HUNGARIAN BANKING ASSOCIATION

Agenda Item No. 2.

REPORT

on Activities of the Hungarian Banking Association

3th Quarter 2018

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I. Executive Summary

In Q3 of 2018 the ***global economy continued to grow as it has in the previous quarter***, however, in the past nearly half year there has been a steadily increasing risk of downturn. The IMF lowered its expectations for this year and the next by 0.2 percentage points, to 3.7%. High oil prices, the USA's trade policy measures and reactions to these have not yet had significant impact on global growth.
The ***protectionist measures and protective tariffs have not yet restrained growth in the USA***, but the possible response from trade partners may increase the risk of a global trade war. At the same time, lower taxes are slightly incentivizing the growth that is already in its mature cycle and which most likely continues to be fueled by internal consumption. Business investment is improving, although its ratio to the GDP still does not reach pre-crisis levels.
In Q3 in the ***European Union***, the business climate continued to deteriorate, as it has since the beginning of the year: this was also demonstrated by slower growth. Weaker performance was mainly caused by weaker industrial production and net export. As for future growth prospects, there are significant risks of a deceleration, mainly due to the danger of a trade war, internal political tension within large member states and at EU level, and Brexit, which seems to have an increasingly higher chance of happening without an agreement in place. ***Japan's*** growth is expected to slow down in the third quarter, though it will remain positive, while the growth rate of the ***Chinese economy*** will continue to decrease moderately.

Despite unfavorable global processes, the external environment of the Hungarian economy continued to be supportive in terms of growth and balance indicator prospects. Consumption dynamics may have mildly decreased due to a strengthening base, but they remained a significant factor of ***GDP growth***, as did investments. Due to a low base and new industry capacities, it is likely that industrial production dynamics will improve. ***Net exports*** performed worse than expected in the first two months of the quarter. Strong internal consumption, graver need for imports due to improving investment, and the summer period may have also played a role in this. With regard to the ***labor market***, the favorable rates of employment and unemployment have not seen considerable change; employment is now increasing at a slower rate because of the decreasing availability of labor force, which may actually pose limits for more and more sectors. Wage dynamics may remain high not only because of the rise in minimum wage and guaranteed minimum wage, but also due to increased market wages. The annual ***inflation*** rate continually exceeded the 3% target rate during the quarter; however, it did fall under the target level by the end of the year. The rise in demand resulting from higher wages still isn't noticeable in terms of prices. The lack of considerable inflationary pressure is visible in that core inflation remained under its target (2.4%).
According to the ***budget deficit on a cash basis*** calculated until the end of July, the previous trend continued: it reached nearly HUF 1,710 billion, which corresponds to 130% of the annual appropriation, due primarily to the pre-financing of projects to be implemented from EU funds from the national budget. According to the Ministry of Finance, the 2.4% target budget deficit calculated with the EU methodology can still be achieved by the end of the year. Although the robust surplus in the balance of trade is being moderated by increased internal demand, ***external balance*** indicators are showing a favorable trend.
Owing to new unconventional instruments introduced in the beginning of the year by the central bank of Hungary (MNB), the 0.9% ***base rate*** will remain persistently unchanged. The forint weakened slightly due primarily to external events, the ***EUR-HUF rate*** moved between 310-328 HUF for 1 EUR. The MNB Monetary Council announced that from the beginning of next year it will significantly alter its monetary policy instruments.

According to preliminary supervisory statistics, in July and August 2018 the ***aggregated balance sheet total of credit institutions*** grew by 0.9% (HUF 346 billion). On the ***liability side*** total gross

