Group*

The former president of the Anti-money Laundering Working Group left the member institution that delegated him, and therefore the members elected a new president on 19 July. András Bácsfalvi was elected as the new president, who used to be the compliance director of Exim Bank and was appointed for the same position at MKB Bank in July 2016.

The new president made a proposal for the Working Group’s work plan for the next year stressing that in the near future the major task will be active participation in the implementation of the 4th AML Directive¹⁰ and support to the amendment of the AML Act. The Working Group will also

¹⁰ 4th Anti-money Laundering Directive (2015/849/EU)

concentrate on the AML risks of new products, developments related to administrative enquiries and the currently observed money laundering trends.

Co-operation with the NGM experts on the implementation of the 4th AML Directive has started; the representatives of the Working Group were invited to the next meeting of the NGM Anti-money Laundering Regulation Sub-group, where the NGM experts gave a short presentation on the transposition of the Directive

ANNEX - INTERNATIONAL OUTLOOK REGULATION AND SUPERVISION

I Global Regulation

I.1 Financial Stability Board (FSB¹¹)

The Financial Stability Board published, before the September summit of G20 leaders in Hangzhou, a letter addressed to Mark Carney, President of the FSB, as well as the second annual report of the FSB on the introduction and effects of financial regulatory reform. The *four key issues in the President's letter* were as follows:

- The financial reforms decided by the G20 work and prove to be effective also in light of shocks to the financial system; they mitigate rather than strengthen shock effects.
- The financial system is undergoing a change, it relies on market financing rather than on bank financing, which is an important positive development; at the same time, it raises new vulnerabilities to be managed by the FSB via its work supporting flexible market-based financing.
- Continuous support is needed from the G20 leaders to the full, consistent and immediate implementation of reforms, in particular to implement essential measures to manage the “too big to fail” (TBTF) issue.
- The recent years' developments point out the importance of new measures supporting a more flexible system, including sustainable globalisation based on cross-border investments.

According to the *annual report*, prepared for the second time, the implementation of these rules is continuous but not even and, as a result of the flexibility reinforced by the reforms, the state of the global financial system is good. The biggest internationally active banks are much more stable than before the crisis and fulfil the Basel III capital adequacy and liquidity standards, while maintaining lending to the real economy. The introduction of the TBTF rules is well advanced at most G-SIBs¹², but there is still a lot to do in the areas of building effective cross-border recovery regimes and making the recovery regimes of cross-border firms operable. Important results have also been achieved in strengthening the stability of financial markets, but a lot of work remains to be done with regard to the reform of OTC markets and the transfer of shadow banking activities to market financing.

This report includes the analysis of three issues revealed in the previous year's report; it examines market liquidity; the effect of reforms on emerging markets and developing economies; and the potential to maintain an open and integrated global financial system.

This report also highlights the key issues to be solved by the G20 leaders to ensure the full, timely and consistent introduction of reforms. As such, it initiates that the G20 (i) grant a legally valid authorisation to share information cross-border in order to ensure the immediate and effective operation of foreign recovery actions; (ii) eliminate legal obstacles to reporting OTC derivative transactions to trade repositories and those of access to the data by authorities; (iii) remove the other legal, data and capacity limits that set back the introduction efforts.

In addition to the above, *in Q3* the FSB *published the following reports*:

- Progress report on implementation of recommendations for reform of major interest rate benchmarks

¹¹ The highest international financial regulatory body

¹² Globally Systemically Important Banks

- Thematic peer review on and comparison of the implementation of the G20/OECD Principles of Corporate Governance.
- Discussion note on CCP resolution planning and progress report on the implementation of the CCP work plan
- Additional guidance to resolution planning and fifth report on resolution
- Progress report and action plan to address the decline in correspondent banking
- Progress report on the implementation of the OTC derivative market reform and addressing barriers to reporting transaction data
- Joint IMF, FSB and BIS publication on the elements of effective macroprudential policies
- Second progress report on measures to reduce misconduct risk
- Progress report on the Second Phase of the G20 Data Gaps Initiative

I.2 Basel Committee on Banking Supervision (BCBS)

