MAGYAR BANKSZÖVETSÉG

HUNGARIAN BANKING ASSOCIATION

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REPORT

on Activities of the Hungarian Banking Association

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I. Executive Summary

In Q1 2018, the ***global economy continued to grow at an accelerated pace***. According to the IMF, after last year's 3.8% growth, the figure could reach 3.9%, both this year and next year. The global monetary conditions are still supportive of growth, even though market returns are rising in the advanced economies due to slowly accelerating inflation. The increase in investments continues to boost growth and global trade cannot yet feel the effects of the protectionist measures of the USA, either.

The annual real growth rate of the ***US economy*** was slightly lower than in the previous quarter and reached 2.3%. This time it was mainly the investments of the private sector that contributed to the growth but domestic consumption also played a major role. The stimulating impact of the major tax cut cannot be felt yet, but a 0.5-1 percentage point GDP rise is projected in that context for the rest of the year. However, the economic recovery financed from the budget may add to the imbalance in an economy using its peak capacity, with almost full employment. The 25 basis point rate increase by Fed in March was in line with expectations.

The economic growth of the European Union has been rising steadily since 2014 without any major dynamism. The political risks (delay in the forming of governments in Germany and Italy, loss of Macron's popularity, uncertainties around Brexit) did not affect the performance of the economy; with the help of the upturn in the global economy, the EU economies grew by 2.5% on a year on year basis. Domestic consumption remained the main driving force behind economic growth, but it is followed increasingly closely by investments and, despite the stronger euro, net exports are also remarkable.

Growth in Japan seems to have broken down, as the performance of the economy shrank by 0.4% in the first quarter. The ***Chinese growth*** surpassed the analysts' expectations, and exceeded 6.8% on a yearly basis. The measures taken for the reduction of lending and speculative real estate development have so far not managed to slow growth. ***The growth rate has slowed down a little in Russia*** (1.3% on a year on year basis) but the reports attribute it to the especially cold weather.

Owing to the favourable global economic conditions and the upturn in Europe, ***the Hungarian economy performed well in the first quarter,*** similarly to most of our regional competitors. During the quarter GDP growth was ***4.7%***, with which our country was in a top position within the European Union. In production, growth stemmed primarily from an increase in market services and trade, as well as the construction industry; compared to the high base figure of the previous year, industrial output rose by only 2.5%. On the consumption side, the earlier trends continued: domestic consumption and capital investments remained the main driving forces. In the labour market, employment (68.7%) and unemployment (3.9%) stabilised at the level measured last autumn, while the ratio of public employment decreased. Public employment in sectors not requiring qualifications may ease the tensions on the demand side of the labour market. Wages increased by almost 13 per cent during the year. There were no changes in the inflation processes; on average there was a 2% price increase during the quarter and the 2.5% core inflation was also below the central bank's target. The budget deficit, on a cash basis, calculated until the end of March, turned out to be high, just as last year, nearing HUF 872 billion, which corresponds to 67% of the annual appropriation. The primary reason for the deficit was the fact that projects to be funded from EU sources had to be pre-financed from the budget. However, the 2.4% target budget deficit calculated using the EU methodology is not at risk, according to the experts. Due to the steep rise in domestic demand, the current account surplus also continues to decrease gradually. The central bank of Hungary (Magyar Nemzeti Bank (MNB)) continued its previous monetary policy and kept the reference interest rate at the same level. The EUR- HUF exchange rate continued to fluctuate within a relatively narrow range (308-314) during the quarter.

In 2018 Q1, ***the aggregated balance sheet total* of *the credit institutions increased by 2.2%*** (HUF 789 billion). ***On the liability side,*** each major type of fund grew, apart from the issued securities; the total gross deposit portfolio grew by 2.3%, HUF 554 billion. In line with the trends of the last period, the average term of deposit portfolios continued to shorten. The increase in the deposit portfolio affected all sectors, but the gross household portfolios achieved the highest growth (3.2%, HUF 274 billion). There was a slight decrease in the portfolio of issued securities. Despite the positive results of the first quarter, equity decreased slightly (by 0.6%, HUF 23 billion), which may be related partly to dividend payments and partly to accrued dividends. On the ***assets*** side***,*** the portfolio of each major asset type increased. The loan portfolio grew more moderately, by 1.2% (HUF 231 billion) in the first quarter. By volume, the gross loan portfolio reflected the same growth rate, i.e., the impairment, the valuation difference and the accrued interest had a neutral effect overall on the portfolio. The gross loan portfolio of the non-financial corporate sector expanded by only 1%, which was somewhat lower than the average; the impairment recognised on that portfolio was greater than the reversals. The gross household portfolio also shrank slightly but the reversed impairment compensated for it. As a result of the above factors, the credit institutions sector's net loan-to-deposit ratio decreased to 88% (76% without interbank loan portfolios).
The ***profit*** was similar to that in the same period in the previous year and reached HUF 188 billion. On an annualised basis, it reflects a 18.2% return on equity and 2.1% return on assets. Adjusted with one-off effects, dividend income of subsidiaries (reversed impairment and provisions), the banking sector generated only HUF 87 billion profit, which translates into an 8.4% return on equity and 1% return on assets across the year. Compared to the earlier trends, net interest income increased and the result of other financial and investment activities also improved, while the net fee and commission income decreased.

In ***retail lending,*** both banks and regulatory authorities strive towards responsible lending, making access to loans easier and providing adequate information to consumers.
The "declaratory principle", introduced within the framework of ***simplification of the rules of the subsidy in the Home Purchase Subsidy Scheme for Families (CSOK)*** allows for the omission of certain certificates and documents, which in the past had to be presented on paper. The extension of the deadline for CSOK application and a better situation for applicants returning home from abroad may also be favourable for CSOK applicants. If ***access to the NAV income database is granted to creditors,*** the credit approval process will become easier and creditors' security will improve. So far, the consultations had been held at a concept level. In this phase the MNB, which is in support of the proposal, had separate consultations with the National Tax and Customs Administration (NAV) and the lenders.
The draft recommendation on promoting the transparency of information on the interest risk of MNB mortgage loans and the introduction of the annual percentage rate adjusted with interest expectations (KTHM) intend to improve the supply of information to, and risk-awareness of customers.

The ***MNB*** intends to introduce the ***Interbank Funding Ratio*** (IFR), which is aimed at increasing the security in accessing bank funds. It is favourable for the banks that, as a result of the consultations, a relatively wide range of ***refinancing sources*** were removed from the scope of potential restriction, while accounts kept for other banks and funds received from foreign parent institutions may be recognised with favourable weights. The institutions must comply with the regulation published on 27 March and entering into force on 1 July on a consolidated basis. Simultaneously with the introduction of the IFR, the ***Foreign Exchange Funding Adequacy Ratio*** (FFAR) will also be modified to function as a kind of currency NSFR indicator in the future.
The most important task in ***reporting*** is the implementation of the ***HITREG project,*** which is aimed at building an analytical credit register at the central bank. The project imposes a rather larger IT development burden on credit institutions, while it is uncertain which other reporting obligations will be terminated with the introduction of the HITREG database and from when it will apply.

The Hungarian Banking Association proposed an amendment of the ***MNB Decree on online identification and filtering systems*** in relation to the Act on the Prevention and Combating of Money Laundering and Terrorist Financing. Our proposal would make it easier to re-identify previously identified customers and it specifies exactly the scope of the audit of customer due diligence.

Our association prepared a detailed draft proposal for the Ministry of Justice ***for the amendment of the legal regulations governing the financial sector*** in relation to the entry into force of the EU General Data Protection Regulation (GDPR) ***and the amendment of the Information Law.*** In our opinion, we also presented the expected economic impacts of the data protection reform.

Banking human resources were intensively occupied with the establishment of the conditions of ***electronic communication with authorities and institutions*** and with building the required connections. Since 1 January 2018, business organizations have had an obligation to use the ***company gateway,*** and therefore banks also use it to communicate (receive and submit documents) with various authorities, including the courts.
Following the practice of ***disclosure of bank secret for national security and criminal investigation purposes***, which has existed for decades, the competent authorities have a ***new demand for data*** in relation to the options of digitisation and such demands were also supported by the applicable legal regulations. In the near future, banks must establish an ***electronic data connection*** with the Special Service for National Security (NBSZ). As a result of the top-level consultations held on the topic, the Hungarian National Authority for Data Protection and Freedom of Information (NAIH) will inspect the pilot system recommended by NBSZ to be established with only one bank and will approve it before it is applied generally.
The Act on Criminal Procedure, entering into force on 1 July 2018, ***will introduce a new covert instrument, i.e., surveillance of payment transactions and the suspension of transactions when so requested by the authorities***. The draft government decree, containing the detailed provisions applicable, is being discussed with the stakeholders by the Ministry of Interior.
Electronic data supply to civil law notaries in inheritance procedures and ***electronic data supply to liquidators*** are also new tasks for the banks, the details of which were discussed between the Banking Association and the competent organisations, i.e., the Hungarian Chamber of Civil Law Notaries and the Hungarian Association of Insolvency Practitioners, in several rounds.

In relation to the implementation of the new Act on attorneys-at-law, the legal counsel ad hoc working group reviewed the ***temporary delegation policy of the Hungarian Bar Association.*** On the basis of the policy, the eligible parties elected the ***national legal counsel section*** at the end of February, led by Bálint Csere, the Head of Legal Directorate at OTP Bank.

In terms of the ***implementation of the second Payment Services Directive (PSD2),*** the adjustment of the entry into force of the regulatory technical standards (RTS) to be issued by the EBA to their application in the European Union by the legislator was a fundamental issue for the Hungarian banks. The Ministry for National Economy (NGM), which is responsible for the legal regulation, gave a promise to extend the implementation deadline of 1 January 2019 stated in the Payment Services Act. The MNB opened a ***Frequently asked questions and answers*** page on its website to promote the consistent application of PSD2.
A Payments Working Group formed a sub-working group to interpret the ***three regulations related to the Payment Accounts Directive (PAD)*** and the tasks associated with them. The sub-working group identified the issues to be clarified and contacted the competent regulatory authorities, the NGM and the MNB in order to find solutions.

The ***Instant Payment System project*** entered a new phase at the beginning of the year when the MNB selected the ***vendor for the settlement system***. The contract was awarded to the Danish NETS A/S company, which has already been involved in the implementation of a number of similar

settlement systems, including the Danish system. According to the schedule, the instant payment service will become available in Hungary in July 2019. The Project Steering Committee will decide in the near future as to whether the service will require an ***independent payment brand***.
As a result of the supervisory inspection relating to the ***Giro bank account switch,*** the legitimate reasons that can be used to reject closing an account should be reduced. Following the consultations of the Banking Association, the banks made a proposal to revise the list of the reasons for rejection.

According to the latest data from the MNB, ***in 2017 the bank card acquiring network expanded by 25 per cent,*** and electronic payment turnover grew dynamically. The terminal installation programme of the NGM had a major role in the expansion of the acquiring network. Last year two thirds of card purchases were made using fast and convenient ***contactless payments***.
The implementation of PSD2 will affect the card business through the application ***of strong customer authentication and the changing compensation and refund rules***.
It will cause a problem to the institutions issuing ***Széchenyi Recreation Cards (SZÉP cards)*** if they have to transform the card issue into a payment service in compliance with the PSD2 requirements. Given the effect of the judgment of the European Court of Justice, the competence of the Hungarian legislator is strongly limited and it is doubtful whether there could be a solution to prevent the replacement of the existing cards already in circulation.

In terms of importance, ***cyber security,*** the implementation of ***the customer security programme (CSP),*** as well as the widening of the use of the ***new SWIFT correspondent banking service*** (***GPI***: global payment innovation) continue to be at the top in the ***SWIFT*** programme.
The credit transfer scheme of the ***Single Euro Payments Area (SEPA),*** known as ***SEPA Credit Transfer Scheme*** (SCTS), was introduced in practice on 28 January 2008. Initially 10 credit institutions joined the scheme and they were followed by 18 other institutions, partly because of the effect of the SEPA End-Date Regulation; as such, there are currently 28 Hungarian SCTS members registered by the European Payments Council (EPC).

Upon the initiative of the European Banking Federation and within the spirit of developing financial literacy and awareness, the ***European Money Week*** was organised for the fourth time this year. The ***Hungarian Money Week*** achieved a unique result in Europe and was conducted on the financial topic of '***Becoming Loan Savvy'*** and on the business topic of '***Business Ideas and Collaboration***' with the involvement of more than 200,000 students, 1,249 schools and 1,645 registered teachers. The opening of the FINTELLIGENCE Financial Education Centre at the University of Miskolc and the presentation of the first financial literacy textbook written in Hungarian were the major events of the Money Week outside Budapest.

The *Financial Stability Board (FSB),* which has a dominant role in ***global regulation***, set the following priorities for the subsequent period: (i) Careful monitoring for the recognition/identification, assessment and management of new and emerging risks. (ii) Prudent completion of the outstanding G20 financial reform priorities. (iii) Shifting the focus from the new sectoral policy initiatives to the assessment of implemented regulations. (iv) Optimisation of the activities of FSB in order to maximise efficiency.
The agenda of the FSB for the first quarter included, among others, the unique transaction identifier, the monitoring of shadow banking activities in 2017, the decline in correspondent banking activities and a supplementary guide to the right remuneration practices.

Following the finalisation of the Basel III regulation in December 2017, the main tasks of the ***Basel Committee on Banking Supervision (BCBS)*** show numerous overlaps with the FSB priorities but they also include the promotion of strong supervision. At its meeting held in March, the Committee agreed on the amendment of the trading book regulation published in January 2016 and confirmed that the new rules would have to be applied from January 2022. Following the consultation process,

it finalised the assessment framework of global systematically important banks. The BCBS also agreed on the capital requirement for short-term, simple, transparent and comparable securitisation and will soon publish the applicable standard.
The Committee is working on the evaluation methods of the implementation of Basel III. The assessment of consistent implementation will be voluntary. Analysing the market processes, the BCBS discussed the impact of the volatility of the financial market on the stability of the banking system and the consequences of the dissemination of crypto currencies. During the quarter, a number of Basel documents (e.g., '*Impact of the fintech development on banks and supervisions'*, *'Central bank digital currencies'*) focused on technical challenges and innovations.

