MAGYAR BANKSZÖVETSÉG

HUNGARIAN BANKING ASSOCIATION

REPORT

on Activities of the Hungarian Banking Association

2th Quarter 2017

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I. Executive Summary

As in the previous quarter, in Q2 of 2017, ***the world economy continued to grow at an accelerated pace***. In July, the IMF maintained its prognosis for global GDP (3.5%) and predicted that this trend would continue in 2018 (3.6%). The large Anglo-Saxon economies missed out on this global acceleration of growth, while the European Union's economy experienced moderate growth, and the Japanese economy grew spectacularly. The main driving force behind growth is cyclical upturn, which seems to primarily be sustainable in the EU, if political risks are reduced. On the other hand, high prices for assets, and the uncertainty around the sustainability of monetary and fiscal policies which are still overall supporting factors, pose negative risks.

In Q2, the annual growth rate of the *United States economy* was 2.1%, which shows considerable improvement compared to its modest performance last quarter (0.7%), however no significant acceleration is expected for the entire year. Growth continues to be fueled by a sound labor market and the stable increase in disposable income.

The *European Union's* economy showed a slight acceleration in growth (to 2.3%). The biggest problem in its development continues to be low investment activity. Growth may also be set back by political risks (election results in Austria, Brexit negotiation results). Out of the larger EU economies, Spain showed the most significant growth, the German economy grew somewhat less than the EU average, while France and Italy still show weak growth. The ECB's lax monetary policy is criticized more and more, although inflation is now stable at 2%, and the relatively stable raw material and energy source prices in the global market do not indicate a need for change.

Owing to internal demand, *Japan's economic performance* was outstanding, with a 4% increase in growth by annual comparison. In *China*, the slow structural shift continues, which demands a sacrifice on the part of economic growth. Real economy operates in a relatively healthy manner; however, the country's weak financial system causes notable problems.

Due to the fact that oil prices have stabilized at a higher level than in the previous one to two years, *Russia's economy* is slowly being restored, although the import substitution program launched by the government may turn out to be counterproductive.

In Q2, ***Hungarian GDP grew by 3.2%*** compared to the same period last year, which – although it is 1 percentage point less than in the previous quarter – is still above EU average. Fewer working days set by the calendar as well as the base effect played a significant role in this slowdown. On the *production side*, it was primarily market services and the construction industry that may have had a positive effect on growth. On the *consumption side*, strengthening internal demand was a major contributor, aided by an over 12% increase in wages.

The *state budget* seems less favorable than last year: the payment deficit for Q2 was HUF 911 billion, which is 75% of the sum planned for the entire year, although according to the ministry responsible for the budget, a slightly higher deficit will not jeopardize the 2.4% deficit target for the end of the year. At the same time, the budget deficit shrank to the lowest it has been in 9 years: 74%. Annual *inflation* increased to 1.9%, due primarily to rising food prices. The *Magyar Nemzeti Bank* (central bank of Hungary) followed its previous policy and did not change monetary conditions. The HUF to EUR exchange rate continued to stay within a relatively narrow range (307 to 314).

In Q2 of 2017 the ***aggregated balance sheet total of credit institutions grew by 1.2%*** (HUF 425 billion). *On the liability side*, apart from the issued securities portfolio, all important liability types grew and the total gross deposit portfolio expanded by HUF 434 billion (1.9%). The deposits of *households* and *non-financial enterprises* grew at an accelerated rate. Maturities continued to shorten; portfolio flowed into sight deposit and account money mainly from deposits with a maturity of less than a year. Interbank borrowed credit grew by 2.8% (HUF 136 billion). As a result of positive profit, *share capital* increased by 4%, and has now nearly reached HUF 4 trillion.

Dynamic growth continues on the assets side; net credit portfolio grew by 3.5% during the quarter (HUF 598 billion). The reversal of impairment losses amounted to HUF 100 billion and improved net values.

The *gross value of household loans* grew moderately (by 0.5%), while the gross value of non-financial enterprise loans increased dynamically (by 5.1%). The reversal of impairment losses and differences in valuation led to growth. *Debt securities* increased slightly since the last quarter; government securities grew, while the stock of securities issued by other banks shrank.

The credit institutions sector's ***net loan-to-deposit ratio*** (104%) continued to increase in Q2.

The ***profit*** in Q2 amounted to more than in the last quarter, ***reaching over HUF 207 billion***, implying a 10.56% return on equity and a 1.14% return on assets. Not counting individual items, the return on equity and the return on assets would approximately be cut in half (out of the HUF 397 billion profit before taxes, improvement due to reversal of impairment losses and provisions amounts to a total of HUF 107 billion, while dividend income was HUF 99 billion).

Interest profits did not significantly change in Q2; improvement was due to moderately better fees and commissions, as well as the profit gained from financial activities, and one and a half times more reversal (HUF 76 billion) than in the last quarter, while dividend income decreased. General expenses stayed at the same level as in the previous quarter.

On March 31, 2017 the Funding for Growth Scheme (FGS), was completed, which has been a defining factor in *SME lending* over the past four years. The *Market-based Lending Scheme (MLS),* which will take its place, has proven to be quite successful, since, according to the Monetary Council's press release in May, MNB will launch *Phase 2 of the MLS,* which will make it possible for banks to increase their commitments to increase their loans to micro, small and medium enterprises.

After the concept of it was presented in March, MNB consulted on the details of the ***certified consumer-friendly housing loans***' (CCHL) design with the Banking Association's negotiating group (consisting of experts from member banks). The tender was announced on May 19th and its most important features are:

- Loans with annuity-type repayment, with a maximum term of 30 years, with a payable interest period of 3, 5 or 10 years or loans with a fixed interest rate throughout their term may be certified exclusively.
- The maximum interest margin will be 3.5%
- The maximum value for the loan assessment fee is set at 0.75%. Clients may be made to pay for the costs presented by third parties independent from banks.
- Prepayment and early repayment fees are consistently maximized at 1%.
- The time limit for loan assessment is 15 days, while the loan disbursement time may be a maximum of 2 days.
- The following must be used: a standardized product description and set tender form adhering to the criteria set by the MNB tender, as well as a list of lending documents recorded in the bank's tenders.
- Clients may also apply for the Home Purchase Subsidy Scheme for Families when purchasing the product.

CCHL products may be compared on MNB's website. Consultations on developing the website continued even after the tender was announced. In response to suggestions made at the presentation of the CCHL, the concept of a ***central income database*** is also being developed.

In addition to creating and introducing the CCHL, the ***Magyar Nemzeti Bank*** also initiated the ***development of a domestic repo market***, and put forward the idea of creating a repo benchmark. A consultation open to debate on the issue was launched, after which the central bank asked for feedback from banks in the form of a questionnaire. It then created the ***Repo Market Working Group*** to elaborate the legal (framework contract) and technical conditions for the process. The central bank also urges the creation of ***mechanisms that support the demand for mortgage bonds***, through which it aims to promote the involvement of investors from outside the banking sector in the mortgage bond market.

One of the most ***important regulatory developments*** during the quarter was the ***implementation of MIFID 2***. At the end of May, the Parliament adopted the amendments to the *act on the capital market* and *the act on Investment Services implementing the MiFID 2 standards into the domestic law*. These granted authorization to adopt two new Decrees by the Ministry for National Economy (NGM) and a Decree by MNB. The NGM Decrees serve the integration of the new topics detailed in the MiFID 2 delegated directive into domestic law, namely the *product approval processes*, and the *application of inducements*. The MNB decree will set the *requirements for persons advising and informing customers*. If interpreted rigidly, the ***MIFID 2 rules on inducements*** *can have a negative influence* on *institutions* which *distribute* investment funds and government securities. To avoid this, the Hungarian Banking Association initiated a consultation on the *interpretation of the fee structure of institutions distributing government securities* with the Government Debt Management Agency (ÁKK), also involving the Association of Investment Service Providers.

In addition to several other areas***, the amendments to the bankruptcy act*** covered the rules on establishing the liability of senior executives as well as the rules applicable to the satisfaction of the lienholder after the sale of the pledged asset, and standardized the provisions applicable to specific types of lien. With regard to the security of creditors, one very important provision is that ***any pledge established prior to the launch 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***. Another favorable provision for creditors is that the amount to be paid to the liquidator from the net revenue on the pledged asset decreased from the envisaged 15% to 7.5% in the amendment adopted. Legal harmonization requirements ***in connection with cross-border insolvency procedures*** make it necessary to make further amendments to the bankruptcy act.

The management of the current situation regarding non-performing mortgage loans would indicate a ***more flexible and simple regulation of personal bankruptcy procedures***, as well as the amendment of the relevant legislation. The Ministry of Justice has launched consultations for developing the relevant concept.

During the quarter, the ***Act on the prevention and combating of money laundering and the financing of terrorism***; the *decree on the detailed rules for minimum standards for the development and operation of a filter system applicable to the service providers supervised by the MNB; and the NGM decree on the mandatory content of internal money laundering regulations* were also adopted.

Act LXXVIII of 2017 on Lawyers' activities was adopted in June and will enter into force in January 2018. ***The law integrates legal counsel into the bar*** and its implementation is aided by a government decree, 6 ministerial decrees, as well as different ***bar policies***. The Hungarian Bar Association's assembly of delegates has to adopt policies in 35 matters, some of which will also affect the activities of ***legal counsels and their employers***. The Hungarian Banking Association set up an ***ad-hoc working group*** within the Legal Working Group for the contribution to the remaining regulatory tasks, and acts for the representation of legal counsels' interests as efficiently as possible.

The ***implementation of the new EU payment services directive (PSD2)*** necessitates the modification of the *legislations on payments, credit institutions, individual payment services, and MNB*. The practical implementation of the PSD2 is made much more difficult by the fact that the Regulatory Technical Standards (EBA RTS) which would define rules in more detail will not yet be available at the time of the implementation deadline: January 13, 2018.

One of the declared aims of MNB is to facilitate FinTechs' (supervised) operation in the market. MNB, which also functions as a supervisory authority will establish a so-called "***Regulatory Sandbox***" to better understand the impact FinTechs have on the financial market (as they may potentially play an immense role in shaping it), their operational mechanisms, and how other market actors react to them. MNB will create an individual, different regulatory environment for the enterprises that apply (including banks), which will help try out innovations in financial services.

The *national project and its institution* for realizing the *Instant Payment System (IPS)* were created in June, targeting mid-2019 as the launch time of the IPS. Several different professional working groups are currently preparing the details, and as requested by the central bank, the Hungarian Banking Association delegated the banking professionals to these. The IPS project's upper management body is the *Project Management Committee (PMC),* while an *Information Forum* ensures the constant flow of comprehensive information to those concerned.

As regards ***international payments***, an important event was the *general assembly* of the *European Payments Council (EPC) and SWIFT*, both organized in early June.

The election of new officials (new Board members and the President of the Ethical Committee), which happens every three years at the ***General Meeting*** of the Hungarian Banking Association, fell to this year's Meeting. As has become tradition, the Banking Association's Golden Beehive Awards were also distributed. This year, for the very first time, a book of interviews with the leaders of member banks (who have held positions over the past three years) was published, and this will continue in the coming years. The printed complementary and personal copies were handed out to those involved. The book is also accessible on the Hungarian Banking Association's homepage.

The ***Money Week program*** took place in Hungary for the third time with once again more participants than before, indicating that the Hungarian program series had the most participants and is the most dynamically growing out of all the Money Week Programs in Europe initiated by the European Banking Federation.

Concerning ***global regulation***, in addition to the finalization of previously approved reforms, emphasis will be put on the ***consistent implementation*** of these. Thus, the Financial Stability Board (FSB) elaborated the *framework for the post-implementation evaluation of the financial regulatory reforms*, which provides a unified method for the assessment of the implementation, results and effects of the G20 reforms, including possible unintended consequences. The *Handbook for FSB Peer Reviews* was also updated at this time, which aids in the evaluation of the implementation and effectiveness of the international financial standards approved by the FSB. In reaction to the rapid growth of FinTechs on the market, the FSB evaluated the *financial stability impact of FinTechs*, in order to identify key supervisory and regulatory issues that merit authorities' attention. A report was also made on *FinTech credit*, directing attention to the lack of relevant official data.
The ***Basel Committee on Banking Supervision*** (BCBS) started a consultation on the *simplified alternative to the standardized approach to market risk capital requirements* and published the final *guidance f*or *regulating the prudential treatment of problem assets* with definitions of non-performing exposures and forbearance.
The ***Basel III regulatory reforms*** however, ***have still not been finalized***. Even though this was promised for the end of last year, BCBS members still could not come to an agreement in June. The USA declared that it will delay the implementation of the fundamental review of the trading book and the net stable funding ratio until the reforms are finalized.