I.2.1 Opinions and views on the finalisation of the Basel III regulation

At the end of August, the *Canadian, European and Japanese Banking Association* addressed a common letter to the Chairman of the BCBS arguing for the use of the internal rating-based (IRB) models. The authors of that letter expressed their commitment to the maintenance of the level of capitalisation already achieved and gradual compliance with the total loss-absorbing capacity (TLAC) requirements. At the same time, they pointed out that the new standards being prepared by the Basel Committee, namely the “*Reducing variation in credit risk-weighted assets*” (IRB proposal) and the related “*Revisions to the standardised approach for credit risk*” (SA proposal), would be detrimental to the economy and banking system of the authors of the letter; they would significantly increase capital requirements with no variation the riskiness of the underlying exposures and unnecessarily restrict the banks’ lending capacity.

Recently the banks spent significant resources on the use of internal approaches (to build up and control the necessary processes) and gained valuable experience in quantifying default and loss estimates, while the competent supervisory authorities gained experience in controlling internal rating-based models. In the Banking Associations’ opinion, strengthening IRB models would be the right way forward, subject to keeping their advantages. In the context of the amended BCBS standards, they state that

- The SA proposal should not result in an increase of capital requirements;
- The output floor referred to in the IRB proposal should be reconsidered (the leverage ratio already serves this backstop function);
- The scope of application of IRB models should not be constrained (especially for corporate exposures).

At the end of August, the *European Banking Federation (EBF)* presented its reservations concerning the finalisation of the so-called “Basel IV” regulation in the *media*. It held that it considers the implementation of the Basel III regulation complete; the European banking system reached the objectives originally set out in the Convention. It presented that the Basel Committee’s further proposals would greatly (according to a calculation in the base scenario, by 55%) increase capital requirements for European banks; it explained why lower risk weights, ensuring competition neutrality, follow from the characteristics of the European bank system; and also it outlined what to do to ensure that regulation acceptable for European banks is developed.

It seems that a great part of the media adopted the arguments related to competition neutrality. It is very important that European banks are not stigmatised by enjoying preferential capital requirements, while the regulatory pressure is at least as heavy as in other jurisdictions.

On 11 September, GHOS¹³ issued a press release on the finalisation of the reforms decided after the financial crisis. Under this communication, BCBS had made progress (its content is not specified) in reducing excessive variability in risk-weighted assets. GHOs discussed and evaluated the results of the ongoing cumulative impact assessment, and reaffirmed that the Committee should focus on not significantly increasing overall capital requirements.

In its mid-September meeting, BCBS also considered that the proposed changes would have too significant effects on banks setting their regulatory capital requirement using the internal model. (According to leaked information, the European stance was very firm and argued for recalibration in order to decrease the effects.)

The European members of BCBS, together with the Japanese, might be powerful enough to block the proposed finalisation of this reform, and even if the change is passed in BCBS, the European Commission might reject its implementation if it resulted in an excessive increase in European banks' capital requirements. *Valdis Dombrovskis*, Vice-President of the European Commission, the Latvian Commissioner (appointed after the Brexit vote) responsible for Financial Stability, Financial Services and Capital Markets Union, spoke about this in September more openly than ever. He stated in the conference of the European Banking Federation that *although the EU Commission supports the BCBS's efforts to mitigate the unjustified variability of risk weights, it will however not support a solution that fails to consider the characteristics of (EU) banks and is not supported by an adequate impact assessment. It is necessary to ensure that the finalised regulation treats mortgage loans, corporate and infrastructure loans appropriately. The EU Commission does not believe a standardised capital floor - on the capital requirement established using internal models - is an essential part of the framework; and it supports a regulation that works and does not put EU banks at a disadvantage compared to their global competitors.*

At the same time IIF¹⁴, operating within the IMF, encourages BCBS to be transparent when finalising the regulatory framework. They agree that the Banking Supervision Committee should comply with the regulatory condition, laid down by GHOS and confirmed by numerous other regulators (FSB, ECB, etc.) that these changes must not lead to a significant increase in the overall capital requirement. However, parallel with this, the recalibration and the measurement of the final package's effects must be made transparent as a whole, in cooperation with industry representatives.

According to information, BCBS currently works on the recalibration of pending proposals. The new version is expected to be presented at the GHOS meeting at the end of November, to be held in Santiago de Chile, while the adoption can take place, according to the most probable scenario, at the first meeting of GHOS in January.