The ***European legislators*** (the Parliament and the Council) have not yet achieved any major progress in the approval of the ***risk reduction package of November 2016,*** implementing the elements of the Basel III regulation accepted so far. Nevertheless, the European Commission initiated an explanatory consultation on the ***impacts*** of the finalisation of the Basel III regulation in December 2017 ***on the European banking sector and on the wider economy***.
The initiatives related to non-performing exposures (NPE/NPL) may have the most serious consequences on the European banking system. The European Commission presented an initiative of four components in March to reduce banks' existing NPL portfolios and to prevent the accumulation of new NPL exposures. The ***European Central Bank had also regulated the provisioning for the NPL loans*** at the banks under its supervision prior to the Committee's proposal and continued to do so at the time the proposal was made.
During the quarter, the European Commission also made numerous important legislative proposals for the ***establishment of the Capital Markets Union*** (management of European covered bonds, cross-border trade in investment funds, decision on the legislation applicable to cross-border transactions affecting receivables and securities.

II. Macroeconomic outlook, operational environment of the banking sector

In Q1 2018, the ***global economy continued to grow at an accelerated pace***. Contrary to the former assumption that global growth in 2017 was a local peak, after which growth will decline, according to the latest projections the current rate seems to be sustainable for one or two more years. According to the IMF, after last year's 3.8% growth, the figure could reach 3.9% both this year and next year. The global monetary conditions still support growth, even though market returns are rising in the advanced economies due to slowly accelerating inflation. The increase in investments gave a further push to growth and global trade cannot yet feel the effects of the protectionist measures of the USA.
The seasonally adjusted ***annual real growth rate of the US economy reached 2.3%,*** which is half a percentage point lower than the figure measured in the previous quarter. This time it was mainly the investments of the private sector that contributed to the growth. Domestic consumption has shrunk since the previous quarter but continues to be significant, with net exports and government sector expenditure having only a slight impact. In March the Fed increased the reference rate by 25 basis points, pushing it to 1.75%. The impact of the major tax cut cannot be felt yet, but a 0.5-1 percentage point GDP rise is projected in that context for the rest of the year. However, the economic recovery financed from the budget may add to the imbalance. In an economy using its peak capacity with almost full employment, a fiscal stimulus may result in lower growth than would be potentially feasible and may overheat the economy, causing significant budget tensions, which may only be increased by the risks of deficit financing.
The economic growth of the European Union has been rising steadily since 2014 without any major dynamism. The previous political risks did not influence economic output yet continued to exist. In Germany, a government was formed almost six months after the elections and there was a delay of a number of months in Italy too, while in France dissatisfaction is growing against the administration elected with a convincing majority. The Brexit shambles continues to be a risk, but the exit of the UK offers an opportunity to reform the EU. With the help of the global economic upturn, the economies of the European Union achieved 2.5% growth in the first quarter on a year on year basis. Domestic consumption remained the main driving force behind the economic growth, but it is followed increasingly closely by investments and, despite the stronger euro, net exports are also remarkable. Inflation is still much lower than the target and therefore the monetary conditions continue to be loose.
Growth in Japan seems to have broken down, as the performance of the economy shrank by 0.4% in the first quarter. This is primarily due to the deterioration of the business expectations of industrial manufacturers, higher inflation and the unfavourable effect of the still depressed wage increase on domestic consumption. Experts believe that the decline will be temporary, because the demand from the main business partners towards Japan continues to be intensive.
The Chinese growth *in the first quarter of the year* ***surpassed the analysts' expectations***, and exceeded 6.8% on a yearly basis. It is driven primarily by the stable domestic consumption, while the net exports have a braking effect. The measures taken for the reduction of lending and speculative real estate development have so far not managed to slow growth.
The growth rate has slowed down a little in Russia (1.3% in the first quarter on year/year basis) but the first reports attribute it to the especially cold weather.

Owing to the favourable global economic conditions and the upturn in Europe, ***the Hungarian economy performed well in the first quarter,*** similarly to most of our regional competitors. According to the first KSH estimate, in comparison with the same period of the previous year, during the quarter GDP growth was ***4.7%*** after seasonal and working day adjustments, with which our country was in a top position within the European Union.
In production, growth stemmed primarily from an increase in market services and trade, as well as the construction industry, although the 19% expansion of the latter was also due to the 8% average

price increase in the sector. Compared to the high base figure of the previous year, industrial output rose by only 2.5%.

On the consumption side, the earlier trends continued. The most important demand factor continues to be domestic consumption, which is also supported by good retail figures (7.7% quarterly increase on a year/year basis). The indicators also suggest favourable changes in investments. The increase in imports, driven by the increasing domestic demand, reduces the foreign trade surplus, which dropped from the HUF 770 billion reported in Q1 2017 to HUF 651 billion in Q1 2018.

In the ***labour market,*** employment (68.7%) and unemployment (3.9%) stabilised at the level measured last autumn. The proportion of those in employment as public workers continued to fall. If they were also included in the unemployed, the overall unemployment rate would be 7-8%. Public employment in sectors not requiring qualifications may ease the tensions on the demand side of the labour market. Wages increased by almost 13 per cent during the year.

There were no changes in the ***inflation processes;*** annual prices continued to decline slightly until February, followed by an increase in March, resulting on average in a 2% price increase during the quarter. Core inflation stood at 2.5%, which was also lower than the central bank's target. The increase in wages did not have any major impact on inflation, which was held back by the moderate inflation processes of the euro zone and the reduction in contributions parallel to wages.

The ***budget*** deficit, on a cash basis, calculated until the end of March, turned out to be high, just as last year in the range of HUF 872 billion, which corresponds to 67% of the annual appropriation. It was caused primarily by the pre-financing of projects to be implemented from EU funds from the budget, in the amount of almost HUF six hundred billion by the end of March (the EU transferred HUF 61 billion from the HUF 652 billion financing). However, according to the experts, the 2.4% target budget deficit calculated with the EU methodology (adjusted with EU pre-financing) is not at risk.

Due to the steep rise in domestic demand, ***the current account surplus*** is expected to continue to decrease gradually.

The central bank of Hungary (Magyar Nemzeti Bank) continued its previous ***monetary policy*** and kept the reference interest rate at the same level.

The ***EUR- HUF exchange*** rate continued to fluctuate within a relatively narrow band (308-314).

In 2018 Q1, ***the aggregated balance sheet total* of *the credit institutions increased by 2.2%*** (HUF 789 billion). The HUF portfolios did not expand at the same rate. The stronger euro had only a slight effect on the increase of the euro portfolios expressed in HUF and the weakening of other major currencies did not offset their nominal increase either.

On the liability side, each major type of funds grew, apart from the issued securities. The total gross ***deposit portfolio*** expanded by HUF 554 billion (2.3%). Within that, inter-bank deposits increased below the average and other deposits expanded at an average rate (by 1.7 and 2.4%, respectively). The main reason for the growth was an increase in domestic portfolios while, in total, foreign deposits declined to a negligible extent (by less than half a per cent). In line with the trends of the last period, the average term of deposit portfolios continued to shorten. What changed within that framework is that, with the current account and sight deposit l portfolios, the short-term deposit portfolio also expanded. It was the result of an increase in short-term deposit taking of financial enterprises and other non-monetary financial institutions. The decline in long-term deposits was primarily due to the shrinking of the portfolio of monetary institutions, while moderate growth could be detected in a number of other sectors.

The deposit increase affected all sectors; primarily the 3.2% increase in the gross portfolio of households (HUF 274 billion) should be highlighted, but public institutions and other financial institutions also increased their deposits by more than 3%.

Despite the shorter maturities referred to above, within the inter-bank liabilities, which also includes inter-bank loans, the terms extended significantly in the total portfolio: while the short-term deposit portfolio contracted by 4.6% (HUF 95 billion), the long-term portfolio expanded by 6.4% (HUF 366 billion).

During the period the portfolio of issued securities declined slightly (by -2.9%, HUF 65 billion).
Despite the positive results of the first quarter, ***equity decreased slightly*** (by 0.6%, HUF 23 billion), which may be related partly to dividend payments and partly to accrued dividends.
Within the ***asset portfolio,*** the portfolio of each major asset type increased. In nominal terms, the expansion was balanced (slightly above HUF 200 billion in each item), in a number of asset types (inter-bank deposits, loans, securities) but there are major differences in the growth rate.
Compared to the average dynamism of the previous year, which reached almost 2% in each quarter, the ***loan portfolio*** grew more moderately, by 1.2% (HUF 231 billion) in the first quarter. By volume, the gross loan portfolio reflected the same growth rate, i.e., the impairment, the valuation difference and the accrued interest had a neutral effect overall on the portfolio. The domestic gross portfolios expanded similarly to the net portfolios (1.8%, HUF 290 billion) owing to the significantly falling (-6.5%) impairment. The value of foreign loans reduced both on a gross (-2.2%), and on a net basis.
In the non-financial corporate sector, a moderate, lower than average, gross portfolio increase took place (1%, HUF 88 billion) and there, across the banking system, impairment was recognised instead of the reversed impairment observed in the past (7.9%, HUF 26 billion). The gross household portfolio also shrank slightly (-0.4%, HUF 24 billion) but the reversed impairment (HUF 46 billion) compensated for it.
In the other asset categories, the increase in interbank loans and deposits needs to be mentioned (4.5%, HUF 341 billion). Within that, the assets held by the MNB, mostly account balances, fell by almost 14% (HUF 253 billion). The 3.5% rise in domestic government securities (HUF 290 billion) and the restructuring towards longer-term securities were also remarkable trends.
As a result of the above effects, ***the credit institutions sector's net loan-to-deposit ratio decreased to 88%*** (76% without interbank loan portfolios).
The ***profit*** was similar to that in the same period in the previous year and reached HUF 188 billion (HUF 190 billion in Q1 2017). On an annualised basis it reflects a 18.2% return on equity and 2.1% return on assets. Besides the dividend income of subsidiaries, realised in the highest amount in Q1 and representing a one-off item, which distorts the above profit figure the most, impairment and reversed provisions had only a minor effect. Without those items, the banking sector earned in total HUF 87 billion in profit, which corresponds to an 8.4% return on equity and a 1% return on assets on an annualised basis. Compared to the former trends, net interest income increased and the result of other financial and investment activities also improved, while the net fee and commission income decreased. In the first quarter of the year, administrative costs went up by 3% compared to the same period of the previous year and, within those, staff costs grew by 8.5%, which is below the wage increase in the national economy.

III. Corporate sector

In the last quarter of 2017, the dynamic increase in corporate lending continued and therefore, as a result of the transactions, the corporate loan portfolio expanded by 10.4% by annual comparison. Also including the self-employed, the loan portfolio of the SME sector grew by almost 12%. In the fourth quarter, the balance of transactions was HUF 184 billion and therefore in 2017 the total corporate loan portfolio increase was more than twice as much as in the previous year. The volume of new loan agreements signed in 2017 was 30% up from the figure recorded one year before and the average loan amounts also increased.
On the basis of the bank responses to the lending survey, in the fourth quarter the lending terms and conditions were eased in both corporate size categories. As a result, according to the responses of the institutions taking part in the survey, the demand for loans increased both in the large corporate and SME segments, giving a further boost to the competition between banks, and leading to a decline in interest premiums. Looking ahead to the next six months, the banks expect the same processes to continue, especially in the case of long-term loans.

Results of phase two of the Market-based Lending Scheme

In view of the achievements of the Market-based Lending Scheme (PHP) launched by the MNB in 2016, which exceeded the expectations for the year, in May 2017 the Monetary Council decided to launch phase two of the PHP. As a result, the banks' commitments to lending increased on average by 34% (from HUF 170 billion to HUF 227 billion) and at the end of 2017 each bank performing lending activity-based interest rate swap transactions (HIIRS) had fulfilled their commitments. As a result, the banks' performance was much higher than one year before and was close to 250% at sector level.

IV. Retail sector

According to the MNB March lending report, "at the end of 2017, household loan transactions cut the loan portfolio by HUF 14 billion, but there was a 2.7 per cent growth over the last 12 months. The volume of new contracts amounted to a total of HUF 326 billion in the fourth quarter, which represents a 41 per cent growth as an annual average. Within the total volume, new housing loans grew by 39 and personal loans grew by 47 per cent, compared to last year. During the quarter, 19 per cent of new housing loans, approximately HUF 33 billion, were disbursed for the construction or purchase of new homes.
On the basis of the responses in the Lending Survey, the banks eased the conditions of their consumer loans by reducing the premiums and the payment to income ratio expected by the banks. In addition, a considerable number of banks indicated further easing in the housing loan conditions over the next six months as competition increases and the Certified Consumer-Friendly Housing Loans are expected to become more widespread. According to the banks' perceptions, demand for housing loans continued to rise and the same trend is expected in the next half-year. The Housing Subsidy for Families continues to boost demand and 16 per cent of the volume of disbursed new housing loans in the fourth quarter related to that instrument. HUF 23 billion was disbursed for Certified Consumer-Friendly Housing Loans in the fourth quarter, making up 13 per cent of the disbursed housing loans and approximately 23 per cent of housing loans with a longer interest period. In the last quarter, Certified Consumer-Friendly Housing Loans expanded more intensively, reaching approximately 40 per cent of loans in value terms in December 2017. The average annual percentage rate (APR) of new housing HUF loans decreased for all interest fixing periods, while in the premium, a moderate reduction may only be observed for loans with interest fixed for 1-5 years for the time being."

Simplification of the CSOK regulation

The government, the users and the credit institutions all expressed a need to simplify the administration of the rules of the Housing Subsidy for Families (CSOK). The Hungarian Banking Association had two rounds of discussions and made proposals for making the applications more effective on the basis of experience. A ***'declaratory principle'*** was introduced ***to replace certain certificates and documents that previously had to be submitted on paper***. The ***extension of the deadline for*** CSOK ***application*** and ***a more favourable situation for applicants returning home from abroad*** may significantly improve the options of CSOK applicants.

Potential access to the NAV income database

Responsible lending means prudent lending by banks and adequate information for customers in the course of lending. Credit approval and the information on income, constituting a part of it, are important factors of responsible lending. The Hungarian Banking Association attended the consultation phase of ***the proposal for electronic income queries submitted by lenders***. More advanced certification of the income data could be achieved with the voluntary consent of consumers and the enforcement of all data protection criteria. So far, the consultations had been held at a conception level. In this phase the MNB proposing this solution had separate consultations with the National Tax and Customs Administration (NAV) and the lenders.