The delay also impacts the ***risk reduction package***, which is a focal point of ***European regulation*** and would implement Basel III regulations. The European Banking Federation asked the European

Commission to postpone the introduction of the new requirements for the trading book and to reconsider transposition of the NSFR until a final decision is made in Basel. It is a fundamental competitiveness issue that the implementation of the new regulatory system should happen at the same time in all jurisdictions. However, a positive development is that members have reached an agreement on three exceptionally urgent issues in connection with the risk reduction package: (1) *the draft directive on creditor hierarchy*; (2) *the draft regulation on transitional arrangements to phase in the regulatory capital impact of the IFRS 9 international accounting standard*, which also regulates (3) *the transitional arrangements for large exposure limits applied to sovereign exposures*. The supervisory authorities of the ***Banking Union*** pay special attention to the treatment of non-performing exposures. This June, for the first time since the existence of the Single Supervisory Mechanism and the Single Resolution Mechanism, the ***crisis management mechanism created after*** the ***reforms*** entered into force and proved to be functioning adequately.

The Capital Markets Union Mid-Term Review reports that 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. The most important achievements are the adoption of the securitization package, the venture capital funds reform and the new prospectus regime.

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

As in the previous quarter, in Q2 of 2017, ***the world economy continued to grow at an accelerated rate***. ***In July, the IMF maintained its prognosis for global GDP*** (3.5% for 2017) and predicted that this trend would continue in 2018 (3.6%). The large Anglo-Saxon economies missed out on this global acceleration of growth, while the European Union's economy experienced moderate growth, and the Japanese economy grew spectacularly. Contributions to growth differed among emerging countries as well. The main driving force behind growth is cyclical upturn, which seems to primarily be sustainable in the EU, by reducing political risks. On the other hand, high prices for assets, and the uncertainty around the sustainability of monetary and fiscal policies, which are still overall supporting factors, pose negative risks.

In Q2, ***the annual growth rate of the United States economy was 2.1%,*** which shows considerable improvement compared to its modest performance last quarter (0.7%), however no significant growth is expected for the entire year. The favorable growth rate of the quarter continues to be fueled by a sound labor market and the stable increase in disposable income. Private consumption grew by 2.8% at an annualized level. The investments of economic actors also supported growth, although residential property investments somewhat decreased. The rise in government expenses was moderate during this period and therefore had no significant impact on economic trends. Increase in export declined to almost half (4.1%) of its value in Q1, import, however, deceased even more, therefore balance between the two is similar to that of the previous quarter.

When compared with last year, in Q2 the economy of the ***European Union continued on its path of moderate growth*** in (with a rise from 2% to 2.3%). Political risks are less than before, as a result of the Dutch and the French elections. The ECB's lax monetary policy is criticized more and more, although inflation is now stable at 2%, and the relatively stable raw material and energy source prices in the global market show no indication of the need for change. Out of the larger EU economies, Spain showed the most significant growth, supported by internal consumption and investments. Germany also show positive trends in growth (2.1%), which is assisted by similar factors. France and still show weak growth (1.8% and 1.5%, respectively) compared to the EU average. The biggest problem in the development of the EU economy continues to be low investment activity. Growth may also be set back by political risks (election results in Austria, Brexit negotiation results).

Japan's economic performance was outstanding in Q2, with a 4% increase in growth by annual comparison. The most significant factor behind this is a positive turn in internal demand, but business investments and government expenses also increased. Due to the weak yen and the expansion of global commerce, export grew by nearly 15% on a year-on-year basis, although import increased even more due to the rise in internal demand, and thus foreign trade did not significantly impact growth rates.

In China, the slow structural shift navigated by the government continues, which demands a sacrifice on the part of economic growth. The economy grew by 6.9% on a year-on-year basis by the end of Q2. The services sector has become the main contributor to the GDP with 52%, though industrial production also grew by more than the GDP. The fact that investments are still the most important item (with a share of over 80%) causes severe tension on the expenditure side. Within this area, it is to China's advantage that as a result of measures taken to halt the inflation of the real estate bubble, the real estate sector's dynamic has become significantly more moderate. Internal consumption supports growth. Foreign trade has increased by 20% on an annual basis. The increase in import was 10 percentage points more than that of export, and the thus created net surplus did not have a great impact on growth. Real economy operates in a relatively healthy manner; the country's weak financial system however, causes notable problems. Meanwhile, the Yuan's comparative strength and the limiting of Chinese corporations' foreign investments helped sustain the equilibrium of the balance of payments and helped to keep reserves from depleting. However, the non-performing portfolio within the Chinese banking system has expanded and further measures are required to cut back on the lending activities of shadow banking systems.

Owing to the fact that oil prices have stabilized at a higher level than in the previous one to two years, ***Russia's economy is slowly being restored***. After a 0.5% growth in the first quarter, ***Q2 saw an economic expansion of 2.5%.*** The Russian government – due in part to sanctions by the USA and the EU – chose a unique road for structural reforms; it launched an import substitution program. However, experts say that this might actually be counterproductive since it may draw resources from those sectors which are competitive and capable of export at international level and put them into sectors with weaker performance.

In Q2, ***Hungarian GDP grew by 3.2%*** compared to the same period last year, which is 1 percentage point less than in the previous quarter. This ***slowdown was primarily due to the fact that there were less working days in the quarter, as well as the base effect*** (in Q2 of 2016, growth was dynamic). GDP after the effects of the season and the calendar have been deducted was 3.6%, which is two-tenth percentage points lower than in the previous quarter. ***From the production side***, mostly market services and the construction industry probably had a positive effect on growth, agricultural production probably decreased compared to before, and the expansion of industry and non-market services also declined. ***On the consumption side***, strengthening internal demand continued to be the major contributing factor to growth. It was aided by an ***over 12% increase in wages*** since last year. Investments also increased as expected. External demand was higher than predicted, which balanced out the increase in import, due to internal demand, thus, despite faster consumption, foreign trade also made a slight contribution to growth. The decrease in stock (especially in agriculture) had a negative impact on growth.

Concerning ***balance indicators***, compared to the same time period of last year, this quarter shows a ***less favorable state budget***. The payment deficit was HUF 911 billion in Q2, which is 75% of the sum planned for the entire year. This depicts quite a large increase compared to last year's 47%. While income increased (due primarily to items relating to employment), expenses grew even more. This is mainly due to payment in advance for expenses which will be funded by EU sources, as well as an increase in home purchase subsidies. Another cause of increased expenses was the payment of interest surplus on larger sum maturing debts. According to the ministry responsible for the budget, a slightly higher deficit will not jeopardize the 2.4% deficit target for the end of the year. At the same time, by the end of the quarter the budget deficit shrank to the lowest it has been in 9 years: 74%.

Inflation calculated for the year increased to 1.9%, due primarily to rising food prices (3.1%), while lower fuel prices had the opposite effect (-1.7%). Core inflation (2.4% in Q2) remains within a stable range.

The ***Magyar Nemzeti Bank*** (central bank of Hungary) followed its previous policy and ***did not change monetary conditions***. Accordingly, it kept its base rate level and displaced further liquidity from the three-month deposit asset portfolio (from HUF 750 billion to HUF 500 billion). The EUR to HUF exchange rate continued to stay within a relatively narrow range (HUF 307 to 314 per EUR).

In Q2 of 2017 the ***aggregated balance sheet total of credit institutions grew by 1.2%*** (HUF 425 billion). During this period, the forint stayed level as compared with the Euro, while it strengthened compared to other currencies (by 2% compared to the Swiss franc, and over 6% compared to the American dollar). This had a moderating effect on the balance sheet. In addition to the stagnation of the forint portfolio, the Euro denominated portfolios grew by more than the change in the exchange rate, while portfolios denominated in other currencies grew by significantly more than the decreased exchange rate would indicate.

On the ***liability side***, apart from issued securities, all important liability types grew. The ***total gross deposit portfolio*** expanded by HUF 434 billion (1.9%). Interbank borrowed deposits increased by 6.8% (HUF 257 billion), while other deposits increased by less than 1% (by HUF 177 billion). Regarding the latter, a favorable development is the increase of household deposits by more than the average level, and more than in Q1 (by 2.1% gross, HUF 175 billion). The total deposits of *non-financial enterprises* also grew at an accelerated rate (by 3.1%, HUF 212 billion), which is favorable for the banking sector, though it still indicates moderate investment activity. As for the decreasing deposit

portfolio of other sectors, the biggest contributors were the decrease in funds and the deposits of other non-monetary financial institutions. The shortening of deposit maturity continued; portfolio flowed into sight deposit and account money mainly from deposits with a maturity of less than a year. Interbank borrowed credit grew by 2.8% (HUF 136 billion). Issued securities increased by almost 9% (HUF -212 billion), which is entirely due to the decrease in long term securities of over two years.
As a result of the positive profit, ***share capital portfolio*** increased by 4%, and ***has now almost reached HUF 4 trillion***.

In Q2, within ***the asset portfolio***, the tendency of growth continued in all other more important asset types besides interbank account and allocated deposit portfolio, which decreased. ***Credit portfolio continues to increase dynamically***; net credit portfolio grew by 3.5% during the quarter (HUF 598 billion). The 2.6% gross increase in credit (HUF 472 billion) is somewhat less than it was at the same period of last year (by HUF 30 million), and a ***further 11% in the reversal of impairment losses (HUF 100 billion)*** is added tot his.
The *gross value of household loans* grew moderately (by 0.5%, i.e. HUF 31 billion). However, the reversal on loss of value (8%, HUF 39 billion) and positive sum differences in valuation (22%, HUF 33 billion) significantly improved net values according to the balance sheet. The gross value of non-financial enterprise loans expanded by 5.1% (HUF 404 billion). Growth in domestic corporate portfolio was more moderate as well as that of lending within the EU (1.7%, HUF 102 billion and 3.3%, HUF 13 billion, respectively, while the portfolio of other loans granted to foreigners in primarily non-Euro currencies increased dynamically, by almost 20% (HUF 289 billion). The net value of corporate loans was significantly increased by the HUF 53 billion reversal on loss of value (12.4%), out of which HUF 51 billion is linked to domestic enterprises. The *interbank account and the deposit portfolio* decreased by 6.3% (HUF 325 billion) total. As opposed to the trend in Q1, in Q2 banks kept the assets withdrawn from central bank deposits on bank accounts, thus portfolios in contrast to the central bank did not change significantly. On the other hand, there was a considerable decrease (9%, HUF 296 billion) in portfolio allocated at credit institutions (more specifically domestic and EU institutions). *Securities, which embody credit relations* increased slightly, while the increase in government securities and the sale of securities issued by other banks continued. The ratio of acquisitions by foreign banks also grew considerably (by 13%, HUF 167 billion. As a result of the above, the credit institutions sector's ***net loan-to-deposit ratio*** was 104%.

The ***profit*** in Q2 amounted to more than in the last quarter, ***reaching over HUF 207 billion***, and granting the banking sector a 10.56% return on equity and a 1.14% return on assets. [1] Not counting individual items, the return on equity and assets would approximately be cut in half (out of the HUF 397 billion profit before taxes improvement due to impairment loss and reversal on provisions amounts to a total of HUF 107 billion, while dividend income was HUF 99 billion). Interest profits did not significantly change in Q2, an improvement was due to a moderately better fee and commission, as well as the profit of financial activities, and a one-and-a-half times more impairment loss and provisions (HUF 76 billion) than in the last quarter, while dividend income decreased by HUF 61 billion. General expenses stayed at the same level as in the previous quarter.