1.2.2 Revision of securitisation frameworks; capital requirement for simple, transparent and comparable securitisation

In July, as one of the steps in the finalisation of the Basel III regulation, BCBS published the revised framework for the treatment of securitised claims, which contains the capital requirement for simple, transparent and comparable (STC) securitisation. The capital regulation replacing the 2014 standard is built on the criteria for STC securitisation developed in 2015, jointly with IOSCO¹⁵. For preferential treatment, this standard provides for the fulfillment of additional criteria. (Such as excluding transactions where the risk level of underlying transactions exceeds a certain level.) Compliance with the additional requirements grants additional security with regard to the

¹³ Governors and Heads of Supervisions: a panel of the Basel Committee's governors and heads of supervisors

¹⁴ Institute of International Finance

¹⁵ International Organization of Securities Commissions

performance of the transactions, which substantiates the mitigation of the capital requirements. The lower threshold for the STC securitised claims risk weight was decreased to 10% from 15% as set out in the November 2015 consultation paper.

I.2.3 Further publications issued by the Basel Committee in Q3

The Committee of Payment and Market Infrastructure (CPMI) prepared a technical report in line with the schedule set by the FSB on correspondent banking activities, describing visible trends and analysing measures that can decrease the costs of correspondent banking activities and the reservations related to that activity. Joint reports with the CPMI and IOSCO on regulations aiming to strengthen the stability of central counterparties, and the establishment of the unique product identifier (UPI) also fit in the global regulatory work plan. In line with its earlier practice, before the G20 meeting BCBS prepared a report on the implementation of the Basel reforms. The usual survey on compliance with the Basel III standards was published mid-September. In order to facilitate the financial inclusion of vulnerable consumers BCBS published its document titled “Guidance on the application of the Core Principles for Effective Banking Supervision to the regulation and supervision of institutions relevant to financial inclusion” (Core Principles) with regard to the affected institutions. In order to facilitate uniform application of the standards, BCBS published frequently asked questions and answers in connection with Net Stable Funding Ratio, the Pillar 3 disclosure requirements and on the supervisory framework for measuring and controlling large exposures.

II. European Regulation

II.1 General Framework

Jean-Claude Juncker, President of the European Commission, concluded, in his State of the Union Address of 20 September, that “Our European Union is, at least in part, in an existential crisis”. But never before has he seen such little common ground between the Member States, and that there are so few areas where they agree to work together. In the President’s opinion: “The next twelve months are the crucial time to deliver a better Europe: a Europe that protects; a Europe that preserves the European way of life; a Europe that empowers our citizens, a Europe that defends at home and abroad; and a Europe that takes responsibility.” Juncker submitted a forward-looking agenda for the next twelve months, consisting of specific European actions. The majority of the announced actions concerned the infocommunication area. With regard to finances, the most significant announcement was the extension of the Investment Plan for Europe, and to double the financial capacity of the European Fund for Strategic Investments.

After the mid-September EU Summit in Bratislava, the Heads of Member States confirmed their intention to cooperate after Brexit in a declaration. They welcomed the Commission President’s State of the Union Address, and undertook to present an attractive vision of the EU to their citizens, an EU worthy of support and trust. The elements of the Bratislava Roadmap, attached to that Declaration are as follows:

- I General diagnosis and objective
- II Migration and external borders (objectives and concrete measures)
- III Internal and external security (objectives and concrete measures)
- IV Economic and social development, youth (objectives and concrete measures)
- V. Way ahead

Commissioner for Financial Stability, Financial Services and Capital Markets Union Valdis Dombrovskis outlined at the Eurofi Financial Forum, held in Bratislava at the end of September, *the most important financial regulatory priorities*. Under these priorities the Commission pays special

attention to *drive forward the CMU Action Plan*, as part of it, to the overhaul to the Prospectus regime; the adoption of a Simple, Transparent and Standardised (STS) securitisation regulation; to the uniform European treatment of insolvency and bankruptcy; and to the creation of the operational conditions of a European personal pensions market. By amending the Solvency II regulation, the Commission intends to achieve that insurance funds are able to participate in the funding of European infrastructure investments. The so-called “Green bonds” scheme encourages sustainable investments.