Draft MNB recommendation promoting the transparency of information on the interest rate risk of mortgage loans

Magyar Nemzeti Bank prepared a draft recommendation to promote the transparency of information on the interest rate risk of mortgage loans. The purpose of the recommendation is to present the degree of the interest rate risk of mortgage loans offered with different interest rates to consumers, with special regard to the longer-term consequences of the interest rate risk associated with the loan selected by them.
Within that framework, the MNB would ***expand the methodology for the annual percentage rate***, applied by the financial institutions on the basis of EU legislation, and ***would also introduce comparative information on the interest rate risk*** in order to enable better informed consumer decisions. If the recommendation is accepted, the banks will also have to calculate an ***annual percentage rate adjusted with interest expectations (KTHM)*** for their mortgage loans and must present the KTHM applicable to the selected loan product to the consumer. They would be obliged to disclose, on their website, information relating to the KTHM calculation, including the source of data used in the calculation and the calculation model.

The Hungarian Banking Association welcomes any step or measure that facilitates more responsible lending. During the review of the draft recommendation, it made proposals ***for the application of the standard estimated interest calculator kept by the MNB*** and ***for the extension of the content of the risk disclosure statement***.

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

Omnibus legislation relating to the Info Act

In response to the call of the Ministry of Justice made during the meeting in November 2017, we sent ***our remark on the amendment of the sectoral acts*** in relation to the entry into force of GDPR and ***the amendment of the Info Act***, summarised in 24 pages, to the Ministry in January. Our Association prepared detailed and narrative proposals for the amendment of certain sectoral legal regulations. The most important acts affected are: *the act on the processing on name and address data used in research and direct marketing, the act on housing savings institutions, the act on mortgage credit institutions, act on credit institutions, act on the capital market, act on certain issues of electronic trade services and services related to the information society, act on security services and the activities of private investigators, act on economic advertisements, act on the Central Credit Information System, act on the collateral register and the act on the prevention of money laundering.* In our opinion, we also covered the expectations of the economic impacts of regulation.

Our supplementary proposal, submitted later, would integrate the term 'GDPR ***group of undertakings'*** into the acts governing the financial sector. (The American Chamber of Commerce (AmCham) made a proposal with identical content.)
The received proposals were discussed with NGOs and trade unions in consultations held for a number of days in February. (See the text relating to the Data Protection Working Group!)

Electronic reporting to notaries in inheritance procedures

The Hungarian Chamber of Civil Law Notaries (MOKK) and the Banking Association organised a discussion on the data supply by credit institutions to notaries in inheritance procedures in the House of Notaries on 15 January 2018, in which banks were widely represented. The MOKK representatives described their reasons for leaving the data supply project initiated by Microsec Zrt. and why they wished to use an official gateway to collect data in inheritance procedures.
The development of the MOKK official gateway has already been completed. The gateway is active; messages can be sent and received by using the ÁNYK[1] form. MOKK intends to develop the ÁNYK form for requesting data in inheritance procedures in cooperation with the credit institutions. Our Association made detailed proposals for the latter, which were sent to MOKK also in writing. In addition, we also agreed on a transitional procedure until the special ÁNYK form is introduced. After the negotiations, MOKK sent us the contents and format of the request and response templates, which were reviewed by the working groups.

Data supply to liquidators

According to the amendment of the Bankruptcy Act made in 2017 and which entered into force at the beginning of the year, payment service providers and investment service providers "shall supply data to the liquidator *in accordance with the rules of secure electronic communication, specified in Section 58 of Act CCXXII. of 2015 on the General Rules of Electronic Administration and Fiduciary Services*."
However, the applicable legislation does not yet allow the use of the company gateway between companies. (The liquidation organisations pursue their administrative activities as business associations and therefore, in the communication between a financial institution and the liquidator, correspondence in fact takes place between two companies.) We prepared a joint letter about the problem with the National Association of Liquidators (FOE) and sent it to the Ministry of Interior and the Ministry of National Development. During the discussion with the FOE, we talked not only about the proposal for the amendment of legal regulations, but also discussed the practical issues of data supply and outlined the rules of procedure for the transition period.

Regulatory data requests

Following the practice of ***disclosure of bank secret for national security and criminal investigation purposes***, which has existed for decades, the competent authorities have ***new demand for data*** in relation to digitisation and the security challenges, and such demands were integrated into the legal regulations governing the operation of the authorities. The introduction of the signalling system described in the National Security Act and the monitoring of payment transactions, integrated into the new Act on Criminal Procedure, have similar purposes in practice; the ***regular reporting of the transactions or a specific group of transactions on payment accounts and bank cards specified by the authority to the authority requesting the data***.

[1] General Form Filling Program

1. *Developments relating to the electronic connection with NBSZ*

The National Security Act made it possible to ***establish an electronic data connection*** from January 2017 both according to the former practice and in relation to the introduction of the signalling systems. The Special Service for National Security (NBSZ), as the agency authorised to introduce that service, approached the major commercial banks with a banking interface specification reflecting the authority's ideas from March 2017. With the solution developed by NBSZ, the data requested by any national security agency may be requested and provided by the banks through the automatic data collection established between NBSZ and the banking systems. The banks approached did not see any practicality in starting the required IT developments prior to the clarification of their data protection concerns. In order to manage the problem, the Administrative State Secretary of the Ministry of Interior and the Director General of NBSZ discussed the issue at the board meeting of the Banking Association in April. As a result, the Banking Association organised a CEO forum, to which the competent State Secretary of the Ministry of Justice and the Ministry for National Economy, the President of the Hungarian National Authority for Data Protection and Freedom of Information (NAIH) and the representative of Magyar Nemzeti Bank were also invited. The authorities all agree that the situation does not require any amendment to the legal regulations and, according to the NAIH President, in general the introduction of the system planned by NBSZ does not raise any concern. In order to ensure that the data protection requirements are fulfilled during the actual implementation, the participants agreed that NBSZ would build a pilot system with one bank, to be examined by NAIH and, if it is found adequate, the electronic data connection will also be established with the other banks concerned.

2. *Sections 216-218 of the new Act on the Rules of Criminal Procedure: observation of payment transactions, consultations with the Ministry of Interior and the competent authorities*

The Administrative State Secretary of the Ministry of Interior approached the Banking Association in February with the information that the Act on Criminal Procedure, entering into force on 1 July 2018, ***would introduce a new concealed instrument, i.e., observation of payment transactions and the suspension of transactions when requested by the authorities***. The State Secretary intended to discuss the text of the Government Decree containing the detailed rules in advance.
In its response letter, the Banking Association listed a number of problems concerning the law, data protection, IT security, development and banking operation, and proposed a consultation.
On the basis of our remarks, the Ministry of Interior significantly revised the respective text of the draft decree and organised two consultations to discuss it in the first half of March, attended by representatives of the Prosecution Office, the investigation authorities, MNB and GIRO. The consultations continued after the new government began its operation.

Temporary delegation policy of the Legal Counsel Section of the National Bar Association

Similarly to the review of the Act on the Prosecution and related legal regulations, as well as Bar policies, the legal counsel ad hoc working group (which also includes legal counsels of other industries) reviewed the ***temporary delegation policy of the Hungarian Bar Association.***
According to the policy, the President of the Hungarian Bar Association set a date for the election of the National Legal Counsel Section of 28 February 2018. The establishment of the National Section is also important because its opinion must be requested for the approval of any policy falling within the scope of competence of the organisations of the Hungarian Bar Association. (In relation to the non-individual decisions pertaining to the sections, the other sections must be consulted while, in relation

to rules pertaining only to them, their consent is also required.) Another reason that active participation in the election was important was that they had to demonstrate the commitment of the legal counsel section, thus enforcing the interest enforcing abilities within the Chamber.
Following identification through the client gateway, those eligible for election may cast their votes electronically on the valasztas.ugyvedikamara.hu website. Dr. Bálint Csere, Head of Legal Directorate at OTP Bank Nyrt., was elected as president of the National Section, which is fortunate because the financial sector can be strongly represented in the National Section.

VI. Developments relating to Magyar Nemzeti Bank

Finalisation of the Interbank Funding Ratio and consultation on the Foreign Exchange Funding Adequacy Ratio

The consultation on the details of introduction of the Interbank Funding Ratio (IFR) with the European Central Bank and the European Systemic Risk Board (ESRB) was closed in February. As previously agreed, during the calculation of the ratio, ***certain refinancing sources*** (refinancing mortgage loans according to the Act on Mortgage Credit Institutions; refinancing loans received from special institutions, including the ECB, MNB, MFB, EXIM, EIB, etc.,; secured bonds issued with retail collateral and recognised under the CRR and other bonds issued for at least two years; sources of foreign branches of Hungarian banks; margin accounts; the subordinated loan capital and other loan capital to be taken into account in the regulatory capital; and funds received from group members in Hungary) ***are taken out from the sources to be used in the calculation***. A preferential weight may be assigned to loro accounts kept for other banks and funds received from foreign parent institutions. As a de minimis rule, institutions with total assets of less than HUF 30 billion do not need to apply the ratio. It is another important aspect that Hungarian institutions belonging to the same group ***must comply*** with the ratio on a ***consolidated basis***.
The central bank announced the regulation on 27 March and it will enter into force on 1 July.

Parallel with the above, the MNB's unit responsible for macroprudential regulations ***amended the rules of FFAR,*** the draft of which has been under consultation since the beginning of March. On the basis of the central bank's ideas, the indicator will function as a kind of ***foreign exchange NSFR indicator*** with its entry into force simultaneously with the introduction of the IFR. Consequently, the MNB adjusted the terms of the Decree to the terms of the CRR and the European Commission regulation issued on the basis of its authorisation. In accordance with the NSFR rules, under the application of the draft decree, it further broke down the short-term portfolios and assigned different weights to foreign exchange liabilities and those assets with a term of shorter or longer than 6 months. By applying the same rules as applied to monetary financial institutions, it introduced more stringency into the consideration of funds and assets placed by non-monetary financial institutions. The asymmetric recognition of derivative transactions, only among receivables affecting their foreign exchange leg (and, in the case of delivery transactions, netting can be applied with the HUF leg), is an important change. During the consultations, in addition to technical clarifications, a number of banks proposed the consideration of foreign exchange funds (liabilities) obtained through long-term swaps in the calculation of the ratio in order to improve competitiveness and encourage lending but, presumably for macroprudential reasons, the MNB still does not support the idea.
The central bank is consulting with the competent European authorities on the amendment.

Proposal for the modification of the MNB Decree on online identification and filtering systems

On the basis of a few months' of experience of the practical application of the *MNB Decree on the implementation of the Act on the prevention and combating of money laundering and terrorist* *financing relating to service providers supervised by the MNB and the minimum requirements of the development and operation of the filtering system specified in the Act on the implementation of the restrictive measures imposed by the European*) *Union and the UN Security Council related to liquid assets and other financial interests,* the MBSZ AML working group prepared the corrections proposed by the sector.

The proposed modifications for the currently effective text of the Decree and their justification were submitted using the track changes function in the text of the Decree. As our members made remarks on a number of topics that are crucial for the sector, we requested a public consultation in order to come up with modifications that take the requirements of both the sector and the Supervisory Authority into account to the highest possible extent. The crucial topics included ***easing re-identification***: for customers who have already been identified, data should be modified and supplemented using existing communication channels; and, according to another proposal, instead of checking the entire real-time ***customer due diligence,*** the proposal defines exactly ***what such a check must cover***.

The consultation and the subsequent modification is likely to take place at the end of the summer or the beginning of autumn.

Review of the MNB Vice Governor's circular (IFRS9 impairment rules)

We asked our members to review the MNB CEO's circular letter***"on the use of macroeconomic information on the application of the IFRS 9 standard and on the factors indicating a major increase in credit risks"*** in March. We received numerous remarks regarding the rules on impairment included in the circular letter and applicable in relation to IFRS 9, and we sent them all to the regulatory authority.

Credit institutions which have their parent banks abroad indicated that their foreign owners strongly centralised the IFRS 9 impairment model and methodology. The Hungarian subsidiaries have limited access to detailed information on the model and to the model itself and cannot change it locally. The market operators felt that, in the event of any deviation from the good practice described in the CEO circular, it is unreasonable and partially impossible to submit detailed documentation, justification or analysis because of the deviation. They recommended reducing the related documentation obligations and to grant exemption in certain cases (e.g., to financial institutions owned by a foreign parent company that have a small market share in Hungary).

They also objected to the fact that the expectations explained in the circular were published after the introduction of the IFRS, and therefore their costs can no longer be included in the capital as FTA[2] but will be charged to the profit and loss account of the banks. They proposed that it should be mandatory to apply the regulation from 1 January 2019, so that the banks can take that item into account when they prepare their budget for the next year.

We also encouraged a standard MNB position in relation to the inclusion of the performing assets to be classified in the "POCI" category (purchased or originated credit-impaired assets defined in the exhibit of IFRS 9) but not currently outstanding in stage categories. This would contribute a great deal to compliance with the principle of comparability across the whole sector.

