



HUNGARIAN BANKING ASSOCIATION

REPORT

Activities of the Hungarian Banking Association in 2017

Budapest, March 2018

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I. Executive Summary

In 2017, the ***world economy grew at an accelerated pace***. This was the first year after 2010 when all the most important growth centers (USA, EU, Japan and China) all showed growth, and emerging countries previously in recession (Brazil and Russia) showed signs of pulling themselves out of it. The expected ***3.7 percent global growth*** presents a kind of peak, and may slow down from now on. Growth continues to be supported by lax monetary conditions at global level, the sustainability of which is generally made possible by inflation approaching the target level from below and raw material prices that can still be classified as moderate. Retail and business expectations have improved and incentivized a gradual increase in consumption and investments. All of this was accompanied by a definite upswing in global industrial production and trade.

After the inauguration of the new President of the ***United States***, the development of the new economic policy trend started less forcefully than had been expected. The most important measure, the ***finalization of the new tax package***, took place only at the end of the fourth quarter. Opinions differ on whether this package will incentivize growth or if it will have negative consequences by rendering the budget unsustainable. American ***GDP growth*** for the entire year amounted to less than expected: ***2.3%***. Growth was fueled by internal consumption, the investments of the business sector and increased export, though import also grew significantly. Unemployment came to its lowest in 17 years: 4.1% at the end of the year.

The ***economy of the European Union showed favorable growth***, even in its unique economic and political environment, with an increasingly better performance throughout the year. According to initial estimations, both the Eurozone and all 28 EU countries reached a ***2.5% growth in GDP***, which is the best performance so far since 2007. The main driving force behind economic growth during the year was internal consumption, supported by the current state of the labor market. Export became an ever more important growth factor. In addition, corporate investments have finally shed the legacy of the crisis.

In ***Japan*** the positive impact of the economic policy weakening the yen became visible; growth has continued over the past eight quarters; however the country only achieved a ***0.5% GDP dynamic*** for the annual average. In ***China***, the slow shift in structure steered by the government continued, with a negative impact on growth, ***GDP growth decreased to 6.8%***. The weakness of the its financial system presents considerable problems for the country, as does the significant non-performing portfolio and widespread shadow bank lending. ***The Russian economy is slowly recovering***, owing to the stabilization of oil prices; it reached an annual ***GDP growth average of 1.5%***. On the other hand, the government's import substitution program launched as a result of sanctions may prove to be counterproductive.

The annual ***Hungarian GDP growth was 4.2%***. On the production side market services and the construction industry were the primary promoters of growth. Due to its decline towards the end of the year, industry contributed less to good performance. Agriculture performed average and therefore showed a decline compared with its outstanding performance last year. With regard to consumption, growth was fueled by internal demand, characterized by a 4.8% increase in retail trade. This was supported by the labor market having a structural surplus in demand: the significant (10%) increase in salaries and real wages. Due mostly to the fast distribution of EU sources, the expansion of investments was quite considerable as well. As a result of the exceptional European and global economic situation, export continues to be an essential factor of growth, although the rise in import exceeded its values, due to strong internal demand. The year saw unique budget balance indicators: the payment deficit arrived at 5% of the GDP, which was primarily caused by the fact that projects to be funded from EU sources had to be pre-financed from the central budget. In contrast, the budget deficit was kept under the planned 2.4%: around 2%. Government debt will likely decrease by 1.5 percentage points, but will exceed the past years', when considering EXIM. Due to strong internal

demand, the current account surplus decreased. Inflation processes were balanced throughout the year. The annual rate of consumer price increase was less than the 3% target level; prices grew by 2.4% on average. The central bank of Hungary (Magyar Nemzeti Bank) kept the benchmark interest rate at the same level. The EUR to HUF exchange rate stayed within a relatively narrow range throughout the year (between 302 and 315).

The **aggregated balance sheet total of credit institutions grew** by a nominal **5.4%** and surpassed HUF 36,000 billion. Overall fluctuations in the exchange rates only had a half percentage point increasing effect on the growth of the balance sheet, i.e. the exchange rate adjusted increase was approximately 5%. On the *liability* side there was a significant increase in deposits and equity, and a moderate one in bank issued securities; meanwhile borrowed credit decreased. Non-financial corporate deposits increased the most, although state deposits grew significantly as well. The increase in retail deposits was moderate, though its growth accelerated compared to the year before. The continued shortening of the average maturity of the entire deposit portfolio is predicted. The total equity of credit institutions grew by 11%, due fundamentally to retained profit and the large scale profit growth experienced during the year. The 7.8% expansion of the *credit portfolio* was the driving force behind growth within *assets*, although securities increased by nearly the same nominal value due to the central bank's self-financing program. All sectors contributed to the 8.7% increase in the gross value of credit positively: domestic and international lending was at a similar level. The expansion of credit was the most pronounced in non-financial corporations (+13.2%, HUF 1,007 billion), the value of which was further increased by a positive valuation difference and net reversal on impairment loss, which together amounted to HUF 136 billion. By the end of the year the credit institutions sector's *net loan-to-deposit ratio* increased to 97% (84% not counting interbank loan portfolios) from 91% the year before.

In 2017 *profit before taxes* was outstanding compared with past years, reaching HUF 637 billion. With this, the banking sector's average pre-tax return on assets (ROA) was +1.8%; and its return on equity (ROE) was +16.2%. However, the high profitability ratios are largely attributable to single factors and those unrelated to the operations of the Hungarian banking system (release of impairment losses and provisions, dividends from foreign subsidiaries). Not counting these, ROA would be 1.1% and ROE 10.2%, which are not outstanding values when the risk environment is taken into account. Due to lasting low interest, the erosion of net interest revenue continued as it had in the past several years; this is compensated for by revenue from fees and commissions and net income from financial operations.

On March 31, 2017 the **Funding for Growth Scheme**, was completed, which has been a defining factor in SME lending in the past four years. The program helped over 39 thousand micro, small and medium size enterprises to receive affordable financing, amounting to a total sum of nearly HUF 3 thousand billion. The Growth Supporting Program launched in 2016 helped banks revert to market-based lending, through the gradual phase-out of the Funding for Growth Scheme and the announcement of the **Market-based Lending Scheme**. In July, at the tenders announced within the framework of the second phase of the scheme banks raised their lending commitments for 2017 to almost HUF 230 billion.

In March MNB launched the **"Certified consumer friendly housing loan" certification** as a step to invigorate the market, strengthen competition and to increase transparency and comparability. Creditors can apply with their housing loan products in line with the terms set out in the **invitation to tender**. The terms include a cap on the interest rates, fees, costs and operation periods. The MNB held several rounds of consultations with banking experts on the invitation to tender including the terms of the Certified consumer friendly housing loan certification and the relevant documentation. During the negotiations, the terms stipulated for the product became technically manageable and less stringent. When initiating the scheme, the MNB also promised to ensure a sounder and faster credit assessment, by urging the competent authorities to **make practically the complete earlier**

loan portfolio accessible in the CCIS and with the help of the National Tax and Customs Administration to make available **customers' current income information**.

The scheme was launched in early June with the publication of the invitation to tender, and the first certification was granted in the same month. In order to facilitate the widespread use of the certification, by September the central bank had developed a clear and readily comprehensible **website for customers to compare certified banking offers**. 50 products from 24 institutions had received the certification by the end of September.

Amendments to the Act on Enforcement and the extension of the eviction ban had an unfavorable impact on retail lending for banks, as they further restrict the right to exercise loan guarantees. In contrast, banks' initiative to update the rules of the **Home Purchase Subsidy Scheme for Families** wished to incentivize housing loans. Based on the experience gained since the introduction of the HPS, banks made several suggestions for alleviating legislative requirements that complicate the use of the subsidy, and for simplifying the complicated administrative procedure for the loan application. No modifications were made to HPS rules in 2017, however. According to the government decree to **reduce the mortgages owed by families with many children through state subsidies**, families with a mortgage will receive a state subsidy of HUF 1 million (as non-repayable aid) after their third and every subsequent child to be born, counting as prepayment for their mortgage. The decision on the subsidy will be made by district offices on behalf of the state, but creditor banks will also have a significant role in the process. The government decree does not provide regulation for several essential issues; in order to resolve these, the Banking Association contacted the ministry concerned.

One of the most important tasks of the past year was the implementation of the **MiFID2 directive and its relevant delegated directive, which regulate the market in financial instruments**. Due to a one-year postponement of the Directive, the transposition of new provisions into national law had to be completed by July 2017, and the new regulations became effective in early 2018. (The postponement was due to the fact that the EU's detailed arrangements were only released in March). MiFID 2 rules were incorporated into national law by **amending the Capital Market Act (Tpt.) and the Investment Services Act (Bsz.)** in May; however, no resolution has been found to some issues raised by professional organizations, such as the conceptual difference between orders under MiFID 2 and the Civil Code or the stricter regulation of investment firms in certain cases. The adopted amendments granted authorization to adopt two new Decrees by the Ministry for National Economy (NGM) and a Decree by the MNB. The **NGM Decrees** serve the integration of the new topics detailed in the MiFID 2 delegated directive into the domestic law, namely the *product approval processes applicable by investment service providers*, and the *application of inducements related to the investment service activities*. The MNB decree concerns the *professional knowledge and competence required for persons providing customers with advice or information on financial instruments or investment services*. The implementation of MiFID 2 is supported by the ESMA guidelines in the same topic and is aided by the MNB recommendations on *complex debt instruments and structured deposits*, and on *cross-selling practices*, as well as a *frequently asked questions and answers (Q&A)* relevant to the topic.

A priority among **further important legislative and legal implementation tasks influencing credit institutions** was the application of the **new act to combat money laundering and its implementing decrees**, which transposes Anti-money Laundering Directive IV. One of the most important triumphs during consultations on the draft legislation was achieving that the copying of official documents is not an option but an obligation in the law.

The new directly applicable EU **General Data Protection Regulation (GDPR)** in force from May 2018, as well as the **directive regulating the processing of personal data for the purpose of law enforcement** made the **amendment of the Act CXII of 2011 on informational self-determination and freedom of information (Info Act)** necessary. The legislator opted for the unique solution of inserting the provisions of the Info Act to be applied alongside the Regulation, as well as the amendments that became necessary due to the implementation of the Directive, into a single amendment to the Act. The chosen codification solution will not help to enforce the requirement of the clarity of norms, thus the HBA proposed **creating a separate law to transpose the Directive into domestic law**. At the expert consultation on the implementation of the GDPR at the Ministry of Justice, the Ministry informed participants that the government intends to **revise the horizontal and sectoral amendments related to data protection reform** together. Market players were therefore requested to **make drafting proposals to amend sectoral laws**.

Banking operations were also influenced by the **amendment to the Bankruptcy Act** with regard to the liability of senior executives, the satisfaction of the lienholder and the standardization of specific types of lien, as well as the provision on **reporting obligations towards liquidators** through electronic channels. The Company Gateway went live on December 28, 2017 and its use is compulsory as of 1 January 2018, which presents economic actors (among them banks) with a difficult challenge.

The new Act on Lawyers, which re-regulates the position of legal counsels and their integration into the Bar will bring fundamental changes to the banking sector's legal practitioners.

Acting in its microprudential regulatory capacity, the **central bank of Hungary** dedicated special attention to the **prudential regulatory package**, which comprises several decrees and recommendations. Consumer protection aspects gained priority during the wording of the **draft recommendation on the consumer debt recovery procedure**. The department of the MNB responsible for macroprudential regulation initiated a consultation on the **Wholesale Funding Ratio**, in order to treat differences in the asset-liability maturity structure of banks and to manage roll-over risk. As a monetary authority, the central bank launched a **repo market development working group**, to render the interbank repo market more active. Concerning **reporting**, the implementation of new reports aligned with IFRS transition and the establishment of the single central bank credit register (HITREG) required the most resources.

Concerning **payments**, the biggest task was the simultaneous preparation for the **new Payment Services Directive (PSD2) and for the instant payment system**. Making the necessary preparations for these projects, which will continue into the next year, was a significant burden, especially in the payments and IT departments. With regard to payment cards **changes in compensation and chargeback rules** may increase the risk of abuse. Nearly 90% of Hungarian banks completed their **self-assessment** within the framework of **SWIFT's client security program** against cyber attacks successfully and within the time limit.

Regarding **international relations**, in addition to our traditionally active participation in the various committees and working groups of the European Banking Federation, the most significant achievements were the cooperation between the banking associations of Central and Eastern Europe. In 2017 the group of regional banking associations was extended to include 8 members, with Bulgaria and Romania joining (V8). The continually deepening relations with China Banking Association granted the opportunity to host the AFCA conference (a highly important event for the Asian financial sector) in Budapest, in November.

Concerning global regulation, the Financial Stability Board (FSB) set out the following priorities for 2017: (i) transforming shadow banking into resilient and flexible market-based finance, mitigating structural vulnerabilities in asset management; (ii) making derivatives markets safer by progressing the post-crisis reforms to OTC derivatives markets, and adopting the coordinated guidance on central counterparties recovery and resolution; (iii) supporting full and consistent implementation of post-

crisis reforms, including the development of a structured framework for post-implementation evaluation of the effects of reforms; and (iv) addressing new and emerging vulnerabilities, including misconduct risk, as well as those stemming from the decline in correspondent banking and from financial risks related to climate change. The operative tasks of the past year were defined in line with the priorities above.

In accordance with the above, the *framework for the post-implementation evaluation for the effects of the financial regulatory reforms* (which provides a unified methodology for the introduction of reforms determined by the G20 leaders) serves to help assess the outcomes and impact of the reforms, including potential unintended consequences. Meanwhile, the *Handbook for FSB Peer Reviews* was also updated. The international regulatory bodies completed their work on the *recovery and resolution of central counterparties*. The FSB finalized its *principles on the internal total loss-absorbing capacity of global systemically important banks* (Internal TLAC), as well as the *guidance on continuity of access to financial market infrastructures for a firm in resolution*. In Q4, the FSB published two consultative documents to aid resolution: one on the *principles in bail-in execution* and one on the *funding strategy elements of an implementable resolution plan*. In addition, it reviewed the list of global systemically important banks. It compiled a status report on *reducing conduct risk, the implementation of remuneration principles, managing the decline in correspondent banking* and the *second phase of the G20 Data Gaps Initiative*. In September, the FSB published for the first time the *list of the key standards for the operation of sound financial systems*.

In response to the growing number of FinTechs in the money market, it examined the *consequences of FinTechs with regard to financial stability*, in order to identify key supervisory and regulatory issues that merit authorities' attention. It also published a report on *lending to FinTechs*, to draw attention to missing relevant official data.

The **finalization** of the **Basel III reforms** after a year of delay was the most important event of the year. In early December, the decision making body of the Basel Committee on Banking Supervision endorsed the remaining elements of the Basel III reform regulatory package. The package adopted on December 7th includes a revised standardized approach for credit risk, revisions to the internal ratings-based approach (IRB) for credit risk, revisions to the credit valuation adjustment (CVA) framework; a revised standardized approach for operational risk; revisions to the measurement of the leverage ratio and a leverage ratio buffer for G-SIBs; and the introduction of an aggregate output floor. The revised standards will take effect from 2022, granting a lengthy preparation period. The Committee also postponed the deadline for the implementation of the fundamental review of the trading book (FRTB) from 2019 to January 1, 2022. Therefore the revised standards will have to be implemented for credit, market and operational risks from 2022 as well.

The BCBS published several other important documents in 2017, the most important of which are the **consultative documents** on *the identification and management of step-in risk, on the simplified alternative to the standardized approach to market risk capital requirements, as well as on the features and identification of simple, transparent and comparable (STC) short-term securitizations and on its capital requirements; the final guidance on the prudential treatment of problem assets*, which defines non-performing exposures and forbearance; and the **discussion paper on the regulatory treatment of sovereign exposures**.

Following the Brexit decision in 2016, the bodies determining European legislation set as their main target to strengthen the Union, and achieve deeper and closer EU cooperation. The European Council, the European Parliament and the European Commission officially agreed on the 2017 common legislative priorities, determining the **general regulatory framework**. With regard to political background and the future of Europe, member states could not agree on the issue of "more or less Europe", the implementation of "federalist or nation-based integration". Numerous Commission proposals, such as to amend the Comitology Regulation, simplifying supervisory reporting obligations within the framework of the streamlining program and establishing a Task

Force on Subsidiarity, Proportionality and “Doing Less More Efficiently” seek to increase the transparency and accountability and to facilitate the operations of the EU.

Little progress was made in 2017 concerning the most important prudential regulatory development of 2016, the adoption of the November *Risk Reduction Package*. Some of the elements of the package were fast-tracked, such as the directive on creditor hierarchy and the regulation on IFRS 9 and on large exposures, thus these were agreed on by decision makers in autumn 2017, making their implementation possible from January 1, 2018.

The *high portfolio of non-performing exposures and their treatment* continues to be a severe burden on the entire Union and its member states. In order to promote the solution of this problem EU institutions (ECB, European Commission, European Council) launched important initiatives, such as the establishment of asset management companies, developing the secondary markets for NPLs, the protection of secured creditors from borrowers’ default, the introduction of backstop-type prudential regulation treat insufficient provisioning for NPLs.

Completing the Banking Union and creating the Capital Markets Union are the most important priorities of Project Europe. The Commission published a press release on the steps to be taken towards completing the Banking Union by 2018, in which it emphasized that risk reduction and risk sharing measures must be implemented at the same time. The Commission aims to renew negotiations on the European Deposit Insurance Scheme (EDIS) and to initiate the creation of a fiscal backstop for the Single Resolution Mechanism.

According to the *Mid-Term Review* of the Capital Markets Union there has been good progress made so far in implementing the 2015 Action Plan, with around two-thirds of the 33 actions delivered in twenty months. Among its achievements, the Commission emphasizes the agreement on the securitization package, the venture capital funds reform and the new prospectus regime. In order to create stronger and more integrated European financial supervision of the Capital Markets Union, the Commission proposed the *reform of the European supervisory structure*. Another important pillar for establishing the Capital Markets Union is the currently debated *insolvency directive (bankruptcy, preventive restructuring frameworks, and a second chance for enterprises)*.

An important development was that in late 2017 the Commission announced that it will withdraw its regulation proposal for the bank structural reform (the reform had been opposed by the sector).

II. Macroeconomic Outlook: the operating environment of the banking sector

In 2017, the ***world economy grew at an accelerated pace***. This was the first year after 2010 when all the most important growth centers (USA, EU, Japan and China) showed growth at the same time, and emerging countries previously in recession (Brazil and Russia) showed signs of pulling themselves out of it. According to experts, the expected ***3.7 percent global growth*** reached a kind of local peak in 2017, and may slow down from now on. The main driving forces behind growth are cyclical factors; growth continues to be supported by lax monetary conditions at global level, the sustainability of which is generally made possible by inflation being near the target level from below and raw material prices that can still be classified as moderate. Retail and business expectations have improved and incentivized a gradual increase in consumption and investments. All of this was accompanied by a definite upswing in global industrial production and trade.

The monetary policy of major central banks differed early on in the year, however ***lax monetary conditions*** generally remained overall. The FED raised interest in March and contrary to predictions, kept it at the same level until the end of the year. The European Central Bank somewhat restrained its asset acquisition program, while the Japanese central bank did not make any changes to its own.