With regard to the operational conditions for the banking industry, the establishment of the European Deposit Insurance Scheme (EDIS); revision of the Capital Requirement Regulation and Directive (CRR/CRD IV); and the improvement of the banking industry’s NPL ratio are on the agenda. With regard to risk mitigation it is an important development that all but one Member State transposed the Resolution and Deposit Insurance Directives, which enables the creation of the fiscal basis for the Single Resolution Fund (SRF), which is an essential condition for a credible banking union.

For the further development of and ensuring the coherence and predictability of the single European supervisory and regulatory mechanism, it is reviewed whether the regulation introduced during the crisis operates as intended, the principle of proportionality is adequately integrated and whether the burden of compliance can be decreased. In addition to this, decreasing reporting obligations, review of the EMIR and the establishment of recovery and resolution rules for central counterparties are also a priority.

The EU started the *preparations for the Brexit negotiations*. The Commission created an ad-hoc working group under the name of “Article 50 Task Force”, which will support the chief negotiator, Mr. Michel Barnier, appointed on 27 July. For the European Parliament, Guy Verhofstadt will be responsible for this area.

II.2 Public consultation on macro-prudential regulatory frameworks

In early August, the European Commission launched a public consultation to obtain feedback and information on the operation of the European macro-prudential regulatory frameworks. The aim of the macro-prudential regulation is to ensure the stability of the financial system as a whole, at the same time to authorise EU Member States to manage specific financial stability risks. Since this comprehensive regulatory framework has been developed gradually over the years, overlaps and inconsistencies between the various components are to be avoided. In the course of the consultations, therefore, stakeholders’ (banks, trade associations academic researchers and consumer organisations) views are requested. Macro-prudential regulatory frameworks currently consist of five regulatory elements: two regulations on the European Systemic Risk Board (ESRB), the Capital Requirements Regulation (CRR), the Capital Requirement Directive (CRD IV) and the Single Supervisory Mechanism Regulation (SSMR). The objective of the comprehensive review of these five components is to prevent all possible inconsistencies. This consultation includes issues related to narrowing and fine-tuning existing macro-prudential tools (such as capital buffers) and the organisational structure of the ESRB and its relations with the European Central Bank. The consultation period ended on 26 October; the public hearing took place on 7 November.

In the context of this consultation, Commissioner Valdis Dombrovskis emphasised the importance of finding the right balance between national flexibility and European-level coordination with regard to the macro-prudential framework. They intend to increase the tools’ effectiveness and transparency and to improve national and EU-level cooperation between authorities, including ESRB’s coordination with non-bank national supervisors and ESAs.

II.3 Banking Union

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

Speech of the Chair of the SSM at the Eurofi Financial Forum

Danièle Nouy, Chair of the SSM Board of Directors, talked about the 2016 challenges to the European banking sector at the above-mentioned Eurofi Forum. In her opinion, the banking industry lives in interesting and insecure times; since the autumn of 2008 it survived the global financial crisis, the global recession, the Eurozone debt crisis, the Eastern European geopolitical tensions and Brexit.

In recent years banks became a lot more resistant, the essential indicator of which is the banks' capital: capital adequacy grew from 9% in 2012 to 13% by now. This was confirmed by the latest stress test of the European Bank Authority; it showed that European banks would be able to resist major stress. Even so, this was not clearly positively perceived by the markets; to date European bank shares have lost more than 20% of their value in 2016. The investors' concerns is caused by the fact that resistance (capital power) is only one side of the coin, the balance sheet total, and investors are worried about the banks' profitability. This is also an important criterion for banking supervisors, since only profitable banks are able to improve their capital buffer and able to remain stable in the long term.

In addition to other reasons, such as slow economic growth, stronger competition and structural changes (e.g. digitalisation), markets are mainly concerned about two issues: long period of low interest rates and legacy assets in banks' balance sheets. Low interest rates affect European banks particularly strongly since on average net interest income makes up more than half of the income of the Eurozone large banks and, in the long term, low interest rates will certainly decrease their net interest income. In this situation, it would be an obvious solution for the banks to substitute their interest income with other sources of income, decrease their costs, and improve their cost-income ratio by revisiting their business model. Considering this, digitalisation represents more of an opportunity than a challenge. Banks have to grab the opportunity to streamline their processes, develop new products, open new sales channels and recruit new customers.