Data supply - HITREG project

The HITREG working group, established in Q1 2018 for the development of the analytical credit register of the central bank, had three meetings. At the meetings, the tables containing coverage and transactions and the data supply obligations of financial enterprises were discussed. It is a new component under the HITREG data model that the information required ***in relation to the ESRB***[3]

[2] first time adaption
[3] European Systemic Risk Board

recommendations (ESRB/2016/14) to be introduced in 2020 ***has also been integrated into the data model***. The MNB regularly discusses the issues related to the recommendations with ESRB. The purpose of the recommendations is to monitor the real estate sector, which has a huge impact on the financial system. The related data supply, which is an obligation of the banks, has also been integrated into the HITREG data model.
On the basis of the discussion at the meeting of the working group dedicated to loan collaterals, the MNB ***gave up the idea of building a central real estate and vehicle collateral registration database*** which would have been part of HITREG according to the original concept.
Upon the experts' request, a decision was made to ***report the total data file instead of reporting periodic changes in the data.*** This involves sending larger volumes of data but it is better structured, more transparent and controllable. The data of the termination of an instrument or credit approval and the transaction tables are exempted from the data supply in a file.
Due to the principles presented during the consultation on the transaction tables, ***no data will have to be supplied about credit card transactions, overdraft draw-downs and repayments***.
Two more meetings are expected to take place between the working group, the MNB and the reporting experts, where they will also discuss ***the expected deadline of implementation, the data supplies replaced by HITREG, the project schedule, the simultaneous KHR development, the uploading of master data, the technical details of submitting data and the rules on monitoring.***

VII. Payments

Preparation for and application of PSD2

The ***application*** of the main principles of the ***PSD2[4] directive began*** in both Hungary and Europe ***on 13 January 2018.*** Prior to the implementation, the Hungarian legislator was very open to professional consultations and gave an opportunity to the Hungarian Banking Association and its members to discuss the transposition of PSD2 into the Hungarian legislation; however, there are still problems that cause major difficulties for the right practical application and occasionally make it totally impossible.
One major issue was ***the application and entry into force of the regulatory technical standards (RTS) to be issued by the EBA***. Following the promulgation of the PSD2 legislation in Hungary, on 19 December 2017 the EBA published an important position statement that also related to the RTS and we requested that the Hungarian legislator pay attention to it. The Banking Association presented detailed arguments and requested the Ministry for National Economy (NGM) responsible for the legal regulation to amend the start date of application of RTS from 1 January 2019 to the date of 18 months after the promulgation of the legal regulation, as is the case in the practice of the EU. The Financial Regulatory Department of the NGM found the request substantiated and confirmed the proposal of the Hungarian Banking Association. The competent experts of the NGM concluded that "the publication of the RTS in the EU was significantly delayed compared to the original plan and was likely to be applied from the autumn of 2019. Consequently, in order to comply with the EU legislation, the Hungarian legislation must also use the same date. In the light of that information, the deadline of 1 January 2019, defined in Section 66/A of the Payment Services Act (Pft.) will definitely be justified." The amendment of the applicable legal regulation [Payment Services Act (Pft.)] is expected to take place during the legislation period in the autumn due to the elections and technical preparations that have taken or are still taking place in the meantime.

PSD2 will open a fundamentally new environment for payment services, which will be ***more open and more customer-centred*** according to the intention of the legislator. As it has a conceptionally

[4] Payment Services Directive (Directive of the European Parliament and of the Council (EU) 2015/2366)

innovative nature, some open issues related to application have remained and constantly pop up, which the Banking Association intends to process and respond to by conducting regular–technical consultations with the departments of the MNB, which exercises the powers of the supervisory authority in Hungary.
Due to the large number of received requests and of stakeholders, the MNB decided to open a page dedicated to PSD2 under the title of ***Frequently Asked Questions and Answers***. In general, the MNB does not respond to individual questions but to a group of questions of a similar nature and topic on this information page: ***data supply, strong customer authentication and secure communication, responsibility*** and ***other,–licensing and implementation rules***. Links to the MNB information page:
http://www.mnb.hu/penzforgalom/psd2-gyakori-kerdesek-es-valaszok

Implementation of the PAD regulations

At the beginning of January this year, ***the three Regulations relating to the Payment Accounts Directive*** (PAD) ***(2014/92/EU)*** were published:

- Commission Delegated Regulation supplementing Directive 2014/92/EU of the European Parliament and of the Council with regard to regulatory technical standards for the Union standardised terminology for most representative services linked to a payment account (2018/32);
- Commission Implementing Regulation laying down implementing technical standards with regard to the standardised presentation format of the statement of fees and its common symbol according to Directive 2014/92/EU (2018/33) ;
- Commission Implementing Regulation laying down implementing technical standards with regard to the standardised presentation format of the fee information document and its common symbol according to Directive 2014/92/EU (2018/34)

A sub-working group was established within the framework of the Payments Working Group for the interpretation of the Regulations and to assess the tasks stemming from them. During its meetings, the sub-working group identified the issues to be clarified and contacted the competent regulatory authorities about them (NGM, MNB). Our Association intends to have discussions on the entry into force of the regulations, the comprehensive cost indicator, the initial date of making the fee information document and the statement of fees available to customers, the national list of the most frequent services, the differences in the use of the terms under the Regulations and the effective Payment Services Act, as well as the operator of the mandatory national comparative website and the data to be supplied to it. The discussions are expected to be closed in the second quarter.

Developments in connection with the Instant Payment system

The project entered a new phase at the beginning of the year with the selection of the ***supplier of the settlement system***. The contract was awarded to the Danish NETS A/S company, which also supplies the Danish instant payment system.
In order to inform the project participants, the MNB organised an ***information forum*** at the beginning of March with the involvement of MBSZ, as in the past. A considerable number of our members attended the forum, where representatives of the MNB, GIRO Zrt. and the foreign supplier gave information according to their role in the project. The audience received detailed descriptions of the most important rules of the regulation on the instant payment service, the status of the project, the schedule of building the central infrastructure and the experience of the company delivering the central infrastructure in other countries so far.
According to the MNB, the establishment of the system is progressing as scheduled and therefore the instant payment service will become available in Hungary in July 2019, as originally intended.

In response to the requests from its member banks, the ***Hungarian Banking Association created a complementary AFR/AZUR sub-working group*** at the beginning of the year to collect, interpret, draft, classify and discuss all issues relating to the project. The activities of this working group are outside the GIRO project and do not influence the deadlines set there. The GIRO Project Manager, Gábor Bakati, also attends the meetings of the working group and reports on the work performed in the GIRO project, the major milestones and their achievements. The sub-working group collected questions on 16 topics, classified them and discusses almost 140 relevant issues at its meetings. The questions that the sub-working group cannot answer are sent to GIRO for interpretation first and, if necessary, they are also forwarded to the regulator.
The increase in the volume of the information available in relation to the project assists our members in their preparations from this year on. Two information interfaces were created on the MNB website; on one, responses are given to the most frequent questions about instant payments, while on the other the MNB's technical opinion is published on interpretation and application issues related to the Payment Services Directive.

The representatives of the Banking Association and its member banks also attend the meetings of the AFR Information Working Group, which began the review and separation of internal and external communication tasks, the foundation of the communication strategy, and collection of information to assist the ***Project Steering Committee (PSC)*** in making a decision on the fundamental issue of whether or not the service will require a ***separate payment brand*** under the control of the Communication Department of the MNB.

Consultations relating to the Giro bank account change

During the inspections conducted at the payment service providers, Magyar Nemzeti Bank objected to the fact that the *"Information on the obstacles of termination of payment accounts"* form relating to the ***GIRO Bank switching service***, and the *"Reason for rejection of account closing"* field in the description of *"Closing status message"* in Section 8 of the *"GIRO Bank Switch standard 2.5"* , some reasons are indicated which could not be used pursuant to the provisions of *Government Decree 263/2016 (31 August)* on switching payment accounts. According to the MNB's position, of the currently existing 13 reasons, the termination of a payment account could be lawfully rejected on the basis of only 3 reasons.
In co-operation with the Hungarian Banking Association and GIRO Zrt., the payment service providers reviewed the currently used reasons for rejection and, in addition to the three reasons also recognised by the MNB, recommended to keep, revise or clarify three further reasons.
The Banking Association sent the proposals to the MNB. On the basis of the MNB's response, there will be a need to:

- develop the Giro system (and possibly the systems of a few banks),
- transform processes,
- prepare new information document.

Latest news on bank cards

According to the latest data of the MNB, published on 19 March 2018, ***in 2017 the bank card acquiring network expanded by 25 per cent,*** and electronic payment turnover grew dynamically. This robust increase in the payment card acquiring system is fundamentally affected by the NGM terminalisation programme in progress. The number of POS terminals operated at the acquiring sites has reached 136,000, and 83 percent of them support fast and convenient contactless payments. The dissemination of contactless technology was also reflected in the purchases, as in 2017 this payment method was used in two thirds of card purchases. It is favourable news that the proportion of card fraud within the total turnover has decreased, i.e., this payment method has become more secure.

To continue the ***POS installation project*** launched in December 2016, in the autumn of 2017 the NGM announced a new tender round, modifying the previous deadlines for completion. At the request of our affected member banks, we sent a proposal to the ministries, requesting them to allow banks that completed the project and reports by the original deadline to be able to stop their participation in the project, enabling other institutions to perform their tasks by the new deadline as an option. Our request was accepted.

The Bank Card Working Group paid constant attention and provided active assistance to the preparations of its members for PSD2, in which ***strong customer authentication (SCA), and the issue of changing compensation and refund rules*** are important aspects concerning bank cards***.*** In addition to the current issues regularly communicated to the MNB and the card schemes, we shared with our members all technical information on the topic relating to bankcards during working group consultations and at workshops. The working group received the executive officers of the MasterCard card scheme and consulted with them on the technical proposal of the company concerning the SCA, according to which the processes should become transparent and understandable to customers even after the introduction of the SCA, yet high customer satisfaction with the service should be maintained without any sudden increase in the number of dropped transactions.
The banking experts deemed it necessary that the card scheme discuss its proposal with the regulatory authorities; the MNB and the NGM.

In terms of ***fraud,*** we began technical work in the international organisation of the European Association for Secure Transactions (EAST). Our Association attended the 44th members' meeting of the organisation on 7 February, and shared the most recent fraud news reflecting the experience of 21 countries with the respective experts from our members. We work in cooperation with the National Investigation Bureau.
We also prepare for the ***e-commerce and Airport Action Days*** events to be organised again this summer in co-operation with the experts from the authorities. In order to enhance the awareness and caution of customers, we began preparing a general ***notice on security advice for bank cards.***

Developments related to SZÉP cards

The Ministry for National Economy distributed for review the proposal for the *rules of issue and use of Széchenyi Recreation (SZÉP) Cards* In order to implement the judgment of the European Court of Justice related to the SZÉP Card, the Ministry plans to amend the regulations on Széchenyi Recreation Cards ***by changing the issue of the cards into a payment service.***
In our opinion, ***the envisaged instrument raises problems in terms of legal, business and practical feasibility***, and therefore we recommend not submitting the draft in its current form to the government decision-making bodies. We proposed a solution which, in our opinion, would be better for all parties concerned and would also comply with the judgment of the European Court of Justice. We also submitted other proposals to the Ministry, which were developed and discussed in a number of meetings.
The Ministry did not change its concept with reference to the fact that the European Court of Justice already accepted the solution described in the submitted draft government decree but agreed with our proposal-for the text of the draft at various points.
At the moment, we continue negotiations with the Ministry for National Economy and the Magyar Nemzeti Bank in order to achieve a consistent interpretation of the Government Decree and the most cost effective transition possible under the future framework. One of the key issues of the negotiations is that the requirements of the RTS, regulating strong customer authentication under PSD2 should be applied to the currently used SZÉP cards or whether we could come up with an

exception rule, according to which not cards will have to be replaced. (There are more than 1.5 million SZÉP cards!)

SWIFT UMG regular meeting in the first half of the year

The user and member group (UMG) held its first half year meeting on 27 February. The agenda of the meeting included tasks and topics started earlier and stretching across a number of years and other extended issues. In terms of importance, ***cyber security*** and the implementation of ***the customer security programme*** (CSP) continue to be at the top. ***SWIFT evaluated the results of the self-assessment*** conducted in 2017 and published its general findings. The attendance of Hungarian parties was slightly higher than the international average; 95% completed the self-assessment appropriately and on time. The institutions (two in Hungary) which missed the deadline can still complete the self-assessment in Q1 2018. The self-audit exercise has not yet been closed finally because, according to the programme, ***in 2018 each institution must repeat the procedure certifying full compliance with the mandatory security requirements issued by SWIFT***.

The other key issues are the ***SWIFT new correspondent banking development and service, known as GPI***[5], which will allow for transparency and tracking of cross-border payments and will significantly shorten their completion time. With transparency and tracking, it will become transparent during the payment process when a particular actor in the payment chain receives the order, how long it takes to transfer it and how much they charge for their contribution. The new service seems to be popular because ***almost 10% of the cross-border payments, automated from end point to end point,*** are already performed using it. Almost 50% of the payments made with this method are credited on the beneficiary's account within 30 minutes.
The Standard Release published in 2018 obliges users to add a ***unique end-to-end transaction reference (UETR) number*** to the data of their payments, thus ensuring the exploitation of all advantages of the service.

SEPA: SCTS started 10 years ago

The EPC[6], i.e., the interbank cooperative organisation of the EU banks and later payment service providers, organised on a voluntary basis, was formed in 2002 in order to contribute to the establishment of the single euro payments area (SEPA), for which the legal framework was provided by the competent regulators issuing PSD1. Joint professional work began for the implementation of the SEPA vision, with the objective of eliminating the fragmentation in the European payments market and the differences in intra-EU payments, including both within and across Member States. The other aim was to develop competitive services for the common currency, the euro, on the basis of common standards and rules.

With regard to the three payment instruments of SEPA i.e., credit transfer, collection and card payments, the first model, known as ***SEPA Credit Transfer Scheme*** (SCTS), was first introduced for credit transfers. The credit transfer model was introduced in practice on 28 January 2008. As, within the framework of the Payment System Forum, the Hungarian banks also worked on integration into the euro payment market and, following our accession to the EU in 2004, Hungary also joined the EPC, it was a natural option that ***well-prepared Hungarian banks would also voluntarily register for the SEPA credit transfer scheme***. The banks that were part of the historic step were Takarékbank, OTP, CIB, CITI, KDB, Deutsche Bank, Commerzbank, Gránit Bank, ERSTE Bank and UniCredit, and MKB Bank also joined a few months later. The first ten credit institutions were followed by 18 other

[5] Global Payment Innovation
[6] European Payments Council

institutions, partly because of the effect of the SEPA End-Date Regulation; as such, there are currently 28 Hungarian SCTS members registered in the EPC.

VIII. Taxation

NGM position statement on the notification of foreign bank accounts

A new obligation was introduced on 1 January 2018, according to which ***business associations*** registered in Hungary ***must notify the Hungarian Tax Authority of their bank accounts abroad*** within 15 days of opening them. The existing accounts could be notified until 31 January 2018. Developed with the Tax Working Group, our request for a position drew the legislator's attention to details that warrant legislative amendments. As an example, the types of accounts subject to mandatory notification are not specified (payment, technical, securities, etc. accounts) or how the terms defined in the Hungarian legal regulations can match the account types used abroad. The NGM confirmed at the end of March 2018 that the obligation applies only to accounts used for payments (payment accounts). In order to facilitate the clear interpretation of the legal regulation, we were promised that *Section 1.24 of Annex 1 of Act CL of 2017 on the Order of Taxation* would be modified and the wording would be clarified.