After the inauguration of the new President of the ***United States***, the development of the new economic policy trend started less forcefully than had been expected. During the year several measures on global trade, and the USA's international economic and financial obligations were introduced, but none had a noticeable impact on global or American performance. The most important measure, the ***finalization of the new tax package*** happened at the end of Q4. Although the impact of this cannot yet be felt, many sceptics believe that it might have unfavorable – and according to some, catastrophic – consequences on the US economy, by rendering the budget unsustainable. The administration is chasing a pipe dream when it expects the package to produce a 3-4 percent growth or above. This pessimistic assessment may also be confirmed by the fact that in early 2018, even if only for a short time, government offices closed once again due to the wrangling over the modification of the budget deficit's ceiling.

After weak performance in the beginning of the year, the GDP grew by over 3% mid-2017, although it was less than predicted for late in the year. Thus ***GDP growth*** for the entire year amounted only to ***2.3%***. Growth is fueled by internal consumption, investments in the business community and increased export, though import also grew significantly, especially late in the year (by a double digit number in percent). The labor market continues to be robust, with unemployment at its lowest in 17 years: 4.1% at the end of the year. The US labor market is characterized more and more by demand: real wages grew to exceed productivity due to wage increases in the business community and individual states raising the minimum wage. Despite this, there was no price pressure within the economy; annual inflation was 1.8%, which made the FED discontinue its tightening after having raised the interest several times early on in the year.

The ***economy of the European Union showed favorable growth***, even in its unique economic and political environment. There were negative expectations for several political events in 2017, however a positive atmosphere triumphed over these, with most of these events coming to a positive close. At the elections held during the year radical forces gained some ground within the parliaments of European states (Germany, Austria, Czech Republic), but there was no severe shift in political balance. Brexit (now officially announced in the spring) only impacts the EU through an ailing British economy. Ultimately fears in connection with the Catalan separatist movement turned out to be unfounded as well.

The economy of the EU performed increasingly better, primarily thanks to the German economy and the Central and Eastern European economies closely related to it early on in the year, and owing to the improving performance of other large economies (mainly France and Spain) towards the middle and end of the year. According to initial estimations, both the Eurozone and all 28 EU countries

reached a **2.5% growth in GDP**, which is the best performance of these past years after 2007. The main driving force behind economic growth during the year was internal consumption, supported by the current state of the labor market, with the end of the year showing the lowest unemployment rate since 2009. Export became an ever more important growth factor, and could not be negatively influenced by the strengthening Euro. In addition, corporate investments have also finally shed the legacy of the crisis. Monetary conditions remained lax, despite the fact that the ECB somewhat curbed its bond acquisition program, with no visible impact on the performance of European economies.

In **Japan** the positive impact of the economic policy to weaken the yen became visible; growth has continued over the past eight quarters. In the last quarter of the year however, growth was significantly less than expected, lowering **GDP dynamics to 0.5%** for the annual average.

In **China**, the slow shift in structure steered by the government continued, with a negative impact on growth. The level reached by Chinese average wage does not make extensive growth founded on cheap wages sustainable. Over the course of the year infrastructural and real estate investments continued to be the primary supporters of growth, with their growth rate greatly exceeding the actual **GDP growth, which decreased to 6.8% at the end of the year**. This implies efficiency problems, and makes the sustainability of the continually increasing mid-term debt portfolio, which is the source of these investments questionable. The **weakness of its financial system** presents considerable problems for the country. Non-performing portfolio is quite significant within the banking system and shadow bank lending has become widespread; the central bank took steps to restrain this. At the same time, a relatively strong yuan and limiting the foreign investment of Chinese corporations helped sustain the balance of payments and protect reserves.

The Russian economy is slowly recovering, owing to the stabilization of oil prices (at a higher level than in the previous couple of years). After weak growth in the first quarter, the economy performed well mid-year, then after a slight setback reached an annual **GDP growth average of 1.5%**. The Russian government, due partly to US and EU sanctions, chose a particular method of structural reforms and launched an import substitution program. Experts however say that this may be counterproductive as it may draw resources from sectors with international competition and export capacity into weaker performing areas.

The annual **Hungarian GDP growth was 4.2%** after seasonal and calendar effects. On the production side market services and the construction industry were the primary promoters of growth. Due to its decline towards the end of the year, industry contributed less to good performance. Agriculture performed average and therefore also showed a decline compared with its outstanding performance last year.

With regard to **consumption**, growth was fueled by internal demand characterized by a 4.8% increase in retail trade. This was supported by **the labor market** structurally having **excess in demand** (annual averages for unemployment and employment were 4.2% and 68.2%, respectively) and the significant increase in real wages: over 10%. The restraining effect on demand of the increase in wages was moderated by a long term agreement made between social partners in 2016. Due mostly to the fast distribution of EU sources, the expansion of investments was quite considerable as well. As a result of the exceptional European and global economic situation export continues to be an essential factor of growth, although the rise in import due to strong internal demand exceeded its values. This will slowly erode the value of net export, which remains considerably positive despite it.

The year saw **unique budget balance indicators**. The payment deficit calculated until end-December was extremely high, reaching 5% of the GDP (HUF 1.974 billion). This is primarily caused by the fact that projects to be funded from EU sources had to be pre-financed from the budget, amounting to a nearly HUF 1000 billion expense by the end of the year. The budget deficit calculated through EU methodology (i.e. EU pre-financing adjusted) was kept under 2.4%, amounting to around 2%, which is

also a result of favorable growth rates. Government debt has also likely decreased by 1.5 percentage points, to 72.4% (74.5% counting EXIM).

Due to the steep rise in internal demand, by the end of 2017 the **current account surplus** decreased. As a result of the fast track use of EU sources, the net external financing capacity of the country may stay high, which may in turn promote an accelerated decline in foreign debt.

Inflation processes were balanced throughout the year. The annual increase rate of consumer prices was less than the 3% target rate, in fact towards the end of the year a slight decrease, leading to an average price increase of 2.4% for the year. Core inflation (which provides a better reference to actual price pressure) is gradually rising, but, though barely, it is also less than the target inflation rate. There is no pressure for inflation coming from the outside environment either. Despite faster wage dynamics, as predicted, price pressure for demand is only building up gradually.

The central bank of Hungary (**Magyar Nemzeti Bank - MNB**) **kept the benchmark interest rate at the same level**. As a result of the steps taken within the framework of MNB's self-financing program the three-month deposit portfolio of commercial banks dropped from HUF 900 billion early on in the year to HUF 75 billion. In November MNB announced the introduction of two new schemes for January 2018: a swap instrument of 5 and 10-year maturity, and a mortgage bond purchase program, the aim of which is to extend the credit interest period of banks.

The **EUR to HUF exchange rate** continued to stay within a relatively narrow range (between 302 and 315) throughout the entire year. Demand-supply dynamics for the forint did not change: the significant current account surplus creates continued pressure for buying, and the decrease in net external debt continues to increase forint supply.

The **aggregated balance sheet total of credit institutions grew** almost steadily, by a nominal **5.4%** (HUF 1.869 billion) and surpassed HUF 36,000 billion. Forint instruments increased significantly: by almost 6%. The forint exchange rate varied similarly to that of the Euro during the year and therefore had no impact on the moderate decline (1%) in Euro stocks. Nevertheless, compared to other significant foreign currencies the forint strengthened considerably (between 8-12%), which in half contributed to the near 20% expansion of these instruments. Overall fluctuations in the exchange rates only had a half percentage point increasing effect on the above mentioned growth in the balance sheet, i.e. the exchange rate adjusted increase in these instruments was approximately 5%.

On the **liability** side there was a significant increase in deposits and equity, and a moderate one in bank issued securities; meanwhile borrowed credit decreased. On the whole, interbank sources (accepted deposits and outstanding loans) also increased during the year. Deposits grew substantially (by 7.6%, HUF 1,712 billion). The main trend of 2017 was that short-term deposits, while current account and long-term deposits increased. Overall, the shortening of the maturity structure of the entire deposit portfolio is predicted. In absolute terms it was non-financial corporate deposits that increased the most (HUF 903 billion, 12.9%), although state deposits grew significantly (by 21.8%, HUF 231 billion) as well. Retail deposits were moderate (4.3%, HUF 360 billion), though their growth accelerated compared to the year before. As a result of the above, corporate deposits continued to gain ground: in 2017 they constituted 2 percentage points more of the entire deposits portfolio (22%), while the ratio of retail deposits decreased by 1 percentage point, to 36%. The increase in interbank liabilities was due to the expansion of interbank deposits (HUF 578 billion), while interbank borrowed credit decreased (by HUF 159 billion). There was an increase in securities issued by banks (2.4%, HUF 52 billion), primarily in instruments with a 1-2 year maturity. The total equity of credit institutions grew by 11% (HUF 414 billion), due fundamentally to retained profit and the large scale growth experienced during the year.

The expansion of the credit portfolio (7.8%, HUF 1,308 billion) was the driving force behind growth within **assets**, although nominal securities increased by nearly the same (HUF 1,297 billion, +13%) – the central bank's self-financing program played a large part in the latter.

The gross value of credit increased by a nominal 8.7% (HUF 1,326 billion) counting interbank credit. 60% of this growth is forint, 24% is Euro denominated. All sectors contributed to growth positively: domestic and international lending was at a similar level. The expansion of credit was the most pronounced in non-financial corporations (+13.2%, HUF 1,007 billion), the value of which was further increased by a HUF 136 billion positive valuation difference and net reversal on impairment loss. As for retail lending, new loans have moderately surpassed portfolio decreasing factors (mainly instalments), increasing gross credit portfolio by 1.2% (HUF 69 billion). Reversed impairment loss and valuation difference had an even more significant impact here (HUF +184 billion). With regard to the size of expansion, the government sector also merits attention, achieving a HUF 239 billion (74.1%) increase in credit.

As a result of the above effects, the credit institutions sector's **net loan-to-deposit ratio** increased to 97% (84% not counting interbank loan portfolios) from 91% the year before.

In 2017 **profit before taxes** was outstanding, exceeding even the 2016's good performance (HUF 515 billion), reaching **HUF 637 billion**. With this, the banking sector's average pre-tax return on assets (ROA) was +1.8%; and its return on equity (ROE) was +16.2% (15.7% in 2016). However, the high profitability ratios are largely attributable to single factors and those unrelated to the operations of the Hungarian banking system (release of impairment provisions, dividends from foreign subsidiaries). Not counting these ROA would be 1.1% and ROE 10.2%, which are not outstanding values when the risk environment is taken into account. Taking a look at business type revenue, one can establish that due to lasting low interest the erosion of net interest revenue continued as it had in the past several years (-7.4%, HUF 62 billion). This especially unfavorable, since interest-bearing assets have increased significantly and market interests set by BUBOR have decreased by less than half a percentage point over the course of the entire year. Revenue from fees and commissions compensate for this nominally, as does the net income from financial operations, which both grew at a considerably higher ratio, over 10%. As a result of more business activity and stronger inflation, administrative costs increased by 3% - this is fueled by an 8% rise in service and material type expenses, while personnel type costs fell moderately.

III. Corporate sector

Completing and assessing the Funding for Growth Scheme

On March 31, 2017 the Funding for Growth Scheme (FGS), was completed. The scheme has been a defining factor in SME lending over the past four years. After its launch in June of 2013, the central bank's targeted monetary instrument helped **39 254 micro, small and medium enterprises to receive affordable financing, amounting to a total sum of HUF 2 811 billion**. Numerous enterprises tried to make delayed investments happen or to redeem loans with the aid of the favorable borrowing conditions guaranteed by the scheme's first phase, despite its short three-month duration. Phase two was launched in autumn 2013, focusing on new loans, more specifically **investment loans**. Phase three started in early 2016, during which only the financing of investment loans was possible, due to the start of the scheme's phasing out process. In 2014 and 2015 nearly half of all medium term SME loans were granted within the framework of the FGS. This ratio decreased in 2016. In all phases together, a total of HUF 1700 billion's worth of loan and leasing transactions were carried out to finance new investments. According to MNB estimates, the FGS may have contributed as much as 2 percentage points to the growth of the economy between 2013 and 2016, and may have provided jobs for over 20 thousand people.

In all three phases of the FGS micro enterprises borrowed the most in terms of the number of loans granted, and this ratio continued to increase with time. This segment was granted nearly HUF 860 billion through over 46 thousand transactions by credit institutions, within the framework of the FGS.

Most of these loans were used for investment purposes. Nearly two thirds of FGS credit was borrowed by enterprises within the trade, repair and manufacturing sector, the agriculture and the processing industry. The FGS **decreased the regional concentration of credit**: while prior to it almost 54% of the SME credit portfolio was tied to enterprises based in central Hungary, only 36% of loan contracts signed within the framework of the FGS can be linked to the same area.

The scheme substantially contributed to the trend turnaround in lending: after the launch of the FGS, the annual 5-7% decrease in SME lending stopped, and changed to a gradual increase from 2015. By 2016 this dynamic reached 5-10%, the value deemed necessary by the central bank for long-term, sustainable economic growth.

The Results of the Market-based Lending Scheme

The Growth Supporting Program launched in 2016 helped banks revert to market-based lending , through the gradual phase-out of the Funding for Growth Scheme and with the announcement of the Market-based Lending Scheme. According to MNB's survey, after the Funding for Growth Scheme was phased out, the Market-based Lending Scheme may remain one of the supporting pillars of SME lending in the banking sector. At the tenders announced in July within the framework of the second phase of the scheme banks raised their lending commitments for this year to almost HUF 230 billion. This represents about 6 per cent of loans outstanding of the SME sector, which projects continued positive developments in corporate lending. (This achieved an average increase of 34% in credit undertakings at banking system level, which indicates a 58% increase in undertakings in the participating nine banks. At least three of these banks have doubled their undertakings.)

IV. Retail sector

The Certified Consumer-Friendly Housing Loan

The MNB has expressed its opinion (debated by the banking sector) that, by regional comparison, the interest rates on housing loans is high, the level of loan replacement is low and the loan assessment period is long. It evaluated this as the sign of the **low intensity of competition** in the market and **the lack of transparency and comparability of products**; therefore in March it launched the **Certified consumer friendly housing loan product** as a step to invigorate competition. The representatives of the Banking Association are of the opinion that competition in the loan market is intense, which is shown by the **large number of institutions and products present in the market** and that when making regional comparisons, the **increased risk costs** linked to the enforceability of collateral and the value of the **total amount of credit** must be considered, which may affect the interest level as well.

The Certified Consumer-Friendly Housing Loan is a certification given by the MNB, for which creditors can apply **with their housing loan products in line with the terms set out in the invitation to tender**. The terms include a cap on the interest rates, fees, costs and operation periods below the level previously established in the market.

The MNB has held several rounds of consultations with banking experts on the **invitation to tender, including the terms of the certification and the relevant documentation**, in both written and oral form. During the negotiations, the terms stipulated for the product became technically manageable and less stringent. When initiating the scheme, the MNB also promised to ensure a sounder and faster credit assessment, by urging the competent authorities to **make practically the complete earlier loan portfolio searchable in the CCIS** and to make available, with the help of the National Tax

and Customs Administration, **customers' current income information** for the credit assessment. The discussions in connection with the latter are still in progress.

The scheme was launched in early June with the publication of the invitation to tender, and the first certification was granted in the same month.

In order to facilitate the widespread use of the certification, by September the central bank had developed a clear and readily comprehensible **website for customers to compare certified banking offers**. The process was supported by intensive communication in the media.

In late summer, the negotiations were restarted, since **several operational and legal uncertainties and technical difficulties** emerged during the development of the banking processes related to the certified products. The most important points, most of which have still not been addressed, include the following:

- the two-day deadline for setting interest rates is too short with regard to certain benchmark rates, therefore it has to be extended to 15 days,
- the contract law issues related to including the rules applicable to the amendment and revocation of the binding offers in internal regulations, which cannot be accessed by customers, need to be managed,
- the operational issues arising due to intermediaries need to be tackled separately, and
- the content of the legal notices on the MNB's comparison website needs to be supplemented.

In connection with the above, the MNB has prepared an amendment to its Invitation to Tender, and held several rounds of consultations. Some technical questions were settled by the publication of an FAQ, and the above-mentioned legal notices were supplemented. The amended Invitation to Tender was finally published in February. Despite the unresolved issues, 50 products from 24 institutions had received the certification by the end of September.

Banks' proposals for modifying the Home Purchase Subsidy Scheme for Families (HPS)

As requested by our member banks, the Banking Association sent its recommendations based on the experiences gained since the introduction of the HPS to the relevant authorities.

In our letter sent to the ministries concerned, we emphasized that the banking sphere is committed to the scheme, since over a quarter of home purchase transactions in the past were made through state subsidy and the collaboration of banks. Based on the recommendations of banks which play a significant role in housing loans, a package was compiled aimed partly at **alleviating legislative requirements which complicate/prevent the use of the subsidy**, and partly at **simplifying the complicated administrative procedure for the loan application**. Thus, we recommended that the time frame of mandatory social security coverage be shortened because citizens who work abroad cannot fulfill the requirements currently in force. We consider the requirement which states that previously utilized subsidies should be deducted from the current request, even if they have already been repaid is inequitable unfair. We made a general recommendation to grant banks direct access (through an electronic channel) to the certificate that the applicant needs to obtain from a government authority/bureau (e.g. declaration of address, proof of the absence of public debts) if the client consents or if the legislation allows for it.

Although the HPS rules were not modified in 2017, based on feedback from the ministries concerned, they will hopefully take these recommendations into consideration in the next phase of the legislation process.

Amendments to the Act on Enforcement and the extension of the eviction ban

At the beginning of March 2017, MPs from KDNP submitted an individual amending motion for the amendment of *Act LIII of 1994 on Court Enforcement (draft law No. T/14298)*. This draft law was tabled to the Parliament without preliminary consultation with the professional organizations. Under

the amendment, for the ***forced sale of residential properties*** under court enforcement, in the event of the collection of a claim based on a consumer contract, ***valid bids can only be made with an amount reaching the starting price (estimated value)***. If there is no such bid, the auction is considered failed. The amendment was justified by helping non-paying debtors, with the intention of reaching higher sales prices for properties. *Act XIV of 2017*, as adopted by the National Assembly, is even stricter than the motion: if more than one year has passed since the continuous auctioning for residential properties without success, the new auction can be called at 90% of the starting price, as opposed to the proposed 80%. Unfortunately, the amendment ignores that forced sales of properties are greatly influenced by real estate market conditions.

Further restrictions to implementing rules make it even harder to exercise lenders' mortgage rights. The ***extension of the eviction moratorium*** from November 15th to April 30th has a similarly negative impact on creditor banks. The Hungarian Parliament ***unanimously*** voted in favor of extending the eviction ban from November 15th to April 30th in the case of private individual debtors. (This period previously lasted from December 1st to March 1st.)

Using the National Tax and Customs Administration's (NAV) income database for loan assessments

During the elaboration of the Certified Consumer-friendly Housing Loan product the idea arose that ***information asymmetry concerning the actual financial situation of clients could be moderated through creating a central database*** (based on the tax authority's data), and ***the loan assessment process could be automated, and thus sped up***. To achieve this, as a first step, MNB compiled a proposal for a dataset based on tax returns to aid loan assessment. Banks commented on this under the coordination of the Banking Association. The comments showed that banks' needs are of a much wider range than what the central bank predicted and that banks require access to the NAV dataset for the assessment of all other loan products, in addition to housing loans. During the consultations the following were discussed: the scope of the database (whether it should include only natural persons or enterprises as well); its content (whether it should include PIT returns or include employers' tax return data of employees); if BISZ Zrt. should be involved; and whether should have to give their consent for the retrieval of their data (at NAV or at the bank approving the loan). In addition to consulting with banks, the central bank met with experts from the National Authority for Data Protection and Freedom of Information (NAIH) and NAV to discuss the project. The consultations recommenced in February 2018.