Apart from low interest rates, markets are also concerned about non-performing loans (NPL). In part of the European bank industry, the proportion of non-performing loans is still high, which devaluates balance sheets, limits the increase of loans and puts back profitability. Cleaning balance sheets is the responsibility of the banks but it cannot be done from one day to the next. The ECB Bank Supervision will issue guidelines to manage non-performing loans. In addition to banks, individual countries could improve their legal and procedural systems to facilitate work-out.

In addition to the above, markets are also concerned by a factor more structural in nature, regulation. Banks claim that higher capital requirements and uncertainty about further regulatory reforms hurt profits. Ms. Nouy agrees with this with regard to the uncertainty but she has a different view on the capital requirements. The regulatory reform was necessary since only well-capitalised banks can finance the economy throughout the entire business cycle. Studies that compare the costs and benefits of higher capital requirements have shown that the benefits outweigh the costs. However, this does not necessarily mean that more regulatory capital is always better. There should be room for supervisors' judgement and Pillar 2 capital. What banks need is regulatory certainty. Basel III will be finalised by the end of the year, and regulators are focusing on not significantly increasing overall capital requirements.

Guideline to the management of non-performing loans

On 12 September 2016, the European Central Bank launched a public consultation on the draft guidance to banks on non-performing loans. The draft is open to suggestions and comments until 15

November 2016; a public hearing is held on 7 November on this issue. The NPL guidance addresses the main aspects regarding strategy, governance and operations, which are key to successfully resolving NPLs. The guidance sets out a number of best practices that ECB Banking Supervision has identified and that will constitute the ECB's supervisory expectations going forward.

The draft guidance recommends that banks with a high level of NPLs establish a clear strategy aligned with their business plan and risk management framework to manage effectively and ultimately reduce their NPL stock in a credible, feasible and timely manner. The strategy should include setting quantitative targets by portfolio and a detailed implementation plan. The guidance urges banks to put in place appropriate governance and operations structures to deliver effective workouts.

The guidance provides short-term and long-term options on viable forbearance solutions with the aim of returning the exposure to a situation of sustainable repayment. The guidance also outlines the policies, procedures and disclosures that banks should adopt when valuing immovable property held as collateral for NPLs.

The guidance will serve the supervisor as a basis for evaluating banks' handling of NPLs. During the months following the consultation, banks will be expected to apply the finalised guidance proportionately and with appropriate urgency, in line with the scale and severity of the challenges they face due to NPL loans. Banks using national accounting standards also have to apply the principles laid down in the guidance. The guidance encourages the approximation of regulatory and accounting approaches.

Recovery plans

On 19 September, the European Central Bank held a workshop on recovery planning with the participation of the bank associations and banks from the Bank Union members of the European Banking Federation. Negotiations at this meeting were on the content and completion of tables established for recovery planning. Tables were established in accordance with the delegated regulation on the content of recovery plans, and so their completion means no additional requirement; at the same time, it facilitates the creation of compliant and consistent recovery plans.

II.3.2 The Single Resolution Mechanism (SRM)

2015 Report by the Single Resolution Board (SRB)

In line with the provisions of the regulation on the operation of the SRB, it prepared and published its activity report this year for the first time. In the first year of its existence, the priorities of the SRB were as follows: building the organisation's capacities, management structure, outlining the resolution task and competence, and developing agreements and Memorandum of Understanding (MoU) with European bodies. The SRB is responsible for developing the resolution plans for more than 120 European Union banking groups subject to its competence, to set their appropriate MREL¹⁶ level and to identify and remove the obstacles to their resolvability. It performs these tasks in close cooperation with national resolution authorities. By December 2015 they had prepared the first version of the Crisis Management Manual, covering all phases of resolution from preparation through setting and selecting resolution tools up to the implementation of the decision-making phase. The SRB also takes part in the European implementation of the TLAC regulation. In addition to the above, the management of the Single Resolution Fund and the investment of its assets are also within its competence. Based on payments by banks in 2015 and 2016, the Fund has EUR 10 billion at its disposal. Under the SRM Regulation, a five member (+two alternate members) Appeal Panel operates alongside the SRB, serving as a forum of appeal against certain decisions made by the SRB.