Results of the consultations between NGM and the IFRS Tax Sub-Working Group

The IFRS Tax Sub-Working Group held a consultation meeting with NGM experts on 22 February 2018. During the meeting, eight issues were closed in relation to the impact of the switch to IFRS on corporate income tax and local business tax.
Of the resolved issues, it should be emphasised that the NGM confirmed the views of the experts of the sector that, during the switch to IFRS, ***the rules of IFRS 1 must be applied to calculate and estimate transition differences***. Consequently, all estimates must be made on the basis of the information and data currently available and reasonably obtainable at the time of the estimates and no subsequently gained additional knowledge, data or information may be taken into account retrospectively. If the accounting estimate is based on the available and reasonably obtainable information, there is no need for any back-testing or self-audits. The need for self-audits arises when the inaccuracies in the estimates reach an extent which subsequently would be deemed an accounting error.
In relation to the question concerning the interpretation of the "***sale of financial instruments***", the experts from the Ministry stated that the Act on Local Taxes did not contain any definition for the sale or any reference to the IFRS standards and therefore the provisions of the Civil Code (Ptk.) must be applied, i.e., sale should refer to a sale and purchase transaction. Further discussions are required to achieve consistency in the interpretation and application of the law.

IX. Developments within the Banking Association

Communication statistics and recent news

In terms of communication, Q1 2018 was a relatively calm period for the banking sector, ***with moderate press interest***, most probably because all attention of the press focused primarily on the parliamentary elections. According to our statistics, during the quarter we were featured in online media approximately 30 times, 16 times in electronic media and 12 times in printed media.

Altogether, the Hungarian Banking Association was featured in Hungarian media more than 60 times, informing the media and the public about the sector's professional views.

During the quarter, we provided a number of presidential, vice presidential and secretary general interviews, statements and communications responding to current issues, and prepared professional summaries from the viewpoint of the sector. ***In response to the MNB recommendation on real estate risks,*** our Association published a ***presidential communication,*** informing the public of the professional position of the banking sector, namely that, thanks to the common efforts of the parties, the retail NPL rate dropped below 10 per cent, which is very favourable, similarly to the decline observed in the corporate indicators, too. At the same time, we also recommended regular market feedback relating to the Regulations, to which our institutions are open and ready to provide support. We also pointed out the regulatory burden imposed on the sector.
Card and ATM security and the security of mobile payments continued to be regular ***topics*** appearing in the ***communication of banks*** during the quarter. The conditions of the preferences granted to family home building and the Certified Consumer-Friendly Housing Loans introduced by the MNB were also followed with constant and particular attention from the press. The introduction of PSD2 in January and the preparations for it were also a topic of communication by the banks.

In the "***Equal Treatment Committee***" we continued to present the experience of the Banking Association members and represent their views during the inter-ministerial consultations led by the NGM, and attended by EMMI and the MNB.

Money Week - events of the 2017/2018 academic year

Money Week, organised in Hungary for the fourth time, led to outstanding and unique results in Europe. Within the framework of the programme launched on 5 March 2018, we were able to develop the financial skills, awareness and business approach of more than 200,000 Hungarian students. 1,249 schools registered for the Money Week programme and 1,645 registered teachers gave lessons on the financial topic of ***"Smartly about Loans!"*** and on the business topic of***"Business Ideas and Cooperation***". In total 438 financial and other entrepreneurs assisted voluntarily during the lessons, making the subject material more interesting and authoritative. The interest in the programme is increasing across the country each year.
The innovation this year is that the experience-based learning was also supported by ***digital solutions and e-learning materials***. During the week dedicated to finance, announced within the structure of the academic year, students were also able to learn about cooperation and responsible problem-solving.
The professional partners co-operating in Money Week, initiated by the European Banking Federation in 2018, included again the Ministry of Human Capacities as project owner, the Ministry for National Economy, the Hungarian Banking Association, the Financial Compass Foundation and the Junior Achievement Hungary Foundation. According to the main principle of Money Week, no brand or commercial logo is presented during the lessons.
In the weeks that followed the Money Week lessons, we also joined the ***European Money Quiz***, in which Hungarian contestants competed with students from 24 other European countries.

At the major rural event of Money Week, Minister of State Responsible for Finances Ágnes Hornung said the following at the opening of the ***FINTELLIGENCE Financial Education Centre*** at the University of Miskolc: "The *Financial Awareness Development Strategy* approved by the government has defined the key action points for the next 7 years, focusing mainly on financial education and the development of a financial approach, which are the key success factors." The FINTELLIGENCE Centre is a centre of financial education and academic research, where financial knowledge and culture are taught to young people using the most advanced digital equipment and with an interactive

exhibition. The Fintelligence Centre was established with the professional and organisational contribution of the Hungarian Banking Association and with financial contributions from the main sponsors –(OTP, MFB and MasterCard)–, and contributions from other sponsors (GIRO, BÉT, BISZ, Garantiqa, OBA, Pénztárszövetség and BNL).
The subject of financial culture was also introduced at the University of Miskolc in September. The first detailed ***Financial Literacy textbook*** written in Hungarian was presented at the Money Week professional conference.

Dissolution of PTÁV

On 31 December 2017, the Standing Arbitration Court of the Money and Capital Markets was dissolved with no successor under *Act LX of 2017 on Arbitration.* The "dissolution" tasks extended to Q1 2018. The Hungarian Banking Association, as founder, supervised the preparation of the closing statements and the transfer of documents and also provided continuous technical guidance to the management of PTÁV in order to facilitate a smooth closure. The tasks associated with the documents and files in progress were discussed with the Permanent Court of Arbitration attached to MKIK.

Other working committees and working groups

- *Data Protection Working Group*

At the meeting of the Data Protection Working Group held in March 2018, information was provided **on the consultation held at the Ministry of Justice on the proposal for the amendment of the acts related to the modification of the Act on the Freedom of Information**. Consultations were held every day between 26 February and 1 March among various experts representing the ministries concerned and who are competent in the topics of the proposal. In addition to the Banking Association, the American Chamber of Commerce and the Competition Law Association attended the consultations as professional interest representation organisations. A revised draft will be prepared on the basis of the consultations so far, to be discussed at the meeting of the Codification Working Group and to be submitted for the autumn parliamentary session. It is expected that a short amendment will be submitted during the spring parliamentary session ***for the appointment of the Hungarian National Authority for Data Protection and Freedom of Information as the national authority under the GDPR.***
The organisational solutions and various problems in the ***preparations for GDPR*** were the next item on the agenda. We requested proposals for the annual work plan and recommended the document on GDPR that was prepared and published by the Italian Banking Association as a potential input.

- *Credit Guarantee Working Group*

At the meeting of the Credit Guarantee Working Group held in the first quarter, the representatives of Garantiqa Hitelgarancia Zrt. described the introduction and details of the Garantiqa ***COSME LGF***[7] Portfolio Guarantee Scheme. The purpose of the ***COSME Programme*** is to support viable SMEs, which would not be eligible for loans due to their higher risks or the lack of the collateral expected by financial institutions, to obtain credit. In the COSME programme, Garantiqa offers up to a 90% guarantee securing loans to businesses and the products are also available without any limitation for companies operating in the agricultural and export sectors. The Garantiqa guarantee related to the

[7] Competitiveness of Enterprises and Small and Medium-sized Enterprises Loan Guarantee Facility

COSME Programme does not contain any state subsidy and therefore does not put any strain on the subsidy budget available for businesses. Consequently, the programme is also accessible for companies that have already exhausted their subsidy options. Diverging from the previous practice, for a ***COSME Portfolio Guarantee no "payment guarantee application" has to be submitted in advance;*** instead it is made subsequently and electronically, ***upon the fulfilment of the data supply***.
Main elements of the products available within the framework of the COSME Portfolio Guarantee:

- The initial credit in an overdraft facility is a maximum of HUF 100 million, without any security and with a fixed 65% guarantee.
- The initial loan amount in working capital bank guarantee investment loans and financial leasing is a maximum of HUF 46 million, with a specific maximum coverage percentage and 85-90% guarantee.
- Overdraft facility, working capital loan, bank guarantee, investment loan and financial leasing with a maximum of HUF 10 million for start-up enterprises. With a fixed 90% guarantee without any collateral requirement. Start-up enterprises are enterprises where no more than 2 years have passed between the date of foundation and the date of their loan agreement (not including the date of foundation).

In February 2018, Garantiqa launched its Irinyi Guarantee Scheme, offering guarantees not only to SMEs but also to large companies of up to HUF 800 million. The condition of that guarantee is the activity pursued under the TEÁOR code specified in the Irinyi Plan.

- *Agricultural Working Group*

The Agricultural Working Group had several meetings during the first quarter. At the beginning of the year, the working group defined its work plan and agendas of its meetings for 2018.
At the first meeting of the year, a representative of the Prime Minister's Office gave a presentation on the implementation of the ***Rural Development Programme for 2014–2020,*** the published calls, the decisions and commitments made until 31 January 2018 and the decisions expected to be made in Q1 2018. It also described the cases in which the Managing Authority can cancel the ***assistance*** and withdraw the support document. The representative presented the ***notice issued by the Prime Minister's Office*** which, similarly to the Economic Development and Innovation Operational Programme, ***also allows the establishment of a mortgage*** for investment projects under the Rural Development Programme without any prior written consent from the Managing Authority of the Rural Development Programme. As a result of the further activities of the working group, the scope of the establishment of mortgages related to the programme was also extended in the last quarter.

At the second meeting, the representatives of Garantiqa Hitelgarancia Zrt. gave a presentation on the ***Garantiqa COSME Programme***, the COSME guarantee assessed individually, the COSME Portfolio Guarantee and the Irinyi Guarantee Scheme. They briefly stated that they would offer guarantees for SME loans, bank guarantees, leasing and factoring transactions.

1. Within the framework of an agreement or portfolio guarantee: for smaller standard transactions, with state or COSME counter-guarantee,
2. in an individual procedure: with a state counter-guarantee, within the framework of the COSME Guarantee Scheme or at its own risk, within the framework of the Irinyi Guarantee Scheme.

They presented in detail the conditions of the Garantiqa COSME products, the guarantee process and their products developed to support agribusiness financing. They highlighted that the guarantees assumed under the COSME Guarantee Scheme and the Irinyi Guarantee Schemes do not have any state subsidy content and therefore are especially advantageous for the agricultural sector.

The representatives of the Hungarian State Treasury (MÁK) gave a presentation on the ***agricultural and rural development paying agency activities of MÁK for the European Union*** and on its certain tasks related to Hungarian agricultural and rural development assistance. In addition, they also

presented a notice on practical issues related to the implementation of projects co-financed within the framework of the Rural Development Programme. In order to simplify and accelerate the tasks of the members and the paying agency, the Hungarian Banking Association offered its communication channels for the publication of mass and typical errors and correct procedures, which the parties happily accepted.
The meetings of the Working Group were followed by detailed consultations and a thorough discussion of the professional recommendations.

- *Internal Audit Working Group*

The Internal Audit Working Group proposed ***the review of the requirements for the annual audit of outsourced activities stated in the Hpt.*** There are two reasons behind this initiative: the regulation is obsolete because, during the last four years, the checks on outsourcing were gradually transferred to the representatives of the first and second defence lines at the representatives of the banking sector; for the majority of the banks, compliance requires significant internal audit resources for the majority of banks, part of which have become superfluous. After drafting the proposals of the Banking Association, a consultation was organised to discuss the positions concerning the topic.
The MNB representatives explained at the consultation that they also saw a need for a review and revision of the legislative framework. However, considering that the EBA also announced a review of its 2006 Recommendations on outsourcing (scheduled for Q4 2018), the new MNB guidelines will only be issued after processing the EBA Recommendation at the end of 2018 or in 2019. The representatives of the central bank wish to rely on the proposals of the Banking Association for the amendment of the related legislation by taking the future EBA recommendations into account.

- *Digitisation Working Group*

The organisation of the Digitisation Working Group began on the basis of the Board decision made in March. The Banking Association requested its members to delegate banking experts into the working group. As a result of the recruitment, the working group has 23 members and 40 people requested to be included in the list of correspondents.

- *Physical Safety Working Group*

The previous leader of the working group resigned in December. The new leader was elected in January. Of the two candidates, the working group supported Péter Jakab by a simple majority decision. Mr. Jakab has many years of banking and management experience in bank security and was also the leader of the Bank Security Committee earlier. The Board of the Banking Association appointed Péter Jakab for the position in its meeting in February.

- *Mortgage Bank Working Group*

A Hungarian statistical database was developed for the ***ECBC[8] Factbook.*** The database provides information not only on new issues, but also on the existing mortgage bond portfolio.

The ***Central Europe Covered Bond Conference*** will take place in Budapest in the autumn of 2018, with which the Hungarian mortgage bond market will also be the focus of attention on the international map. In the first quarter of the year, the working group began working on operational

[8] European Covered Bond Council

tasks related to the topics of and participants in the conference in close cooperation with the main organiser, the VdP German Mortgage Bank Association.

The European Commission published its ***legislative package on secured bonds***, which consists of a minimum harmonisation directive and a regulation on capital requirements. The Legal and Capital Market Sub-Committee began the work required for joining the legislation.

- *SME Working Group*

The SME Working Group had four meetings in the first quarter of the year. ***As of 1 January 2018, the use of Company Gateways is compulsory for economic actors;*** it went live on 28 December 2017. In this context, the SME and Legal Working Group held several consultations in the first quarter with representatives of the Ministry of Interior and Nemzeti Infokommunikációs Szolgáltató (NISZ) Zrt. on the legislative background of ***e-administratio***n, on hosting for economic actors (Company Gateway), the obligations of entities providing electronic administration/ required to use electronic administration, infringements by economic actors and on ***Electronic Administration Supervision***. The working group meetings were followed by a thorough discussion of the issues and professional recommendations for the switch to the new system and the use of the Company Gateway.