Reducing the mortgages owed by families with many children through state subsidies

According to the Hungarian government's decree, ***families with a mortgage will receive a state subsidy of HUF 1 million (as non-repayable aid) after their third child*** and every subsequent child, counting as prepayment for their mortgage. The decision on the subsidy will be made by district offices on behalf of the state, but creditor banks will also have a significant role in the process:

- if the state subsidy is requested, they will inform the district offices in detail about the main parameters of the mortgage in question; and
- if the district office approves the subsidy, they will make the prepayment on behalf of the client, recalculate the mortgage parameters, and come up with new (reduced) installment plans.

Based on detailed data supply, banks will settle with the ***Hungarian State Treasury on the prepayment that they advanced***. During the preliminary consultations, we managed to achieve that banks will be reimbursed for the complicated and responsible work they must conduct to carry out this process.

After the decree was issued, several of our member banks indicated that it does not provide regulation for several essential issues. They therefore recommended that we indicate these problems to the ministry responsible as soon as possible. As asked, the Banking Association sent a letter to the Ministry for National Economy (MNE), in which (among other things) it stated that:

- it is not clear who is entitled to the subsidy;
- it poses difficulties in management that the prepayment – in opposition with the Civil Code – must first be used for the capital and can only be used for its contributions afterwards;
- the details of the content and form of information flow between creditor banks and state organizations have not been properly elaborated;
- the new scheme is difficult to harmonize with banks' already existing customer help programs.

In its response, the MNE tried to give detailed answers to the questions raised and to clarify unclear requirements set in the directive. With regard to certain problems (such as the clashing of banks' own client rescue programs and the provisions of the directive) the MNE expected both clients and banks to be flexible in their collaboration. By elaborating and recommending forms, the Ministry is supporting the hopefully short transition period during which the state authority and banks must manage subsidy related data exchange on paper, instead of electronically.

Problems with reclassifying mortgage credit intermediaries

As a result of EU regulation the ***classification of mortgage credit intermediaries changed***. While formerly to be a mortgage credit intermediary one had to sell the products of several creditors (who entrusted him or her with their products), according to the ***new regulation one can only classify as an independent intermediary if his or her creditors hold at least a 50% market share of the product that he or she is selling***.

At the same time the relevant legislation does not arrange which authorities are responsible for measuring market share and on what data or who will be licensed to reclassify a given intermediary, if necessary. The regulation also does not explain the ***responsibility, professional training, fee policy and complaint management requirements that apply to reclassified intermediaries***. This would be especially important since in the case of ***intermediaries who are reclassified as dependent from previously being independent, the entrusting credit institution must take the responsibility for completing their tasks***.

Based on the detailed outline of relevant problems that the Banking Association received from its member banks, we sent a letter asking the Ministry for National Economy (MNE) and the MNB to take measures to remedy these gaps in the legislation. The MNB wrote a letter of response in which it gave a detailed explanation on the special transitional instruments it will use to resolve the issues arising from an insufficient legal environment, and also proposed legislative changes. Furthermore, the MNE revealed its willingness to take the necessary legislative preparatory measures.

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

MiFID 2 implementation

Due to a one-year postponement of the MiFID 2 Directive, which regulates the market in financial instruments, the transposition of new provisions into national law had to be completed by July 2017, and the new regulations became effective in early 2018. The postponement was due to the fact that although the draft legislative acts delegated under the MiFID 2 had already been published

in spring 2016, approval suffered delays, and **detailed arrangements** were only released in March. Major interpretation issues remained open, answers to which only arrived at a slow pace from the ESMA, published in its Q&A.

○ *Transposition of MiFID 2 and the delegated Commission Directive into national law*

In early March, the Ministry for National Economy started work on implementation tasks through the engagement of market advocacy organizations (Banking Association, Association of Hungarian Investment Fund and Asset Management Companies [BAMOSZ], Association of Investment Service Providers [BSZSZ]). Also with regard to the relative short time limit ending in July, the Ministry for National Economy **focused its efforts on the transposition of Level 1 EU legislative acts (without any alterations)**, and resumed the **codification of the delegated Commission Directive into a Government Decree** during the summer. As a result, during the consultations in March and April, while a number of issues were raised in connection with the application of the MiFID 2 rules, only few of those issues could be resolved by means of incorporating the appropriate wording into the *Capital Market Act (Tpt.)* and the *Investment Services Act (Bsz.)*. Wording aimed at specification was typically incorporated into the explanatory provisions of the amendments.

Despite the proposition raised by professional organizations, no resolution has been found to the **conceptual difference between orders under MiFID 2 and the Civil Code**, the former also including cases where financial instruments owned by an investment provider or purchased to its own account are sold to its customer on the customer's behalf, while under the latter such operations are classified as commission agency. Another issue concerns the fact that **in some aspects, regulations for investment firms under the Investment Services Act are more restrictive** compared to the MiFID 2. Such aspects include conflict of interest rules for executive officers and sales representatives, restrictions on activities additional to investment services, and provisions for professional requirements. This appears to benefit customer protection; however, with regard to the freedom to provide services within the EU, **no level playing field is provided for the operations of Hungarian market participants** compared to participants supervised in other Member States.

The Government tabled its proposed amendments to the Capital Market Act and the Investment Services Act, which were passed by the Parliament in late May and the new rules were promulgated on 9 June. It is important to note that several EU Member States deliberately delayed the transposition and enforcement of the Directive, considering the legal uncertainty resulting from the large number of open interpretation questions.

The adopted amendments granted authorization to adopt **two new Decrees by the Ministry for National Economy (NGM) and a Decree by the MNB**.

The **NGM Decrees** serve the integration of the new topics detailed in the **MiFID 2 delegated directive** into the domestic law, namely the **product approval processes applicable by investment service providers**, and the **application of inducements related to the investment service activities**. (The relevant legislative package included, in addition to these two new Decrees, the amendment of several Ministerial Decrees. Thus *the Decree of the Minister of Finance on detailed rules for the information standards on publicly trade securities*, and *the Decree of the Minister for National Economy on the tasks related to the training and official exams on financial service intermediary, insurance brokerage and capital market brokerage* have been also amended.) The Ministry for National Economy submitted the draft decrees for consultation in the second half of May; however, in line with the practice followed in the course of legislative amendments, it exclusively supported the incorporation of the EU delegated Directive's text. Accordingly it accepted only a small number of proposals to clarify the text.

The MNB developed its draft decree concerning the **professional knowledge and competence required for persons providing customers with advice or information on financial instruments or investment services**, regarding which it conducted consultations from September onwards. While the

central bank developed its draft in alignment with the *ESMA¹ guidelines for the assessment of knowledge and competence*, published in March 2016, regulation by decree was warranted by the wording of EU legislation and the regulations previously in effect. In addition to criteria for the professional knowledge and competence of staff providing the services concerned, the draft contains detailed regulations on the specific training program to be provided in order to ensure the required knowledge and competence², as well as on the obligations concerning record keeping and cooperation. The most important concern raised about the draft is that, as opposed to the provisions of the ESMA guidelines, it gave equal treatment to persons providing investment advice and persons merely providing information related to investment services and instruments, and subjected them to the same level of requirements, while in practice the levels of training and expertise that may be expected for the two activities are significantly different. This issue was still not addressed by the text of the decree promulgated in the last days of December.

- *MNB recommendations facilitating MiFID 2 implementation*

In late November and early December, respectively, the MNB submitted for consultation its draft recommendations on **complex debt instruments and structured deposits**, and on **cross-selling practices**, developed on the basis of the corresponding ESMA guidelines. The first recommendation plays an important role in the identification of the products indicated in its title and in ensuring the consistency of application, to facilitate which it also provides specific examples.

The recommendation on cross-selling specifies the concept, drawing a distinction between **bundled packages**, where each of the products or services offered is available separately, and **tied packages**, but imposing consistent information requirements for both. We identified a problem in the possible interpretation resulting from the textual application of the ESMA recommendation that the payment or customer accounts that are required to be opened would also be considered as parts of the package; however, in the central bank's view this problem could be remedied by issuing a position. The MNB released both recommendations in early January 2018.

- *Interpretation of the commission of fund managers and government securities distributors in the context of MiFID 2 provisions for inducements*

Compared to the earlier regulation, MiFID 2 typically poses significant challenges to the implementing institutions in terms of **administration and reporting**. However, **rules on inducements** can seriously influence, if interpreted rigidly, the fee structures of institutions distributing investment units and government securities, and the business models currently used in the market practice.

Under the applicable provisions, if the **distribution fees paid to the distributor** by fund managers or, respectively, the agency responsible for the issuance of the government securities concerned, **are classified by the authorities as inducements**, then these fees are either fully payable to the relevant investor, purchasing the securities concerned or, in certain cases, can only be used for specific purposes only, the certification and administration of which is rather difficult. It would become dubious whether the cost of resources spent on distribution in such a system can actually be recovered, which might create opposing interests for the actors of the traditionally established distribution channels. In the European Union this is the most disputed issue in the context of capital market rules; since this interpretation varies greatly in Member States, depending on the applied models, on the one hand, and due to its significant market influencing effect, on the other hand.

Following consultations with professional organizations, at the end of September the MNB expressed its view in the form of Q&A. As regards the **GDMA's distribution fees**, it clearly stated that such fees **were not subject to the rules for inducements** even in cases where the fee was transferred by a primary distributor to a secondary distributor. By contrast, regarding fund managers' fees, it only

¹ European Securities and Markets Authority

² The program was modelled on the themes covered by previous examinations required by authorities.

stated that ***the rules for inducements were not applicable to fees demonstrably linked to actual service***, but failed to specify eligible fee items.

Expert consultations on risk-rated fees payable to the Investor Protection Fund (Beva)

Upon the proposal from the Beva work organization, an expert working group was established in the fourth quarter of 2016 with a view to revising the methodology of risk-rated fee payment introduced earlier and suspended subsequently. The participants of this working group were, in addition to the Beva experts, delegates from the MNB, the Banking Association and the Association of Investment Service Providers. In its work that lasted until October last year, the working group has surveyed ***the objectives to be accomplished by a methodology for risk-rated fee payments*** in the light of the experience gained in the context of 2015 events that led to indemnification, as well as ***the key requirements for the introduction of risk-rated payments and the effect of risk on fees, the prominent risk factors*** to be taken into account subject to the current deposit ratios, ***and the options for incorporating risk factors into calculation methods.***

The working group has examined ***risks*** posed by the ownership background and management of institutions, their capital positions, the composition of portfolios managed by them, the nature of the investment service provided, counterparty risks (including sub-depositories) and operational security, ***the indicators*** that are able to ***represent them properly, and assessed their practical applicability*** using anonymized reporting.

The working group concluded that although there are certain indicators that are suitable for measuring risks, it has not supported their stand-alone introduction as an indicator for risk-rated fee setting, since the introduction of individual factors would show a disproportionate picture of the individual institutions' risk exposure.

The experts proposed performing further examination of this issue. The Board of Beva took note of the working group's report unanimously.

Amendment to the Act on Bankruptcy

On 16 May 2017 the Parliament enacted the *Act XLIX of 2017 on the Amendment of the Act XLIX of 1991 of the Bankruptcy and Liquidation Procedure, and certain related acts*. The Act ***has amended the rules on establishing the liability of senior executives*** in the event of a liquidation procedure, ***covered the rules applicable of the satisfaction of the lienholder*** applicable after the sale of the pledged asset, ***and standardized the provisions applicable to specific types of lien***, and has repealed the specific rules on pledged assets defined by description. The Bankruptcy Act stated that ***any pledge established prior to the launching of the liquidation on future receivables covers the receivables due to the debtor which were generated or received after the launch of the liquidation procedure.*** This amendment provides equal treatment for the holders of fiduciary loan collaterals with lienholders, where the relevant collateral rights is registered in register of loan collaterals (HBNY) or in the real estate register. The amendment identifies independent lien, secondary lien and the lienholder's agent within the Bankruptcy Act.

We provided our feedback to the draft in several rounds, as a result of which the rule on fiduciary collaterals was clarified. The deadline for the presumption of service notice was decreased from 30 days to 15 days, and the ratio of deduction from the revenue arising from the pledged asset was significantly decreased (from 15% to 7.5%), which is of utmost importance for the lienholder creditors. The Bankruptcy Act entered into force on 1 July 2017.

In relation to the Bankruptcy Act, we dedicated several rounds of consultations to the *Government Decree 300/2017 (X.17.) on the amendment of provisions on the public sale of the debtor's property in liquidation procedures*. The purpose of the decree is to define a minimum price for public sales.

During the consultations, we managed to achieve that the creditor's committee will be **notified of the call for tenders** for the sale and the setting of the date for the auction, irrespective of value limits, **before publishing it in the Company Gazette**.

The adoption of the amended Bankruptcy Act **was followed by the preparation of another amendment** to a law, which **became necessary from harmonization reasons** due to Regulation (EU) No. 2015/848, in connection with cross-border insolvency procedures. By June 2018 EU Member States must establish an **insolvency register**, which contains the required data on insolvency procedures initiated in the member states. Data on pending procedures can be queried free of charge.

With regard to this draft we made observations of codification nature, furthermore we encouraged the development of appropriate rules with the view **to search for assets located in other member states and to render them subject to the insolvency procedure**. The draft was adopted and published by Parliament together with Act CXXVI of 2017. The provisions of cross-border insolvency procedures will enter into force on 28 October 2017.

Reporting obligations towards liquidators

The amendment to the Bankruptcy Act that entered into force on 1 July 2017 **provided for an electronic reporting obligation** in bankruptcy and liquidation procedures for banks and investment service providers towards the liquidator companies. However, this act has not dealt in detail with the information security and secrecy protection aspects. The Banking Association initiated a consultation with the National Association of Liquidators and Administrators (FOE) with a view to settle this issue; this consultation was joined by the Authority Keeping the Register of Liquidators (FNVH), which belongs to the Ministry for National Development. The affected parties agreed that the liquidator shall contact the financial institutions in an authenticated electronically signed and timestamped letter, to request the data of the entity subject to liquidation. Financial institutions keeping an account for the company subject to liquidation will send a response letter to the liquidator, without releasing any bank secrets. The appointed liquidator may receive detailed data from the financial institution after its identification in accordance with the AML Act³. After a multi-round consultation, the FNVH sent out a standard letter to liquidator entities, advising them of the envisaged measures in the context of reporting and the standard procedure that is requested to be certified. A similar letter was prepared for financial service providers. To streamline the above procedure, the FNVH initiated an amendment to the Bankruptcy Act, which was included in *Act CXCIX of 2017 on the Amendment of certain acts related to national assets and national financial services*. Under this amendment, **after the publication of the order on the liquidation of the debtor, the payment service provider and the investment service provider shall notify the appointed liquidator if they keep an account for the debtor**. The liquidator may request information after its identification under the ALM Act, which needs to be sent to it in accordance with the rules of **secure electronic liaising** in line with the general rules for electronic administration and fiduciary services. It is problematic that liquidators have a company gateway rather than an office gateway and currently **communication between two company gateways is not possible**. We initiated the resolution of this issue at the Ministry for National Development and the Ministry of Interior.

Ideas regarding private bankruptcy

Under the consultation initiated by the Ministry of Justice we reviewed the situation surrounding **non-performing mortgage loans**. (At the end of 2016 18% of the portfolio of retail mortgage loans

³ Act LIII of 2017 on the Prevention and Combating of Money Laundering and Terrorism Financing

was non-performing; this meant some 136 thousand debtors.) The *MNB recommendation on non-performing loans* hardly had any actual result; only a low number of restructurings took place, at the same time the facilities of the Hungarian National Asset Management Inc. have also been depleted. (After the issuance of this recommendation banks contacted some 72 thousand debtors, as a consequence they concluded agreements with 3,800 debtors, around half of which was on restructuring.) A tool to resolve this issue would be ***the more flexible and simpler regulation of private bankruptcy***, which would provide a solution for non-performing debtors.

With this in mind we sent our proposals on the suggested amendments to *Act CV of 2015 on Debt Settlement Procedure for Private Individuals* to the Ministry of Justice. We emphasized that ***in addition to burden sharing by the debtor and the creditors the state's participation is also indispensable***: the repayment subsidy and the tax discount on debt forgiveness under the legislation in effect have an important role in restoring the solvency of debtors. We proposed that ***debt forgiveness should take place only after the successful performance of the 5-year bankruptcy protection period***. As a reasonable solution, we proposed to allow the option of loan replacement after the five year period, and to conclude a repayment in installments agreements by debt managers. It is indispensable that the mortgage secure the mortgage lender's claim even in these cases. We have also made proposals for the extension of the grace period in connection with the exchange rate cap. The modifications did not become part of the government's agenda.

The new act to combat money laundering and its implementing decrees

The Draft law transposing the 4th AML⁴ Directive was sent in January by the Ministry for National Economy to the Banking Association for consultation. The key issues were discussed by a meeting of the Working Group for the Prevention of Money Laundering at several meetings within the consultation period. We highlighted our main proposals, and we discussed these main points at a more restricted separate meeting before the consultation deadline with the representatives of the Ministry for National Economy, finally submitting over nearly twenty pages of comments to the ministry. The most important achievements are that the ***copying of official documents is not an option but an obligation in the law*** and that in the context of the nature of interest of ***beneficial owners, the MNB expects a proposal from the Banking Association for the feasible structure of data recording***.

After the publication of the draft law, the Working Group took stock of the remaining open issues that were reasonable to be dealt with in one of the implementing laws still under preparation. The working group arranged meetings to this end with the representatives from the MNB and the Ministry for National Economy, mainly on the subjects of ***online identification, repeated customer screening, and the consequences of the copying of official documents***.

The working group received reassuring responses to several of our resolutions regarding the act and the implementation decrees. Based on its experience regarding the MNB decrees, the working group is currently compiling a new proposal.

Amendment to the Info Act

The amendment of *Act CXII of 2011 on informational self-determination and freedom of information* became necessary due to the ***changes in the EU law and law harmonization obligations***. In 2016, two new pieces of EU legislation which comprehensively affect data protection laws were published:

⁴ Anti-Money Laundering Directive

- *Regulation (EU) 2016/679 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC, (commonly known as GDPR⁵),*
- *Directive (EU) 2016/680 of the European Parliament and of the Council on the protection of natural persons with regard to the processing of personal data by competent authorities for the purposes of the prevention, investigation, detection or prosecution of criminal offences or the execution of criminal penalties, and on the free movement of such data, and repealing Council Framework Decision 2008/977/JHA*

The Regulation will be directly applicable to data processing in the territory of the EU. The scope of the Directive covers the data protection legal relationships of organizations engaged in certain activities for the protection of the public order, law enforcement and criminal procedure; the Info Act needs to be amended in this context. The legislator opted for the unique solution of inserting the provisions of the Info Act to be applied alongside the Regulation, as well as the amendments that became necessary due to the implementation of the Directive, into a **single amendment to the Act**. (It ordered the Info Act to apply generally to criminal law data processing, and amended it in line with the Directive.)