¹⁶ Minimum Requirement for own funds and Eligible Liabilities

In the spirit of accountability and transparency, in addition to publishing annual reports, the SRB is obliged to report to the European Council, the European Parliament, the European Commission, the national parliaments of countries participating in the Banking Union and the European Court of Auditors.

Interim MREL report by European Banking Authority (EBA)

In July the European Banking Authority published an interim report and launched a consultation on the Minimum Requirement for own funds and Eligible Liabilities. This interim report, addressed to the European Commission, informs on the legislative proposal for the future implementation of the TLAC regulation as provided for by the FSB and on the review of the MREL.

This report contains, amongst other issues, the following provisional recommendations:

- To change the reference base of MREL to RWAs (from equity + total liabilities), subject to a parallel addition of a leverage ratio exposure backstop.
- The use of CET1 capital to meet MREL and also to meet regulatory capital buffers should be avoided and the consequences of the introduction of an automatic maximum distributable amount (MDA) threshold (MDA trigger) are to be considered.
- The set of measures available for the breach of MREL requirements are to be enforced and extended.
- Business models may be worth considering when calibrating MREL to the extent they lead to differences in resolution strategies. Calibration of MREL should in all cases be closely linked to and justified by the institution's resolution strategy.
- For at least some banks, mandatory subordination of MREL-eligible liabilities would need to be introduced; in general, the transparency and publication of creditor hierarchies must be reinforced for all creditors.
- Requirements creating bail-inable liabilities to be implemented in international recognition clauses need to be streamlined.

This interim report contains preliminary results on funding capacities, but methodology reservations can exist with regard to these calculations, and so the results should be evaluated in this light.

This interim report does not cover the entire BRRD mandate; further elements will be set out in the final report, which will be submitted to the Commission by end October, as intended.

II.3.3 The European Deposit Insurance Scheme (EDIS)

As it was presented in our previous quarterly report, Member States and Members of the Parliament were rather divided with regard to the creation of the EDIS. To progress, they are waiting for the quantitative and qualitative impact assessment by the Commission, promised by end-October. In the meanwhile, the Ad-hoc Working Party (AHWP) established to strengthen the Banking Union continued with the consultations to clarify issues of a technical nature. The AHWP also negotiated on the insurance phases proposed by the Commission (reinsurance, co-insurance, full(y joint)-insurance), and the amendment options to the Commission proposal.

The Council and the Parliament both believe that making further risk-sharing decisions such as the adoption of EDIS should be conditional upon progress in risk mitigation. In the field of risk mitigation, the Parliament identified the following tasks:

- decrease of national options and discretions,
- revision of macro-prudential frameworks,
- harmonisation of national deposit insurance schemes,
- implementation of the MREL /TLAC regulation,
- making the SRF operational,
- consistent application of the bail-in regulation,
- alignment of bankruptcy regulations,

- resolution of non-performing loans,
- implementation of further prudential rules (leverage ratio, NSFR, comparability of risk weighted assets),
- managing sovereign risks.

With regard to the progress achieved in the above regulatory areas, delays in the adoption of the EDIS regulation can be projected.

II.4 Accelerating the establishment of the Capital Markets Union (CMU)

In mid-September, the European Commission issued a Communication on accelerating the creation of the Capital Markets Union, which can be divided into three phases:

- Finalising the ongoing first decided CMU measures (Prospectus Directive, securitisation, venture capital and Social Entrepreneurship Funds)
- Accelerating delivery of the next phase of CMU actions (insolvency regulations, tax refund, Juncker Plan to support infrastructure investments)
- Developing further priorities (personal pension products, action plan on retail financial services, green bonds, coordinated treatment for FinTech companies, covered bonds, reinforcing supervision), elimination of obstacles to free movement of capital.

In the context of accelerating CMU, Valdis Dombrovskis emphasised the following at a conference: Completing the Capital Markets Union as soon as possible plays an important role in the promotion of the final goals of the Commission, growth and employment. In the year following the launch of the Action Plan, the Commission developed its proposals on streamlining the Prospectus Directive, the relaunch of the securitisation market, and reinforcement of the European Capital Markets and support for social investments. This can help to improve access to financing by businesses, more precisely by SMEs. Currently the ball is with the Parliament and the Council to adopt these new rules by the end of the year.