III. Corporate lending

According to MNB's report on trends in lending, in 2017 Q1, corporate lending continued to grow, as the loan portfolio grew by 4 percent year-on-year on a transaction basis. The lending of the narrow SME sector expanded by 8.1 per cent, while the broad SME sector including the self-employed sector increased by 12.8 per cent year-on-year. Transactional growth in loans to non-financial corporations amounted to a total of HUF 260 billion. In Q1, the total corporate loan portfolio increased by HUF

[1] The data cannot be mechanically annualized due to the transition to IFRS

108 billion. In the past one year, however, market-based HUF loans also expanded significantly, in addition to the loans granted within the framework of the Funding for Growth Scheme. Loans in the third stage of the FGS amounted to HUF 132 billion in the first quarter, accounting for 18 percent of new corporate disbursements. The third phase of the FGS concluded with 98 per cent utilization at end-March 2017, but banks' commitments made under the Market-based Lending Scheme to increase the SME loan portfolio continue to facilitate corporate lending.
Based on banks' responses to the Lending Survey, corporate lending conditions have not changed, while banks primarily eased non-price credit conditions in the case of small and micro enterprises showing significant increase in demand during the quarter. The spreads on small-amount forint loans increased, while looking ahead, banks indicate an easing in price conditions, although no further wide-ranging easing is expected in the standards in the coming half year. For banks participating in the survey, ample liquidity continues to guarantee the possibility of – and market competition the necessity for – further easing of lending conditions, which might also be influenced by improving economic prospects in the next half year.

The Funding for Growth Scheme and its results

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, and 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.

Phase two of the Market-based Lending Scheme

In accordance with the Monetary Council's press release, MNB will launch ***Phase 2 of the Market-based Lending Scheme (MLS),*** which will make it possible for banks to increase their commitments in increasing loans to micro, small and medium enterprises. In Phase 2 of the MLS, the central bank instruments available to banks will be limited. The limit amount for conditional interest rate swaps (LIRS) and the preferential deposit facility will be HUF 300 billion and HUF 150 billion, respectively. In its LIRS tender from July 6th, MNB entered into transactions with commercial banks, for a total worth of HUF 228 billion. This raised the 2017 SME lending undertakings of banks from HUF 170 billion to HUF 227 billion, achieving 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 lending

According to ***MNB's May issue of Trends in Lending, lending growth in the household sector turned into positive***, and thus loans outstanding increased by 1.2 %. The annual value of household loan transactions amounted to HUF 67 billion, with Q1 contributing to this by HUF 4 billion. The value of loans borrowed by the self-employed sector had a major impact in Q1 as well, but even disregarding this, household lending growth has been steadily improving. The annual average increase in the volume of new loans was around 50%. Within that, new housing loans rose by 44% in the past one year.

According to banks' responses to the Lending Survey, the conditions of both housing and consumer loans remained practically unchanged in the quarter under review. In the case of housing loans no change is expected for the next half year either – though at the time of the survey, final conditions of the certified consumer-friendly housing loans were unknown, and the notification of this may have an easing effect on lending conditions. Against this background, banks continued to perceive a pick-up in credit demand in the case of both products, and looking ahead they expect this trend to continue. The rise in demand is still supported by the Home Purchase Subsidy Scheme for Families (HPS). In Q1, 16% of the new housing loan volume was related to the HPS. Both the average APR and the interest rate spread on new housing loans declined in the period under review, though they remain above the regional average.

Consultations on the certified consumer-friendly housing loans of MNB

After the concept of it was presented in March, MNB consulted on the details of the ***certified consumer-friendly housing loans***' (CCHL) design with the Banking Association's negotiating group (consisting of professional bankers) both verbally and in writing. As a result of these meetings, the tender was announced on May 19th and its most important aspects are:

- Only, ***loans with annuity-type repayment, with a maximum term of 30 years, with a payable interest period of 3, 5 or 10 years or loans with a fixed interest rate throughout their term*** may be certified.
- The ***maximum interest margin*** will be ***3.5%***
- ***The variable parameter of the loan assessment fee is 0.75%.*** By putting emphasis on fixed elements, clients may be made to pay for the costs presented by third parties independent from banks (such as notarial, appraisal and land registry fees).
- ***Prepayment and early repayment fees are consistently maximized at 1%;*** fees at this value are not restricted to loans with mortgage bond sources.
- ***The time limit for loan assessment is 15 days, while the maximum time allowed for the lending operation itself is 2 days*** (starting from the time that the client meets all bank criteria for borrowing)***.***
- The following must be used: a standardized product description and set tender form, adhering to the criteria set by the MNB tender, as well as lending document list, recorded in the bank's tenders.
- Clients may also apply for the Home Purchase Subsidy Scheme for Families (HPS) when purchasing the product.

During the consultations those cases in which despite their previous binding offer, banks still aren't obliged to enter into contract (such as when there is a 0.75 percentage point shift in the benchmark

interest rate, since this condition, according to credit policy, annuls the obligation) were recorded. Comparing offers is possible through accessing the central bank's website.
After the tender was released, MNB continued the consultations on its comparison website at expert level. During these and during the preparation for the tender within banks, several conceptual problems arose. The central bank plans to solve these through a FAQ. However, various legal issues are still open and it is not clear as to how profound of a credit suitability test banks must develop and how many data types must simultaneously be combined for this in order to have MNB's comparison website functioning.
In response to suggestions made at the presentation of the CCHL, the concept of a ***central income database*** is also being developed.

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

MIFID 2 implementation

- *Regulations implementing the MIFID 2 delegated Directive*

At the end of April, after a one month inter-department consultation, the Government tabled ***the amendments to the Act on Investment Enterprises and Commodity Exchange Service Providers and the Credit Institutions Act implementing the MiFID 2 standards into the domestic law***. The Parliament adopted the proposals at the end of May and the amendments were published on 9 June. The adopted rules granted authorisation 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 NGM sent the draft decrees in the second half of May and also held preliminary face-to-face consultations with market actors. The Hungarian Banking Association primarily made proposals with the view to ensure coherence with the Directive, the Civil Code and the sectoral legislation. In the context of the text the NGM exclusively supported the integration of the EU delegated Directive's text. Accordingly it accepted only a small number of proposals to clarify the text.

The ***MNB Decree*** on the subject of ***requirements for persons advising and informing customers*** is currently under preparation; the central bank team has given no information yet on the expected timetable for consultation.

- *ÁKK consultations on the interpretation of the government securities' distribution commission*

Compared to the earlier regulation, MiFID 2 typically poses significant challenged 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 the business models*** currently ***used*** in the market practice. If the distribution fees paid to the distributor are classified by the authorities as inducements, then these fees are either fully payable to the relevant investor, or, in certain cases, can only be used for certain 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 currently 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.
In Hungary, the rigid interpretation of rules on inducements is especially detrimental, apart from institutions distributing investment funds, to ***distributors of government securities***, since the allocation of government securities to final investors takes place in accordance with a similar model. Since the rigid interpretation of rules is not in the interests of either the issuer ÁKK, nor the financial service providers, we had several consultations with ÁKK to resolve this issue, with the involvement of the Association of Investment Service Providers. The material to be drafted as a result of these negotiations will be submitted to the central bank by market players, with the view to establish the official interpretation and the publication of it.

Amendments to the Bankruptcy Act

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 (hereinafter the Amended Bankruptcy 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 standardised the provisions applicable to specific types of lien*** (it 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. (Thus the lienholder will be satisfied primarily from all rentals paid under any lease contract concluded (and took effect) before the commencement of the liquidation procedure, thus also from the rentals paid during the liquidation procedure. From rentals arising from the lease contracts concluded by the liquidator the lienholder will not have priority rights.) This amendments 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. This amendment ***identifies*** in the Bankruptcy Act ***the independent lien, the secondary lien and the lienholder's agent***.
We made observations to the draft in several rounds. We managed to achieve the amendment of the rule on fiduciary collaterals. 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 (the amount to be paid to the liquidator from the net revenue from the pledged asset decreased from the envisaged 15% to 7.5%), which is of utmost importance for the lienholder creditors.

The adoption of the Amended Bankruptcy Act was followed by the preparation of another amendment to a law, which ***became necessary from harmonisation 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.

In the context of this draft we made observations of codification nature, furthermore we encouraged the development of appropriate rules with the view to search assets located in other Member States and to make them subject to the insolvency procedure. This draft will be discussed by the Parliament in the Autumn 2017 session.

Non-performing mortgage loans - Reform of private bankruptcy

Under ***the consultation initiated by the Ministry of Justice*** we reviewed the situation surrounding the non-performing mortgage loans. (At the end of 2016 18% of the portfolio of retail mortgage loans was non-performing; this meant some 136 thousand debtors.) The MNB Recommendation on non-performing loans hardly any actual result; only a low number of restructurings took place, at the same time the facilities of the National Asset manager have also been depleted. After the issuance of this Recommendation the banks contacted some 72 thousand debtors, as a consequence they concluded agreements with 3,800 debtors, around half of which was on restructuring.)
To resolve this issue ***the more flexible and simpler regulation of private bankruptcy*** may be a tool that provides 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 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 only 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 secures the mortgage lender's claim even in these cases. We have also made proposals in the context of the extension of the grace period in connection with the exchange rate cap.

Consultation on the implementation decrees to the Act on the prevention and combating of money laundering and the financing of terrorism

Out of the implementation decrees to the Act on the prevention and combating of money laundering and the financing of terrorism the Money Laundering Prevention working Group provided opinions in several rounds on the ***draft MNB Decree on the detailed rules for minimum standards for the development and operation of a filter system*** applicable the service providers supervised by the MNB, and the ***draft decree on the mandatory content of internal regulations*** as prepared by the NGM.

In the context of the *so-called* ***"online" identification*** the MNB emphasised that despite the existence of numerous fully automated technologies, they expressly aimed the human resource control of the identification process by adopting this regulation. Due to this, the MNB turned down the proposal from some market actors that would consider a completely automated procedure acceptable. A further objective of the decree was to ensure the identification of legal entities. The online identification cannot be used if a natural person has only a passport, since the security requirements of passports are not always compliant with the standard.
We discussed our detailed observations to the draft decree on the minimum criteria for the minimum standards of the set of filters during a face-to-face wide ranging consultation. The MNB either took into account our proposals or gave its reasons for leaving the provisions unchanged. The text of the final and published decree corresponds to what was agreed on these consultations.

The ***mandatory content elements of the internal MAL regulations*** do not significantly differ from the earlier ones and do not go beyond the rules laid down in the new Directive and its implementing act, therefore no observations on the merit were received from the member banks during this consultation

Act on Lawyers' activities

On 13 June 2017 the Parliament adopted *Act LXXVIII of 2017 on Lawyers' activities.* This ***law enters into force on 1 January 2018, parallel with the new Civil Procedure.*** The implementation of this law will be associated with one Government Decree, a ministerial decree to be adopted in six various issues, as well as bar policies. In addition to this, a separate law is under preparation on the amendment of certain acts on lawyers' activities, included in the Government's autumn legislative schedule with October submission.
In the context of this draft we prepared a highly detailed comment, by integrating the views of the cooperating legal counsels, significant part of which was integrated in the law.
An important novelty in the law is ***the integration of legal counsels into the bar, under the name of bar member legal counsel.*** 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 not pursuing such activities are not required to join the bar, but no separate legislation regulates their work otherwise. Also, trainee legal counsels spending their practice required for the bar exam must join the bar.
Legal counsels and trainee legal counsels can 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.
Policies affecting bar member legal counsels will be developed in the remaining part of the year. The MÜK assembly of delegates has to adopt policies in 35 matters, a part of which will also affect the activities of legal counsels and employers). (Out of them, one of the most important for the sector is the policy on the professional requirement on employees engaged in the drafting of documents.)

The Hungarian Banking Association set up an ad-hoc working group within the Legal Working Group for the contribution to the remaining regulatory tasks, and acts for the representation of legal counsels' interests as efficiently as possible.

VI. Developments related to Magyar Nemzeti Bank (the central bank of Hungary)

Establishment of the MNB repo market working group and its activities

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 Banking Association delegated professional and legal experts to the small working group based on a consultation with the ACI Hungary.
The working group started its activities on June 1st. Progress has primarily been made in legal issues, and the group consulted with KELER and ÁKK experts in order to resolve technical problems.

Reporting

In April, MNB continued its ***consultation for improving the quality of reporting with the COREP reports in relation to capital adequacy.*** The central bank's assigned experts informed us about the results of the inspection and the typical mistakes of data reporters, emphasizing the relevant regulation requirements, with reference to the regulation on capital requirements ((EU) No 575/2013 - CRR) and the complementary Implementing Regulation ((EU) No 680/2014 – ITS). In their experience, most errors are due to the misinterpretation of legal concepts, a bad system setup or wanting or flawed recording of data. The presenters responded to several concrete reporting inquiries and once again emphasized their zero tolerance policy concerning data review.