The draft amendment to the Info Act was discussed by the data protection working group of the Banking Association. In our observation sent to the Ministry of Justice, we draw attention to the fact that the **chosen codification solution will not help to enforce the requirement of the clarity of norms**. Due to the complex regulation establishing its personal and objective scope, this Act causes difficulties, even for experienced law enforcement professionals. We proposed a separate law to transpose the Directive into domestic law. We drew attention to the fact that the draft law contains a restrictive regulation with regard to mandatory data processing, contrary to the Regulation, and proposed to word the legal basis of data processing in line with the Regulation.

In November representatives of the Data Protection working committee took part in the expert consultation convened at the Ministry of Justice. They received an overview on the requirements related to the amendment of the Info Act and that the **Government intends to revise the horizontal and sectoral amendments related to data protection reform** together. Market players were therefore requested to **make drafting proposals to amend sectoral laws**, as well as to try and outline the economic effects of the GDPR application on market actors. Taking into account the **uniform text** submitted in early December, the committee completed its proposal on the amendment of sectoral laws by the deadline in January.

The new Act on Lawyers: regulating legal counsels

In connection with the new Act on Lawyers, we sent our detailed written proposal at the beginning of the year to the Ministry of Justice, in which we advocated against the integration of legal counsels in a bar; however we made some proposals for improvement that make the framework of bar integration somewhat more acceptable to legal counsels and their employers. In this regard we considered as a conceptual issue **the countersigning of documents by legal counsels, the regulation of secrecy and disciplinary liability, the bar membership fee and those outside the scope of the regulation**. Focusing on the bar integration, we received a very definite rejection from the Minister of Justice. In his letter, he relied on the earlier decision on bar integration made by the Strategic Cabinet and the Government.

At the end of March 2017 we received the draft text of the law for consultation. The lengthy draft, consisting of 213 sections, **considers the activities of the bar member legal counsels and trainee legal counsels as a type of lawyer's activities**. With regard to name use, the secrecy obligation and the document archiving it is based on the characteristics of the lawyers' activities; however, the

⁵ General Data Protection Regulation

lawyers' mandatory third party liability insurance does not apply to a bar member legal counsel. It can be concluded that, in general, the draft fails to take into account a decisive circumstance, i.e. that **a bar member legal counsel performs his/her tasks under an employment relationship**. According to the draft the legal counsel could only be employed under advocacy activities by a single employer, which does not match the operations and interests of corporate groups. In reaction to the draft, we sent our feedback, complete with wording proposals integrating the views of other, collaborating legal counsels from the sector as well.

On 13 June 2017 the Parliament adopted Act LXXVIII of 2017 on Lawyers' activities. This law entered into force on 1 January 2018, parallel with the new Civil Procedure. The implementation of this law is associated with further legislation and chamber regulations (35 types).

Under this law, legal representation and countersigning documents qualify as lawyers' activities, and legal counsels engaged in such activities can pursue these activities as members of the Hungarian Bar (Magyar Ügyvédi Kamara - MÜK). Legal counsels and trainee legal counsels could apply for their bar membership between 1 October and 31 October 2017 in order to have the opportunity to perform their activities continuously. It is a positive development for the sector that the legal privilege rules also cover bar member legal counsels, and the law allows for representation within a Group of Companies. The protection of legal counsels' interests is guaranteed by the appointment of the chairperson of the national section of bar member legal counsels as a deputy chairperson of MÜK.

In addition, a separate law was prepared *on the amendment of certain acts related to the entry into force of Act LXXVIII of 2017 on Lawyers and other acts of justice subject (Act CXXXVI of 2017)*: we also contributed to the preparation of this law. The law contains not only provisions closely linked to the entry into force of the act, but **as an "Omnibus Act", more substantial amendments to some other acts** as well, such as the *Act on Public Notaries, Act on Court Enforcement, Act on Probate Procedure, and Act on Civil Procedure*.

The ad hoc working group created for this purpose played a very active role in drafting and consulting on bar policies. The legal counsels of banks and from the industry joined the working groups of the Hungarian Bar engaged in the preparation of policies on the basis of spontaneous self-organization and work sharing, and they represented the interests of bar member legal counsels there. The Banking Association provided organizational, consultation and infrastructural assistance in this process.

Developments related to the Company Gateway

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 Working Group and the Legal Working Group held several consultations in the fourth quarter with representatives of the Ministry of Interior Affairs and the National Infocommunications Service Provider Co Ltd (Nemzeti Infokommunikációs Szolgáltató Zrt. - NISZ Zrt.) on the legislative background of electronic administration, on hosting for economic actors (Company Gateway), the obligations of entities providing electronic administration/ required to use electronic administration, the obligations of economic actors and on the Electronic Administration Supervisor. The representative of the National Office for the Judiciary explained the ***procedure for e-liaising, the process for submitting submissions, the amended ANYK⁶ forms, requirements for e-signatures, sanctions for violating electronic liaising, deadlines for submitting electronic submissions, and the process of serving electronic documents*** applicable in procedures initiated on 1 January 2018 and later. In addition, he provided information on ***the relationship between the Company Gateway, the Client Gateway and the Office Gateway*** and their users.

In November we contacted the Ministry of Interior with a request to postpone the deadline for mandatory application ***by a couple of months*** to avoid the problems that can be expected due to the

⁶ General Form Completion Application

late testing and the year-end launch coinciding with its mandatory application, but the Ministry rejected it. We then received a draft decree for consultation that exempts certain entities from the mandatory application of the Company Gateway. *The amendment to Act CCXXII of 2015 on the general rules of electronic administration and fiduciary services* provided the Government with the opportunity to specify, in a decree, those entities that are subject to the obligation to ensure electronic administration that will not apply the rules of the *e-administration act* on liaising with clients and other entities, since they were not able to provide the conditions for it through no fault of their own.

In ***inheritance procedures the reporting obligations towards notaries*** that apply to the accounts of a deceased person must be fulfilled through using the Company Gateways of financial institutions and the Hungarian Chamber of Public Notaries.

VI. Developments in connection with Magyar Nemzeti Bank (the central bank of Hungary)

Establishment of the MNB repo market working group and its activities

During the 2016 modification unsecured interbank credit interest (BUBOR) fixing, it became apparent that it would be useful to revitalize the activity of the interbank repo market to give greater support to the current interbank financing practice, in addition to the facility towards government securities repo transactions sustained by the Government Debt Management Agency. With regard to this, in February, MNB invited the Treasury experts of certain banks to a consultation, with the goal of presenting its ideas regarding the possible directions for development concerning the domestic repo market, and as a means of starting a debate on the issue. The aim was to find out banks' standpoint on the matter, and to start assessing the obstacles that might stand in the way of the repo market's development. The central bank also suggested the possible creation of a ***repo benchmark***, which could be applied in the pricing of market transactions, in addition to unfunded deposit/credit interest rate benchmarks (such as BUBOR).

After the consultation, central bank staff asked the banks concerned to fill out a ***questionnaire***. According to the information gained from these, ***all banks who participated in the survey support*** the developing of the repo market, primarily for a 3-6 month interval. Banks' general reasons for supporting the development process were more efficient risk and liquidity management, as well as the significantly lower limit and capital requirement (even lower than those in connection with swap), which would facilitate liquidity flow in the market. In addition to these, banks mentioned that an active repo market would also aid in government bond pricing activities, the pricing-in of expected market return, as well as market stability (in turbulent times). The most significant obstacles to developments were determined to be the absence of a standard framework contract system, and certain limiting aspects of KELER's and ÁKK's (Government Debt Management Agency) clearing and settlement systems. Banks did not show interest in the short term introduction of a repo benchmark or involvement in the quoting process.

Based on the above survey, the Monetary Council of MNB decided on starting the development process and on the launch of a ***Repo Market Working Group*** for its support, in order that it may elaborate the legal (framework contract) and technical conditions for the process. The working group started its activities in early June by compiling a questionnaire that inquired about the framework contract to be applied, the legal direction applying to the framework contract, and banks' individual positions on KELER, ÁKK and central bank statistics concerning the market. After assessing the questionnaires' results the working group consulted with experts from KELER and ÁKK on how to solve technical problems. The most important out of these problems is that ***KELER's system is not capable of managing negative interest***. Due to differences in size, interbank relation systems and

financing needs, banks have very differing position on the legal standards. The harmonization of these needs is therefore still in progress.

Consultations on the Wholesale Funding Ratio

The department of the MNB responsible for macroprudential regulation presented its preliminary vision in early October at a high level leader's consultation on the **differences in the asset-liability maturity structure of banks** and the new instruments for **managing roll-over risk**, which aims to keep within limits the amount of liabilities that can be accepted from financial institutions (including non-credit institution actors). According to MNB, in the current expansive growth period, the banking sector, in addition to the slowing increase in clients' deposits, tends to lean more and more on interbank liabilities, which, in case of difficulty in financing, will disappear all too quickly and bring institutions that rely on them heavily into quite difficult situations. According to preliminary aims, the new **Wholesale Funding Ratio**, will limit **risk-weighted financial interbank liabilities to 30% compared to total liabilities without counting own capital**.

In-person consultation was followed by a consultation period, during which several proposals were formed for calibrating the individual elements of the Ratio, primarily concerning the interbank liabilities to be considered and determining the value of the Ratio. As a result **subordinated loan capital, refinancing sources** (according to the act on mortgage credit institutions these are refinanced mortgage loans, refinancing loans granted by MNB, the MFB-Hungarian Development Bank, EXIM or EIB), **issued bonds with at least two years' maturity, and sources gained from parent institutions within Hungary will not be considered**. Although roll-over risk associated with sources gained from foreign parent companies is not significant, the MNB does not wish to exclude these from the category of liabilities to be considered. According to current plans, it is also probable that institutions with total assets under HUF 30 billion will not need to apply the Ratio.

In light of overlapping regulation the **foreign exchange financing adequacy ratio** will also be introduced together with the new Wholesale Funding Ratio, which will serve as a kind of **foreign currency NSFR** in the future. In answer to the Banking Association's request, MNB will introduce the two changes at the same time.

After the consultation (which lasted until the end of October), the central bank sent out the text of its draft decree for comments in mid-December. MNB also began to consult with the European Central Bank and the European Systemic Risk Board (ESRB). The consultations are expected to finish by January 2018, and the MNB decree will be announced by the end of Q1 2018, and is planned to come into effect in summer 2018.

The Prudential Regulatory Package

At the Board meeting in November MNB's officials responsible for microprudential regulation presented the aim, logic, elements and their relation to one another of the prudential regulatory package created in 2017. Some elements of the package had already been completed before the Board meeting (such as the new credit risk recommendation) or were about to be disclosed (such as the modification of the decree on the treatment of non-performing exposures or the recommendation concerning IFRS9). In the second half of November MNB informed the sector about three other important draft recommendations: the draft recommendations **on reducing high levels of non-performing exposures, on some issues concerning the assessment and management of loans for real estate financing projects, and on the real estate risks of financial institutions**. The aim of these measures (which follow European examples) is to in the future prevent a too-large buildup of exposures in areas that proved to be especially risky during the crisis. We consulted in detail on them first with the representatives of banks, then with MNB's experts. Our basic request was that the

recommendations be fitted to existing and currently forming legal frameworks (both domestic and European), and that **they should not contain mandatory requirements, but best practices concepts**. Furthermore, it is important that the sector have enough time to prepare after the recommendations are announced – MNB promised us that it would guarantee this.

The MNB package included the draft recommendation on **granting loans with pledge coverage directly by the financial institution as well as through prioritized dependent intermediaries**. With this, MNB aims to fill the much lamented gap in material legal regulations on these transactions. In our comments sent to MNB, we pointed out that the draft **has little consideration for the essential features of a pawnshop transaction**, due to which it is difficult to align it with the requirements for loans set in the Civil Code and the Act on Credit Institutions.

Other MNB recommendations and draft recommendations

- *MNB recommendation on out-of-court corporate restructuring*

As a final deliverable of its joint project with the EBRD, in May 2017 the MNB issued its *recommendation on the consensual restructuring process for claims on co-financed corporate debtors*. Essentially, this was based on the draft completed in October 2016 as part of technical cooperation with the EBRD, and incorporated previous key comments by the Banking Association; however, it was regressive in that regarding the amount claimed, it **reduced the threshold for the applicability of the recommendation from the previous HUF 2 billion to HUF 1 billion**. As early as during consultations on the draft, we identified the problem, which nevertheless persisted in the final document that the recommendation continued to impose requirements that may give rise to creditors' legal liability to their debtors. Such requirements are counter-productive, and may deter banks from applying the procedure regulated in the recommendation. Additional problems may arise from the fact that in specific cases, primarily in matters concerning documentation, the recommendation sets formal requirements the inclusion of which at the regulatory level would be appropriate if reasons of concerning consumer were relevant, while this is not warranted with regard to the customers and transactions falling within the scope of the recommendation (co-financing, threshold). There are some additional inadequate technical details, such as the inclusion of *de facto* deferred payments in the KHR register and in bank information requested by debtors.

The MNB expects the recommendation to be applied as of November.

- *Draft recommendation on the remuneration of sales staff*

MNB sent its *draft recommendation on the remuneration of product sales staff* in late October, awaiting comments. The draft recommendation concerns retail bank products and aims to implement the EBA⁷'s guidelines in the same subject. The **main criticism** that the banking community had regarding the draft was about the **management of intermediaries**. First, in the environment that was created as a result of previously established regulation on intermediaries, it is counterproductive to further tighten regulations. Second, in certain cases that concern the employee of the intermediary, due to the Civil Code, it is not feasible to ask for this level of requirements in the control recommendation by the financial service provider. In the case of other persons who have a different legal work relationship, the limiting of variable remunerations in proportion to fixed remuneration is also problematic, as the relevant government decree does not make this possible. It is also counterproductive (and may result in the significant migration of the employees concerned to other sectors) if the delayed payment of variable remunerations will apply to sales staff of lower rank. We requested that the entry into force of the recommendation in January (as required by the

⁷ European Banking Authority

EBA) should happen in a way that makes it possible to meet requirements later, and grants an adequate implementation period to credit institutions and intermediaries.

Our suggestions are currently under review at MNB's relevant professional department. According to the information we know, MNB's relevant professional department supports ***including an implementation period of adequate length*** in the recommendation. With regard to the issues raised, the Financial Stability Council will make the final decision.

- *Draft recommendation on the consumer debt recovery procedure*

In September 2017 the central bank of Hungary sent a consultation request ***on the MNB Recommendation on the consumer debt recovery procedure***. The recommendation serves to revise the format and content of Recommendation No. 14/2012 (XII.13.) of the Chairman of the FSA *on the consumer protection principles expected from debt collectors in their debt recovery practice* as well as the re-regulation of the debt collection activities via supervisory expectations.

The Workout Working Group discussed the key issues of the opinion sent to the MNB in a separate meeting. In our comments, we proposed to ***clarify the scope of this recommendation*** and, in view of the significant time needed for preparation, ***that MNB expect the application of these rules only from 1 July 2018***. We specifically dealt with the data protection aspects of debt recovery. An oral consultation on the matter took place in November with MNB, while we held a separate consultation with credit institutions and debt collection agencies.

Reporting

In 2017, the two greatest challenges involved in central bank reporting concerned changes due to the transition to the IFRS⁸, and the activities of the working group set up for the establishment of the single central bank credit register.

In the context of MNB reporting for monetary and supervisory purposes, in 2016 development was completed on the ***new reports aligned with IFRS transition***, which the sector was first required to apply in 2017. Additional complexity resulted from the fact that in 2017 the IFRS were used by some market participants and the national accounting standard by others, and the new reports to the MNB, which were new in terms of both structure and contents, and also involved a much greater depth of detail, were prepared accordingly.

In the course of commenting MNB decrees and recommendations, questions were also primarily raised regarding the rules related to IFRS.

The central bank is giving particular focus to the establishment of the ***single central bank credit register (HITREG)***, which includes individual credit details in an anonymized form and provides opportunities, in the long term, for the replacement of a number of data reporting procedures currently in place. Set up for the specification of data contents, the ***HITREG Working Group*** is expected to hold a total of seven meetings, of which the first three were held in 2017. Bank experts have indicated that the implementation of the new sub-ledger based reporting as of early 2019 would impose an extremely heavy burden due to the short preparation time allowed following the adoption of the decree. The NBH showed flexibility in connection with the extension of the deadline for the start of data collection and it will consider the possibility to extend the range of reporting agents gradually. No agreement was reached on the exact deadline; at the same time all agreed that this decree should be finalized as soon as possible, and reporting agents will be able to assign suitable resources for the developments only after that.

⁸ International Financial Reporting Standards

While scope of the data required for the HITREG is changing continuously due to the issues raised in consultations, compliance with the objectives related to analysis and supervision must also be ensured. Overall, negotiations are characterized by efforts to find mutually acceptable solutions. For all parties concerned, the establishment of the HITREG presents a major challenge and requires very costly developments. Consideration must also be given to the fact that the single credit register may only replace current reporting procedures in 6 to 18 months following its implementation.

VII. Payments

Implementation of the new Payment Services Directive (PSD2)

One of the most prominent tasks for the last year concerned the **transposition of the new Payment Services Directive into national law**. Underpinned by the requirements of the digital era, the regulations apply a broader definition of payment services, and define payment service providers as including **FinTech companies** whose services are interposed between account servicing providers and their customers in the fields of **payment initiation** and the **aggregation of account information associated with single customers**. The Directive places particular emphasis on **cyber-security**, on addressing the now permanent exposure to cyber threats, on the **authentication** of the customers and service providers involved in transactions, and on the security of their communication.

In completing the various phases of the implementation task, we allocated resources in proportion to the weight of each phase. The working documents produced by the working group set up for preparations were commented on by the Payments, Bankcard, SEPA and IT Security Working Groups. Following Board approval, the finalized documentation was submitted to regulators.

As part of the legislative process, we engaged in continuous and intensive consultations with the Ministry for National Economy and the MNB, with the latter also in the context of amendments to the applicable decree. Over the course of these trilateral consultations, a number of key issues were discussed, including the rules for **determining and accounting for fees**, and for related **customer information**.

A specific feature of the Directive is that on a number of points it **delegates the right to adopt specific legislation to the European Banking Authority**. Consequently, processing the extremely large amount of information generated over the course of public consultations on the **RTS⁹** and **Guidelines** issued by the EBA caused delays and, as a result, uncertainty in the preparation arrangements of our payment service providers. Among RTSs, particular importance is attached to the requirement for **strong customer authentication and secure communication**, knowledge of which is key to ensuring that the payments infrastructure, which is currently stable, secured by strict rules on access to data, and controlled, also remains adequately safe and secure following the introduction of **payment initiation and account information service providers (TPPs¹⁰)** that provide new payment services. As a general rule, the adoption of the RTS is followed by a preparation period of 18 months. As a result, there may be a **transitional period of several months (years)** between the effective dates of general PSD2 rules and of the detailed arrangements. Regarding the appropriate practical procedures for the transitional period, we requested an official position from the MNB in its capacity as the national authority. On issues arising with relevance to the subject, we also engaged in direct written consultation with the European Banking Authority, and we also ensured that information received from the competent EBF¹¹ Working Group was continuously shared with our members.