The Vice-President highlighted the reform of the insolvency regulation out of the new priorities aiming at the elimination of obstacles to free movement of capital. The Commission submits a proposal to implement effective restructuring regimes, while classifying various insolvency regimes, pointing out those in need of reforms.

Investment decisions are highly influenced by taxation matters. In cooperation with the Member States, the Commission takes efforts to avoid double taxation and to develop a Code of Conduct supporting best practices. They want to terminate the distortion where taking out a loan can be more favourable (from the taxation point of view) than issuing shares.

The Capital Markets Union must also extend the pension savings options. They pay greater attention to retail investors that they are able to choose from the widest possible investment portfolio and to compare the long-term yields on individual investments. The Commission puts great emphasis on ensuring the transparency of fees and commissions greatly affecting yields. They seek to create a single European market for retail services (insurance, pension, lending and deposits) where FinTech service providers/services play a primary role.

Support for switching to a low-carbon economy by the financial sector is also a priority; they are setting up an expert group to develop a comprehensive European strategy for green financing.

II.5 Structural reform

In September, Commissioner Valdis Dombrovskis addressed a letter to the Parliamentary rapporteur and shadow rapporteur for the Banking Structural Reform (BSR). This letter stated that the

Commission continues to be committed to the implementation of this structural reform and offered its assistance to develop the joint Parliamentary position.

According to the information, the PPE Group of the European Parliament would rather withdraw that legislative proposal. According to rapporteur Gunnar Hökmar, this proposal is blocked in political terms, and despite numerous compromises no common ground could be reached. Despite this, he would not find a meeting with the Commissioner pointless.

The EBF monitors these events and, if it deems it necessary, it will again let the competent bodies know the views of the industry, under which it is redundant to revisit the structural reforms in the light of the new regulations (reinforced supervision of large banks, FRTB¹⁷, BRRD, TLAC/MREL, CRR/CRD4).

II.6 European Banking Authority

II.6.1 Results of the 2016 EU stress test

At the end of July EBA published the results of the 2016 stress test. In this test 51 banks from 15 EEA countries participated, covering some 70% of all jurisdictions and banking assets within the EU. The aim of this test was to compare and evaluate consistently, subject to common analytic frameworks, the extent to which large EU banks are able to resist unfavourable economic effects. The results showed that in recent years the industry has greatly reinforced its capital position. According to end-2015 data, the CET1¹⁸ capital adequacy ratio was 13.2%. (This is 200 basis points higher than the end of 2014 and 400 points higher than the 2011 figure.) In the event of the unfavourable scenario set out by the ESRB, this proportion would decrease by the end of 2018 by 380 basis points to 9.4% on average. (This decrease would consist of -370 basis points from lending losses, -110 from operating risks and -100 basis points from market risks; negative effects are partly compensated for by profits before provisioning.) Assuming an unfavourable scenario, the overall leverage ratio would drop from 5.2% to 4.2%.

In the context of this stress, no failure threshold was set. The results serve as information for supervisors and provide orientation to efforts aiming to maintain the system's capital, healing balance sheets and lending to the real economy. Accordingly, the results from these stress tests are important inputs to the 2016 Supervisory Review and Evaluation Process (SREP).

The aggregate and individual results from this stress test are accessible, in an exemplarily transparent manner, on the EBA website (more than 16,000 data per bank).

II.6.2 Foreword from the Chairman of the EBA to the meeting of the European Parliament's Committee on Economic and Monetary Affairs (ECON)

At a hearing in the 26 September ECON meeting, the Chairman of the EBA explained, with reference to the test results, that the reinforcement of the banks' capital position proved to be effective but further progress is needed to treat the remaining vulnerabilities of the sector. Although the capital reinforcement created the conditions for the cleaning of balance sheets, improvement of asset quality was slow and uneven. The ratio of non-performing loans (NPL) in the EU is 5.7%, which is three times as high as in other jurisdictions. In ten Member States the NPL ratio is above 12%. This high NPL ratio pushes the already weak profitability further down and decreases the access to loans by businesses and households. EBA proposes a threefold measure to manage this high NPL ratio: (1) to increase supervisory pressure to decrease the NPL ratio, to set quantitative and qualitative targets; (2) legislative treatment of structural (accounting and taxation) issues; and (3) improving the operation of secondary markets to be able to sell bad loans.