The representative of the Ministry for National Economy presented to the working group ***the SME strategy of the Economic Development and Innovation Operational Programme for 2014–2020*** and the experience of the evaluation of the GINOP calls to date.

The SME and the Legal Working Groups also held consultations with the representatives of the Hungarian Chamber of Civil Law Notaries (MOKK) in relation to the ***Hungarian financial institutions contacted by civil law notaries in inheritance procedures*** and in relation to the IT framework for the response of the financial institutions. As a result of the consultations, MOKK sent the contents and format of the request and response template, which were reviewed by the working groups.

According to the provisions of Section 28 (5) of the Bankruptcy Act, effective from 28 December 2017, ***electronic data supply from banks to liquidation organisations is mandatory***, in relation to which the SME -Legal Working Group consulted with the representatives of the Hungarian Association of Insolvency Practitioners. As a result of the consultations, the working group developed and submitted to the FOE a proposal for a practical procedure in the performance of the banking data supply.

- *Leasing Working Group*

The Leasing Working Group had a number of meetings in the first quarter of the year. It organised a training day in relation to the introduction of the ***EXIM domestic leasing refinancing framework product,*** during which presentations were held on the product documentation and conditions and the rules of support content calculation (de minimis, general group exemption regulation, Article 17), the product brochure and the calculation table used in the OECD methodology. The working group reviewed the template contracts of the domestic leasing refinancing framework product and, based on the remarks made during the meeting, EXIM also prepared a simplified flowchart.

The Leasing Working Group prepared and submitted to GIRO Zrt. its development requirements for the ***GIRinfO service***. The users would like to have the “data of the vehicle owner” and the data of “vehicle documents and official certificates” available in one query. In response to the question from

GIRO Zrt., the working group explained in detail the data meant by the “official certificates”. The consultations on the topic are still in progress.

At the request of the Hungarian Banking Association, the Ministry of Interior, Transport, Administration and Registration Department, Transport Registration Unit issued a position statement on the transfer of vehicles. Accordingly, whenever ***any change in the ownership right or operator’s status is certified with a private document,*** that document must comply with *the mandatory content specified in Section 3* and, when the operator’s status changes, in Section 4, *of Government Decree 304/2009 (22 December) on “The mandatory content components required for eligibility for use in transport administration procedures*”. If these content elements are included, the offices of government-issued documents accept the operators’ declarations prepared by the leasing companies as contracts with operators.

- *Litigation Working Group*

During its February meeting, the working group focusing on invalidity lawsuits discussed the following topics:

1. The preliminary ruling procedure initiated by the Curia on declaring the contract condition establishing the amount of costs, disbursement commission and fees payable by the consumer to be unfair when the specific service covered by the particular cost is not defined.
2. Preliminary ruling procedure to declare the contract provision on the notarial certificate of facts unfair.

The employees of the banks affected by the above cases gave a short summary presentation on the procedures. We requested the colleagues to share with us information related to the recent lawsuits. The participants in the meeting also discussed whether a new wave of lawsuits may be expected in the Hungarian courts, as certain press statements intended to create that impression.

I Global regulation

I.1 Financial Stability Board (FSB)[9]

I.1.1 The FSB's priorities

Ahead of the G20 meeting of finance ministers and central bank governors in Buenos Aires on 19–20 March, FSB Chair Mark Carney sent out a letter articulating the FSB's priorities. He noted that strong and balanced economic growth is supported by a stable and resilient financial system that is the product of the determined efforts of the G20 and the FSB in the past decade. The FSB's ***priorities*** rest on this firm footing, and seek to foster strong, sustainable and balanced growth:

1. Vigilant ***monitoring to identify, assess and address new and arising risks.***

One important tool for monitoring risks is the ***biannual Early Warning Exercise conducted jointly with the IMF.*** In response to members' calls, the FSB also examined how the ***risks arising from the rapid growth in crypto-assets impact financial stability.*** It was established that due to their negligible amount (comprising less than 1% of global GDP), they do not pose a threat at this time. As crypto-assets raise numerous consumer and investor protection concerns, and may conceal illicit activities (money laundering, terrorist financing), while the technologies underlying them may enhance efficiency, they are continuously examined by the FSB, which informs the G20 when necessary. Global coordination is ensured by the competent international organisations (CPMI,[10] FATF,[11] IOSCO[12]).

2. ***Disciplined completion of the G20's outstanding financial reform priorities.***

Following the finalisation of the Basel III regulatory reform package in December, the FSB now concentrates on completing work in other regulatory areas. With respect to the ***decline of correspondent banking,*** the FSB prepared a progress report for the summit in Buenos Aires on the implementation of the correspondent banking action plan. Four strategic recommendations were offered for improving remittance providers' access to banking services. Regulatory authorities have developed the corporate governance framework that is able to mitigate ***conduct risks.*** The regulatory work on ***market-based finance*** and ***central counterparties*** has also been completed. The ***cyber-security lexicon*** supports the consistency of various authorities, regulators and the private sector. The ***climate-related financial disclosure*** initiated by the private sector and its ***voluntary implementation*** highlight good practices and foster wider adoption.

3. Shifting the focus from new policy initiatives to the ***assessment of existing regulations*** to ensure that the reform programme is enforced in an efficient and coherent manner, appropriately addressing unintended consequences.

The FSB seeks to assess whether the reforms work as originally intended, and to make any necessary adjustments without jeopardising the initial goals and the appropriate resilience. The dynamic introduction ensures that the reforms adapt to the changing environment. For the G20 summit in

[9] The top-level international body for financial standard-setting

[10] Committee on Payments and Market Infrastructures (similar to the Basel Committee on Banking Supervision, it operates under the auspices of the Bank for International Settlements [BIS])

[11] Financial Action Task Force: an international working group against money laundering and terrorist financing, operating alongside the OECD

[12] International Organization of Securities Commissions

November, the impact of financial reforms on infrastructure investment and the incentives for the central clearing of OTC derivatives will be assessed.

4. ***Optimising how the FSB works in order to maximise its effectiveness,*** facilitating the utilisation of the advantages of an efficient and responsive organisation controlled by members' contributions and consensus.

In order to ensure that the FSB continues to function appropriately, the members thoroughly examine its work. The evaluation covers transparency, consultation practices, the mechanisms for setting the strategic agenda and the safeguarding of principled and efficient operation.

I.1.2 Further important publications of the FSB from Q1

The FSB published ***Governance arrangements for the unique transaction identifier (UTI): Conclusions and implementation plan*** in January. G20 leaders decided to reform OTC derivatives markets in 2009, having identified the lack of the markets' transparency as a key factor in the financial crisis. As part of the reform, all OTC derivatives transactions should be reported to trade repositories (TRs). The primary objective of the UTI is to identify unique OTC transactions during reporting to trade repositories. It is intended to help avoid transactions being taken into account multiple times. The related ***technical guidance*** regulates the responsibilities linked to the generation of the UTI, the structural definition and the format specification. The UTI has to be introduced in the various jurisdictions by the end of 2020. The UTI is supervised by CPMI and IOSCO acting as international governing bodies, however, the final decision on supervision will be taken after the completion of the consultation on the unique product identifier (UPI).

The FSB published the ***Global Shadow Banking Monitoring Report 2017*** on 6 March. The report, prepared for the seventh time, is based on 2016 year-end data from 29 jurisdictions responsible for 80% of global GDP, and for the first time it includes shadow banking data from Luxembourg and China. It gives a detailed picture about the extent of shadow banking activities, as well as their growth and composition in 2016.

The FSB also published ***updated data on the decline in correspondent banking***. The slump in this area has a potentially negative impact on international trade, affecting growth as well as the integrity and stability of the financial system. The data show that the number of correspondent banking relationships continued to diminish, as in June 2017 the number of relationships was lower than a year before. However, the change happened unevenly in geographical terms: in North America and Eastern Europe, correspondent banking expanded, while in Africa and Oceania there was a slowdown in the fall, while a greater drop was observed in other parts of America and Europe and Asia than one year ago.

The Basel Committee on Banking Supervision, the CPMI, the FATF and the FSB published a joint press release to welcome the industry initiative aiming to address the decline in these activities by a ***correspondent banking due diligence survey.*** The survey is part of the private and public sector's shared ***Know-Your-Customer*** programme.

The FSB published two other documents related to correspondent banking before the G20 meeting: the ***progress report presenting the implementation of the correspondent banking action plan*** and the ***stocktake of remittance service providers' access to banking services.*** The latter formulates 19 recommendations in four areas to promote enhanced access, and the recommendations' implementation will be presented at the G20 meeting in July 2019.

The FSB conducted a ***survey*** involving stakeholders participating on a voluntary basis to assess the impact of financial reforms on the financing of infrastructure projects. It expected first-hand information from market participants regarding the drivers and trends of infrastructure financing as well as any impact of the regulatory reform.

Following the consultation announced in June 2017, a ***supplementary guidance to the FSB principles and standards on sound compensation practices*** was published.

I.2 Basel Committee on Banking Supervision (BCBS)

I.2.1 BCBS work programme and priorities

At its meeting on 15–16 March, the Basel Committee on Banking Supervision discussed its ***work programme and the strategic priorities for 2018–2019.*** The work programme focuses on four main topics:

(i) finalising existing regulatory initiatives and targeted regulatory recommendations,
(ii) ensuring full, timely and consistent implementation of the Committee's post-crisis reforms,
(iii) promoting strong supervision,
(iv) evaluating and monitoring the impact of post-crisis reforms, as well as gauging and assessing emerging risks.

The work programme was endorsed by the GHOS.[13]

The Committee also discussed its ***ongoing work:***

- The trading book regulation (market risk framework) published in January 2016 was agreed to be revised in a targeted and limited manner, and a related consultation was launched on 22 March. It was reaffirmed that the new rules have to be implemented from January 2022.
- After the consultation process, the assessment framework of global systemically important banks was finalised, and it will be published soon.
- The capital requirement for short-term simple, transparent and comparable securitisation was agreed, and the related standard will also be published.

The Committee is working on the assessment methods of the Basel III implementation. The consistent implementation will be assessed on a voluntary basis.
In the spirit of promoting strong supervision, the BCBS adopted a report on early supervisory intervention practices. Analysing market developments, the Committee discussed the impact of financial market volatility on the stability of the banking system as well as the consequences of the spread of crypto-assets.

I.2.2 Trading book regulation review

The consultation document aims to address the issues that the Committee has ***identified during the standard's introduction and the monitoring of its effects.***
The BCBS recommends the following changes:

- Modification of the standardised approach to increase risk sensitivity, including a change in treating FX risk,
- Recalibration of standardised approach risk weights applicable to general interest rate risk, FX risk and equity risk,
- Revisions to the assessment process to determine whether a bank's internal risk management models appropriately reflect the risks of individual trading desks,
- Clarification of the requirements linked to the identification of risk factors eligible in internal models,
- The more precise delineation of the exposures subject to market risk capital requirements.

[13] Group of Central Bank Governors and Heads of Supervision

Following the consultation on the simplified standardised approach announced in June 2017, the document also proposes a ***recalibration of the standardised approach used in the Basel II system.*** This approach could be used by banks with less material exposure to market risks.
The Committee wishes to finalise the regulation as soon as possible, to give ample time to jurisdictions for the implementation and to banks for developing the necessary infrastructure until its introduction in January 2022.

I.2.3 Pillar 3consultation

On 27 February, the BCBS launched a consultation on the updated framework of the Pillar 3 disclosure requirements. The majority of the proposed changes are linked to the ***finalisation of the Basel III regulatory package in December 2017.*** The new or updated requirements are as follows:

- credit risk (including the provisions ensuring the prudential treatment of assets), operational risk, leverage ratio and CVA[14] requirements,
- the risk-weighted asset (RWA) values as calculated with the standardised approach that serve as a benchmark for the values calculated with the internal model,
- the overview information related to risk management, key prudential metrics and RWA values.

Another new requirement pertains to asset encumbrance and the disclosure of capital distribution constraints. The Committee requests separate feedback regarding the disclosure requirement on the composition of the regulatory capital, which was introduced in March 2017.
Together with the requirements issued in January 2015 and March 2017, the present package comprises a uniform Pillar 3 disclosure framework.
The consultation on the requirements ended on 25 May.

I.2.4 Introduction of the Basel III regulation

According to the calculations with the 30 June 2017 data, all banks under review fulfil the CET1 capital requirement targeted since the end of 2015. Moreover, all G-SIBs[15] meet the comprehensive liquidity requirements.
Within the framework of the RCAP[16], the Committee disclosed the actions undertaken by the jurisdictions to ensure consistent implementation in 2017, and updated the ***Handbook for jurisdictional assessments.***

I.2.5 The impact of fintech development on banks and supervisors

The document published in the wake of the consultation in August 2017 presents the effect of fintech on banks and supervisors. With respect to the potential effects, the BCBS examined five stylised scenarios:

- The better bank: modernisation and digitisation of incumbent players,
- The new bank: replacement of incumbents by challenger banks,
- The distributed bank: fragmentation of financial services among specialised fintech firms and incumbent banks,
- The relegated bank: incumbent banks become commoditised service providers and customer relationships are transferred to new intermediaries,
- The disintermediated bank: bricks-and-mortar banks become irrelevant as customers interact directly with fintech service providers.

[14] Credit Valuation Adjustment
[15] Global systemically important banks
[16] Regulatory Consistency Assessment Programme

Experience shows that although the banking sector has introduced a wide range of innovations, the new technologies and emerging business models present various opportunities and risks to incumbent banks. Banking standards and supervisory expectations need to adjust to the innovations, while also preserving prudential standards.
The BCBS document practically reiterates and reaffirms the ten recommendations for banks and supervisors in the consultation documents.

I.2.6 BIS–IMF cooperation

The Bank for International Settlements (BIS) hosting the Basel Committee on Banking Supervision will cooperate more closely with the IMF on bolstering financial supervisory skills all over the world. The cooperation aims to enhance the expertise of financial regulatory bodies and supervisors, especially with respect to the implementation of post-crisis reforms and the new issues such as fintech. In this spirit, the BIS and the IMF initiate a new ***joint online banking supervision course***, which will become available to supervisory officials worldwide this year.