deposits grew by HUF 298 billion (1.2%). Domestic deposits basically stagnated (0.3%), while foreign deposits increased significantly (by 5.7%). The previous trend of shortening with regard to the average maturity of the deposit portfolio was turned around in the previous quarter and average maturity continues to lengthen both in the case of interbank and client deposits. The increase in deposits was significant for corporations (3.9%) and average for retail deposits, while there was a considerable withdrawal of deposits by state organizations (-9.3%, HUF 119 billion). ***Equity*** increased by HUF 107 billion (by 2.6%) in this period, more than profit did for the quarter.
Within ***assets*** the ***gross loan portfolio*** grew by 2.2% (HUF 449 billion) in July and August and by 2.6% (HUF 460 billion) not considering interbank credit. Impairment loss and valuation difference dropped by 3.5%, while the accumulated interest did not have any relevant impact on the portfolio, thus the ***net loan portfolio*** in total grew by 2.5% (HUF 485 billion). The moderate rise in lending was determined by the slow growth rate in the domestic portfolio (+1.9%), while growth was twice as big in foreign deposits. The gross loan portfolio of the non-financial corporate sector grew at an above average rate (by 3.8%, HUF 347 billion) which was aided by a smaller reversal of impairment loss than previously. The increase in household loans was once again less than average (1.7%, HUF 104 billion).
As a result of the above effects, the ***total net loan-to-deposit ratio of the credit institution grew to 82%***, and it also increased by one percentage point (to 79%) not counting interbank loans.
The ***profit*** before tax was down by almost 14% compared to the same period of the previous year and was slightly higher than HUF 420 billion. On an annualized basis, this reflects a 15.1% return on equity, and a 1.7% return on assets, which is just slightly less than in the previous year. Without dividend, provisions and impairment the profit was HUF 262 billion, return on equity and assets was only 9.4% and 1% respectively, which does however demonstrate improvement over the course of the year. Administrative expenses increased drastically, by more than 7% on an annualized basis, with staff costs showing a rise of 9%.

Based on the study conducted by Magyar Nemzeti Bank (MNB - the central bank of Hungary) the Funding for Growth Scheme and the Market-based Lending Scheme both contributed to incentivizing the ***SME*** lending market, however they did not have any significant impact on the lending structure. Based on the experience gained from these, at the beginning of 2019, the MNB will launch the ***Funding for Growth Scheme Fix (FGS fix),*** with a total amount of HUF 1,000 billion to finance new investments by SMEs. The MNB aims to improve access to financing for SMEs by also creating the ***Standardized Loan Application Interface*** too.

To avoid the excessive indebtedness of ***households***, the MNB amended its decree on the ***Payment to Income Ratio (PTI).*** In order to mitigate future risks, the MNB decree (in effect from October 1, 2018) has been fine-tuned and now differentiates between various loans based on payment to income ratio, according to interest rate period categories. The ***modification*** of the ***tender for Certified Consumer-Friendly Housing Loans*** (valid from October 1st as well) also aims to steer people towards ***loan products with fixed or with longer interest periodicity.***

The MNB also elaborated the ***MNB draft recommendation on determining the definition of a group of connected clients (client group)*** with the goal of implementing the European Banking Authority's relevant guidelines. After it consulted with the sector and considered the comments it received, the MNB modified several points of the draft recommendation. The sections referring to great exposure will have to be implemented from January 1, 2019, while the rest of the recommendation will have to be implemented from July 1, 2019.

Acting in its capacity as ***a resolution authority,*** the MNB started its ***preparations for setting the MREL***: it developed its concept for determining the requirement within the framework of relevant legislation and shared this with market players at a ***consultation***. The opinions of the parties concerned will be considered when definitively determining the fundamental principles for setting MREL and when determining individual MREL. The plan is to set and communicate individual MREL, in ***Q2 of 2019***, parallel with the requirements set by the Banking Union's resolution authority. A 4-year transition period (with intermediate targets and annual monitoring) will be provided to fulfil the requirements.

Upon requests from member banks, the Banking Association asked the relevant deputy governors of the MNB ***to revisit the scheduling of the HITREG (Central Bank Analytical Credit Register) launch.*** They will submit a proposal to the MNB directorate in consideration of the comments received, according to which HITREG reporting needs to be completed first in February 2020 and with data from December 2019.

The Banking Association's proposals for the ***omnibus act on amendments to certain acts affecting the financial intermediary system for legislative harmonization purposes***, including comments about ***securitization***, aim to aid in law enforcement, and to strengthen the coherence between the EU and Hungarian legal acts, in line with practical needs.
Parallel with the enactment of the ***act on simplified private bankruptcy***, the Ministry of Justice plans to amend the "normal" ***private bankruptcy act*** on the debt settlement of natural persons, to which the Banking Association has collected experts' comments based on their experience gained so far.
The new decree of the Ministry of Justice on the tariff for public notaries would have brought the significant increase of public notary fees, which would in turn have lead to a significant increase in costs for customers taking out a mortgage loan. In view of the consultations that have already been started, the Ministry of Justice postponed the new decree's entry into force from October 1, 2018 to January 1, 2019. New provisions will be developed instead of the tariffs that have already been adopted, but did not enter into force. The HBA strives to lessen the new decree's negative effects on the acquisition of housing properties.
In order to protect the interest of employees at bank branches the Banking Association initiated the amendment of the ***testimony rules for private documents with full probative value***, with a view to having the possibility to exclude the address of the witness from the document.