¹⁷ Fundamental Review of the Trading Book

¹⁸ Common equity tier 1

Banks' balance sheets and corporate structures are also influenced by the new BRRD requirements. Resolution authorities are working on the finalisation of resolution plans and resolvability assessments and setting the expected MREL level, and implementing the TLAC requirements set by the Financial Stability Board for global large banks.

In his foreword, Mr. Enria mentioned the efforts to decrease the unintended variability of RWAs, to reinforce the application of proportionality and challenges set by the progress of technology. He also mentioned that frequent questions and replies help to establish a consistent supervisory practice without entering into the area of legislation within the competence of the Commission.

II.6.3 Q2/2016 Risk Dashboard

According to the Risk Dashboard published by the EBA at the end of September, the key issues for the European bank industry are low profitability and the high NPL ratio. In Q2, the average CET1 capital adequacy ratio of European banks was 13.5%, slightly (10 basis points) higher than in the previous quarter. This change is partly explained by the growth of capital (undistributed profits), and partly by a slight decrease in the RWAs. Portfolio quality somewhat improved (the NPL ratio decreased also by 10 basis points, to 5.5%), but is still cause for concern. Data for individual countries show great variation, between 1% to nearly 50%; smaller banks typically show higher NPL values. Collateral coverage of non-performing loans (43.9%) improved slightly (10 basis points). Profitability is unchanged (the annualised ROE is 5.7%), but nearly 1 percentage point lower than the figure in Q2 2015. Difference between countries are rather high in this field; ROE values range from -16% to +19%. The net interest margin remained on the decreasing trend, although only just. The loan-deposit ratio also decreased, it was nearly 120.5% at the end of the quarter.

II.6.4 Reporting and publication obligations

The European Banking Authority proposed that information from the supervisory reports for individual banks could be posted on the EBA website, thus making them accessible for the public. Currently EBF consults its members to form a common position on the EBA proposal.

II.6.5 Other relevant EBA's documents in Q3

Guidelines

Guidelines on communication between supervisors and statutory auditors (EBA/GL/2016/05)

Final guidelines on the remuneration of sales staff (EBA/GL/2016/06)

Final guidelines on the application of the definition of default (EBA/GL/2016/07)

Consultation papers

Consultation paper on the appropriate target level basis for resolution financing arrangements under BRRD (EBA/CP/2016/08)

Consultation paper on Guidelines on the treatment of connected clients for large exposures (EBA/CP/2016/09)

Consultation paper on Guidelines on credit risk management practices and accounting for expected credit losses (EBA/CP/2016/10)

Opinions

Report on the benchmarking of diversity practices at European Union Level (EBA/OP/2016/10)

Introducing the Leverage Ratio in the EU (EBA/OP/2016/13)

Report on core funding ratio (EBA/OP/2016/15)

ESAs reject proposed amendments from the European Commission to technical standards on non-centrally cleared OTC derivatives

Regulatory and implementing technical standards

Final draft Regulatory Technical Standards on assessment methodology for IRB approach (EBA/RTS/2016/03)

Final draft RTS on preferential treatment in cross-border intragroup financial support (EBA/RTS/2016/04)

Amendments technical standards on benchmarking of internal approaches

Revised list of ITS validation rules

Final draft technical standards on information exchange between authorities regarding qualifying holdings (EBA/ITS/2016/05)

Reports and other documents

Report on asset encumbrance

Comparative report on governance arrangements and indicators for recovery plans

Details of 2016 transparency exercise

Second update on the monitoring of Additional Tier 1 (AT1) instruments of EU institutions

Report on the convergence of supervisory practices

Report on non-performing loans in EU banking sector

List of designated Resolution Authorities

Indicators from 36 global systemically important institutions

Input based on the Single Rulebook Q&As to the European Commission's CRR-CRD4 review

Joint Committee report on risks and vulnerabilities in the EU financial system

Updated CET1 list

Results of the CRR- CRD4/Basel III monitoring exercise as of 31 December 2015