Another important development in Q2 is that due to the expansion of domestic card payment system network (a result of the support provided for increasing the number of card terminals), ***obligations concerning reporting on bank card payments will change***. MNB plans to issue the new information request mid-year, which will apply to the number of terminals installed as part of the support program, the payments transactions executed with the help of these terminals and the profit made by payment service providers. In view of that fact that preparing for the data request requires significant IT development, we asked that the original deadline for providing the requested data be moved to three months later. MNB accepted our request.

VII. Payments

PSD2[2] consultations with NGM[3] and MNB on implementation

At its May meeting, the Payments working group thoroughly analyzed the activities and working papers of its ***expert working group, which helps banks prepare for the implementation of the directive***. It approved the closing document, which contains the comprehensive and detailed

[2] Payment Services Directive 2: The EU's new directive on payments
[3] Ministry for National Economy

suggestions of banks, and which had previously been consulted on by a wide range of participants, and had also been sent to the regulatory authorities (NGM and MNB). In addition, the working group recommended that the Banking Association achieve that the work on implementation start as soon as possible, due in part to the necessity for adequate preparation time, and in part to the urgent need for clarification on what the minimum service that banks are expected to guarantee will be when the implementation is launched in January, 2018.

The trilateral preparatory work (NGM-MNB-HBA) started in late June and the proposed text on the implementation of the directive was created through many consecutive verbal and non-verbal consultation sessions. The ***implementation*** process ***necessitates the modification*** of the *legislations on payments, credit institutions, individual payment services, and MNB*. The Banking Association set up a negotiating working group of 6-8 bank experts, which represent the interests of banks during the trilateral meetings. The Banking Association regularly informed its members about the meetings' events in writing.

At the meetings on the implementation of the directive, the main issue raised was that of the ***minimum requirements of the legislator and supervisory authorities***, which will be in effect from the date of the start of implementation (January 13, 2018). This issue is especially important since the EBA is still working on several Regulatory Technical Standards (RTS) which would define rules in more detail. Among these is the key criteria for ***"strong customer authentication and secure communication",*** the understanding of which is essential for maintaining an adequately secure and safe payments infrastructure and keeping customer data inviolate. Currently this infrastructure is secured and monitored through stable, rigorous rules, and only those with proper authorization may access customer data. After the RTS is approved an 18-month preparatory period will follow. Therefore there could be a ***multiple-month (or one year)*** time period in-between the implementation of the general regulatory system of the PSD2 and its more detailed rules. As for the proper practical application for the temporary time frame, we will inquire at MNB for the national authority's official resolution on the matter.

In order to aid our member banks in their preparation for PSD2, we have conducted a direct, written consultation with The European Banking Authority, through which we could clarify relevant questions. In addition, we continue to share relevant information gained from the EBF's assigned working group and the V6 regional collaboration between banking associations.

The Regulatory Sandbox – a method for authorities to get to know more about FinTechs

MNB set it as its goal to better understand the ***impact FinTechs have on the market (as they may potentially play an immense role in shaping the financial market), their operational mechanisms, and the reactions of other market actors to them.***

Consequently, it organized a consultation for FinTechs and other financial enterprises already on the market (therefore banks as well). The Banking Association organized banks' representation for the consultation. During the meeting MNB informed participants that it wishes to use the so-called "regulatory sandbox" method to better understand the regulatory environment that FinTechs operate in, and what kind of supervisory mechanism would allow them to function effectively. FinTechs have to apply through a tender, and MNB will work out a different regulatory environment with the applicants, which (due to its size) cannot distort the market, but may allow for the discovery and live tryout of useful market innovations. MNB is also open to banks applying for FinTech type services, within the framework of the "sandbox".

The Banking Association took active part in providing expert bankers' opinions on MNB's ***questionnaires on FinTechs***.

The Instant Payment System (IPS) project and its institution

In March 2017, MNB's Executive Board made the decision ***to have GIRO Zrt.*** (owned by the central bank) ***establish the central infrastructure for an instant payment system***. Once they join, Hungarian financial service providers will be able to provide instant payment services to their customers. The new infrastructure will aid in the introduction of innovative services and will help new service providers enter the market. After the decision was made, the ***national project and its institution*** were created in June, targeting mid-2019 as the launch time of the IPS.

The IPS project's upper management body is the ***Project Management Committee*** (PMC), and its chair is MNB's deputy governor responsible for financial infrastructures. The PMC's meetings are organized by MNB, its central infrastructure is realized by GIRO, while ***account managing financial service providers in project management are represented by the Hungarian Banking Association***, actors using state payment services are represented by the Hungarian State Treasury, and traders and enterprises are represented by the Hungarian Chamber of Commerce and Industry. MNB attends to the secretarial activities of the PMC. Activities concerning the organization of the project are handled by a national project manager. An ***Information Forum*** guarantees the flow of information, to which different parties are invited every few months, based on the topic at hand. The Forum ensures the flow of information and that the parties concerned are granted extensive information.

The largest working group will be the ***Bank Adherence Working Group***, which will have several sub-working groups, such as business, liquidity management, IT, testing and security sub-working groups.
The ***Working Group for Complementary Services*** consists of two parts. One is the service provision sub-working group, which handles the basics of market-type complementary services, while the other is the state sub-working group, concerned with the system's use in situations where payment is made by the state.
The ***Regulatory Working Group***'s main task is preparing and implementing relevant changes in legislation.
The ***Information Working Group*** provides internal information for project participants and external information for users.

Based on MNB's request, and with the assistance of the Banking Association, the working groups have been formed with the participation of banking experts, and we have put together a ***contact list,*** with its content determined by banks. MNB and GIRO may keep in contact concerning the national project with all those who are on the list, and they will be the ones to – within their institutions - make sure that the information is forwarded to those concerned, as well as that feedback is collected and channeled back to them.
The PMC will play an important role in making those essential decisions, which arose in working groups, but cannot be made there and therefore require its participation, as well as in involving other decisionmakers, when necessary. It is a basic requirement for PMC members to continuously provide information to the sector that they represent, to collect feedback, and to channel it into the project.

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 company which won has since then finished the audit, the results of which will also be sent to the banks concerned.

Bank Cards

Based on MNB's data from Q1 2017 electronic payment continued to increase, as it typically has before. As regards bank cards, contactless payment has become the most significant, with 63% of purchases being executed using this new method, and accounting for nearly half of all transactions. Paying with bank cards has becomes more secure, bank card fraud on domestically issued cards only grew by 2%, and loss from fraud actually decreased in late 2016.

The international police operation focusing on e-Commerce (or online) scams took place from June 6, to 16, 2017, with 26 countries who participated. As a result, over twenty thousand scam transactions were identified, 76 scammers and cyber criminals were caught by authorities and arrested for conducting online scams, with their crimes causing over 5 million Euros of damage. Police and civil society worked together during the operation. In response to the National Bureau of Investigation, several member banks participated in the program, although luckily their exposure to these scams in Hungary is low each year.

The Bank Cards working group helped in preparations for ***introduction of the Automatic Billing Updater, made mandatory by MasterCard***, by conducting active consultations with the card company. The service grants a data request option for the service providers in the case of expired/lost/stolen cards, in order to allow them to complete their client's regular payments (e.g. newspaper or service subscriptions), which is part of their contract. During the consultations, through our arguments, we managed to portray that Hungary's legal and consumer protection laws are not adequately in line with the implementation of the service, and therefore the card company promised to ***postpone its introduction at national level***.

Starting from the end of last year, we have regularly participated in the professional consultation organized by the NGM on preparations for ***blocking the payment transactions of prohibited gambling***. The working group also processed those ***parts of MNB's recommendation on the equal treatment of persons with disabilities, which concern bank cards,*** since the text classifies ATMs as customer service points, and therefore requires that the accessibility of ATMs be a part of the strategy for servicing customers with disabilities.

Information on the EPC and SWIFT general assembly

The general assembly of the ***European Payments Council*** was held on June 14, 2017 in Brussels, with the participation of 61 members. Based on the recommendation of the audit committee, the general assembly approved the ***balance sheet and the profit and loss statement for 2016***, and decided on the ***division of surplus profits and its utilization***. According to this decision, the previously approved program, which targets ***maintaining scheme member fees at a moderate level,*** and to which another 100 thousand Euros have been allocated for the coming year, will continue next year. The MAZARS Group has been reinforced in its position as the EPC's external auditor. In addition to the above, there were decisions made regarding the approval of new members (Banco de Sabadell and

UK Finance – previously Payments UK) as well as the changes in members of the Board, and the EPC Charter's modification in connection with PSD2.
From the Board's report, it is worth highlighting the EPC's activities in connection with the ERPB[4]. The ***Payment Initiation Service Providers (PIS) working group***'s task within the ERPB is setting the conditions regarding innovation and competition of the new financial service's integrated, pan-European market, which meet the requirements. The working group continues to work on its report, which includes 9 recommendations, and questions for clarification for the European Commission and the European Banking Authority on the requirements of secure communication between financial service providers, in connection with regulatory technical standards concerning PSD2. The panel leader and head of EPC Modul1 discussed among other topics, the current situation of the implementation of the instant payments model (SCT Inst) as well as the plans for development of the already existing models.
A serious debate arose about the recommendation elaborated by the NGC[5], which regards the modification of the Charter's text on EPC membership, due to PSD2. More specifically on whether the ***two new service provider types introduced by the PSD2*** (PISPs[6] and AISPs[7]) ***may also become EPC members in the future***. Although PSD2 clearly states that the new service providers may operate as payment institutions and therefore are eligible for EPC membership, many members voiced their disagreement. Some argued that even though in form it is true that the new service provider types may join the EPC as payment institutions, their operational models are completely different from that of current payment service provider members. According to others, account information service is not in any way related to payment transactions, and therefore those who provide this type of service should not even be considered for EPC membership. There were two rounds of votes on the modification. The previously mentioned restrictive alternatives did not gain the necessary majority, making NGC's original recommendation the winner and thus allowing for the new payment institutions to become members of EPC in the future – although none of them have applied for membership so far.

SWIFT's shareholders held their general assembly on June 8, 2017, where nearly 80% of members were represented. In his report, Yawar Shah, president of the Board ***defined 2016 as successful in both in the administration of finances and in reaching the organization's set operational targets***. The institution, which is present in over 200 countries and connected through more than 11 000 SWIFT networks, further increased the utilization of its services. There were over 6.5 billion messages sent according to FIN standards, which shows an increase of 6.9% since last year. The average daily number of messages was above 25.8 million, and peaked at over 30.3 messages on the most busy day. All this was realized by the community is in addition to the high level availability of the network – 99.997% in the case of FIN messages. As a result of its smooth operation, SWIFT made a net profit of EUR 28 million in 2016, which will not be used for rebate this time, but will be put into developments that increase efficiency and reduce the cost of messaging. The chairman stated that the three directions that the management concentrated on (***cyber security, enhancing business performance and supporting innovations, as well as keeping geopolitical context in focus***) was proven to be the right approach in practice, and thus it must be continued in the coming years.
With regard to cyber security, the Chairman marked the ***Customer Security Program*** (CSP[8]) as the year's most significant success. In connection with this, he emphasized that individual participants must complete the security test by the end of 2017, which is built on the methodology that is based on the surveys conducted in 2016. He emphasized that the network level security frameworks created by SWIFT are only truly effective in reality if all users individually subject their own systems

[4] Euro Retail Payments Board: the body for small Euro payments
[5] Nomination and Governance Committee (EPC)
[6] Payment Initiation Service Providers
[7] Account Information Service Providers
[8] Customer Security Program: After the cyber attack on Bangladesh Bank, which was executed through its SWIFT connection, SWIFT created this global security program for all of its users.

and SWIFT connection to the requirement system established through the CSP and effectuate it in real life.

VIII. Taxation

The *amendment regarding tax laws* was published on June 19, 2017 in the Hungarian Official Gazette (Magyar Közlöny). According to the bill the aim of the modifications is to improve competitiveness, to cut back on tax administration, simplify taxation and to introduce tax policy measures which incentivize certain highlighted aims. In the interest of clear legislation, numerous modifications of legal technicalities and clarifications as well as amendments are included in the legislation package, in connection with the problems and issues that arose. A portion of the modifications also satisfies legal harmonization criteria.