The most important project within ***payments*** is the creation of the ***instant payment system***, which is going according to plan. At the project's ***Information Forum***, the parties concerned received news about the results of the work done so far during the specification and implementation phases, about accepted requests for change and about plans for liquidity management. In addition, the list of documents to support the joining of banks was presented, as well as the timing for the tasks to be carried out in the time remaining until the launch of the system. The MNB is gathering ideas for a common name for the Instant Payment System, in order to establish ***a payment brand*** to be used in the long term., In collaboration with GIRO and with the participation of permanent invitees from MNB, the ***Payment application sub-working group*** created the content and regulatory system for the ***payment application*** service as a part of instant payment systems.
In line with the requirements of the ***payment accounts directive***, as the annex of the relevant government decree, the Bank account fee transparency sub-working group compiled the ***registry of the most typical services linked to payment accounts***, which consists of 20 items.
To implement the second payment services directive, the Banking Association created and operates the ***Strong (secure) customer authentication sub-working group***. Due to the large quantity and complexity of the issues that need to be clarified the sub-working group has been conducting even more intense work than originally planned.
Concerning consultation on the ***Széchenyi Recreation Cards (SZÉP cards),*** the sector aimed to achieve as ideal of a functionality as possible. As such, we managed to achieve that ***money transfers to SZÉP card accounts will be exempt from financial transaction levy***. The Ministry of Finance will initiate the amendment of the Judicial Enforcement Act to allow transfers by authorities on the limited-use accounts tied to SZÉP cards.
While compiling the Feasibility Study aimed at ***developing interbank cash trade***, we asked several IT developer firms for their offers. The offers received are currently being evaluated.

Regarding accounting, the Banking Association requested a consultation opportunity from the MNB in connection with the ***monetary policy purpose interest swaps*** (MIRS). We also sent our initiative to the Ministry of Finance to ***extend auditors' mandates*** from 8 business years to 10 years, since the 10 year rotating system has already been introduced in the majority of European Union Members States.

The most important ***developments within the Banking Association*** were: the preparation and approval of the HBA Competition Law Policy; the favorable first instance court decision in the BankAdat case; and preparations for the 2018/2019 Money Week.

Instead of making new proposals during this time period the ***global regulatory bodies*** focused on assessing the reforms made in the wake of the crisis, monitoring, and managing possible unintended effects. The ***Financial Stability Board*** (FSB) published a consultation report on the effects of reforms on the financing of infrastructure, while in collaboration with other competent regulatory bodies it announced a consultation on the effects of reforms on incentives to centrally clear OTC derivatives. In addition, the second report, which maps interdependencies between central counterparties was published. The FSB consulted on a Cyber Lexicon, which would aid the work of authorities and market players. Furthermore it compiled a report on the framework to monitor crypto-asset markets. At its meeting in September, the ***Basel Committee on Banking Supervision*** (BCBS) discussed current policy and supervisory issues, and assessed its members' implementation of post-crisis reforms.
The Committee discussed the results of the annual assessment exercise for global systemically important banks (G-SIBs), its revised assessment methodology and the higher loss absorbency requirement, as well as progress on revising the market risk framework. It also debated the joint document on the incentives to centrally clear OTC derivatives. Furthermore, the Committee is publishing a newsletter on leverage ratio window-dressing behavior and a Frequently Asked Questions on the treatment of "settled-to-market" derivatives in liquidity standards. The Committee once again reiterated its expectation of ***full, timely and consistent implementation of the Basel III standards for internationally-active banks***.