⁹ Regulatory Technical Standards

¹⁰ Third Party Service Providers

¹¹ European Banking Federation

As a key result of these consultations, the central bank expressed its professional view on the **services that account servicing payment service providers were required to provide** under the transposed legislation. This is accompanied by **provisions for responsibility arrangements**, according to which up to 1 January 2019 the relationship of a bank and its customer would remain subject to the previously applicable responsibility arrangements. We put forward a proposal requesting that for 18 months following the adoption of the **EU Regulation providing for the secure operations of TPPs** and including the standard developed by the EBA (i.e. during the foreseen preparation period for the Regulation), relations with new TPPs would be exempt from the security requirements provided for in the Regulation. This proposal was approved only partially, granting a preparation period of 12 months instead of 18 months.

Although with delays, the national legislator has completed its tasks even if the official translations of the EBA's standards and guidelines are still not available. A key achievement of our advocacy work during the legislative process is that banks will not be liable for the legal consequences resulting from the government's delay in transposition.

The emergence of FinTech companies that carry the potential for innovation and technological development (in the field of payments, they are payment initiation and account information service providers) also **presents new tasks for regulatory and supervisory authorities**. For that reason, the MNB has set itself the objective of developing a deeper understanding of FinTech companies in terms of the **market effects**, their **operational mechanisms**, and the **responses drawn from other market participants**. With the **regulatory sandbox approach** taken for that purpose, the authority seeks to explore the regulatory environment and supervision that enables FinTech companies to operate efficiently.

Setup of the instant payment system

Over the recent period, the implementation of **the instant payment system (AZUR¹²) has been the most significant strategic development on the Hungarian payments infrastructure**, a response to the challenge of digital transformation. Expected to be launched in July 2019, it introduces a new dimension to payments: rather than increasing the number of intraday clearing cycles further, it provides customers with the experience of instant payments on a 24/7 basis throughout the year for payments up to HUF 10 million.

Following the adoption of fundamental central bank decisions, the **AZUR project organisation** was set up, in which an important role was undertaken by the Banking Association. First, in the **Project Steering Committee (PSC)**, being the supreme decision-making body for the project, **account servicing payment service providers** are represented personally by the Secretary General of the Association. Second, we delegated bank experts to the project's **four Working Groups** and their **seven Sub-Working Groups**. This enabled all of the Sub-Working Groups to become operational and start work on the overview and elaboration of regulatory and information issues concerning business, liquidity, information technology, testing, security, service, and public payments, and the development of the required decisions on specific aspects of the model.

With the applicable deadline, the Regulatory Working Group drafted the amendments to **MNB Decree 18/2009** that were required because of the AZUR service, and in mid-December 2017, **in MNB Decree 35/2017 (XII.14.) on the execution payments, the legal regulations on instant payments were promulgated alongside the amendments and additions warranted by the PSD2**. As part of the regulatory work, the MNB provided opportunities for the payment service providers and credit institutions concerned to comment on the draft decree also outside the project working group. As a

¹² AZUR is the acronym for "Azonnali Utalási Rendszer" (Instant Funds Transfer System), the Hungarian project for the implementation of an instant payment system.

result, some of our proposals concerning **secondary account identifiers, requests for payment** and **system maintenance** were approved and incorporated into the decree.

The Banking Association contributed to the **extension of the License Agreement** which was previously made with the EPC¹³ in the context of IG2 on using the SCT Rulebook and concerned the use of the HCT Inst Rulebook for the Hungarian instant payment system. Due in part to that contribution, the project has already released the *HCT Inst Rulebook*, the *Secondary Account Identifiers Rulebook*, and the *Requests for Payment Rulebook*.

The Banking Association is a contributor to the maintenance of regular **internal and external communications** related to the project. We called an **information forum** for Member Bank CEOs, where MNB and GIRO Ltd. provided senior management information on the project.

Main developments in the card market

In 2017 there was stable operation and a **dynamic increase in turnover** at a pace beating the growth rate of the past few years, as well as **gradual expansion of the card acceptor network** in the Hungarian **payment card business**. According to the MNB figures for Q3, card purchases were up by more than 25% over the figure reported one year ago, while the number of physical acceptance sites grew by 6.5%. Of all bank card transactions, 69% were performed using the fast and advanced contactless technology which is spreading and is becoming increasingly popular among consumers in Hungary. The incidence of fraud committed using payment cards relative to turnover reduced, i.e., the use of cards became more secure for cardholders.

Within the framework of the ordinary election in September, the **Bankcard working group** elected Gábor Fóti, Head of Department at K&H Bank, **as its new chairman**. The working group supported its members with constant attention and active work in their **PSD2 preparations**, the important bankcard-related aspects of which include strong customer authentication and **changes in the compensation and chargeback rules**. In addition to the current issues regularly communicated to the MNB and the card companies, we shared all technical information on the topic relating to bankcards during working group consultations and at workshops. The working group began preparations for the main issues of the forthcoming **GDPR (General Data Protection Regulation) Regulation** concerning the card business; it processed and interpreted the reports and studies, as well as the changes in the payment statistics issued by the MNB.

In relation to the **bankcard chargeback** procedure, we presented the identified risks occurring when an intermediary merchant becomes insolvent and their potential management to the legislator and the competent organizational unit of the central bank. According to the MNB, the issue could only be addressed by legislation, but the central bank does not consider the restriction to be justified.

To continue the **POS installation project** launched in December 2016, the Ministry of National Economy (NGM) announced a new tender round in the terminal supply project in the autumn of 2017. We passed on the questions of our affected member banks to the competent unit of the Ministry to enable our members to assume their commitments while being aware of the exact terms and conditions of the tender. The tender was closed before the original tender deadline because all supported terminals were allocated.

In 2017 we took part in the regular consultations initiated and led by the NGM in relation to the preparations for **blocking the payment transactions of prohibited gambling games**. During the consultations, we prepared our remarks on feasibility and the technical barriers to the legislator and to the Gambling Supervisory Authority.

¹³ European Payments Council

In terms of fraud: according to the Europol annual summary study, a shift may be observed in ATM attacks from local, physical actions to the virtual space. Due to this online shift, the role of virtual protection is becoming increasingly important.

Prevention and effective co-operation with the authorities is paramount in **card security and ATM security**. In order to promote that, the MBSZ Board made a decision that in **2018 the Association will join the international organization of EAST** (European Association for Secure Transactions). Since its foundation in 2004, EAST has been focusing on ATM and transaction security issues and published studies and case summaries on the topic. It organizes international consultations for its members; these may be extremely useful, partly because of the fast international fraud migration observed in relation to bankcards.

The ***e-commerce and Airport Action Days***, international police action, concentrating on online commercial fraud, was held in June 2017 with the involvement of 26 countries. Following an appeal by the National Investigation Bureau and the Banking Association, a number of our member banks took part in the event.

The audit of the interbank bank-switching system handled by GIRO

During the transposition and implementation of the EU Payment Accounts Directive (PAD) in September 2017, a fundamental emphasis was put on ***executing the account switching process as smoothly as possible***. GIRO Zrt. received a key role in this, and undertook to ***manage interbank data flow***, as well as playing a defining role in the ***standardization of interbank messages***. This way however, bank data is handled by an external entity, which classifies as outsourcing according to the Act on Credit Institutions and Financial Enterprises. According to the act, outsourced activities must be audited, however it seemed unnecessary for all banks involved in the bank switching process to individually have their system outsourced to GIRO audited. Based on its Board's decision, the Banking Association agreed to have the auditing carried out on behalf of its member banks, therefore helping to avoid the unnecessary extra workload and extra costs. Thus, the Banking Association announced a restricted tender and signed a contract with the winner, to have the audit conducted. The winner company has finished the audit and its results were sent to the member banks concerned.

Developments in the European Payments Council (EPC)

The EPC has been working on the implementation of a Single European Payments Area as part of ***voluntary interbank cooperation*** since the early 2000s. In the course of that work, it has developed the payment schemes to which our Member Banks have also acceded, at the latest as required under the SEPA end date regulation.

As a notable achievement in the past year, the EPC's latest payment scheme, ***the instant payment scheme (SCTInst) became operational*** on 21 November 2017. The scheme is the fourth in a series that includes the credit transfer scheme (*SCT Scheme*) and two direct debit schemes (*the SDD core and business-to-business schemes*), which are already in operation. As of its launch, ***the new electronic system EUR credit transfers enables credit transfers of up to EUR 15,000*** on a 24/7 basis throughout the year, including bank and national holidays. The model was launched with approximately 600 payment service providers (PSPs), including ***primarily bank providers*** from Austria, Estonia, Germany, Italy, Latvia, Lithuania, the Netherlands and Spain, and is free of charge for the time being. The scheme was also open to acceding PSPs that were only prepared to receive credit transfers. In practice, however, ***90% of acceding providers are at their customers' disposals both as payers and payees***. Going forward, the geographical scope of the scheme will be extended to all 34 Member States, while participation will remain optional. The EPC intends to cooperate with the communities concerned on further improvements to the scheme, as part of which it will first assess

the possibility of increasing transaction amounts. From the beginning, the instant transactions executed within the scheme have been cleared in **seven SCTInst compliant CSMs**.

The new SEPA scheme has no Hungarian members at this point, which is presumably explained by the fact that the capacities of our Member Institutions are allocated to compliance and development tasks related to AZUR and PSD2 transposition.

The launch of the new scheme also means that in 2018 the EPC will **review its fee policy** currently applicable to payment schemes. According to plans, participant payment service providers would be charged standard participation fees per scheme, i.e. each participant would pay the standard participation fee for each scheme in which it is a member.

The EPC PIS¹⁴ Working Group has also produced its report in connection with the EBA RTS on **secure customer authentication and secure communication between payment service providers** as required under the PSD2. In that context, an evaluation team has been set up, seating delegates of the European Commission, the ECB and, hopefully, the EBA, for the development of an API that is compatible with the new payment services, complies with the requirements set out in the RTS, and supports initiatives for setting specific API standards as well as the work of national competent authorities. The EPC is participating in the team as an observer.

The report by the EIPP¹⁵ Working Group addressed the minimum requirements for business rules related to **E-invoice Payment and Presentment**, and the setup of the standard concerning the technical, message and message flow aspects of these activities, providing an overview of solutions at the individual, Member State and pan-European levels, as well as opportunities for their integration.

Developments related to SWIFT

As in previous years, in the past year the primary concern for **Hungarian members and users** was to **prevent and fight cyber crime**. The case of the central bank of Bangladesh dates back to 2016, when the bank fell victim to hackers through its SWIFT connection as a result of inadequate security equipment and procedures. Responding to that incident, SWIFT developed and announced its **CSP¹⁶ program**, to implement which SWIFT has mobilized significant resources within its own organization, requiring all of its members and users to do the same. The implementation of the program seeks to ensure that each user of the global SWIFT network is given the same level of security in the face of constant and increased exposure to cyber threats. The program covers three main areas: ensuring the security and protection of users' local systems, preventing and identifying fraud risks that potentially occur in counterparty relations, and leveraging the information and power inherent in concerted action across the SWIFT community with a view to preventing cyber attacks. 2017 was a year of key importance in the implementation schedule of the program, given the deadline of 31 December 2017 for all stakeholders to carry out the **mandatory self-assessment** compiled by SWIFT following a thorough survey. Preparations for the self-assessment was supported by a dedicated SWIFT team, which ran a road show to explain the methodology to all national SWIFT user and member groups. In Hungary, this was implemented in two steps: at the spring user and member meeting chaired by the regional country manager, and in early May 2017 in the form of a full day's training with contributions from the dedicated SWIFT team. Participation at the two events implied that stakeholders would complete the self-assessment successfully within the time limit. Those falling behind, affecting four users in Hungary, may still make up for their delay in Q1 2018. Subsequently, however, users missing the deadline or failing to complete the test successfully must expect SWIFT to notify the competent national authority.

¹⁴ Payment initiation services

¹⁵ E-invoice Payment and Presentment

¹⁶ Customer Security Programme

The global summaries, and the national statistics and evaluations circulated by SWIFT to national chairs indicate that Hungarian users performed well. **Close to 90% of stakeholders completed the self-assessment successfully within the time limit.**

VIII. Taxation

Changes in taxation

Amendments to taxation laws (Act LXXVII of 2017 amending specific tax law and other related laws) were promulgated on 19 June 2017 in the Official Gazette.

One of the most important changes concerning the sector is that under the provisions of the *act on the special tax for financial institutions* effective as of 20 June 2017, it has become possible to **apply reductions of up to 50% to the amount of special tax payable in the future** by the amount of support granted for eligible purposes. Eligibility requires that the taxpayer should be eligible for a corporate tax credit, but should not apply that tax credit to the corporate tax. The tax cut may also be applied in respect of support granted previously and to be granted in the future. The tax credit was already available for fiscal 2017. The initial limitation period for conducting surcharge-free self-assessments on bank tax returns submitted for 2017 was 10 September 2017, which was extended until 10 December 2017 by a legislative amendment adopted in November. The legislator provided a positive response to our request concerning the transfer of unused tax credits between years.

Under a new obligation, **companies** registered in Hungary **are required to register any foreign bank accounts** with the Hungarian Tax Authority within 15 days of opening such accounts. Existing accounts could be registered by 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. For instance, there are no specifications for the types of account to be registered (payments, technical, securities, etc. accounts), or for matching the terms defined in Hungarian legislation to account types used outside Hungary.

Following the legislative amendments, sole proprietors opting for a personal tax exemption remain exempt from the obligation to open a payments account.

It came as a relief to the sector that the **obligation to report real time data on invoices including output VAT in excess of HUF 100,000** will only be applicable as of 1 July 2018, a year after the original effective date. Aligned with the postponement of the online reporting obligation, the HUF 1 million threshold of domestic summary statements will also be reduced to HUF 100,000 only as of 1 July 2018.

The Banking Association's **Tax Working Group** actively participated in commenting the *NGM decree on the registration obligation related to the specification of the arm's length price*, the acts on *taxation and the tax administration regime*, and the *act on the enforcement measures available to the tax authority*. During the year, the Tax Working Group provided comments on key **tax return and reporting forms** of relevance to the sector, and proposed modifications to the forms and amendments to streamline reporting legislation.

As regards the **VAT treatment of bankcard payments**, the need emerged to update the 2013 Ministry position, given the major changes in the regulatory environment of payment services. In response to our request, the Ministry for National Economy confirmed that the change applied by the EU with a view to opening up the market for technical processors (by enabling the selection of technical processors) did not affect the complex character of the bankcard service, which would **continue to qualify as a non-taxable financial service** under Section 86(d) of the VAT Act in cases

where the payment, transfer and technical support services are all provided by the bankcard company.

The Tax Working Group requested a position from the Ministry for National Economy on the interpretation of Sections 8(3)–(10), effective as of 1 January 2017, of *Act CXVI of 2012 on the financial transaction duty*. Under the legal provision referred to in the previous sentence, a payment service provider that increases its holdings of customer receivables from financial services by at least 20% in two years may reduce the payable amount of the transaction duty by applying cuts as specified in the Act. Our question concerned the **calculation of customer receivables**. In its response, the Ministry explained that customer receivables were to be taken into account at their **net carrying amount as recognized in the accounts**. The position also addressed issues concerning foreign exchange conversions, the treatment of consolidation within the banking sector, and sanctions. The legislator confirmed that foreign exchange customer receivables were to be taken into account as recognized in the accounts at the applicable year-end exchange rates, and that appropriate application of the law could be sufficiently supported by proving that the increase in customer receivables was generated by real customer demand and a business policy objective based on real economic interest, and that the transactions were not carried out in order to ensure eligibility for the tax credit.

As a new means of countering aggressive tax planning and tax structures, through amendments to the act on the specific rules of international administrative cooperation, the CbC (Country by Country) reporting obligation took effect as of 31 May 2017. This **transfer pricing documentation requirement** concerns multinational groups whose consolidated sales for the year preceding the reporting year equal or exceed EUR 750 million. The reporting obligation primarily applies to parent undertakings. The tax authorities automatically share report contents with the tax authorities of the other countries concerned.

In response to the Banking Association's request, the Ministry for National Economy confirmed that Annex 1 to *Act CXC of 2015 promulgating the agreement on the automatic exchange of financial account information* remained open to be updated with new countries only as of 1 January each year. This is relevant to the sector because if new countries could also be added to the list of participants as of the effective date of the agreements, our members would be required to carry out additional, extremely costly and time-consuming developments for compliance with due diligence and reporting obligations and related taxation tasks.

Published by the European Commission in December to collect methods to improve the efficiency of withholding tax procedures, primarily in the field of tax refund, we shared the **Code of Conduct on Withholding Tax** with the expert of our members. In order to prevent double taxation the Code suggests transparent, standardized, user friendly digital solutions, also keeping the interests and options of small investors in mind. The implementation of this Code is voluntary for Member States.

Activities of the Sub-Working Group on the tax implications of IFRS transition

The IFRS Tax Sub-Working Group was set up in September 2017 and operates as part of the Tax Working Group.

In connection with the transition to IFRS, significant transition differences arise primarily due to the different recognition and measurement of assets and liabilities in terms of accounting and, separately, taxation, which also have tax implications. The Sub-Working Group is in charge of analyzing tax effects (corporate tax, local business tax), interpreting the specific taxation rules related to transition, formulating joint proposals to regulators, and requesting positions concerning the sector.

The IFRS Tax Sub-Working Group held six meetings in 2017. In relation to the transition to IFRS it examined the corporate tax and local business tax effect on issues classified into 29 categories. Originally, the Sub-Working Group would have remained operational only until the end of 2017; however, consultations on the issues that remained open could not be conducted with the Ministry for National Economy until mid-February 2018. Whether or not the Sub-Working Group will continue its operations depends on consultations with the Ministry.

IX. Developments within the Banking Association

The General Meeting

The annual General Meeting of the Hungarian Banking Association took place on May 12th, this year. In addition to the leaders of member institutions, Ágnes Hornung, State Secretary of the Ministry for National Economy, also spoke and participated in the professional opening ceremony of the Meeting, at which deputy governors of the Magyar Nemzeti Bank (the central bank of Hungary) were also present. The election of new officials, which happens every three years within the Association, fell to this year's Meeting. The Hungarian Banking Association re-elected Dr. Mihály Patai as its President, Mr. András Becsei as its Vice-President, as well as Henrik Auth as Chairman of the Ethical Committee. Éva Hegedűs, Radován Jelasity, Pál Simák, Zoltán Urbán, and György Zolnai were elected as Board Members of the Association for the next three years.

In connection with the election of new officials, a book of interviews was created (with the intent of making this a tradition later on), containing dialogues with the primary leaders of our member banks. These were ceremoniously distributed to the participants of the General Meeting.

The reports and plans for financial management and the budget were complemented by the Supervisory Board's report. In 2017, the leaders of the Hungarian Banking Association's member institutions once again approved a common standpoint and the issuing of a communique for the Association, according to which a new positive turnaround in trend seems to be visible in the banking sector that may have a stabilizing, dynamic effect on domestic economic growth. The press release published for the public and the media draws strong attention to the fact that in order to support the fast and plannable development of the economy, financing entities also need a predictable regulatory environment. It mentions that this involves the reduction of special taxes to European levels and the abolition of the transaction levy. The communique also discussed global and European banking events, including unified regulations which have changed the competitive environment, as well as changes to financial markets.