I.2.7 CPMI report on cross-border retail payments

According to the February report, there is ample room to improve the infrastructure of cross-border payments initiated by individuals and businesses. Payments from one jurisdiction to another are slower, costlier and more “opaque” than those within individual jurisdictions. Even though the former are riskier and more complex, the differences in the associated fees are often unwarranted. Competition and innovations like mobile or e-banking have made these payments more convenient, but the bulk of cross-border payments is still made through the traditional correspondent banking system, which struggles with the growing volume of retail payments and lower individual amounts. The alternative clearing and settlement solutions improve the efficiency of cross-border payments.
The report analyses the market based on the examination of ***around 100 global firms providing innovative cross-border payment services,*** outlining the key issues and challenges.

I.2.8 Central bank digital currencies (CBDC)

According to the report published by the CPMI in March, central banks have to carefully assess the impact of the digital currencies issued by them on financial stability and monetary policy. The report pays special attention to wholesale digital currencies (issued for financial markets) and general-purpose currencies. It finds that wholesale CBDC may prove useful in payments, but assessing its impact requires further analysis. It will not change the basic mechanism of implementing monetary policy, however, it may impact transmission.
On the other hand, the general-purpose CBDC could have wide-ranging implications for banks and the financial system. Commercial banks’ stability based on customer deposits may be undermined if the deposits can flow to central banks in times of stress.
The report concludes that the introduction of CBDC requires careful consideration in all jurisdictions.

I.3 IASB: Review of the Conceptual Framework for Financial Reporting

In March, the IASB[17] published a revised version of its key document entitled ***Conceptual Framework for Financial Reporting*** in March. (The conceptual framework was devised in 1989, then it was partly modified in 2010.) The revised framework fosters the consistency of the standards adopted by the IASB, ensures that similar transactions are treated in the same manner, and provides useful information to investors and other stakeholders. However, the conceptual framework supports the

[17] International Accounting Standards Board

development of companies' accounting policies even if there is no IFRS[18] standard applicable to the given transaction, and it also contributes to the better understanding of the standards. The revised document contains a new chapter on the ***measurement of instruments; on presentation and disclosure;*** and on ***derecognition.*** The definitions of assets and liabilities were modified, just like the criteria for recognising instruments. At the same time, several important concepts (e.g. prudence, stewardship, measurement uncertainty and substance over form) were clarified. From now on, the IASB will use the revised framework, while companies will be required to do so from 2020.

II European Regulation

II.1 Developments regarding the Risk Reduction Package (RRP)

The European Parliament has made more progress in discussing the November 2016 risk reduction package, which amends the capital requirements regulation and directive (CRR/CRD4), the bank recovery and resolution directive (BRRD) and the single resolution mechanism regulation (SRMR), with respect to resolution rules than in connection with the prudential part. (Accordingly, the European Banking Federation (EBF) has prepared separate proposals for the two areas.)
However, the package was removed from the Council's agenda in March.

According to the Presidency's report to the Council, there are three main groups of issues where member states disagree:

- ***the introduction of the regulation for the fundamental review of the trading book;***
- ***the subordination of MREL[19] instruments;***
- ***exemption from the scope of the CRR/CRD.***

The most important interest of banks is that, in line with the BCBS decision, the introduction of the FRTB in Europe be postponed. It is fundamental that no expenses are imposed (not even for the purposes of reporting), where the standards these are based on will be significantly modified in the future. The European Commission is currently contemplating the arguments regarding the FRTB. Going beyond the FRTB, the adoption of the RRP will take place independently from the finalization of the Basel III reforms in December.
The package will enter into force in 2019 at the earliest.

Major points for which the European Banking Federation is lobbying in connection with the prudential rules of the RRP

- Removing the FRTB from the package (put on hold until the decision by the Basel Committee),
- Amending the treatment of repurchase transactions when calculating the NSFR (netting by maturity bucket),
- Treating derivative liabilities as prescribed in the calculation of the NSFR ([up to] 5% RSF[20] instead of 20% in line with the Basel Committee's decision in October 2017).
- Disregarding the exposures guaranteed by export credit agencies in OECD countries when calculating the leverage ratio, irrespective of country rating and currency),
- The automatic granting of the liquidity subgroup status to subsidiaries within the EU, and the preferential treatment of intragroup transactions (which is definitely justified within the Banking Union),

[18] International Financial Reporting Standard
[19] Minimum requirement for own funds and eligible liabilities
[20] required stable factor

- The rejection of the proposal by certain Member States that systemic risk should be treated in Pillar 2,
- The rejection of deducting software from capital,
- More flexible remuneration options for IT staff,
- Maintaining the SME supporting factor and potentially raising the upper limit (EUR 1.5 million) on its application,
- Introduction of a supporting factor in the case of infrastructure project loans,
- Simplification of the reporting requirements of small institutions while adhering to the principle of proportionality,
- Remove daily reporting requirement for NSFR,
- Remove general prior permission for redemption of MREL instruments,
- Maintaining the existing large exposures regime,
- Maintaining the currently effective simple method for determining the capital requirement of counterparty risk.

Major points for which the European Banking Federation is lobbying in connection with the resolution rules of the RRP

- Limiting the subordinated part of MREL,
- Adapting the calibration of MREL for well capitalised banks and financed deposit funded banks (such banks should not be required to issue debt instruments, and they should be able to use their existing excess capital),
- Maintain guidance in MREL calibration,
- Limiting MREL guidance to relevant buffers post resolution,
- Making MDA restrictions non-automatic in case of MREL breaches,
- Ensuring grandfathering provisions are in place for existing own funds and eligible liabilities,
- Clarifying the various eligibility criteria,
- Taking into account the EU Single Market and the Banking Union while adapting internal MREL rules,
- Recognition of the MPE[21] strategy
- Limiting the moratorium tool to international agreed time frame of 48hours,
- Ensuring the alignment between resolution and insolvency.

II.2 The European Commission's consultation regarding of Basel III finalization

In March the European Commission launched an exploratory ***consultation on Basel III finalization*** to gather views from interested parties on the potential impact that amendments may have on the EU banking sector and the wider economy, as well as to highlight possible implementation challenges. At the announcement of the consultation, the Commissioner responsible for regulation emphasized that it is essential that all major jurisdictions implement all elements of the agreement. The implementation of this agreement in the EU will require amendments to the ***Capital Requirements Regulation (CRR)***. Before considering such amendments, the Commission will carry out a thorough impact assessment, in accordance with its Better Regulation Agenda, the first step of which is the currently ongoing consultation. The Commission announced that the consultation period will end on April 12th.

The European Banking Federation wrote a letter to the Commissioner responsible for financial regulation, asking that the consultation period be extended to two months, given the scale of this issue.

[21] multiple point of entry

In its response sent by the 12 April deadline, the EBF claimed that the core equity capital adequacy ratio has increased to 13.8% since the crisis, and the LCR has also doubled since 2011, when it stood at 70%. The new recovery and resolution scheme has been launched, and risk management practices have improved. Based on this, the EBF has reiterated its earlier opinion that the ***regulatory reform has achieved its objective with respect to ensuring financial stability.*** Further revisions can add little, if anything at all, to bolstering stability. Quite the contrary, additional rules may hamper banks' lending capacity and indirectly contribute to the emergence of financial instability.

II.3 Initiatives regarding non-performing exposures (NPE/NPL)

The reduction of NPL portfolios is regarded as a fundamental condition for establishing the Banking Union; therefore various proposals were made for their treatment. In July 2017, the ***European Council agreed on an action plan on the European treatment of non-performing loans***, in which it called on EU institutions (among them the European Commission) to take several measures.

The ***Commission's initiatives*** (published March 14th) aim to reduce EU banks' existing NPLs, and to prevent the buildup of new NPL exposures. (NPLs decreased from 6.7% at the end of 2014 to 4.4% in 2017 Q3, although they remain significantly above levels before the crisis, and are distributed unevenly among member states.) The measures proposed would liberate banks' lending capacity and would ultimately contribute to economic growth as well as to increasing employment rates, and at the same time moderate the vulnerability of the banking sector.

The Commission's package consists of four measures:

1. ***The introduction of a mandatory prudential backstop by modifying the Capital Requirements Regulation (CRR).*** The measure requires a minimum coverage (impairment/provision) for newly originated loans that become non-performing. It thus incentivizes banks to work out NPLs in their early stage phase and avoid their excessive accumulation.
According to the proposal, an impairment /provision of 100% after two years, and 35% after the first year must be established for unsecured, new loans turned non-performing. The draft prescribes progressive loss provisioning: in the case of secured loans, 8 years are granted – 5% must be provisioned by the end of the first year, 27.5% by the end of the fourth, and 75% by the end of the seventh. 100% must be reached by the end of the 8th year (as opposed to the 7th proposed by the ECB). The draft also differentiates between loans expired by over 90 days and loans categorized as non-performing for other reasons. ***The missing provisions must be covered by tier 1 capital***. These requirements apply to exposures originated ***after March 14, 2018***.
The ECB and the EBA gave their preliminary support for the Commission's proposal.

2. The measures will facilitate creditors' ***access to collateral***. According to the ***draft directive***[22] creditors would be able to ***recover collateral through an accelerated, out-of-court enforcement procedure***, if both parties previously consented to this in the loan contract. Agreeing to this would be in the interest of credit purchasers, due to thus achieved lower credit prices. According to the Commission's estimates, financing expenses may decrease by 10-18 basis points on average (price effect may be 40% stronger in the case of SMEs).
The measures would be applied in line with insolvency rules, i.e. the accelerated, out-of-court recovery of collateral is not enforceable if a ***moratorium was granted***. (This option is not available at all for consumer credits.)

[22] Proposal for a directive on credit servicers, credit purchasers and the recovery of collateral

3. The further development secondary markets for NPLs, creating a European market, and ***incentivizing sale to market actors specialized in the treatment of NPLs. Selling NPLs or outsourcing their treatment*** is important for member states with an especially high NPL portfolio. The proposed draft directive ***harmonizes requirements for credit servicing*** and ***allows for such servicers to operate across the EU on a single authorization***, as well as ***cross-border operation within the Union***. (According to the Commission NPL sales may increase by 15% per year.) Consumer protection is ensured by legal safeguards and transparency rules so that the transfer of a loan does not affect the legitimate rights and interest of the borrower.

4. A technical ***Blueprint for how national Asset Management Companies*** (AMCs) ***can be set up*** in compliance with existing state aid and EU banking resolution regulations. The non-binding recommendation helps to treat the NPL issue at member state level.
The Commission stresses that the elements of the package reinforce one another; therefore they must be applied in unison to achieve the considerable reduction of NPLs.

The Commission ***published its second progress report on the reduction of NPLs in Europe*** alongside the above proposals. (The first progress report was published in January.)

In March 2017 the ***European Central Bank (ECB)*** published its ***final guidance on tackling non-performing loans***, then in early October, it launched a consultation on ***complementing the guidelines*** (***Addendum).*** The finalized Addendum was published in March 2018. The ECB emphasized the ***Pillar 2 nature and the bank-by bank (case-by-case) application*** of the supervisory expectations. According to the requirements set in the Addendum, exposures turned non-performing after April 1, 2018, must be ***registered and tracked according to the point in time when they became non-performing***. Non-performing exposures must also be put into one of two groups, based on ***whether they are secured by collateral or not***. Banks are expected to provision for /recognize impairment loss on 100% of unsecured exposures that have been non-performing for 2 years. The same applies to NPLs secured by collateral 7 years after they are reclassified as non-performing. The regulations apply to banks under direct ECB supervision, and the ECB will assess banks over the course of Supervisory Review and Evaluation Process individually – first, during the 2021 SREP. The requirements are meant to act as a ***backstop regulation*** and will have no operational impact on banks that regularly carry out loss provisioning.

Germany and the Nordic Member States urge the ECB to apply similarly strict rules to the treatment of existing stocks, which is opposed mainly by Italy and Portugal.
NPLs represent the most pressing issue in Greece where 46.7% of all loans are affected, while in Portugal and Italy the corresponding figures are 17.8% and 12.3%, respectively. In absolute terms, the largest amount of NPLs can be found in Italy, amounting to EUR 221 billion (or EUR 285 billion according to other sources).
According to news from 17 April, Intrum, a Swedish credit management service company, will buy the debt management department of Intesa and its bad loans worth EUR 10.8 billion for EUR 3.6 billion in total (making it the biggest credit management service company in Italy).

In March, the European Banking Authority (EBA) launched a consultation on the ***treatment of non-performing and forborne exposures***. The draft guidance poses requirements towards banks with elevated levels of NPLs (above 5%) with regard to governance, risk management, creating an internal control framework, early warning processes, and the fair treatment of consumers.
Just as the European Commission published its package, the EBA disclosed its ***advice on the use of statutory prudential backstops to prevent the accumulation of new non-performing exposures***. At the request of the Commission, the EBA examined how the different options proposed by the Commission would impact banks' profit and capital and the interaction of the backstop with the full set of available regulatory and supervisory measures, which are currently in place.

The Commission, the ECB, and the EBA are also cooperating to create an information base on NPL exposures.

II.4 Banking Union

II.4.1 The Single Supervisory Mechanism (SSM)

The SSM's priorities

The majority of the 2018 ***priorities*** in the annual report of the European Central Bank on its supervisory activities, were also among the key tasks one year ago and will continue to be pursued in the next year. The priorities in the different areas are as follows:

Business models

- Impact of interest rate risk on businesses' income and profitability

Credit risk

- Development and use of a consistent methodology for non-performing loans / forborne exposures (deep dives, on-site inspection)
- Exposure concentrations, collateral management and valuation (for example real estate or Level 3 assets)

Risk management

- Targeted review of internal models (TRIM)
  credit risk, market risk and counterparty risk models
- Improving banks' ICAAP and ILAAP[23] approach
- Assessment of banks' preparedness for the IFRS 9 standard and other regulatory changes

Multiple risk dimensions

- Brexit preparations
- EU-wide stress tests (every other year) and SSM stress testing.

At her presentation of the supervisory report before the ECON[24], SSM Chair Danièle Nouy underlined that in one year the average CET1 capital adequacy ratio of euro area banks increased from 13.7% (2016 Q3) to 14.3% (2017 Q3). In the same period, NPLs of banks supervised by the ECB declined from 6.5% to 5.2%. Profitability also improved, as the average return on equity grew from 5.4% to 7%.