One of the most important changes which concern the sector is that according to the provisions of the act on the special tax on financial institutions, which are in effect from June 20, 2017, it will become possible to reduce special taxes to be paid in the future by up to 50%, with the help of support granted for the targeted tax benefit. The condition for using the tax benefit is that the tax payer must be eligible for it according to corporate income tax, but cannot deduct it from the corporate income tax. The opportunity of tax reduction is present for both support granted previously and in the future. Special tax declarations submitted in 2017 may be self-audited for free until September 10th.

A new requirement is that business associations registered in Hungary must notify the Hungarian tax authority of all their foreign bank accounts.

Contrary to the rules set by the bill, as before, private entrepreneurs with VAT exempt status will not have to open a payment account.

Real time data reporting obligations applied to data in invoices with output VAT of over HUF 100 thousand will come into effect a year later than planned (on July 1, 2018), which is also convenient for the sector. The aim of the one-year delay for “online invoice submission” is to allow those involved to make the necessary technical developments. With regard to the delay in online reporting, the HUF 1 million ceiling of domestic summary statements will only decrease to HUF 100 000 on July 1, 2018.

From January 1, 2018 the IAS 18 Revenue and IAS 11 Investment Standards will be replaced by the *IFRS 15 Revenue from Contracts with Customers Standard*, which will determine the net sales revenues according to IFRS (the base for local business tax).

As a new instrument for actions against aggressive tax planning and taxation structures, amending *Act XXXVII of 2013 on the Rules of International Administrative Cooperation Related to Taxes and Other Public Duties*, on May 31, 2017 the CbC (Country by Country report) requirement entered into force. This documentation element for transfer pricing applies to those multinational enterprise groups, which have consolidated revenue of over EUR 750 million for the previous financial year. It is parent companies that are primarily required to report data. Tax authorities will automatically share the contents of the report with the other tax authorities concerned.

IX. Developments within the Hungarian 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.
The reports on the activities, financial management and budget, as well as future plans of the Hungarian Banking Association were presented by the President and Secretary General, and were approved unanimously, and were complemented by the Supervisory Board's report.
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 emphasized 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.

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 in 2017:

- 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.

This year, for the very first time, a book of interviews with the leaders of member banks (who have held positions over the past three years) was published. The printed complementary and personal copies were handed out to those concerned. The book is also accessible on the Hungarian Banking Association's homepage.

Communications

Q2 of 2017 was a decidedly calm period as regards communications, with significantly less media interest than average. Our statistics indicate about 90 mentions in printed media, approximately 170 instances of online media coverage, and around a further 25 appearances in electronic media during the quarter. In total, the Hungarian Banking Association represented the sector's standpoint to the public through the Hungarian media nearly 285 times in Q2.
The Home Purchase Subsidy Scheme for Families (HPS), the basic bank account, personal insolvency, and changing banks remained regular communications topics. The launch of certified consumer-friendly housing loans also caught the attention of the media. In addition to these, ATM security, safe mobile banking, the Hungarian Competition Authority's BankAdat proceedings, and the issue of financing political parties were also covered. The new payment services directive in connection with the entering into force of the PSD2 next year drew the attention of journalists as well; therefore we discussed possible directions for development and the visible and probable impact of FinTech and digitalization. After its General Meeting, the Banking Association's re-elected President and Vice-President both gave personal interviews.

The V6 meeting

The 11th meeting for regional banking associations (held twice per year) took place in Bratislava in early June. The participating leaders and experts from the banking associations discussed their experiences regarding the ongoing implementation of EU legislation, the efficiency of individual national banking sectors and other current issues.
In connection with the ***implementation of PSD2 and MiFID 2***, it was uniformly agreed that the EU professional regulatory institutions' delay in the elaboration of technical rules, as well as their hesitation to establish a resolution on ambiguous rules, causes significant delay and uncertainty in the efforts to transpose these directives into national legislation. Thus, implementation is behind schedule in many areas. At the time of the meeting, it was generally true for participating countries that the initial draft legislations had been prepared, but consultations with the sectors and other actors of the national administration were only at an initial stage, and therefore submission of them to Parliament was still a long way off.
With regard to the profitability of the banking sector, almost all participants reported ***positive profit level indicators***, however most of these were the result of one-off items; for example several participants mentioned that their profits were exceptionally high due to the sale of VISA shares. Poland reported data, which showed decreasing profit compared to previous years, and attributed it primarily to extraordinary contributions to deposit guarantee and resolution funds, as well as bank levy.
In addition to the above, participants consulted on their experiences and problems concerning the ***automatic online loan approval*** processes, which have been introduced in several countries.
In order to improve their advocacy capabilities, the group made the ***decision to expand*** (this was initiated by Hungary), therefore banking association leaders from Romania and Bulgaria will also be invited to next year's meeting.

Money Week – A European summary and research results

The third Money Week program was held in March 2017 and the number of its participants grew once again: this year's 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 (which was originally 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 for feedback from teachers and volunteers. We received almost 950 responses, and drew the following conclusions:

- Overall 88.5% of participants rated the Money Week program positively.
- Schools found both the Money Week website and the registration interface adequate, and considered the preparatory material for teacher and the personal training outstanding. In their experience, students showed interest and actively participated in classes.
- Data shows that most of the participating teachers were math teachers. It can be stated that in the case of participating teachers, the program theme is generally relevant to their area of expertise, and they use its ready teaching materials outside of the program series as well.
- Almost all schools unanimously consider improving students' financial literacy through the program a useful initiative and agree that the basic financial education should already start in elementary schools.
- Teachers think it is very important to change the program's theme from year to year, and in the meantime allowing them to teach previous years' curricula.

The feedback from teachers provides the incentive for continuing the program. We have received an extraordinary amount of suggestions for the next program's theme, with the majority of them recommending credit as the new topic.

The cessation of the Money and Capital Market Permanent Court of Arbitration

Based on *Act LX of 2017 on Arbitration*, the Money and Capital Market Permanent Court of Arbitration (PTÁV) will cease to exist by operation of law as of December 31, 2017. According to the new act, in order to prepare a list of recommended judges as well as the text of the ***Order of Business and the Rules of Procedure for the court of arbitration of commerce***, a new Preparatory Committee must be established. Ceasing courts of arbitration will delegate one member each to the Preparatory Committee, therefore the Hungarian Banking Association has also appointed its representative. The Banking Association has taken the necessary steps (after consulting with the Budapest Stock Exchange) for the cessation of PTÁV and for the efficient operations of the money and capital market section in the future.

Working committees and working group previously not mentioned

- *Data protection working group*

The Data protection working group focused on the implementation of *Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 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 (GDPR[9])*. At the Banking Association's Board Meeting in April, we explained that the ***GDPR (in effect from May 25, 2018) will impose significant restrictions, including the broadening of the scope of sanction options***. We emphasized that bank leaders and coworkers must

[9] General Data Protection Regulation

be made aware that preparations for the GDPR will affect banks' entire apparatus, and the relevant work will require the support of the upper management.
During the working group's meetings, we listened to presentation on the new pleas of data management in the GDPR, on data management according to legitimate interest, on regulatory and data protection issues concerning financial intermediaries, and Big Data. The working group reviewed the ***provisions of the act on money laundering which are important for data protection***.

- *Agricultural working group*

The agricultural working group held several meeting sin Q2. A representative of the Rural Credit Guarantee Foundation held an informative presentation on the activities of the Foundation, on developments concerning the guaranteed SME credit portfolio, on the changes brought by the new regulations introduced on April 10, 2017, and on current events in 2017.
During ***Profession Day*** (held now for the second time) representatives of the Hungarian Chamber of Agriculture presented us with information on common agricultural policy (valid until 2020), on the prospects of the agricultural sector, the state of the food industry, on changes to the primary producers' system, and on the long term plans of the Chamber.
In order to facilitate ***mortgage relating to the tenders of the Rural Development Program***, we consulted with the Prime Minister's Office on the publication of a document, which would be similar to and would take into account the elements of the *informative packet on facilitating mortgage within the Economic Development and Innovation Operative Programme*. The recommendation is currently pending.

- *EXIM sub-working group*

At the EXIM sub-working group's meetings in Q2, EXIM representatives informed us about changes to the pre-financing loan conditions included in the interest make-up scheme, in effect from April 4, 2017. They informed us about the 2017 collaboration program between EXIM and credit institutions, which includes changes to the conditions of export pre-financing loans, the introduction of EXIM's customer evaluation, the launch and product conditions of the Future Exporters Program, as well as the introduction and timing of programs for 2017.
Two training days were held during the quarter for the ***Future Exporters Program*** and the ***Export Pre-financing Program,*** which was launched on June 30, 2017. The working group gave its opinion on the ***draft contracts*** for working capital loans and investment loans. Based on the comments given at the meetings, ***the maximum amounts and the requirement on segment classification*** with regard to the definition of simplified and full client evaluation ***were modified***.

- *Credit guarantee working group*

At its meeting during the quarter, the Credit guarantee working group reviewed the ***measures introduced in this past time period at Garantiqa Hitelgarancia Zrt.***, as well as its ambitious annual ***plan for*** 2017. They presented their data on third-party guarantees for the year 2016, and the first five months of 2017. These support the assumption that there is an increase in third-party guarantees in all areas, compared to the same time period of last year. From July 2017, Garantiqa will support lending to SMEs even more by providing ***reduced*** (discount) ***third-party guarantee fees.*** Representatives of Garantiqa presented their recently introduced ***web service***. Through the web service (real time and online), when submitting the application for a third-party guarantee, an interface connection is made between the bank and Garantiqa's servers. By using Garantiqa's new service, banks also have the possibility to significantly save on labor, rationalize processes and avoid errors made during manual work.

Owing to the IT development of the last few years, 99% of third-party guarantee applications are submitted to the company electronically. Two partner banks are also already working on creating a similar interface connection, which implies a higher level of digitalization.

The mortgage bank working group's Real Estate Valuation sub-committee consulted on the methodology of real estate valuation, in order to find out what professional developments could be made to increase effectiveness.
The Legal and Capital Market sub-committee had EU regulations, consulting with the supervisory authority on the covered bond directive, which is under preparation and following legislation process in connections with the directive on its agenda. The sub-committee also worked on the creation of ***mechanisms that support the demand for mortgage bonds***, on account of the changing of the mortgage financing adequacy ratio in 2018, through which it aims to involve investors outside of the banking sector in the mortgage bond market.
In addition, both the Legal and the Capital Market sub-committee consulted on the possible introduction of the so-called green mortgage bonds (now present at EU level) and the creation of favorable rules in connection with it.

- *SME working group*

The SME working group held two meetings in Q2. At this quarter's first meeting the Ministry for National Economy's representative ***presented the Irinyi Plan and the instruments for its realization in detail***. One of the main objectives of the Plan is to strengthen Hungarian SMEs, improving their effectiveness, productivity and competitiveness, another is to create cooperation between large companies and SMEs, as well as promoting the ability to join into global value chains.
Until now, the ***electronic administration portal (the Citizen's Portal)*** was restricted to natural persons. However, as of January 2018, ***companies must also use the electronic portal.*** Consequently, at the working group's second meeting, representatives from the Ministry of Interior and the National Infocommunications Service Company presented the new ***Central e-Government Portal's*** registration, data modification, messaging and institutional services in detail. Companies must register on the portal by the end of August according to the Act on electronic administration, however they are also given a temporary preparatory period, which allows them to avoid sanctions if they register by December 31, 2017.

I Global Regulation

I.1 Financial Stability Board (FSB[10])

Letter from the Chair of the FSB ahead of the G20 summit

Mark Carney – as customary – sent a letter to G20 leaders ahead of the summit in July, in which he reported on the implementation of the financial reforms decided on after the financial crisis.
The Chair of the FSB stated that the G20 ***reforms have built a safer, simpler and fairer financial system***, banks are considerably stronger, more liquid and more focused in their activities. As a result of the measures taken they are eliminating the toxic forms of shadow banking and transforming it into resilient market-based finance. Reforms to the OTC derivatives markets have made them more transparent and secure. All this has been achieved without impeding the supply of credit to the real economy.
At the same time, there is ***some unfinished business to finalize and the implementation of reforms merits attention***. Basel III must be completed urgently and then implemented faithfully. FSB policies to address the structural vulnerabilities associated with asset management activities were finalized in January and their operationalization is underway. Further work is required to build effective cross-border resolution regimes, and to realize fully the benefits of trade reporting in improving transparency in OTC derivatives markets. The underlying causes of misconduct can be managed through better aligning incentives and reward, but more still needs to be done in this regard.
The financial system is constantly evolving and thus the ***FSB will continue to scan the horizon to identify, assess and address new and emerging risks to financial stability***. It will monitor the impact of FinTechs and cyber risks on financial stability, address the decline in correspondent banking relationships, and will continue to work on the promotion and adoption of recommendations in connection with climate change-related financial disclosures.
The ***dynamic introduction of the reform program*** is a key issue in terms of efficiency and coherence. Building on the above foundations, the G20 countries now have a strategic opportunity to create an open, global financial system, which supports cross-border investment, and strong sustainable balanced growth.