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As has become tradition, the Hungarian Banking Association once again distributed its Golden Beehive Awards at the 2017 General Meeting. This was the sixth time that colleagues from our member institutions or our freelance co-workers who significantly contributed to the operations and development of the banking sector have been presented with the award. The following people received the Golden Beehive Award at the 2017 General Meeting:

- Anna Batka (Hungarian Banking Association) – for decades of scrupulous work in the accounts, taxation and reporting working groups
- dr. Attila Bógyi (OTP Mortgage Bank Ltd.) - for his active, high-standard work in legislative efforts affecting the banking sector;
- Zoltán Makó (Riot Police; National Bureau of Investigation) – in recognition of his exemplary

- work in preventing and combating bank card fraud;
- Mrs. Németh, Gyöngyi Szűcs (Unicredit Bank) – for her outstanding work on accounting regulations;
- Gábor Weissmüller (Citibank) – for his dedicated professional work in preventing and uncovering financial fraud.

At the year-end dinner, the President of the HBA presented one person with the Golden Beehive Lifetime Achievement Award of the Hungarian Banking Association:

- Mr Hendrik Scheerlinck for his outstanding professional work as Member of the Board of the Hungarian Banking Association, his valuable work as President of the Foreign Banker’s Club, and his professional contributions to the development of the banking sector.

Other recipients of the Golden Beehive Award in 2017 were:

- dr. Katalin Auer (Hungarian Banking Association) – for two decades of outstanding professional work and leadership in legal matters and relevant working groups within the Association.
- Mr. Tamás Gábor Földi (Hungarian Banking Association) – for nearly three decades of leadership and organizational work done with great professional competence in the retail and payments fields and their relevant working groups.
- dr. Adrienne Kraudi for her exceptional professional work as Chair of the Permanent Court of Arbitration for Money and Capital Markets, and for the introduction, extension and operation of the Permanent Court of Arbitration for Money and Capital Markets in Hungary.
- Mr Chen Huaiyu for his valuable work as Chief Executive Officer of Bank of China Hungary through which he supported the Hungarian Banking Association’s efforts and the expansion of its international relations, and for his leadership, through which Bank of China Hungary became a regional center.
- Yang Zaiping for his contributions to establishing an active and mutually beneficial relationship between China Banking Association and the Hungarian Banking Association, for aiding and supporting Chinese-Hungarian governmental and financial relations, and for his dedicated work, as a result of which the Asian Financial Cooperation Association (AFCA) regards Hungary as a gateway to the European connection

Money Week – A summary of the 2016/2017 school year and preparing for 2017/2018

The third Money Week program was held in March 2017 and the number of its participants grew once again: the program reached 1100 schools, 160 thousand students, 400 financial and entrepreneurial volunteers, and included 11 000 classes. These numbers indicate that the ***Hungarian Pénz7 or Money Week program initiated by the EBF saw the most participants and is the most dynamically growing out of all the Money Week programs in Europe.*** One of the biggest triumphs of the program is that it has now been ***included in the national school curriculum.*** The program series was realized through the project management of the Ministry of Human Capacities, and through the professional collaboration of the Ministry for National Economy, the Money Compass Foundation (within MNB) and Junior Achievement Hungary. Following the Money Week program series we sent out detailed questionnaires to ask inquire about the opinions suggestions of teachers and volunteers. The nearly 950 responses received provided positive feedback for the organizers of the program. After the successful program in the spring, with help in project management from the Ministry of Human Capacities and through the professional collaboration of the usual organizers, preparations were started for the week of financial and entrepreneurial topics for the 2017/2018 school year. The next Money Week program series took place from March 5th to 9th, with its non-traditional classes ***focusing on lending as a financial topic*** (“Becoming loan-savvy”) and business ideas and collaboration as an entrepreneurial topic.

Experts have compiled three different curricula in the topic of finance for two different age groups. All preparatory and teaching materials (guides, videos) are available online at www.penz7.hu to the teachers and volunteers who have registered. The primary accompanying program of the Money Week is a **Europe-wide financial awareness quiz in 2018**, initiated by the EBF, with nearly 30 participating countries, among them Hungary. Another important element of the 2018 program was the Money Week Professional Day, held at the University of Miskolc. The event was tied to the opening of the first regional Fintelligence Financial Literacy Center.

Termination of the Permanent Court of Arbitration on Money and Capital Markets

On 6 July 2017 Parliament passed a new **Act on the Courts of Arbitration**, pursuant to which the Permanent Court of Arbitration on Money and Capital Markets (PTÁV) ceased to exist without a legal successor by force of law as of 31 December 2017. The remaining assets of the terminated courts of arbitration after the fulfilment of all creditor claims were transferred to their founders.

Pursuant to *Act LX of 2017 on the Courts of Arbitration (Vbt.)* the tasks of the terminated courts of arbitration will be transferred to the **Commercial Court of Arbitration** attached to the Chamber of Industry and therefore the new Court of Arbitration will have competence to conduct the cases in progress and to decide in legal disputes.

The processes required for the termination of the PTÁV were completed by the set deadline. Simultaneously, the Banking Association was also involved in the preparations for the new Court of Arbitration.

Developments concerning the BankAdat procedure

In the Hungarian Competition Authority's procedure opened in April 2012 on the assumption of unlawful agreement in connection with the BankAdat database, in the first days of 2016 the Competition Council adopted a decision directly condemning the Hungarian Banking Association and the Institute for Training and Consulting in Banking. The decision obliged the Hungarian Banking Association to pay a penalty of HUF 4 billion in 20 equal monthly instalments. The decision also named the participant banks in the database, and indicated its intention to issue a specific order to oblige, on a joint and several basis, the named banks to pay any penalty that has not been paid and cannot be collected.

The Banking Association submitted an application to the Budapest Court of Public Administration and Labour, requesting a review of the decision and suspension of the enforcement of the penalty. The court validly dismissed the request to suspend enforcement of the penalty. Following the submission of petitions by the plaintiffs and the defendant Hungarian Competition Authority, the Court scheduled the first hearing of the case for September 2016, which was postponed due to the replacement of the judge. The case was first heard by a judge ordinary in December 2016. This was followed by an additional three hearings in the case. The legal representative of the Banking Association proposed that an **expert be assigned** for the professional assessment of the case, given the fundamental difference in the positions of the plaintiffs and the defendant concerning evidence that BankAdat had the effect of restricting competition. (The Competition Authority considers the assignment of an expert to be unnecessary.) Progress on the case was hindered by another replacement of the judge in June. The newly appointed judge held three hearings in the case, but the hearings scheduled for February 2018 have not been held, and it is possible that the judge will be replaced again, and the case will be heard by the Judicial Council.

By transferring the last instalment in September, the Hungarian Banking Association has **fully paid the penalty imposed**.

Communications

2017 was a calm, ordinary year for communications with a **media interest of average intensity**, save for a few exceptional topics. According to our statistics, during the quarter we were featured in online media 1080 times, 400 times in printed media and 166 times in electronic media. Altogether, the Hungarian Banking Association was featured in Hungarian media **over 1600 times**, giving information to the media and the public about the sector's professional views.

In 2017 we responded to arising problems, questions and gave professional summaries from the sector's point of views through **several interviews, press releases and statements by the HBA's President, Vice-President and Secretary General**. After the General Meeting we issued a communication to inform the public about the banking sector's professional resolution on current economic and financial events.

One of the most regular communication topics during the year continues to be the **management of mortgage loans in arrears**. Other frequent topics were the basic account, changing banks, bank card and ATM security, the security of mobile payments, and personal insolvency. In addition to the conditions of the Family Housing Allowance, MNB's Certified Consumer-Friendly Housing Loans received continued, intense media attention. We teamed up with authorities (Budapest Police Department, EUROPOL) several times for communications activities and campaigns in order to draw the attention of clients to online bank card fraud and its prevention to handle concerns about potential contactless card fraud and we also joined the international campaign on information about preventing money laundering. In addition, we discussed the developmental directions for the banking sector in the future and the visible and potential effects of digitalization.

International cooperation and conferences

HBA staff continued their active participation in the activities of the **European Banking Federation's various committees and working parties** in 2017. In some cases relevant working groups processed the regulatory topics on the agenda and contributed their feedback to establishing a common EBF position.

Going beyond cooperation within the EBF, the HBA dedicated special attention to cooperation between the banking associations of the Central and Eastern European region, through which it becomes possible to discuss the unique problems of those countries that joined the European Union later on. At their June meeting in Bratislava, the V6 regional banking associations (Croatia, Czech Republic, Hungary, Poland, Slovakia and Slovenia) decided to expand the number of cooperating countries, in addition to debating their professional issues. Therefore, at their next, 12th meeting in October, leaders of the Bulgarian and Romanian banking associations were also invited to join, thus adding two more participants to the group (V8).

The professional cooperation with **China Banking Association** has deepened in the past few years, and is especially important for the banking community – the renewed Memorandum of Understanding between the two banking associations is also proof of this. The **agreement concluded by the Asian Financial Cooperation Association (AFCA) and the Hungarian Banking Association** signals a new chapter in Chinese-Hungarian cooperation. AFCA held its high level financial leaders' forum (lasting multiple days) in Budapest, in November, with more than 120 participating bankers from 27 countries. The professional cooperation between the banking associations and the banking sectors of the countries continues after the experience gained from the **AFCA conference**, coordinated by Dr. Levente Kovács, the Hungarian Banking Association's Secretary General and the only European Vice Chairman of AFCA's Executive Board.

The **delegation of the Estonian Banking Association** visited Budapest, and met with professional experts from the NGM, MNB, Budapest Stock Exchange, two commercial banks and the OK Center for Education, in addition to HBA staff. They gained comprehensive insight into the Hungarian economy, and the regulation and situation of the Hungarian banking sector.

The Banking Association organized for its **Cash working group to pay a professional visit to the Austrian Cash Logistics Center**, where the institution's upper management informed the group about how the center operates. Although the Austrian system is quite different from the Hungarian one, the working group considered the trip t very useful and believes that several elements of the Austrian system should be introduced into Hungarian practice.

Another important program during the year was the **joint conference** organized the Ministry for National Economy and the Hungarian Banking Association for the **150th anniversary of the Hungarian General Credit Bank's (MÁH) establishment**. The anniversary conference was held on József nádor square, in the building of the MNE, which was originally built in 1913 and once served as the headquarters of MÁH. The audience assembled for this conference about the history of the banking sector in the hall of the historical building consisted of ministry and bank officials, and economic and financial experts.

We organized a professional event for the HR and taxation departments of our member institutions on the new **MRP income benefit program** (the application of which is possible since 2016) at the end of March. At the meeting, in addition to experts from the KCG Partners Law Firm and the PwC Company (who worked out how to meet the legal and taxation requirements of the program), the practicing chief executive officer of MKB's MRP organization also participated.

Other working committees and working groups

- *Data Protection working committee*

The Data protection working group focused on **preparing for the implementation of the European Union's data protection reform, the General Data Protection Regulation. Data protection standards must be applied by data controllers in each field of their activity**, and processes, procedures and all data processing must be reviewed in terms of their compliance with the new standards. The greatest challenge is the enforcement of the **principle of integrated and default data protection**: data controllers must implement technical and organizational measures by taking into account the scientific and technical progress and implementation costs and risks that provide guarantees in the entire process of data processing for compliance with the requirements set out in the Regulation. High risk data controlling (for example, a high number of data subjects, high volume of personal data) must be preceded by an impact assessment, and also the data protection authority must be consulted in advance. All in all, data protection experts consider the preparation for the GDPR as a similar scale of task as the Basel II implementation. Under the GDPR, data controller and data processor companies controlling a large volume of data due to their activity **must employ a data protection officer**, directly reporting to the top management.

The GDPR sets up a **uniform system of sanctions**: an administrative fine of up to 10 MEUR, or for companies up to 2% of the entire previous year's global turnover of the business can be imposed as a rule. (The higher of the above mentioned amount must be imposed.) In serious cases, the fine can be 20 MEUR or 4% of the turnover.

At the Banking Association's Board Meeting in April, we informed participants that the GDPR, in effect from 25 May 2018, will impose significant restrictions and greatly broaden the range of sanctioning options. In line with the accountability principle, data controllers are expected to develop

processes within their organization to guarantee compliance with the Regulation and they must be able to demonstrate it. We informed the Board on the preparation for the GDPR and we requested its support in raising awareness of bank managers and employees that **preparation for the GDPR is not only the personal task of the data protection officer, but it affects the entire staff of the banks under the leadership and coordination of the data protection officer**, and the completion of this work requires support from the top management.

At the working committee's meetings, we held presentations and consultations on issues to be interpreted in connection with the GDPR, and on the recommendations of the EU's data protection body, **the Article 29 working party**. At our meeting in October, we hosted dr. Szabó Endre Győző, the Deputy President of the National Data Protection and Freedom of Information Authority (NAIH) who held a presentation on **the preparatory tasks for the General Data Protection Regulation (GDPR)** and the **function of the Code of Conduct regulated in the GDPR**, and the possible ways of creating it. In December the members of the committee took part in the last conference for data protection officers organized by NAIH, where we heard presentations by the leaders of NAIH.

- *Working Group on Agriculture*

During 2017 the Working Group on Agriculture liaised regularly with the representatives from the Prime Minister's Office, the Hungarian State Treasury, the Ministry of Agriculture, the National Food Chain Safety Office and the State Aid Monitoring Office (TVI). The Working Group's meetings dealt with the following main issues: key objectives of the **2014 to 2020- Rural Development Program**, their supporting tenders and their financial allocations, recent issues of direct payments within Pillar I, new titles and changes in existing ones, in particular greening, and reorganization of the Office of Agriculture and Rural Development and its consequences. The Working Group actively participated in the consultations on the future of the Common Agricultural Policy (CAP).

One of the most important achievements of the working group on Agriculture is the **information issued by the Prime Minister's Office**, which, similarly to the Economic Development and Innovation Operational Program (GINOP), **authorizes mortgage establishment to the investments under** the Rural Development Program without a prior written agreement of the Rural Development Management Authority. As a result of the working Group's further work the possibilities to establish a mortgage in connection with the program were also extended. The Working Group initiated to TVI the revision of aid intensity, if the aid intensity included in the grant award decreased due to the change in the investment costs. As a result of this initiative calls have already been amended and it is now possible to re-establish eligible total costs for the entire project while leaving the earlier approved aid amount unchanged, leading to a lower aid intensity.

As a result of the Working Group's activity the **Day of Agriculture Business** was organized for the second time in 2017, where the prospects of the sector, the situation of the food industry, changes in the small scale agricultural produces system, as well as the long term plans of the Chamber were discussed.

- *Internal Auditors working group*

The Internal Auditors working group (founded in line with the Board's resolution) held its inaugural meeting on October 18, 2017. Róbert Kollár (K&H Bank) will be the Chair of the working group for the first year (appointed by the Secretary General), while after him members will choose the Chair in the usual manner.

The working group **decided on its one-year work plan** and members have compiled the topics on which the working group wishes to work in the medium term. In certain areas the application of a **risk-based approach** gains priority over the current annual and quarterly auditing obligations. The two most important topics (obligations to audit outsourced activities, and issues related to internal auditing in line with IRA Section 96 Article 3 and issues regarding the **position of a safeguarding**

officer) have already been discussed at the working group's first two meetings. The request for a resolution to reinforce the working group's position has been completed for both topics.

- *Compliance working group*

The Compliance Group initiated that similarly to *Act CXXXVIII of 2007 on Investment Firms and Commodity Dealers, and on the Regulations Governing their Activities (Bszt)*, *Act CCXXXVII of 2013 on credit institutions and financial enterprises (Hpt.)* should also provide for an obligation **to establish an organizational unit responsible for compliance or to appoint a responsible person (recognition of the compliance function)** In the justification annexed to our proposal for the amending act we emphasized that for credit institutions Compliance plays a significant role in the continuous maintenance and classification of the bank's internal controls, risk management and management tasks not only for investment services but also for financial services. This support activity is an essential interest of the authority responsible for supervision.

The draft text developed by the working group was inserted into Hpt, without any material change, alongside the spring amendment of financial acts.

In autumn 2016 the members of the Compliance working group decided on compiling a **Compliance Best Practice Code**, on its concept and the topics to be regulated. The members agreed to include the best practice in the market today and to also consider international guidelines, primarily leaning on the experience of countries that are also represented in the Hungarian market. The document therefore does not wish to summarize the "common" practice solutions currently present in all institutions, but rather aims to determine a direction to be followed in the future by collecting the most forward-thinking solutions from all institutions.

After it was approved by the Board, the Secretary General published the Code as a recommendation by the Banking Association, which does not require accession. Depending on the letters of intent received from institutions, there will be a decision made within the coming year on whether the Code should be issued as a recommendation requiring accession or not.

- *The Equal Treatment sub-working group*

In accordance with the decision of the Board, on November 14, 2017, the Banking Association's **"Equal Treatment" sub-working group** was called to meet for the first time, to participate in the activities of the Communications working group. Vilmos Freisleben, head of MNB's Consumer Protection directorate gave an opening presentation at the working group's first meeting. According to what was said, MNB's main requirement is that the supervised institutions, according to their developed strategy, dedicate conscious attention to achieving the highest level solutions possible for **guaranteeing equal treatment to customers living with disabilities**. If need be they may also apply a step-by-step developmental approach.

- *EXIM Sub-working Group*

Eximbank aims to provide access to export markets to domestic businesses. EXIM Sub-working Group contributes through **consultations on the programs offered by the bank and amending proposals** to provide a structured and transparent product range to small and medium sized enterprises, priority in the national economy and to be supported in the international market competition. During 2017 Eximbank developed, based on the proposals from the Sub-working Group, **the updated product documentation for the competitiveness enhancing working capital loan**, and amended the standards on **limits** and **segment classification**. The Sub-working Group sent proposals to the *Guideline on the state aid rules for competitiveness enhancing arrangements and refinancing products*, and to the *contract templates* available in the Future Exporters Loan Program. In 2017

EXIM concluded 458 new individual refinancing agreement and disbursed altogether a HUF 260 billion refinancing loan in 2,173 items. The refinancing loan portfolio reached HUF 581 billion, and the 2017 portfolio increase was 3%.

- *Credit guarantee working group*

Throughout its activities the Credit Guarantee working group **actively supports the expansion of banks' SME financing**. In 2017 the working group reviewed the measures introduced at Garantiqa Hitelgarancia Zrt., as well as its **reduced** (discount) **guarantee fees** in effect from July 2017 and their web service. Through the web service. By using Garantiqa's web service, banks also have the possibility to significantly save on labor, rationalize processes and avoid errors made during manual work. With regard to the above, 99% of third-party guarantee applications are submitted to the company electronically already. Two partner banks are also already working on creating a similar interface connection, which implies a higher level of digitalization.

The working group reviewed Garantiqa's new products, which it announced as part of the **European Investment Fund's COSME LGF**¹⁷ program. Working group members believe that the program is a particularly suitable instrument for supporting SME lending activity, especially since it is exempt from state aid laws. With this design, Garantiqa can best support investment loans, due to its favorable fees and its ability to provide a guarantee of 85-90%. In addition, a presentation was held on the new **portfolio guarantee**, a unique product in the Hungarian market, available from 2018.

- *Mortgage banks working group*

The normative text of the European Commission for the **EU legislative act on Covered bonds** will likely be published in the spring of 2018. At the same time, according to the Commission's preliminary information, the content of the legislation will primarily be based on the EBA report published in late 2016. The working group thus began its consultations with the institutions concerned on specific parameters (excess collateral, LTV limits, frequency, stress test) and will conduct further consultations when the text of the legal act has been published.