Public consultation on the draft ICAAP and ILAAP guides

In early March, the ECB has announced a public consultation on the draft guide relating to the internal assessment of capital adequacy and liquidity (ICAAP/ILAAP). The draft sets out the ECB's expectations regarding the internal management of capital and liquidity.

Appropriate capital and liquidity management is key for banks' safe operation. Banks can be expected to treat their risks with a forward-looking approach, identify and effectively manage all material risks, and have the necessary capital and liquidity at all times. Banks send their ICAAP/ILAAP information annually to JSTs[25], which use that data in the SREP.

[23] Internal capital adequacy assessment process / Internal liquidity adequacy assessment process
[24] The European Parliament's Committee on Economic and Monetary Affairs
[25] Joint Supervisory Teams

The ECB published its expectations regarding ICAAP/ILAAP in 2016. After careful assessment, the ECB has identified substantial differences between the approaches of the different banks, and significant enhancements were considered necessary for all banks. In early 2017, the ECB launched a multi-year programme to improve ICAAP/ILAAP processes. The goal is to prepare more detailed regulatory expectations by taking into account the feedback from banks and other stakeholders. The current ECB consultation on the revised draft guide ended on 4 May.

Some other developments

In January, the ***European Court of Auditors*** issued a ***report on the European Central Bank's crisis management activities.*** The report states that the ECB's crisis management activities are anchored on a solid foundation, and only minor shortcomings could be identified. The Court of Auditors recommended that the internal guidance on early intervention and the assessment of institutions that are failing or likely to fail be further enhanced.

ABVL, the third largest bank in Lithuania, went bankrupt after the US Treasury Department declared on 13 February that the bank had been involved in money laundering and necessary action would be taken against it. After a marked deterioration in the bank's financial situation, the ECB instructed the Lithuanian supervisory authority to freeze payments, then it announced that ABVL was failing or likely to fail. This sparked a debate on the responsibility of the ECB in charge of prudential supervision and the ***extension of the ECB's supervisory powers to controlling money laundering.***

Following the consultation in October, the ECB published the ***final guides on the assessment of licence applications*** and the ***assessment of fintech credit institution licence applications*** in March.

II.4.2 The Single Resolution Mechanism (SRM)

In her speech delivered at the SRB[26] press breakfast, Chair Elke König said that the recent bank failures have shown the necessity of harmonising Member States' insolvency laws. The Single Resolution Mechanism currently has to be used with 19 insolvency laws. Ensuring consistency between resolution and liquidation is key to eliminating incorrect incentives. It is important that the SRB's decisions be carried out, whether they pertain to resolution or not, therefore the finalisation of national resolution authorities' handbooks is a priority for 2018. The chair also underlined that ***resolution planning was a process rather than a product,*** and that plans are continuously fine-tuned.

Elke König pointed out five priorities in the SRB 2018 work programme:

- Strengthening resolvability for SRB entities and for less significant, smaller banks too,
- Developing a robust resolution framework,
- Preparing and carrying out effective crisis management,
- Operationalising the SRF[27],
- Ensuring that the SRB is an efficient organisation.

One key task for this year is to adopt the resolution plans of the banking groups under the SRB. Banks are resolvable when the MREL is sufficient from both a quantitative and qualitative perspective. The SRB will ***determine binding MREL targets at consolidated level*** for all important banking groups in 2018, but work will also begin on the MREL targets at the entity level. In addition to the MREL, guidance will be developed for internal resolution teams in other areas as well to support resolution planning.

[26] Single Resolution Board
[27] Single Resolution Fund

Another priority is the identification of the material factors hindering resolution. Such factors include the lack of access to data, overly complex structures, the lack of access to financial infrastructure and the lack of funding for resolution. Banks do not need to wait for the SRB's formal decision to eliminate these hurdles.

The SRB cooperates closely with competent authorities at the national, European and even international level (US), and the memorandum of understanding signed with the ECB has been reviewed in view of the experiences since 2016.

Covered deposits grew by 3% in 2017, therefore the SRF's 1-per cent contribution target also increased, and contributions to ***the SRB are expected to amount to EUR 7.5 billion*** in 2018.

II.4.3 debates about the European Deposit Insurance Scheme

Completing the Banking Union is one of the most important priorities of the economic and monetary union. On October 11, 2017 the ***Commission published a press release on the steps to be taken towards completing the Banking Union by 2018***. The communication presents the progress made so far towards establishing the Banking Union (the establishment of the Single Supervisory Mechanism and the Single Resolution Mechanism) and outlines further measures necessary for completing it. It states that while completing the Banking Union, ***risk reduction and risk sharing must be implemented together.***

With regard to the ***European Deposit Insurance Scheme*** – an indispensable part of completing the Banking Union – there was no significant progress made for a long time following the Commission's proposal published in November 2015, under which EDIS would be established gradually, in three stages by 2024. To facilitate the creation of the EDIS and to nudge forward stagnating negotiations, in October the Commission suggested some ***modifications with regard to the phases and the timeline of the deposit insurance scheme***. The proposed ideas addressed diverging views and concerns raised in the European Parliament and the Council. A number of member states (Germany, the Netherlands, and the Northern and Baltic states) do not support establishing EDIS, as they are fearful that in the case of the possible failure of banks with high levels of NPLs, it will be member states with stable banking systems that will have to pay for the expenses.

In late 2017 the Commission proposed a ***more gradual introduction of EDIS***. According to the proposal, there would only be ***two phases*** of creating the deposit insurance scheme: the first, a ***more limited reinsurance phase,*** where national deposit insurance schemes could only take out credit from the common fund if they pay back this support and EDIS would only provide liquidity coverage to national deposit insurance schemes, the second, a ***coinsurance phase,*** moving on to which would however be conditional on progress achieved in reducing risks.

The Commission wants to come to a decision on the introduction of EDIS by the end of 2018. Germany set the reduction of the NPL portfolio, the harmonization of insolvency procedures, the achievement of bail-in buffers, and solving the sovereign bond problems of banks as conditions for the implementation of EDIS.

Completing the Banking Union also requires the creation of ***a common fiscal backstop for the Single Resolution Fund***, which could be secured by the credit line of the European Stability Mechanism.

Vítor Constâncio, the outgoing vice president of the ECB, sought to convince MEPs when presenting the ECB's annual report to the European Parliament to complete the Banking Union in order to increase stability and bolster the system's resilience. He believes that the Banking Union is within reach. According to Valdis Dombrovskis, the commissioner in charge of financial regulation, the political negotiations on the Banking Union have now entered a critical phase, and if they do not bear fruit, the project will remain in uncertainty due to next year's parliamentary elections.

II.5 The Capital Markets Union (CMU)

Legislative proposal and notice: Removing barriers to cross-border investments and speeding up the implementation of the Capital Markets Union

In the spirit of creating the Capital Markets Union, the European Commission made legislative proposals in March to foster alternative sources of finance and eliminate barriers to cross-border investments. The proposals aim to provide momentum to the ***cross-border market for investment funds,*** facilitate the ***development of the market*** for ***covered bonds*** as long-term sources of finance and create ***greater legal certainty*** for investors taking part in cross-border ***securities transactions*** and ***holding claims.***
The Commission called on co-legislators (the Parliament and the Council) to ensure the speedy adoption of key reforms that are currently being discussed (i.e. the proposals for strengthening capital market supervision, business restructuring and new savings opportunities for consumers). Out of the 12 proposals presented by the Commission as building blocks of the Capital Markets Union, only three have been adopted by the co-legislators.
Valdis Dombrovskis said that "To have a genuine Capital Markets Union in Europe by 2019, we need to advance in three directions: ***European labels and passports for financial products, harmonised and simplified rules to deepen capital markets and more consistent and efficient supervision.***"

The concrete proposals are as follows:

- ***European covered bonds***

The Commission proposed common rules for ***covered bonds***, ***one directive and one regulation.*** Covered bonds, amounting to EUR 2.1 billion, currently comprise one of the largest segments on the EU's bond market. European banks are global leaders on this market, as covered bonds represent an important source of long-term finance in several EU Member States. However, the EU market is fragmented at the national level, and regulations vary across Member States. The proposed rules are based on high standards and best practices, and aim to foster the use of covered bonds as stable and cost-effective sources of finance for credit institutions, especially on less advanced markets. Another important objective is to reduce the borrowing costs for real economy actors.

- ***Cross-border distribution of investment funds***

The Commission seeks to ***remove the barriers to the cross-border distribution of investment funds*** for all funds, making distribution simpler, faster and cheaper. The greater competition offers more choices and more valuable products to investors, while providing a high level of investor protection.

- ***The law applicable to cross-border transactions in claims and securities***

Currently it is legally uncertain which national law should be used when determining who owns a claim after it has been assigned across borders. The proposed new rules clearly define the ***prevailing law in such legal disputes.*** As a general rule, it is the law of the country where the assignors have their habitual residence, regardless of which Member State's courts or authorities examine the case.
The Commission also proposed regulating ***which country's laws should be applied*** when deciding ***who the owner of the securities is*** in cross-border securities transactions.

The Commission's press release also discusses the ***action plan for financial technology*** and the ***action plan for sustainable finance.***

The Commission believes that several targeted initiatives are necessary at the EU level to ***utilise the opportunities offered by the innovative technologies emerging in financial services.*** The ***fintech action plan*** defines clear and concrete steps that seek to promote the success of innovative business

models, support the widespread use of new technologies (e.g. blockchains, artificial intelligence and cloud services), enhance cybersecurity and improve the integrity of the financial system. It guarantees that the European financial sector remains innovative and competitive, without jeopardising financial stability and investor protection.
As a first major measure, the Commission proposes new rules for ***promoting the growth of crowdfunding platforms on the Single Market.*** A pan-European label and "passport" for crowdfunding platforms is also proposed. This would ensure that a platform licensed in one Member State can operate in all other Member States.

The ***action plan for sustainable finance*** aims to pave the way for more sustainable economic growth and development by guiding capital towards more sustainable investments (e.g. projects facilitating the transition to clean energy sources and to a circular economy). Another important objective of the plan is to take into account sustainability aspects in risk management, and to promote transparency and long-term thinking in the public and the private sector, steering more public and private investment towards sustainable development, in line with global commitments such as the Paris Agreement and the 17 sustainable development goals of the UN.

II. 6 Proposal to reduce the costs of euro transfers within the EU

In late March, the European Commission proposed to ***cut the costs of cross-border payments*** in euro across the whole EU. According to current rules, it makes no difference for euro area residents and businesses whether they conduct euro transactions in their home country or another Member State of the euro area. The Commission's proposal aims to extend this rule to the residents and businesses of the countries outside the euro area. This way, all consumers and businesses could fully benefit from the advantages of the Single Market when sending money, paying or withdrawing cash abroad. If the proposal is adopted, ***all intra-EU cross-border payments in euro outside the euro area would incur the same*** small or zero ***fee as domestic payments in the local official currency.*** The Commission also proposed to improve the transparency and competition of currency conversion services, for the cases when consumers buy goods and services in a currency other than their own.

II.7 Taxing the digital economy

The Commission also formulated a proposal to tax the digital economy in order to make all businesses pay their due share of taxes in the EU. The Commission aims to tax digital business activities in the EU in a fair manner fostering growth. The measures could put the EU in the global vanguard of developing tax laws fit for the modern economy and the digital age. The proposals were put forward because the Member States wish to have permanent and lasting solutions to ensure the fair distribution of the tax revenues from online activities.
The two separate legislative proposals of the Commission result in fairer taxation of digital activities in the EU:

- The first initiative aims to **reform corporate taxation rules** to register and tax profits where significant interactions occur between the companies and the users through digital channels. This is the long-term solution preferred by the Commission.
- The other proposal responds to the calls from several Member States for an **interim tax** covering the major digital activities that currently fall completely outside the scope of taxation.

This package sets out a coherent EU approach with respect to digital taxation, which supports the digital Single Market, and which will also be taken into account at the international negotiations aimed at addressing the issue at the global level.

The EBF lamented the Commission's proposals in a press release. It underlined that only a global approach can ensure a level playing field and avoid unintended double taxation. It also reaffirmed its commitment to the approach assuming a global consensus and included in the 16 March Interim Report by the OECD/G20.

II.8 Further relevant developments in connection with the European Commission

The Commission has started reviewing the ***definition of microenterprises and SMEs***[28], currently regulated by Recommendation No. 2003/361/EC. An ***SME survey*** examining the appropriateness of the current definition and the possible avenues of change was designed.

Commissioner Dombrovskis in charge of financial regulation announced in early March that the EU Commission will ***not impose additional requirements on the treatment of sovereign exposures*** until a global consensus is reached at the Basel Committee on Banking Supervision.

British regulators decided to ***extend the operating licences of European banks until 2021,*** therefore no contingency plans are needed at this time. Yet it is vital that Brussels also guarantees to British banks the option of uninterrupted operation within the EU.

II.9 Relevant EBAs and ESAs[29] documents in Q1

Guidelines
Final Guidelines on disclosure requirements of IFRS 9 transitional arrangements (EBA/GL/2018/01)

Consultation papers
Consultation paper on draft guidelines on management of non-performing and forborne exposures (EBA/CP/2018/01)
Consultation paper on the application of the Joint Committee Guidelines on complaints-handling to the new institutions under PSD2 and MCD[30] (EBA/CP/2018/02)

Opinions
Opinion on measures to address macroprudential risk (EBA/OP/2018/01), (EBA/OP/2018/02)

Reports and other documents
Risk Dashboard Data as of Q3 2017
Report on the implementation of the EBA guidelines on methods for calculating contributions to DGS
Updated list of credit institutions subject to an LCR inflow cap derogation
EU-wide stress testing 2018
Methodological guide on risk indicators and detailed risk analysis tools
Joint ESAs warning on virtual currencies
Corrective update of XBRL taxonomy 2.6 for remittance of 2018 benchmarking exercise
Financial education report
DPM data dictionary
CRDIV-CRR/Basel III monitoring exercise
Revised list of ITS validation rules

[28] small and medium-sized enterprises
[29] European Supervisory Authorities
[30] Mortgage Credit Directive

Report on statutory prudential backstops
Roadmap on FinTech
Joint Committee final report on Big Data (JC/2018/04)
Report on the functioning of supervisory colleges in 2017
Report on Credit Risk Mitigation (CRM) framework
Updated list of public sector entities for the calculation of capital requirements