The most important development in ***European Regulation*** is that after the Council's and the Parliament's approval the trilogue began on the Risk Reduction Package of November 2016, aimed at modifying capital requirement and liquidity regulation (CRR/CRD4) and the rules for resolution (BRRD, SRMR). The European Banking Federation is actively lobbying to ensure the competitiveness of the sector, to support market liquidity and short term financing activities, to take full advantage of the EU Single Market and the Banking Union, to finance the European economy and innovation, and to make regulation and supervision fit for purpose and avoid unnecessary burdens for banks.
In compliance with the European Commission's request concerning the ***finalization of the Basel III reforms***, during the quarter, the European Banking Authority (EBA) published and finalized the data collection templates that its impact survey is based on. Banks who volunteered to participate had to send the data requested in October, with reference to June 30, 2018.
Within the ***Banking Union***, the ***Single Supervisory Mechanism*** (SSM) seems to be well-oiled, working well. In July, the European Central Bank announced further steps to be taken to reduce the stock of existing NPLs, and published a report on recovery plans. The SSM thematic review on profitability and business models was also published. The ECB launched a public consultation on its guide to internal models, as well as publishing—its guide to on-site inspections and internal model investigations. The establishment of the ***Single Resolution Mechanism*** (SRM) is going according to the Single Resolution Board's timing. Experience gained up until today suggests that in order for the SRM to function adequately it is important to provide the necessary liquidity, in addition to a financial backstop. According to the SRB Chair, in order to complete the Banking Union, it is essential

to create and to put in place an EU liquidation regime for banks. No progress was made on the European Deposit Insurance Scheme (EDIS) in the third quarter.

As time goes on it becomes more and more dubious if the goals set out for the creation of the ***Capital Markets Union*** will be achieved before the end of the mandate of the Commission and the Parliament. Out of the 13 legislative proposals submitted by the Commission since 2014, the Parliament and the Council approved only three: a well-justified reason to speed up the processes. A breakthrough has been achieved with regard to the ***Insolvency Directive***; therefore they are ready to start the trilogue. The discussion on the European Commission's proposal on the handling of ***covered bonds*** continues in the Council and the Parliament, and will hopefully come to a successful conclusion by the end of this year. The trilogue phase will probably end in the first half of 2019 as well.

II. Macroeconomic outlook: the operational environment of the banking sector

In Q3 of 2018 the ***global economy continued to grow as in the previous quarter***, however in the past nearly half year there has been a steadily increasing risk of downturn. The IMF clearly lowered its expectations for this year and the next, by 0.2 percentage points (to 3.7%). Money market conditions remain favorable at global level, although the differing monetary policy measures of leading economic nations lead to some uncertainty here as well. High oil prices, the USA's trade policy measures and reactions to these have not yet had significant impact on global growth.
The ***protectionist measures and protective tariffs*** announced and introduced by the president of America ***have not yet reached the level where they would restrict US growth***, however, the possible responses of large trade partners to these may increase the risk of a global trade war. This may damage calm business and willingness to invest in the mid-term, as opposed to lowered taxes that are slightly incentivizing growth, which is already in its mature cycle. Based on data about the labor market and salaries, consumption continues to be the main driving force behind growth. Tax reduction may have aided business investment in the short term, therefore the favorable trend of H1 continued, although their ratio to the GDP still does not reach values before the crisis, which is probably due to moderate dynamism in the construction of homes. In September, the Fed once again raised the reference rate by 25 base points (to 2.5%).
In Q3 in the ***European Union***, the business climate continued to deteriorate, as it has since the beginning of the year, which was demonstrated by slower growth. This weaker performance was mainly caused by worsening industrial production and net export, while internal consumption continues to have a positive effect, which is supported by favorable labor market data (unemployment is the lowest it has been in nine years, while the number of new jobs is at its highest). As for future growth prospects, there are significant risks of a deceleration, mainly due to the danger of a trade war, political tension within large member states and at EU level, and Brexit, which seems to have an increasingly higher change of happening without an agreement.
After outstanding growth in Q2, it is expected that ***Japan's*** growth will slow down in the third quarter, however ***growth will remain positive***. Internal consumption continued to grow moderately in this quarter as well, while net export increased, due to favorable foreign market demand. Concerning investment, it was mainly foreign capital investment which strengthened. Construction activity for the Tokyo Olympics also had a positive effect.
The ***growth of the Chinese economy*** likely ***continued to decrease*** in Q3. Internal consumption remains the main base pillar of growth, but its rate of growth continues to lessen, along with that of investments, and net export also restrains growth. China is visibly preparing intensely for the trade war. In order to avoid a decline in growth, it uses targeted measures to ease its carefully launched fiscal and monetary tightening, supports the investments of provincial governments and mitigates its instruments for restricting the credit growth of shadow banks.