With the view to further support the recovery in the mortgage bond market, the MNB and the Stock Exchange established **three new mortgage bond indices (BMBX indices)**. The indices were introduced for the time being as an experiment. The function of these indices, as intended by the central bank, is to provide more information to investors, and to facilitate the pricing of mortgage bonds and evaluating the performance of mortgage bond portfolios.

The working group has consulted with the Magyar Nemzeti Bank on the **MNB's recommendation on the management of the risks borne by financial institutions related to real estate**, making several substantive comments in line with international standards.

The **development of property valuation** and increasing the expertise of property valuers have been on the working group's agenda on several occasions, and the working group has engaged in consultations with the organizations concerned to this end.

The legislators repealed the definition of **non-problematic debt** on 1 January 2017, and from then on debt can either be a performing or non-performing exposure, and restructured receivables need to be distinguished within both categories. Following several rounds of discussions and in order to ensure consistency between the categories of the individual receivables and the harmonisation of the laws, *Act XXX of 1997 on Mortgage Banks and the Mortgage Bond* was amended, and mortgage banks can now only purchase receivables that do not qualify as non-performing or restructured receivables according to the auditor of the selling financial institution.

The working group also discussed the introduction of the so-called **green mortgage bonds** appearing at the EU level, as well as the favorable formulation of the rules.

¹⁷ Competitiveness of Enterprises and Small and Medium-sized Enterprises, Loan Guarantee Facility

- *Keler User Committee*

On 13 December 2016 KELER Központi Értéktár Zrt. established its Use Committee provided for in *Regulation (EU) No 909/2014 on central securities depositories*. The User Committee is an independent committee of the KELER customers (and their representatives) that provides expert opinion to the Board of KELER. The objective and importance of the User Committee lies in involving customers into non-operative matters, in having an insight into the operation of KELER and expressing their opinion to the management. In 2017 the User Committee held a single meeting, its agenda contained the adoption of its **final rules of procedure**, and the **declaration** required for the central securities depository license, i.e. that the rules, procedures and contracts of KELER are clear, legible and enforceable in all relevant jurisdictions. In addition, the User Committee discussed the **disaster recovery plan**, and the set up of the **working group on settlement discipline**.

- *SME Working Group*

In 2017 the SME Working Group kept regular contact with the representatives of the Ministry for National Economy, the European Investment Bank and the European Investment Fund, Nemzeti Infokommunikációs Szolgáltató Zrt., the Ministry of Interior and the National Office for the Judiciary. During the discussions, the working groups received information on the **SME strategy of the Economic Development and Innovation Operational Programme (EDIOP)**, and the experiences of evaluating EDIOP project applications, as well as the **Irinyi Plan** and its implementation tools.

From Q2 2017, the activities of the working group were concentrated mainly on the introduction of the Company Gateway, compulsory for business associations from 1 January 2018, as well as the **e-communication process in court procedures** and the general process of submissions in procedures launched on 1 January 2018 or later. The topics of the discussions included the amended ÁNYK forms, requirements for e-signatures, sanctions for violating electronic liaising, deadlines for submitting electronic submissions and the process of delivering electronic documents. In addition, the relationship between the Company Gateway, the Client Gateway and the Office Gateway was also the topic of a number of consultations.

- *Leasing working group*

In 2017 the Leasing working group focused on three main activities. The Office of Government Issued Documents (OGID) Sub-Working Group on Leasing developed a **template private document** in connection with the recording of vehicle data in the vehicle register, the registration of the transfer of title and the registration of the lessor customer's operator right, published by the Central Office for Administrative and Electronic Public Services (KEKKH), and available from this year for each government one-stop shop. Due to the **differing practices of OGID's** concerning motor vehicle proprietary transfers and the registration of operational rights into the road traffic registry, the working group compiled and sent its recommendations to the Prime Minister's Office to **amend Government Decree 304 /2009 (XII. 22.)**. A significant number of the working group's recommendations were taken into consideration and the decree was amended on January 1st.

The Deputy State Secretariat in Charge of Record Keeping at the Ministry of Interior, Idomsoft Zrt. and GIRO Zrt held a consultation in connection with the development needs for the GIRinFO service: that it should be possible to make a query about the vehicle's previous license plate and make by only **specifying the chassis number and make**, in addition to queries requiring the license plate and chassis number. An achievement of the consultation was that the working group elaborated and submitted the reporting request for the new type of query to GIRO Zrt.

Furthermore, the working group provided feedback on the domestic leasing refinancing framework product developed by EXIM, which was modified based on the working group's comments. In 2017, within the export targeted leasing scheme, a sum of HUF 20.4 billion was financed for leasing

purposes, made through 447 transactions from Eximbank's refinancing. The previous scheme ended on June 30, 2017, after this the new leasing scheme announced within the **Export lending sub-loan program** was launched. EXIM signed a contract with 8 financial institutions. The leasing portfolio reached HUF 37.8 billion by the end of the year.

Documentary Credits working group

The Documentary Credits working group consulted with the representative of the National Tax and Customs Administration (NAV) on the **financial collateral to be applied according to the new regulation on excise tax**. As a result of these consultations NAV created a recommendation on the **data content of financial collateral**, which promotes the unequivocal fulfillment of new excise provisions in relation to providing financial collateral as well as facilitates and simplifies the tasks of credit institutions regarding the granting of collateral to clients.

At the consultations **experiences concerning customs guarantee** were debated and so was **paragraph 3 of Article 60/A of Act XIII of 2016 on the implementation of EU customs**. Hungary undertook to introduce the **electronic public procurement system** by December 31, 2017, by which it wished to satisfy the new **EU public procurement directives**. The working group consulted with representatives from the Prime Minister's Office several times on the possibility of introducing the guarantee undertaken by banks into the electronic public procurement system, in order to allow for the offering parties to grant the collateral offered electronically from then on.

Within the Documentary Credits working group experiences gained after issuing the common guidelines made by the **Hungarian Banking Association and the Piece-rate system Performance Expert Organization (TSZSZ)** were exchanged. The guidelines, which convey the role of TSZSZ in debates on the exercise of bank guarantees for construction and technical planning and the fulfillment of construction and contractor contracts, was published a year ago. Up until now, TSZSZ received a total of 37 requests for exercising bank guarantees; in 2016 the Organization examined 10 bank guarantee exercising requests, and 3 in H1 of 2017. The sum of the debated (exercised) guarantees amounts to nearly HUF 1.4 billion, out of which HUF 800 million was not justified according to acting experts.

○ *Working group on Litigation*

In 2017 the working group consulted mainly on the **preliminary ruling procedures pending at the European Court of Justice**, in the following issues:

- The acting judge raised questions in connection with the relationship between Section 37 of the Settlement Act and EU law.
- The Budapest High Court of Appeal made an order to initiate a preliminary ruling procedure, wishing to find out whether allocating exchange rate risks to customers as an unfair contractual condition can be examined or not, and whether the related information fulfilled the requirements of clarity and comprehensibility.
- The judgment handed down by the European Court of Justice in a Romanian FX loan case (C-186/16): The preliminary ruling procedure was referred by the Nagyvárad Court of Appeal (Curtea de Apel Oradea) in connection with a CHF denominated loan agreement concluded by the Banca Românească SA and asked to what extent is a bank required to inform customers of the exchange rate risk involved in loans denominated in foreign currency. (In its judgment, the Luxemburg Court concluded that the challenged term constitutes the main subject matter of the loan agreement and therefore its unfairness can only be examined with regard to the Directive if this term was not drafted in plain intelligible language.)
- We studied the guiding judgments of the German and Austrian Supreme Courts in the matter of handling fee and disbursement commission (which also came before the European Court of Justice).

In addition, the working group reviewed the material of the September 2016 meeting of the Curia consultation body dealing with FX loan cases, as well as the material of the official FX lending meeting held in the Pécs High Court of Appeal on 8 April 2016.

- *Treasury Working Group*

The Presidency of the Banking Association has established this Working Group for the interpretation of the provisions of MiFID2 and the MiFIR, as well as the numerous related delegated acts, to support the bank's preparation, and to handle recent issues related to this area. The founding meeting of this Working Group was held at the end of January, and in its regular monthly meetings until the summer it dealt with ***the implementation issues of the new capital market legislation, interpretation of rules***, and issue detection and ***review of best practices***. In this context it consulted with the representatives of BSZSZ and ÁKK on the issues related to the ***commission of sovereign bond dealers***, and with the representatives of KELER in connection with ***LEI codes***, and the ***pre- and post-trade reports***.

In addition to the MiFID/MiFIR rules the Working Group dealt with the extension for the deadline for compliance with the variable margin requirements provided for in the EMIR in the context of OTC derivatives, the issue of the annulment of book entry securities of certain dissolved companies, the questionnaires of the NBH Repo Market Group, requirements and risks of direct CLS membership, and the liquidity issues of the instant payment system.

- *Workout working group*

The representatives of the Banking Association met with the new management of the Hungarian Association of Insolvency Practitioners and Asset Controllers and ascertained that although the interests of creditors and insolvency practitioners differ on several points, it is worthwhile consulting regularly in order to promote more effective collaboration between the two sides. Consequently, the consultation did take place when opinions were given about amending the *draft government decree on the provisions for the public sale of the debtor's assets during the liquidation process; and on the issue of providing data to liquidators through electronic channels*. The consultations were held with the participation of the Ministry for National Development and the Association of Investment Service Providers (BSZSZ). The working group also provided feedback on the ideas for simplifying the personal insolvency procedure, draft proposals for modifying the bankruptcy act (several times during the year), and a draft recommendation for debt management.

In the following chapter we will provide a summary of the most important developments in prudential regulation in 2017, presenting global and European processes separately. The detailed accounts of these events are available in the annexes to our quarterly reports.

Global Regulation

In politics, the global regulation aims are set out at the meetings of the heads of state and governments of the G20 countries. The professional content and details are shaped by the international bodies responsible for global regulations. The Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (BCBS) play key roles in establishing a regulatory framework that intends to be consistent and effective.

The Financial Stability Board

The Chair of the **Financial Stability Board** set out the following **priorities for 2017**:

1. Transforming shadow banking into resilient and flexible market-based finance, mitigating structural vulnerabilities in asset management;
2. Making derivatives markets safer by progressing the post-crisis reforms to OTC derivatives markets, and adopting the coordinated guidance on central counterparties recovery and resolution;
3. Supporting full and consistent implementation of post-crisis reforms, including the development of a structured framework for post-implementation evaluation of the effects of reforms;
4. Addressing new and emerging vulnerabilities, including misconduct risk, as well as those stemming from the decline in correspondent banking and from financial risks related to climate change.

The operative tasks of the past year were defined in line with the priorities above.

In accordance with the above, before the G20 summit in Hamburg the **FSB** made the following progress on the **review and regulation of shadow banking activity**:

- It assessed the post-crisis development of shadow banking activities and the related financial stability risks, as well as the adequacy of the measures taken and monitoring of them, and
- It reported on the operationalization of the proposals regarding asset management.

Regarding the **comprehensive renewal of OTC derivatives markets and the regulation of central counterparties** (CCPs), the FSB:

- gave a comprehensive report on the reform of the OTC derivatives market;
- published the final guidance on the recovery and resolution of CCPs. The guidelines by CPMI¹⁸ and IOSCO¹⁹ containing the detailed rules will also be drawn up for the summit.

With respect to **post-crisis reforms**, the FSB

- finalized its guidance on internal TLAC,²⁰
- published its third annual report on the implementation and effects of the financial regulatory reform,

¹⁸ BIS Committee on Payments and Market Infrastructures

¹⁹ International Organization of Securities Commissions

²⁰ Total loss-absorbing capacity

- developed a framework for evaluating the effects of the introduced reforms.

With regard to ***new and emerging vulnerabilities***,

- prepared a report on the measures taken in order to manage misconduct risk in line with the action plan and the recommendations on managing this risk;
- published a consultative paper on using compensation (remuneration) tools to address misconduct risk;
- reported on the progress made and further steps to be taken in connection with the implementation of the action plan made to curb correspondent banking and remittances.

The agenda of the G20 summit also included:

- the final report of the task force responsible for financial disclosure obligations related to climate change;
- the report on the impact of fintech innovation on financial stability, also touching upon regulatory and supervisory aspects.

The annual report on the introduction of regulatory reforms identified the key areas where authorities need to remain vigilant (maintaining an open and integrated global financial system; market liquidity; and the effects of reforms on emerging markets and developing economies) and asked for the G20 leaders' support to reinforce global regulatory cooperation.

The ***framework for the post-implementation evaluation for the effects of the G20 financial regulatory reforms*** serves to help assess whether the reforms achieved their intended outcomes and to identify any material unintended consequences that may have to be addressed, without compromising the objectives of the reforms. The framework clarifies ***concepts and terms, describes analytical approaches and specifies the processes*** for the evaluations. The framework is constantly refined with the help of feedback and experience. The ***Handbook for FSB Peer Reviews***, which was originally prepared in 2009 and revised in 2017 for the fourth time, focuses on evaluating the implementation and effectiveness of international financial standards and policies.

The international regulatory bodies (FSB, CPMI, IOSCO and BCBS) deemed their workplan regarding the ***recovery and resolution of central counterparties*** (CCPs) created in April 2015 completed, after issuing three guidelines and two reports.

With regard to the ***resolution of global banks*** the FSB finalized its principles on the internal total loss-absorbing capacity of global systemically important banks ('Internal TLAC'), as well as defining the minimum requirements for bail-inable instruments that may be used in resolution. The guidance on continuity of access to financial market infrastructures (FMIs) for a firm in resolution was also finalized, and a report on introducing the resolution reforms was created for the sixth time.

The FSB published two consultative documents on the Key Attributes of Effective Resolution Regimes²¹ in November, in order to promote the implementation of its content. The document concerned the principles in bail-in execution and the funding strategy elements of an implementable resolution plan. In addition, the list of systemically important banks was also updated.

In September, the FSB published for the first time the ***list of the key standards for the operation of sound financial systems***.

The ***dynamic development*** of technology-enabled innovation in financial services i.e. ***FinTech*** made it necessary for the FSB to identify key supervisory and regulatory issues that merit authorities' attention. According to the FSB's report the managing operational risk from third-party service

²¹ The document entitled Key Attributes of Effective Resolution Regimes was published in 2011 and later updated in 2014. It is referred to simply as „Key Attributes“ by professionals.

providers, mitigating cyber risks, and monitoring macrofinancial risks requires **international collaboration**.

According to the shared report released by the FSB and the CGFS²² in May, **FinTech platforms account for an increasing share of credit provision**, therefore policymakers have to consider the opportunities and risks such activity brings.

The reports on Fintech drew attention to the missing relevant official data.

During the **second phase of the G20 Data Gaps Initiative** (DGI-2) a second status report was compiled and was delivered to the G20 Finance Ministers and Central Bank Governors ahead of their summit in October.

The Basel Committee on Banking Supervision

The Committee updated its **two-year work program for 2017-2018** in April, establishing four main scopes of activity:

- I. Finalizing existing policy initiatives and initiating targeted policy development;
- II. Monitoring emerging risks and assessing the impact of the Committee's post-crisis reforms;
- III. Promoting strong supervision;
- IV. Ensuring full, timely and consistent implementation of the Committee's standards.

I. Concerning the **completion of professional policy initiatives**, the **finalization of the Basel III reforms** was the most important step, which was agreed on in December 2017, after a one-year delay. The decision was made by the decision making body of the BCBS, central bank governors and heads of supervision (GHOS) to endorse the remaining Basel III post-crisis regulatory reforms, namely:

- *a revised standardized approach for credit risk*, which will improve the robustness and risk sensitivity of the existing approach;
- *revisions to the internal ratings-based approach (IRB) for credit risk*, where the use of the most advanced internally modelled approaches for low-default portfolios will be limited;
- *revisions to the credit valuation adjustment (CVA) framework*, including the removal of the internally modelled approach and the introduction of a revised standardized approach;
- *a revised standardized approach for operational risk*, which will replace the existing standardized approaches and the advanced measurement (AMA) approaches;
- *revisions to the measurement of the leverage ratio and a leverage ratio buffer for G-SIBs*, which will take the form of a Tier 1 capital buffer set at 50% of a G-SIB's risk-weighted capital buffer; and
- *an aggregate output floor*, which will ensure that banks' risk-weighted assets (RWAs) generated by internal models are no lower than 72.5% of RWAs as calculated by the Basel III framework's standardized approaches. Banks will also be required to disclose their RWAs based on these standardized approaches.

The revised standards will *take effect from 2022, granting a lengthy preparation period*. The output floor value of 50% in 2022 will gradually rise to 72.5% from January 1, 2027, with a 5 percentage point increase each year. The Committee also postponed the deadline for the implementation of the fundamental review of the trading book (FRTB) from 2019 to January 1, 2022. Therefore the revised standards will have to be implemented for credit, market and operational risks from 2022 as well. The GHOS also reaffirmed their expectation of full, timely and consistent implementation of the new elements of the package. Alongside the above announcement, the Committee also published the *results of a cumulative quantitative impact study* based on end-2015 data.

²² Committee on the Global Financial System

In its press release published before the announcement of the decision, the *European Banking Federation* (EBF) generally welcomed the agreement; however it noted that it may threaten financing in the European economy by penalizing low-risk exposures, particularly residential mortgages. It therefore emphasized that a *cumulative impact study* was necessary before the introduction of the framework in Europe. The European Commission also vouched for this. Prior to the introduction of the framework, the Commission will conduct a consultation with member states and other parties concerned. The necessary modifications will be carried out independently from the risk reduction package in November.

The Basel Committee made an important decision at its meeting in October on the *net stable funding ratio's (NSFR) treatment of derivative liabilities*, as well as establishing a *procedure for issuing technical amendments to its standards* in December. In addition, it published its first proposed technical amendment at the same time, which is related to the *treatment of extraordinary monetary policy operations in the NSFR*.

Based on the report of the high-level Task Force (TF) set up in January 2015 the Committee published a discussion paper on the *regulatory treatment of sovereign exposures*.

In March 2017 the Basel Committee published its *draft guidelines for the identification and management of step-in risk* for the second time, which was finalized in December. The guideline's provisions will be in effect from the end of 2019.

The BCBS also published further details of the *interim regulatory treatment of accounting provisions* and standards for transitional arrangements, as well as releasing a working document on the *interplay of accounting and regulation and its impact*.

The Committee revised the *assessment framework of global systemically important banks*; compiled a *progress report on G-SIBs' implementation of the principles for effective data aggregation and reporting*; and enhanced *Pillar 3 disclosure requirements*.

The BCBS developed a *simplified alternative to the standardized approach to market risk capital requirements*, and held a consultation in the same topic. The Committee also seeks feedback on whether retaining a recalibrated version of the Basel II standardized approach could be an alternative solution to the proposed *reduced sensitivities-based method (R-SbM)*.

In early July BCBS and IOSCO jointly announced a consultation on the *features and identification of simple, transparent and comparable (STC) short-term securitizations* and on the *capital treatment for STC short-term securitization*.

Naturally, the Basel Committee continuously monitors which ***other areas may need further professional policy initiatives***.

II. In early April the Basel Committee published its ***final guidance on the prudential treatment of problem assets***, in order to ***monitor emerging risks***, changes in banks' business models and innovative transactions or regulatory arbitrage which may go against the objective or spirit of Basel III. The guidance ***harmonizes the definitions of non-performing exposures and forbearance*** to promote consistency in disclosure and supervisory reporting and complement the existing accounting and regulatory framework for asset categorization.