Annual report on the implementation and effects of the G20 regulatory reforms

The third annual report complements the Chair's letter with further detail. The report identifies three key areas where authorities need to remain vigilant:

- maintaining an open and integrated global financial system
- market liquidity
- the effects of reforms on emerging markets and developing economies

The report asks for the G20 leaders' support to reinforce global regulatory cooperation by:

- revising legal frameworks to facilitate cooperation and information sharing amongst authorities
- encouraging full and consistent implementation of standards
- participating in post-implementation evaluations of the effects of reforms, and
- considering how progress made in agreeing and implementing standards can best be leveraged to preserve an open and integrated system.

[10] Financial Stability Board: The highest-level international financial regulatory body

Framework for the post-implementation evaluation for the effects of the G20 financial regulatory reforms

In April, the FSB consulted on and afterwards in July it released the ***framework for the post-implementation evaluation for the effects of the G20 financial regulatory reforms***. The implementation of the main reforms decided on by the G20 post-crisis now makes possible the evaluation of their impact. The FSB coordinated the evaluation frameworks in close collaboration with the standard-setting bodies and other stakeholders and taking into account the results of public consultations. The developed frameworks will help assess whether the reforms achieved their intended outcomes and 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 will be refined with the help of feedback and experience.
Within the evaluation frameworks they will first examine whether the combination of particular reforms – namely relevant derivatives reforms and the regulation of the leverage ratio – adequately incentivize central clearing for OTC derivatives transactions.

Handbook for FSB Peer Reviews

In early April, the FSB published the newest version of its handbook for peer reviews. The handbook focuses on ***evaluating the implementation and effectiveness of international financial standards and policies.*** FSB member jurisdictions agreed to undergo periodic peer reviews. There are two types of FSB peer reviews (thematic reviews and country reviews) and they comprise five distinct stages (prioritization, preparation, consultation, evaluation and follow-up), which are described in detail. The handbook was originally prepared by the FSB Standing Committee on Standards and Implementation in 2009, and was further revised in 2011, 2014, 2015 and 2017.

Financial Stability Implications from FinTech

Technology-enabled innovation in financial services, or FinTech is growing rapidly, which makes it necessary for the FSB to identify supervisory and regulatory issues that merit authorities' attention. The FSB's report (compiled in 2017 as requested by the German presidency) identifies 10 such areas, ***of which three are seen as priorities for international collaboration***:

- managing operational risk from third-party service providers,
- mitigating cyber risks, and
- monitoring macrofinancial risks that could emerge as FinTech activities increase.

Other issues that the report deals with are the following:

- cross-border legal issues and regulatory arrangements,
- governance and disclosure frameworks for big data analytics,
- assessing the regulatory perimeter and updating it on a timely basis,
- shared learning with a diverse set of private sector parties,
- further developing open lines of communication across relevant authorities,
- building staff capacity in new areas of required expertise,
- studying alternative configurations of digital currencies.

The report classifies FinTech innovations ***by their primary economic functions rather than their underlying technologies***. It notes the lack of information on official and privately disclosed data and highlights the need for authorities to provide data on FinTech activities.

FinTech credit

In May, the FSB and the CGFS[11] released a shared report on FinTech credit. The report establishes that ***FinTech platforms account for an increasing share of credit provision, therefore policymakers have to consider the opportunities and risks such activity brings***. The report concludes that:

- Lower concentration of credit provision from banks could help to diversify economies' credit channels and reduce the risks of credit upsets if bank lending is interrupted.
- FinTech platforms may increase competition and help consumers by pressuring banks to be more efficient.
- While FinTech credit could lead to increased financial inclusion, it could also lower lending standards with negative consequences for financial stability in countries where credit markets are already deep.
- Incentive problems, caused by a reliance on fee income (an 'originate-to-distribute' model), could pose a problem at some platforms.
- FinTech credit provision could rise and fall with the business cycle, with the potential for a pullback of credit provision to certain parts of the economy, if market stress leads to a loss of investor confidence.
- If FinTech credit growth could encourage greater risk-taking by banks and there is an abrupt erosion in bank profitability, it could generate broader stresses for the financial system, given banks provide a range of systemically important services.

In connection with FinTech lending, the FSB once again points out the lack of official data.

Other important documents released by the FSB in Q2

Thematic Review on Corporate Governance
Global Shadow Banking Monitoring Annual Report 2016
Stocktake of Efforts to Strengthen Governance Frameworks to Mitigate Misconduct Risks
Supplementary Guidance to the FSB Principles and Standards on Sound Compensation Practices
Recommendations on Climate-Related Financial Disclosures
Report on Reforms to OTC Derivatives Markets
Assessment on Shadow Banking Activities, Risks and the Adequacy of Policy Tools

I.2 Basel Committee on Banking Supervision (BCBS)

The two-year work program of the BCBS

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

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

Within the framework of the ***finalization of the Committee's policy-related initiatives***, the finalization of the Basel III reforms is the most important. Other priorities in addition to this are: the regulatory treatment of sovereign exposures and expected loss provisioning, the identifications and measurement of step-in risk, targeted adjustments and simplifications to the revised market risk and

[11] Committee on the Global Financial System

securitization frameworks. The Committee will also assess ***where additional focused policy initiatives are warranted.***

Monitoring emerging cyclical and structural ***risks***, changes in banks' business models and innovative transactions or regulatory arbitrage which may go against the objective or spirit of Basel III is also a priority. In addition, the Committee will distinctly assess the impact of the post-crisis reforms.

More focus than before will be put on supervision. This includes further improving supervisory tools and techniques, and the establishment of best practices.

The Basel Committee's ***Regulatory Consistency Assessment Program*** (RCAP) remains a high priority. They will asses the implementation of the LCR[12], then review the implementation of other standards (NSFR[13], large exposures) and will first report on these in 2018. They will also review banks' implementation of the standard on interest rate risk in the banking book. Furthermore, they will discuss the implementation of the ***regulatory framework with a broad range of non-BCBS member jurisdictions from emerging market economies***.

Prudential treatment of problem assets – definitions of non-performing exposures and forbearance

In early April the Basel Committee published its final guidance on the prudential treatment of problem assets. The guidance ***harmonizes the definitions of non-performing exposures and forbearance to promote consistency in disclosure and supervisory reporting*** – taking into account existing banking practices.

The definition of non-performing exposures:

- introduces harmonized criteria for categorizing loans and debt securities that are centered on delinquency status (90 days past due) or the unlikeliness of repayment.
- clarifies the consideration of collateral in categorizing assets as non-performing.
- introduces clear rules regarding the upgrading of a non-performing exposure to performing and the interaction between forbearance and non-performing status.

The definition of *forbearance*:

- provides a harmonized view on the modification or refinancing of loans and debt securities that result from a borrower's financial difficulty.
- allows forborne exposures to be categorized as performing or non-performing.
- sets out criteria for discontinuing the forbearance categorization and emphasizes the need to ensure a borrower's financial soundness before the discontinuation.

These guidelines complement the existing accounting and regulatory framework for asset categorization. It is an important circumstance for both European and domestic banks that the definitions set by the BCBS are harmonized with the technical standards previously issued by the EBA[14] and the MNB regulations which mirror it).

Simplified alternative to the standardized approach to market risk capital requirements – consultative document

In January 2016, the Basel Committee on Banking Supervision published the standard Minimum capital requirements for market risk. The standard includes an internal models approach and a standardized approach as well. In order to facilitate adoption of this standard for banks other than those that are large and internationally active, the document sets out a simplified, alternative method to the standardized approach.

The proposed ***reduced sensitivities-based method (R-SbM)*** represents a simplified version of the ***sensitivities-based method (SbM)***, which is the primary component of the standardized approach.

[12] Liquidity Coverage Ratio

[13] Net Stable Funding Ratio

[14] European Banking Authority

(Such simplifications include for example the removal of capital requirements for vega and curvature risks, simplification of the basis risk calculation, as well as reduction in risk factor granularity and the correlation scenarios.)
Use of the proposed R-SbM is available only to banks that meet certain qualitative and quantitative criteria (non-G-SIBs[15] and non-D-SIBs[16]) with the approval of the relevant authority. (The supervisory authority can require the use of the more complicated SbM in those institutions, which satisfy implementation criteria.) As proposed, for banks that adopt the reduced SbM, the standardised approach market risk capital requirement would be the sum of three components: ***(i) the risk charges under the reduced SbM (as proposed in the consultative document); (ii) the default risk charge; and (iii) the residual risk add-on***. (The latter two are to be calculated as specified in the January 2016 standard.)

Throughout the consultation, the Committee also seeks feedback on whether retaining a recalibrated version of the Basel II standardized approach to market risk would better serve the purpose of including a simplified method for market risk capital requirements in the Basel framework.
The consultation period will end on September 27th.

The FX Global Code

The FX Global Code for global FX markets was published in May 2017, and was completed over the course of nearly two years and through the work of representatives from the central banks and market actors of the 16 jurisdictions. The volunteer Code is organized around important principles such as ***business ethics***, corporate governance, the execution of transactions, confirmation and settlement processes, ***information sharing*** and ***risk management***. The Code is not a legally binding or regulatory document for market actors; its aim is to complement local regulations by presenting good practices. The central banks are very dedicated in keeping to the Code and incentivize market actors to act according to the Code as well.
The central bank governors of the Basel Committee welcome the Code and the establishment of the Global FX Committee, which is dedicated to maintain the Code in the future.

Report to G20 leaders on the implementation of Basel III

The BCBS 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 national or regional banking regulations with the Basel III standards; and (iii) analyzes the prudential outcomes from those regulations***. Overall further progress has been made since last year's report in implementing the Basel III standards in a full, timely and consistent manner. Banks continue to build larger and better-quality capital and liquidity buffers while reducing their leverage. The regulatory reforms on short-term liquidity and G-SIBs applying to capital have been implemented in all 27 BCBS member jurisdictions. Many member jurisdictions have already mad efforts towards the implementation of the margins requirements for non-centrally cleared derivatives, the NFSR, the leverage ratio, and revised Pillar 3 disclosure requirements. However, the domestic rules on the standardized approach for measuring counterparty credit risk, capital requirements for exposures to central counterparties and capital requirements for equity investments in funds are delayed in many jurisdictions. Market risk capital requirements and limits on large exposures and securitizations may also be delayed.
Delayed implementation may disrupt the level playing field and put unnecessary pressure on jurisdictions that have implemented the standards based on the agreed time lines. The Committee

[15] Global systemically important banks
[16] Domestic systemically important banks

will continue to monitor closely the implementation, as its consistent and timely introduction is fundamental to reaping the benefits of the reform.

Further relevant documents

Range of practices in implementing the countercyclical capital buffer policy
Harmonization of critical OTC derivatives data elements – consultative report by CPMI[17] and IOSCO[18]
Frameworks for supervisory stress testing of central counterparties (CCPs) – consultative report

II European Regulation

II.1 The General Environment – possibilities for deepening the Economic and Monetary Union

Following the presentation of the ***White Paper on the Future of Europe*** on March 1st, the Commission set out possible ways forward for deepening Europe's Economic and Monetary Union. The reflection paper builds on the ***Five Presidents' Report of June 2015,*** and it's intended both to ***stimulate the debate on the Economic and Monetary Union and to help reach a shared vision of its future design***. Paying due attention to the debates in member states and to the views of other EU institutions, the paper sets out concrete steps that could be taken by the European elections in 2019, as well as a series of options for the years after the completion of the Economic and Monetary Union.
According to the Commission's assessment, moving ahead would involve staking steps in three key areas:

- Completing a genuine Financial Union
- Achieving a more integrated Economic and Fiscal Union
- Anchoring democratic accountability and strengthening euro area institutions

Further political integration could involve a rethinking of the ***balance between the Commission and the Eurogroup*** and could justify the appointment of a full-time permanent Eurogroup chair, as well as ***unifying the euro area's external representation.*** The public debate also discusses the idea of a euro Treasury – possibly with a euro area budget – as well as a European Monetary Fund.