Despite the unfavorable processes mentioned above, the ***external environment of the Hungarian economy still classifies as supportive*** in terms of growth and balance indicator prospects. ***Consumption*** dynamics may have mildly decreased due to a strengthening base, but according to expectations it will remain a significant factor in GDP growth. ***Investments*** continue to promote growth, with investments in the real estate, industrial and service provision sector each playing their part. Due to a low base in H1 of last year and new production industry capacities, it is likely that ***growth in industrial production will improve***. This is supported by favorable industrial trust indices and a recent surge in new industrial orders. These trends have not yet shown up in ***net exports*** which performed worse than expected in the first two months of the quarter. Strong internal consumption and graver need for imports due to improving investment and the summer period may have also played a role in this.

With regard to the ***labor market***, employment and unemployment have not seen considerable change: the former improved by 0.1 percentage point, while the latter declined by the same amount. Employment is now increasing at a slower rate because of the decreasing availability of labor force. This is due almost solely to job creation in the primary labor market. The lack of work force may actually limit more and more sectors; therefore ***wage dynamics*** may remain high not only because of the rise in minimum wage and guaranteed minimum wage, but also due to increased market wages.

The ***annual inflation rate continually exceeded the 3% target rate*** during the quarter, however experts expect it will become more moderate towards the end of the year. The surge in price quality was mainly due to the change in the price of fuel. In spite of this, in the coming months (as a result of the increasing base from a year before) the impact that fuel prices have on inflation will become less and less. Consequently inflation may fall below the 3% target rate by the end of the year. The rise in wages was 10% in July on a year-on-year basis, but with the exception of some subfields the ***rise in demand still isn't noticeable in terms of prices***. Its impact is probably compensated by persistently low imported inflation and the reduction of wage and enterprise burdens. The lack of considerable inflationary pressure is visible in that core inflation remained under the 2.4% target.
According to the ***budget deficit on a cash basis*** calculated until the end of July the previous trend continued. It reached nearly HUF 1,710 billion, which corresponds to 130% of the annual appropriation. This was caused primarily by the pre-financing of projects to be implemented from EU funds from the budget, in the amount of nearly HUF 1,150 billion by the end of July (the EU transferred HUF 162 billion from the HUF 1,309 billion financing). However, according to the Ministry in charge, the 2.4% target budget deficit calculated with the EU methodology (adjusted with EU pre-financing) can still be achieved by the end of the year, and the reduction of the budget deficit in proportion to the GDP can continue, despite the pre-financing of EU sources.
Although the robust surplus in the ***balance of trade*** is moderated by increased internal demand ***external balance indicators*** are showing a favorable trend. The capital account may improve considerably due to a rise in funds transferred by the EU, which may contribute to external financing capacity reaching 6% of the GDP.
At the beginning of the year the ***Magyar Nemzeti Bank (the central bank of Hungary)*** introduced new unconventional instruments which helped interbank forint liquidity, which remains significant, push the level of short term yields well below the 0.9% base rate. Short term yields might stay well below the base rate in the coming months too, which may have the result that the central bank base rate will not be effective until the mid term, staying persistently unchanged. According to the Monetary Council inflation developments don't indicate raising it either.
The MNB Monetary Council announced that from the beginning of next year it will ***significantly alter its monetary policy instruments***. The non-conventional instruments affecting short term yields will be simplified and the non-conventional tools affecting long term yields will be fine-tuned. The three-month deposit instrument will be phased out at the end of 2018 and a ***mandatory reserve will take over for the role of the benchmark instrument***. Looking ahead, the central bank will want to create the necessary monetary conditions to sustainably reach the target inflation through an optimal combination of a swap portfolio providing forint liquidity and the interest rate corridor. In addition, the IRS instrument for monetary policy and the mortgage bond acquisition program will be phased out by end-2018. In order to increase the ratio of loans with a fixed rate interest in SME lending, the MNB will introduce the Funding for Growth Scheme Fix from 2019, where it will sterilize liquidity with its preferential deposit construction, the interest of which is equal to the base rate.
The ***EUR-HUF rate*** rose moderately during the quarter due primarily to external events, moving between 310-328 HUF for 1 EUR.