Fintech development and IT security are of priority within emerging risks; therefore in August, the Committee released a consultative document on the *implications of fintech for the financial sector, banks and bank supervisors*. The document assesses various future potential scenarios considering their specific risks and opportunities. A separate working document was compiled on the supervisory approach to enhancing banks' ***cyber security*** frameworks. In addition, CPML initiated consultation on reducing the risk of wholesale payments fraud related to endpoint security.

In addition, the Committee is distinctly assessing the impact of the post-crisis reforms.

III. ***The BCBS will put more focus than before on supervision***. This includes further improving supervisory tools and techniques, and the establishment of best practices. The *progress report on*

supervisory colleges and the *consultative document on stress testing principles and a range of practices* aim to promote this initiative.

IV. The Basel Committee's **Regulatory Consistency Assessment Program** (RCAP) remains a high priority. The BCBS also published its report on the progress of the reforms for the G20 summit. This was the sixth report to assess the results of the Basel Committee's RCAP program. The RCAP (i) monitors progress in adopting the Basel III standards; (ii) assesses the consistency of introduced regulations; and (iii) analyzes the prudential outcomes from those regulations. They will assess the implementation of the regulatory framework with non-BCBS member jurisdictions from emerging market economies as well. The Committee continues to regularly (every half-year) publish the results of its **Basel III monitoring exercise** based on current data.

European Regulation

Following the Brexit decision in 2016, the bodies determining European legislation set as their main target to strengthen the Union, and achieve **deeper and closer EU cooperation**. In December 2016, for the very first time, the presidents of the European Council, the European Parliament and the European Commission officially agreed on the **2017 common legislative priorities**. The strengthening and thus improving of the European Fund for Strategic Investments (EFSI) and **continuing to build the Banking Union and the Capital Markets Union** were also among the priorities concerning the economy. In March, the European Commission published a White Paper, outlining the potential scenarios for the future of the 27-member EU until 2025. The aim of the *White Paper* is to trigger a broad debate across the whole continent on the issue of **"more or less Europe", the implementation of "federalist or nation-based integration"**. The Commission's Roadmap aims to deepen Europe's Economic and Monetary Union, while the Council's work program seeks to strengthen the Union and build a future together. At the same time, political advancement has been halted by the prolonged German coalition negotiations.

The Commission, the Maltese and the Estonian presidency all strived to implement and operationalize the priorities that were set out. The Commission's proposal to amend the **Comitology Regulation** in February (changing the voting rules, involving national ministers, increasing voting transparency and ensuring political input) seeks to increase the transparency and accountability and to facilitate the operations of the EU. Establishing a **Task Force on Subsidiarity, Proportionality and "Doing Less More Efficiently"** aims to simplify and democratize processes and to promote the better and more efficient distribution of work between the EU and member states. The program incentivizing the **inclusion of consumer representatives in professional policy decision-making** related to financial services and the budget dedicated to its financing is another important step towards democratization.

Little progress was made in 2017 concerning the most important prudential regulatory development of 2016, the adoption of the **Risk Reduction Package** in November. By June member states had already agreed on topics requiring fast-track negotiations. In accordance with these, after their adoption in the fall, the following regulations are in force as of January 2018:

- A directive on the **ranking of unsecured debt instruments in insolvency proceedings** (bank creditor hierarchy);
- A regulation on transitional arrangements to **phase in the regulatory capital impact of the IFRS 9 international accounting standard** over the course of several years. The regulation will also regulate the **transitional management of large exposure limits regarding sovereignties**.

The FSB regulation on TLAC to be implemented from 2019 requires that banks hold subordinated instruments (subordination requirement). The draft, which mainly amends article 108 of the BRRD, requires member states to create a new class of 'non-preferred' senior debt, eligible to meet the subordination requirement. The regulation on the introduction of IFRS 9 and large exposures will mitigate the potential negative regulatory capital impact on banks due to the introduction of the IFRS. The regulation allows banks to add back to their common equity tier 1 capital a portion of the increased expected credit loss provisions as extra capital during a five-year transitional period. The regulation also provides for a three-year phase-out, and using this, banks will be granted exemption from the large exposure limit for their exposures to public sector debt denominated in the currency of another member state.

Developments concerning the entire Risk Reduction Package are slow paced. The Swedish Rapporteur (Gunnar Hökmark) published the preliminary report on regulations for crisis management (BRRD, SRMR²³) in September. In connection with the amendment to the capital requirement regulation, Peter Simon, the German rapporteur submitted his preliminary report for the CRR2/CRD5 in mid-November. They are currently debating the amendment proposals of parliamentary representatives. According to the preliminary agenda, ECON²⁴ will vote on these in April. The Estonian presidency prepared compromise proposals for all four legal texts. According to the progress report prepared by the presidency, the key debate issues concerning the content of the package are: ***the relationship between the macroprudential framework and pillar 2, the implementation of the Basel Reforms, the capital and liquidity waivers in CRR, exemptions from the CRR/CRD, and MREL²⁵ calibration.***

The European Banking Federation's comprehensive response (completed with the help of quite a large professional apparatus) groups its comments²⁶ around the six important guiding principles below:

- Securing competitiveness, consistency and a level playing field for European banks;
- Supporting market liquidity and market making;
- Treating the Single European Market and the Banking Union as a prudential reality;
- Limiting burdensome regulation and supervision;
- Fostering the growth and innovation dimension of RPP;
- The fast-tracking of some key reforms.

In addition, the EBF asked in a separate letter the Vice-President of the European Commission to ***postpone the introduction of the new requirements for the fundamental review of the trading book (FRTB)***, and to ***reconsider the transposition of the NSFR*** until a final agreement has been reached in Basel. Valdis Dombrovskis defended the implementation of the FRTB and the NSFR and stated that he did not agree with delaying them, mentioning that European specificities should be considered. (The USA had previously announced that it would delay the implementation of the FRTB and the NSFR until the Basel Committee comes to a decision.)

Completing the Banking Union is one of the most important priorities of the economic and monetary union. On October 11th, 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 (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 this in mind the Commission disclosed its risk reduction package, which modifies the Single Rulebook. The

²³ Single Resolution Mechanism Regulation

²⁴ the European Parliament's Committee on Economic and Monetary Affairs

²⁵ Minimum requirement for own funds and eligible liabilities

²⁶ As a result of the professional consultations involving diverse working commissions and working groups, a "container" document of nearly 300 pages was born. The document discusses the relevant modification recommendations by grouping them into 22 issue topics.

Commission aims to renew negotiations on the European Deposit Insurance Scheme (EDIS) and to initiate the creation of a **fiscal backstop** for the Single Resolution Mechanism, in order to strengthen the Banking Union. The communication discusses in detail the Commission's measures for to treat NPLs²⁷. By incentivizing the creation of Sovereign Bond-Backed Securities (SBBS), the Commission will facilitate the diversification of banks' sovereign portfolios and cross-border risk sharing.

EU institutions dedicated special attention to the treatment of **non-performing loans** in 2017 as well, which it regards as a fundamental condition for establishing both Banking Union and the Capital Markets Union. In March the **European Central Bank** published its **final guidance on tackling non-performing loans** (NPLs), which outlines the measures, processes and best practices aimed at the tackling of NPLs by banks, and calls on banks to create and implement realistic and ambitious strategies aimed at the reduction of NPLs. (In June the ECB published its second stocktake on the national supervisory practices concerning the management of non-performing loans and its legal frameworks, which applies to countries of the Banking Union.)

In early October, the ECB launched a consultation on **complementing the guidelines**. According to the **Addendum** (which caused quite a stir) banks are expected to provision and calibrate 100% for unsecured exposures that have been non-performing for 2 years or after 7 years – depending on whether they are secured or not. The requirements are meant to be a backstop regulation and only apply to banks under direct ECB supervision.

Some (European parliamentary representatives, European Banking Federation) believe that **the ECB is going beyond its mandate**. The ECB may only impose impairment/provisioning measures on individual banks and cannot create a requirement that applies to all banks, as this is the task of legislators.

As if trying to follow the ECB, in November the European Commission also introduced a new initiative for the treatment of NPLs. The **Commission's targeted consultation on the statutory prudential backstops** lasted only 20 days and aimed to **address insufficient provisioning for newly originated loans that turn non-performing**. The Commission proposes to consider at EU-level the introduction of backstop-type prudential regulation within the CRR framework, and to treat insufficient provisioning for non-performing loans through capital deduction. Along with the above, the European Commission conducted an **Inception Impact Assessment (IIA)** on statutory prudential backstops, in which it included possible options for resolving this problem. During the consultation the **EBF emphasized** that the situation of NPLs is very diverse across EU member states and, in line with the principles of subsidiarity and proportionality, it seems appropriate to address it at a member state level under EU general blueprint.

In July the Commission announced a consultation on the **development of secondary markets for NPLs and distressed assets and protection of secured creditors from borrowers' default** and asked for feedback on the possible introduction of a new EU security right, the "accelerated loan security". Also in July, the **European Council agreed on an action plan** to help reduce stocks of non-performing loans which remain at high levels, and to take professional policy measures to prevent their future emergence in the EU. Based on an expert report, the Council believes that measures are necessary regarding bank supervision, insolvency and the reform of debt collection systems, the development of the secondary market for non-performing loans, and the restructuring of the banking system.

In addition to the Single Rulebook the first other pillar of the Banking Union to be established after the Euro crisis of 2012 was the **Single Supervisory Mechanism (SSM)**. Within the SSM, the European Central Bank is the direct supervisory authority for significant Eurozone banks. The SSM department of the ECB set the following **supervisory priorities for 2017**: 1. *Business models and profitability drivers; credit risk (with a focus on non-performing loans and concentration); and risk management.*

²⁷ Non performing loans

At the hearing of ECON, Daniele Nouy, chair of the ECB Supervisory Board argued that – similarly to practice in the USA and the UK – European **banking supervision should be extended to large investment firms that pose systemic risk**.

As part of risk management, the ECB dedicated special attention to the **targeted review of internal models (TRIM)**. The TRIM guide released in February details how the ECB interprets the relevant EU rules on the internal models for credit, market and counterparty risk and model use in general. The ECB draft guide to *on-site inspections (OSI)* and *internal model investigations (IMI)* published in August aims to increase transparency for supervised institutions and on-site supervisors.

The 2017 **stress test** of the ECB analyzed the interest rate risk in the banking book (IRRBB). The results of the stress test were used in the Supervisory Review and Evaluation Process (SREP), while prescribing the Pillar 2 capital requirement. The ECB also announced that it will **change the liquidity assessment ILAAP tables** in the next cycle of the SREP.

The ECB published a guideline and a recommendation concerning the exercise of *options and national discretions (ONDs) in less significant institutions (LSI)* aiming to **harmonize supervisory practices**. Later, in May it published a guidance on the *uniform management leveraged transactions (LT)* and a guide to *determining the suitability of banks' board members*. In October it held a consultation on the *draft guides on the assessment of license applications* and *fintech credit institution license applications*.

The ECB reviewed the **supervisory reporting requirements** linked to the IFRS transition, however it did not postpone the AnaCredit reporting deadline, despite the sector's request. Therefore banks will need to report data on individual loans from September 2018 for the first time in November 2018. At the ECB conference on supervisory reports in November, it was demonstrated how the relevant national authorities process that data from supervisory reports, and how they pass it on to the ECB and the EBA. They reviewed measures to improve data quality and presented the methodology behind assessing bank data.

At the **ECB workshop on recovery planning and crisis management**, ECB officials presented how much improvement was shown by the 2016 recovery plans compared to those of the previous year. In early June the ECB also announced a consultation on its regulation on the review of the payment of supervisory fees. The ECB has estimated that **the total costs associated with its supervision for 2017 will be €425 million**. Significant, directly supervised banks and bank groups amount to EUR 391 billion, while less significant supervised entities will have to pay EU 34 billion. Due to the changes in group structures and other developments concerning bank groups the number of institutions under direct ECB supervision decreased from 125 to 119 in 2017.

This summer, for the very first time since the SSM, the **crisis management mechanism** created in the wake of the reforms entered into force in the case of significant bank under direct ECB supervision. The ECB first announced on June 7th, due to the significant deterioration of the liquidity situation of the bank that Banco Popular was **failing or likely to fail (FOLTF)**. Following this, the SRB²⁸ concluded that the resolution of the bank was a public interest. The solution was the sale of Banco Popular to Banco Santander S. A..

The second time the ECB declared that two Italian banks, Veneto Banca and Banca Popolare di Vicenza have failed, due to the continuous breach of capital requirements. In their cases there was no possibility of resolution according to the SRB therefore the two banks were liquidated according to Italian regulations.

According to the authorities participating in the crisis management mechanism (ECB, SRB), it was successful, although its events were widely debated (due to the state taking part in the liquidation process). The **precautionary recapitalization** of Monte dei Paschi di Siena shed light on the fact that the Commission's 2013 banking communication on the state support for banks should be reviewed with regard to experiences gained through the BRRD.

²⁸ Single Resolution Board

Another important pillar of the Banking Union is the **Single Resolution Mechanism (SRM)**. Since January 2016, the Single Resolution Board has been fulfilling the duty of a resolution authority of full power over significant institutions and another 15 international bank groups. In 2016, with the cooperation of banks, the SRB compiled the reports necessary for resolution planning and began determining the Minimum Requirement for own funds and Eligible Liabilities (MREL) for each bank. In 2017 they started developing a **binding MREL targets at consolidated level** for all major banking groups, which will have to be met after an adequate transition period. In 2017–2018, the **individual MREL values** will also be determined, taking into account the risk profiles. The determination of **internal MREL values** within resolution groups was started as well, and a special methodology was developed for the multiple points of entry strategies. In addition significant progress was also made in managing the cross-holding of MREL instruments and in the field of subordinated instruments

In addition to defining the MREL, in 2017 the SRB focused on the **operationalization of resolution plans**. They are putting an emphasis on preferred resolution strategies and the elaboration of the toolbox, critical functions and the material obstacles to resolvability. Preparing for effective **cross-border resolution** was another important priority.

By the end of June the Single Resolution Fund (SRF) – by paying its fee of EUR 6.6 billion for the year – has reached EUR 17.4 billion and they have signed the Loan Facility Agreements (LFAs) with all member countries of the banking union, thus providing bridge financing to tune all the provisions in the SRF, i.e. EUR 55 billion. When the Single Resolution Mechanism (SRM) was set up, member states agreed on the importance of a **common fiscal backstop to protect financial stability**. This is to ensure that after private investors have borne losses via bail-in, the fund has sufficient resources to deal with a major bank resolution. The Commission's reflection paper on deepening the Economic and Monetary Union identified a **credit line from the European Stability Mechanism** as the most effective option.

In 2017 the SRB organized two meetings (in January and in November) with sectorial representatives, and held a conference in late September on providing the conditions for resolution. The SRM expert group established within the EBF consists of SRB representatives and banking experts and held its first meeting in November.

With regard to the European Deposit Insurance Scheme, an indispensable part of completing the Banking Union, no significant progress was made throughout most of 2017. The Ad Hoc Working Party (AHWP) continued to debate **technical details** for strengthening the Banking Union. After the European Commission's impact study was published in October, a survey was conducted, the results of which convey that member states consider consultations necessary in the following topics: *Risk-Based Contributions; Alternative and Preventive measures; Irrevocable Payment Commitments; Scope of EDIS; Institutional Protection Schemes; and Temporary High Balances*. In addition, the technical aspects of accession to and departure from EDIS also need clarification. The AHWP also examined the interaction between EDIS and options and national discretions (ONDs) under the Deposit Guarantee Scheme Directive (DGSD).

To facilitate the creation of a single European Deposit Insurance Scheme, in October the Commission suggested some **modifications with regard to the phases and the timeline of the deposit insurance scheme**. The proposed ideas try to address diverging views and concerns raised in the European Parliament and the Council. They suggest for discussion the **introduction of EDIS more gradually** compared with the original proposal of November 2015. There would be only **two phases** for creating the deposit insurance scheme: a **more limited reinsurance phase** and then a phase of **coinsurance**. However moving to this second phase would be conditional on progress achieved in reducing risks (above all reducing the non-performing loan portfolio). In the reinsurance phase, EDIS would only provide liquidity coverage to national deposit insurance schemes. The specialized press regards the Commission's proposal as a step back as opposed to previous initiatives.

Establishing the **Capital Markets Union (CMU)** is another important target for Project Europe.

In June, the Commission assessed the steps taken to realize the Capital Markets Union. According to the **Mid-Term Review** there has been good progress made so far in implementing the 2015 Action Plan, with around **two-thirds of the 33 actions delivered in twenty months**. Among its achievements, the Commission emphasizes the *agreement on the securitization package, the venture capital funds reform and the new prospectus regime*. The Mid-term review also set out the new measures to be proposed in the coming months, including nine new priority actions: *strengthening the powers of ESMA; delivering a more proportionate regulatory environment for SME listing on public markets; reviewing the prudential treatment of investment firms; assessing the case for an EU licensing and passporting framework for FinTech activities; presenting measures to support secondary markets for non-performing loans (NPLs); and providing guidance on the treatment of cross-border EU investments*.

Providing the best supervisory coordination and integration possible will become increasingly important in the future, especially concerning the development and integration of European capital markets. In March, the European Commission launched a public consultation on the operation of the European Supervisory Authorities (ESAs), which covered the tasks and powers, governance, structure and financing of supervisory authorities. After the consultation the Commission proposed the reform of the European supervisory structure. The proposal would extend the mandate of the ESAs (the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority) and improve their steering systems and financing. ESMA would receive direct supervisory power in special segments of the financial sector in order to aid the uniform implementation of EU regulations and support the Capital Markets Union.

Representatives contributed quite a number of opposing modification proposals to the **preliminary parliamentary report to the insolvency directive (bankruptcy, preventive restructuring frameworks, and a second chance for enterprises)**; in December the Committee on Economic and Monetary Affairs (ECON) agreed on these modifications. According to the Committee's negotiations a number of member states would like local courts to have greater power in the restructuring process. An agreement might also be difficult to reach concerning the reduction of the period of the stay. The EBF wrote a letter about the insolvency directive proposal to decision makers, in which it drew their attention to the contradictions between the action plan for the treatment of non-performing loans (NPLs) and in it the measures enhancing the protection of secured creditors, and the regulation proposal for preventive restructuring.

The European Commission announced that it will **withdraw its regulation proposal for separating retail banking and investment banking activity (bank structural reform)**, due to lack of a foreseeable agreement. No progress has been made in this area since 2015. The Commission justified this step by emphasizing that the main financial stability rationale of the proposal has in the meantime been addressed by other regulatory measures in the banking sector, most notably the entry into force of the Banking Union's single supervisory and resolution system.

Due to the Brexit decision, it became necessary to move the headquarters of the European Banking Authority. Paris was chosen out of the capital cities that applied. The **EBA's 2017 activities** focused on the strategic areas set in its work program: establishing regulatory frameworks for the European Single Rulebook; promoting efficient and coordinated crisis management; promoting convergence of supervisory methodologies and practices; identifying and analyzing trends, potential risks and vulnerabilities stemming from the microprudential level across borders and sectors; maintaining and developing the common supervisory reporting framework; protecting consumers, monitoring financial innovation; and being a competent, effective professional organization.

The **European Banking Federation** continued to perform extensive lobbying to influence the content of the upcoming EU and global regulations, to ensure a level playing field and to protect the interests of EU banks.