II.2 The Risk Reduction Package of November (RPR)

II.2.1 Report from the Maltese presidency and agreement reached within the Council

Towards of its mandate, the Maltese presidency released a common report on the results achieved through the risk reduction package, which modified the ***CRR/CRD4[19], the BRRD[20] and the SRMR[21],*** as well as the EDIS[22] consultations. After the report was published, on June 16th, member states formally agreed on three regulatory issues (deemed urgent) concerning the RRP.

[17] BIS Committee on Payments and Market Infrastructures
[18] International Organization of Securities Commissions
[19] Capital Adequacy Regulation/ Capital Adequacy Directive
[20] Bank Recovery and Resolution Directive
[21] Single Resolution Mechanism Regulation
[22] European Deposit Insurance Scheme

- a ***draft directive on creditor hierarchy***: the ranking of unsecured debt instruments in insolvency proceedings;
- ***a draft regulation on transitional arrangements to phase in the regulatory capital impact of the IFRS 9 international accounting standard;***
- the regulation also contains provisions on the ***large exposures treatment*** of public sector debt denominated in non-domestic EU currencies.

The FSB regulation on total loss-absorbing capacity (TLAC - to be implemented by banks in 2019), requires the holding of subordinated instruments ('subordination requirement'). The draft directive therefore requires member states to create a new class of 'non-preferred' senior debt, eligible to meet the subordination requirement. It will thereby facilitate the application of EU bail-in rules in cross-border situations.

The regulation, which became necessary due to the introduction of the IFRS 9 on January 1, 2018, will ***mitigate the potential negative regulatory capital impact on banks***.

IFRS 9 is aimed at improving the loss provisioning of financial instruments and represents a more forward-looking model for the recognition of expected credit losses (ECL) on financial assets. financial assets. Use of it, however, may lead to a sudden increase in expected credit loss provisions and a consequent sudden fall in their regulatory capital ratios. It was therefore decided to apply fast-track, transitional regulation. The presidency prepared the resulting draft regulation, which would allow banks to add back to their 'common equity tier 1' capital a portion of the increased ECL provisions as extra capital during a ***five-year transitional period***. That added amount will progressively decrease to zero during the course of the transitional period.

The draft regulation also provides for a ***three-year phase-out*** of an ***exemption from the large exposure limit for banks' exposures to public sector debt denominated in the currency of any other member state***. The exemption mostly applies to banks in non-Eurozone member states, which have euro-denominated holdings of those member states' public debt. Unless the CRR is amended with priority, the exemption will cease to apply after December 31, 2017.

Due to the urgency of these issues, ministers asked the next (Estonian) presidency to start talks with the European Parliament on the adoption of the draft regulations as soon as possible.

In addition to the above, the Maltese presidency’s report on RRP discussed the following key issues:

- eligible liabilities items and instruments
- balance between home and host country authorities
- the fundamental review of market risk, and trading book regulation[23]
- the scope of regulation (CRD)
- pillar 2 requirements and guidance
- the leverage ratio
- regulatory reporting
- interest rate risk in the banking book (IRRBB)
- counterparty credit risk (CCR)
- the SME supporting factor
- contractual recognition of Bail-in
- and moratorium tools

The report discusses the above issues in details and also presents the results achieved in connection with them.

Although the working group has started the debate, there was no significant progress made in the topics of remuneration, NSFR, Intermediate Parent Undertaking (IPU), Mixed Financial Holding Companies, managing infrastructure exposures, and the review of investment services. With regard to ***BRRD and SRMR***, further work is needed for the elaboration of technical details in connection

[23] Fundamental review of trading book (FRTB)

with MREL[24] criteria, calibration, Pillar 2 requirements, MREL guidance and the breach of MREL requirements, as well as supervisory reporting and disclosure requirements in connection with MREL requirements.

II.2.2 The European Banking Federation's (EBF) views on the risk reduction package

The EBF established its views on the Commission's rick reduction package of November with the aid of quite a large professional apparatus. 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.
In its concise answer (which includes the main professional policy ideas) for the risk reduction package, the EBF highlights that when analyzing the RRP first of all it is necessary to appraise what has been done in the last decade, what could have been done better, and what remains to be done. It mentions that the core equity tier 1 capital ratio of EU banks increased from 5% before the crisis, to 13.6%, and that the LCR increased from 70% in 2011 to 141%. The NSFR is also above the compliance bar, while the leverage ratio has increased from barely 3% to over 5%. Everything comes with a price, however: EU banks have ***sacrificed profitability to increase their capital buffer reserves and their holding of liquid assets*** amid a monetary environment of ultra-low interest rates.

The comprehensive EBF response groups the issues around the six most important guiding principles:
(1) Securing competitiveness, consistency and a level playing field for European banks
- Putting on hold the Fundamental Review of the Trading Book
- Safeguarding consistency on MREL requirements
- Drawing clear delimitation of the scope of Pillar 2
- Excluding extraordinary events from risk estimates
- Letting banks hire digital talent
- Respecting the regulatory level playing field in third countries

(2) Supporting market liquidity and market making
- Reviewing the NFSR calibration
- Preventing an unintended combined (negative) impact on market making
- Avoiding automatic MDA[25] restrictions for MREL breaches
- Applying consistency to high-quality liquid assets (HQLA) across policy tools

(3) Treating the Single European Market and the Banking Union as a prudential reality
- Making waivers at solo level automatic and not discretionary
- Removing internal MREL
- Granting preferential treatment for intragroup transactions
- Recognizing the reduced systemic risk

(4) Limiting burdensome regulation and supervision
- Reducing disclosure requirements in scope and granularity
- Keeping current simplified methods for counterparty credit risk
- Removing supervisory approval for redemption of MREL

(5) Fostering the growth and innovation dimension of RPP
- Reviewing the regulatory restrictions to trade finance
- Reviewing the risk weight of Collective Investment Undertaking (CIU)
- Reviewing the calibration of counterparty credit risk (CCR) to avoid increasing the cost of hedging

[24] Minimum Requirement for own funds and Eligible Liabilities
(The aim of both TLAC and MREL requirements is for institutions to have a sufficient amount of bail-inable loss absorbing liabilities in the case of a possible resolution. The TLAC requirements determined by the FSB apply to G-SIBs, while the EU regulated MREL applies to all European banks.)
[25] Maximum Distributable Amount

- Removing the deduction of software from banks' regulatory capital
- Maintaining and extending the SME supporting factor
- Replicating the supporting factor for infrastructure projects

(6) The fast-tracking of some key reforms

- The ranking of unsecured debt instruments in insolvency hierarchy
- The transitional approach to mitigate IFRS 9 impact on capital
- SME and infrastructure supporting factors
- The transitional arrangements for the large exposure limits applied to sovereign exposures of member states denominated in non-domestic currencies

The EBF asked the Vice-President of the European Commission to *postpone* the ***introduction of the new requirements for the trading book,*** and to ***reconsider the transposition of the NSFR*** until a final agreement has been reached in Basel.

The EBF summarized its ***recommendations for modifying the comprehensive review of the trading book***, and its ***proposals for managing partner risk in a separate document***. It will not disclose the technical recommendations for the trading book regulation, until a decision has been made concerning its postponement.

European decision makers are influenced by the fact that in accordance with Republican recommendations and the Mnuchin report (published in June) in the United States, as expected by Wall Street an easing will take place in financial regulation, and steps will be taken backwards in many ways with respect to the from the Dodd-Frank Act adopted after the crisis. The power of the Consumer Financial Protection Bureau (CFPB) have been significantly cut. The ***USA will delay the implementation of the FRTB and the NSFR*** until the Basel Committee comes to a decision. Only internationally active banks will be able to apply the LCR, and resolution plans will only have to be made every two years. At the same time, in order to improve the competitive position of US banks, they support the introduction of a limit on the output of internal models – opposed by EU banks.

II.3 The Banking Union

II.3.1 The Single Supervisory Mechanism (SSM)

In relation to the SSM, it is worthy of mention that Daniele Nouy, chair of the ECB Supervisory Board at the hearing of the European Parliament's Economic and Monetary Committee argued that – similar to the practices of the USA and the UK – ***European banking supervision should be extended to large investment firms***, which do activities similar to that of banks' and ***pose systemic risk***.

Harmonizing supervisory rules for less significant institutions (LSI)

After a professional consultation, the ECB published a guideline and a recommendation concerning the ***exercise of options and national discretions (ONDs) in less significant institutions***. The two documents are addressed to national competent authorities and the guidelines must be applied by the LSIs they supervise. The aim is to further harmonize supervisory practices, to ensure a level playing field and the smooth functioning of the euro area banking system as a whole while taking proportionality fully into account. The majority of options and national discretions must be exercised equally for LSIs and Sis. The 7 ONDs included in the guidelines are of general nature, while 43 of the ONDs in the recommendations must be applied through case-by-case analysis, according to a common method. In the case of the 8 recommendations, the LSIs developed a simplified method for alleviating the burdens on banks.

Supervisory Fee

The ECB has estimated that ***the total costs associated with its prudential supervision of the banking system 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.
The supervisory fees have increased about 10% compared with 2016. Fees for directly supervised banks will amount to 92% of the total fees, while indirectly supervised banks' fees will decreased compared to last year. Increase in expenditure relates to the different activities identified by the ECB as supervisory priorities for 2017. Predominantly, the increase relates to work associated with the targeted review of internal models (TRIM). Fees also reflect an increase in the number of supervisory staff members due to an increased workload. Banks will receive their individual fee notices in October.

In early June, the ECB started a public consultation (with a deadline of July 20th) for reviewing its directive on supervisory fee payment.

Guide to determining the suitability of banks' board members

In mid-May, the ECB published a ***guide to clarify the supervisory criteria and process for determining the suitability of banks' board members***[26] in order to unify supervisory practices. The document takes into account the comments received during the public consultation, and thus further clarifying on the theoretical and practical experience and time commitment required of board members, as well as explaining potential conflicts of interest in more detail. The ECB aims to harmonize the evaluation process of the SSM while taking into consideration the differences arising from national legislation. The ECB was in close collaboration with the EBA while putting together the guide that is why the document used in SSM is in line with the draft guidelines of EBA on the assessment of the suitability of members of the management body and key function holders. Any changes to those guidelines as a result of the consultation may therefore lead to changes in the ECB guide.

Guidance on leveraged transactions (LT)

The guidance, which was published in May as closure to the public consultation held in the subject, the seeks to ***facilitate the identification of LT by means of an overarching definition encompassing all business units and geographical areas***, so as to give a bank's senior management a comprehensive overview of the bank's leveraged lending activities. It also outlines expectations regarding the risk management and reporting requirements for leveraged transactions. The more stringent risk management of exposures classified as LT strengthens banks' ability to operate lending to leveraged borrowers through the entire business cycle. Safe and sound origination practices enable the smooth financing of the real economy.
The guidance applies to the significant institutions of the SSM. The contents of the guidance should be applied by adhering to the principle of proportionality and taking into account institutions' LT lending proportions.

Second stocktake on the national supervisory practices concerning the management of non-performing loans (NPL) and its legal frameworks

In its report in September, the ECB examined the practices of eight countries within the banking union, in general those with high NPL rates. The reviewed report, which was published in June was complemented by the analysis of the NPL management in the remaining 11 countries, and therefore

[26] fit and proper

an assessment of all member countries' state at December 31, 2016 was made. One of the key lessons of the report is that it is necessary to be ***proactive and adequately prepared before NPL levels become elevated***. Stakeholders should make preparations in quieter times, so that they are prepared when needed. Current legal backlogs relating to insolvency and debt restructuring in a number of jurisdictions with high NPL levels can, for example, be traced back to a ***failure to establish out-of-court settlement frameworks*** in quieter times. Many jurisdictions with high NPL levels had implemented strategies and taken actions to address the issue since the first stocktake. In certain cases they have also established the legal frameworks, however, changes are taking place gradually, and therefore the time that has passed since is not enough to determine their effectiveness. It is important to mention that the ECB's guidance on NPL management is also used in the NPL management of less significant institutions.

In the euro area there are about more than 900 billion worth of NPLs. To solve the NPL problem, which puts a severe burden on European banks, Andrea Enria, Chairman of the EBA recommended the establishment of a ***Pan-European asset management company***.

Crisis management

This June, 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 SRB[27] concluded that the resolution of the bank was a public interest. The solution was the sale of Banco Popular to Banco Santender S. A..
The second time the ECB declared that two Italian banks, Veneto Banca and Banca Poplare 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 will be liquidated according to Italian regulations. (The Italian state will undertake to pay EUR 17 billion for the liquidation process. The Intesa Sanpaolo will buy the assets of the two banks to be shut down for one Euro. The state will grant EUR 4.8 billion in cash with an EUR 12 billion guarantee. The actual net expense of the state will be significantly less than the nominal sum.)
Assessing the initial experiences in connection with the above mentioned failures of banks, Ignazio Angeloni (member of the ECB Supervisory Board) concluded the following:

- ***The crisis management mechanism works,*** as visible through its operation; decision makers were able to achieve fast and efficient coordination.
- It is of fundamental importance that the ***failing of an institution be declared at the right time***.
- The ***danger of contagion has not materialized*** in the above cases. Deposits flowed to stable institutions, the market mechanism worked.
- ***Opinions on what happened differ***. Some analysts say that the interference of the state in the liquidation of banks (and the rescue of senior bond holders) is a breach of EU resolution regulation, although – according to the Commission – it complies with requirements on state aid.

II.3.2 The Single Resolution Mechanism (SRM)

The ***Single Resolution Board*** (SRB) is focusing on the ***operationalization of resolution plans in 2017. 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***

[27] Single Resolution Board

resolution is another important priority, they will continue exercise within the Banking Union, have table-top discussions with relevant authorities within the Eurozone, and do trilateral exercises with the USA and the United Kingdom. They will start developing binding MREL targets at consolidated ***level*** for all major banking groups and strictly adhering to the ongoing EU legislation process (RRP),they will address the problem concerning the quality of MREL within a group.

It is of key importance for the SRB to take into account their most recent ***experiences with resolution cases***. It is thus, that the European Commission authorized the ***precautionary recapitalization*** of Monte dei Paschi di Siena. The relevant regulation is included in the BRRD, however, this may change during ongoing modifications. Elke Kőnig, Chair of the SRB mentioned the following takeaways that are already evident:

1. There are strong advantages to a ***Moratorium Tool*** covering all liabilities.
2. Ad-hoc ***availability of liability data*** is crucial to obtain a full picture of the situation. Banks need to build the relevant IT infrastructure to provide this kind of data at the push of a button in times of crisis.
3. Acquisition by a strong buyer is not always a possible resolution method. ***Open bank bail-in is only viable with adequate liquidity support.***
4. ***Cross-border cooperation is of vital importance***. (Even concerning the Spanish bank with mainly European activity, cooperation with US authorities was a defining factor.)
5. ***It must be ensured that incentives are set correctly.*** The Commission's 2013 banking communication on the state support for banks should be reviewed with regard to experiences gained through the BRRD.

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. The establishment of an ***effective common financial backstop*** is also on the agenda.

II.3.3 The European Deposit Insurance Scheme

In its June report for the Council, the Maltese presidency recounted its activities in relation to establishing an Ad Hoc Working Party (AHWP) for strengthening the banking union. ***The AHWP,*** which worked on the technical details of EDIS, ***analyzed the responses to the survey performed by the Slovak presidency, primarily the feedback in relation to various sections of the Commission Services Effects Analysis on EDIS, the interaction between EDIS and options and national discretions (ONDs) under the***

Deposit Guarantee Scheme Directive (DGSD). Based on the responses the areas beow are where further work was considered relevant:

(a) Risk-Based Contributions;
(b) Alternative and Preventive measures;
(c) Irrevocable Payment Commitments (IPCs);
(d) Scope of EDIS;
(e) Institutional Protection Schemes (IPSs);
(f) Temporary High Balances (THBs)

In addition, the technical aspects of accession to and departure from EDIS also need clarification. A number of delegations requested additional analysis by the Commission on whether and how EDIS would impact the EU internal market. The presidency also conducted a ***technical discussion on the design of EDIS***, ***considering alternative design elements***.

II.4 The Capital Markets Union (CMU)

II.4.1 Simplifying the regulation on prospectuses for the issuing of securities

On 16 May 2017, the European Council adopted new rules on ***prospectuses for the issuing and offering of securities.*** The new rules are aimed at ***lowering*** one of the main regulatory hurdles that companies face when issuing equity and debt securities. Replacing directive 2003/71/EC, the ***prospectus regulation*** sets out to simplify administrative obligations related to the publication of prospectuses but in a manner that still ensures that investors are well informed. The regulation is another element contributing to the improvement of the business environment, so important for realizing a capital markets union in Europe and will help enable a strengthened role for market-based finance, alongside bank finance, in the funding of European companies.
The European Parliament approved the text on April 5, 2017, following an agreement between Council and Parliament representatives on 7 December 2016. Most provisions will apply 24 months after entry into force.

II.4.2 Money market fund rules

The aim of EU rules to be introduced on money market funds, is to support the role that the €1 trillion market plays in financing the economy. The regulation adopted by the European Council and the European Parliament aims to ensure the ***smooth operation of the short-term financing market***. This follows initiatives by the G20 and the Financial Stability Board. The new rules will go a long way in improving the supervision and regulation of a largely unregulated sector. Whilst money market funds are vital to investors and issuers alike, the crisis showed us that they can also be vulnerable to shocks.
The regulation lays down rules and common standards to:

- ensure stability in the structure of money market funds;
- guarantee that they invest in well-diversified assets of a good credit quality;
- increase the liquidity of money market funds, to ensure that they can face sudden redemption requests.

The European Parliament approved the text on April 5th, the Council approved it on May 16th and provisions will apply 12 months after its entry into force.

II.4.3 Agreement on securitization

On 30 May 2017, the presidency reached agreement with European Parliament representatives on proposals aimed at facilitating the development of a *securitization market in Europe*. A framework for securitization is one of the main elements of the capital markets union. Developing a securitization market will help create new investment possibilities and provide an additional source of finance, particularly for SMEs and start-ups. The initiative will encourage financial market integration in Europe and make it easier to lend to households and businesses.
The proposals make it possible to ***differentiate the management of simple, transparent and standardized (STS) products***. The concept of STS refers not to the underlying quality of the assets involved, but to the process by which the securitization is structured.
One of the most important elements of the regulation is the so-called ***risk retention requirement***. This refers to the interest in the securitization that originators, sponsors or original lenders of securitizations need to retain themselves. The requirement will ensure that securitized products are not created solely for the purpose of distribution to investors. The negotiators agreed to set the risk retention requirement at 5%, in accordance with the relevant existing international standards.
Other elements agreed with the Parliament include:

- ***the creation of a data repository system for securitization transactions,*** which will increase market transparency***;***

- ***a light-touch authorization process for third parties*** that assist in verifying compliance with STS securitization requirements.

The agreement with the Parliament covers two draft regulations:

- one setting rules on securitizations and establishing criteria to define STS securitization;
- the other amending regulation 575/2013 on bank capital requirements.

II.4.4 Mid-term review of the Capital Markets Union – building on the first round of achievements

After announcing its consultation 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:

1. strengthen the powers of European Securities and Markets Authority (ESMA) to promote the effectiveness of consistent supervision across the EU and beyond;
2. deliver a more proportionate regulatory environment for SME listing on public markets;
3. review the prudential treatment of investment firms;
4. assess the case for an EU licensing and passporting framework for FinTech activities;
5. present measures to support secondary markets for non-performing loans (NPLs) and explore legislative initiatives to strengthen the ability of secured creditors to recover value from secured loans to corporates and entrepreneurs;
6. ensure follow-up to the recommendations of the High Level Expert Group on Sustainable Finance;
7. facilitate the cross-border distribution and supervision of UCITS and alternative investment funds (AIFs);
8. provide guidance on existing EU rules for the treatment of cross-border EU investments and an adequate framework for the amicable resolution of investment disputes;
9. propose a comprehensive EU strategy to explore measures to support local and regional capital market development.

In addition, the Commission will advance on outstanding actions under the 2015 Action Plan. In particular, the Commission will put forward:

1. A legislative proposal on a pan-European personal pension product to help people finance their retirement;
2. A legislative proposal for an EU-framework on covered bonds to help banks finance their lending activity;
3. A legislative proposal on securities law to increase legal certainty on securities ownership in the cross-border context.

In its press release, the European Banking Federation responded to the Mid-Term review of the Capital Markets Union, emphasizing that special EU level measures need to be taken to introduce regulations concerning insolvency, financial education and securitization.

After the CMU Mid-Term review, the first concrete step was taken by the Commission by proposing a more robust supervision of central counterparties (CCPs).

II.5 Agreement on the involvement of consumers in policymaking

On February 14, 2017, representatives of the Council and the European Parliament reached agreement on a program to promote the involvement of consumers in policymaking in financial services. Grants will be provided to ***two non-governmental organizations*** (NGOs) - Finance Watch and Better Finance - ***to support activities that encourage the involvement of consumers and other end-users in policymaking.*** The program will also contribute to the information of consumers about issues at stake in regulation of the financial sector. The program will have a financial envelope of ***€6 million until December 31, 2020*** to realize its aims. The relevant regulation was adopted by the Parliament on April 27, 2017, and was approved by the Council on May 11th.

II.6 Relevant EBA and ESAs[28] documents published in Q2

Guidelines
Final guidelines on the interrelationship between the BRRD and CRR/CRD (EBA/GL/2017/02)
Final guidelines to assess Information and Communication Technology (ICT) risk (EBA/GL/2017/05)
Final guidelines on credit institutions credit risk management practices and accounting for expected credit losses (EBA/GL/2017/06)
ESAs AML/CFT guidelines (Guidelines on risk factors and simplified and enhanced customer due diligence) (ESAs/JC/2017/37)

Consultation papers
ESAs consultation paper on draft Guidelines to prevent terrorist financing and money laundering in electronic fund transfers (JC/GL/2016/16)
Consultation paper on security measures for operational and security risks under the PSD2 (EBA/CP/2017/04)
Consultation paper on draft RTS on simplified obligations for recovery and resolution planning (EBA/CP/2017/05)
Consultation paper on draft recommendations on cloud outsourcing (EBA/CP/2017/06)
Consultation paper on the scope of draft guidelines on connected clients (EBA/CP/2017/07)
ESAs consultation paper on technical standards to strengthen group-wide money laundering and terrorist financing risk management (EBA/CP/2017/08)
Consultation paper on draft RTS on central contact points under PSD2 (EBA/CP/2017/09)

Regulatory and implementing technical standards
Amended implementing technical standards on supervisory reporting (EBA/ITS/2017/01)
Implementing Technical Standards on amendments to FINREP due to IFRS 9 (XBRL taxonomy 2.7 for supervisory reporting)
Amended technical standards on benchmarking of internal approaches
Final draft Technical Standards under the Payment Accounts Directive to enhance transparency and comparison of payment account fees (EBA/RTS/2017/04), (EBA/ITS/2017/03), (EBA/ITS/2017/04)
Final technical standards on valuation in resolution (EBA/RTS/2017/05), (EBA/RTS/2017/06)
Draft amending technical standards on CVA proxy spread (EBA/RTS/2017/07)
ESAs central contact point standards in fight against financial crime (ESAs/JC/2017/08)

Opinions
Opinion on own funds in the context of the CRD CRR review proposal (EBA/OP/2017/07)
Opinion on EU Commission consultation on the operation of the ESAs (EBA/OP/2017/08)
Opinion in response to the European Commission intention to amend the EBA Technical Standards for open and secure electronic payments under the PSD2 (EBA/OP/2017/09)

[28] European Supervisory Authorities

Discussion Papers
Discussion Paper on the treatment of structural FX (EBA/DP/2017/01)

Reports and other documents
Risk Dashboard Data as of Q4 2016
EBA Pillar 2 Roadmap
Report on the Peer Review of the ITS on supervisory reporting requirements
ESAs report on risks and vulnerabilities in the EU financial system
Fifth updated list of CET1**capital instruments**
Details of 2017 EU-wide transparency exercise
2018 EU-wide stress test methodology for discussion
Revised list of ITS validation rules
2016 Annual Report
Response to the European Commission public consultation on FinTech
Instructions for 2016 CVA risk monitoring exercise
Consumer trends report 2017
Report on innovative uses of consumer data by financial institutions