According to supervisory statistics in July and August 2018 the ***aggregated balance sheet total of credit institutions*** grew by 0.9% (HUF 346 billion). Forint instruments basically remained stagnant (+0.2%). Foreign currency instruments differed in their changes, with the forint exchange rate shift

playing an insignificant part. The first two months of the third quarter saw a significant rise in the forint value of EUR stock (4.5%), while a fallback was visible for other foreign currencies (-2.4%).
On the ***liability side,*** apart from stagnating issued securities stock all important liability types increased. ***Total gross deposits*** grew by HUF 298 billion (1.2%). Within this, interbank deposits decreased (by 1.8%), while there was an above average increase in other deposit types (1.7%). Domestic deposits basically stagnated (0.3%), while foreign deposits increased significantly (5.7%), especially those related to the EU, where the increase value reached a two-digit number. The previous trend of shortening for the average maturity of the deposit portfolio was turned around in the last quarter and continues to grow at the time this report is written, which is visible through the 2.4% increase in deposits with a long term maturity in the case of both interbank and client deposits.
The increase in deposits was significant for corporations (3.9%, HUF 329 billion), while retail deposits increased at a more average rate (1.1%, HUF 102 billion). There was a considerable withdrawal of deposits in state organizations (-9.3%, HUF 119 billion). Restructuring was visible in interbank liabilities (which include interbank credit), concerning both those domestic and those foreign, while aggregated deposits stagnated.
Equity increased by HUF 107 billion (2.6%), more than profit did for the quarter.
Within ***assets*** all important asset types increased apart from interbank deposits. The growth of the credit portfolio was above average both counting interbank portfolio and without counting it.
The ***gross loan portfolio*** grew by 2.2% (HUF 449 billion) in July through August and by 2.6% (HUF 460 billion) not considering interbank credit.
The impairment loss and valuation difference dropped by 3.5%, while the accumulated interest did not have any relevant impact on the portfolio, thus the net loan portfolio in total grew by 2.5% (HUF 485 billion). The change in the forint exchange rates had an overall negative effect on the portfolio's amount. While the HUF portfolios produced a moderately above average increase (2.4%), the foreign currency portfolios showed differing results in forint value: they grew by 3.1% in the case of Euros and 1.8% in the case of other currencies). The slow rate of growth in the domestic portfolio (+1.9%) played an important part in achieving a moderate increase in lending, while compared to this foreign lending was twice this amount, which is due the growth of EU relations by two digits.

The gross loan portfolio of the non-financial corporate sector grew at an above average rate (by 3.8%, HUF 347 billion) which was aided by a smaller reversal of impairment loss than previously. The increase in household loans was once again less than average (1.7%, HUF 104 billion).
As a result of the above effects, the ***total net loan-to-deposit ratio of the credit institution grew to 82%***, while without interbank loans it also increased by one same percentage point (to 79%).
The ***profit*** before tax was down by almost 14% compared to the same period of the previous year and was slightly higher than HUF 420 billion. On an annualized basis, it reflects a 15.1% return on equity, and a 1.7% return on assets, which is just slightly less than in the previous year. Without dividend, provisions and impairment the profit was HUF 262 billion, with this calculation the return on equity and assets was only 9.4% and 1% respectively, which has however shown improvement over the course of the year. Administrative expenses increased drastically, by more than 7% both on a quarterly and annualized basis, with staff costs showing an annualized rise of 9%.

III. Corporate sector

According to the ***August issue of MNB's Trends in Lending*** "in 2018 Q2, the transaction-based growth in corporate lending continued, amounting to nearly HUF 240 billion. Accordingly, corporate loans outstanding have increased by a total HUF 750 billion in the past 12 months, yielding a growth rate of 12.1 per cent. Based on the preliminary data, lending to the SME sector in a narrow sense and taking into account the self-employed as well expanded, year-on-year, by nearly 16 per cent and by 14 per cent, respectively. Within the SME segment, the strongest expansion was observed in the case of micro corporations, with an increase of 22 per cent annually. The value of new contracts also rose significantly, by 19 per cent in the past year. There has been no major rise in the ratio of fixed-rate loans, especially in case of long-term loans, since the decline following the phasing out of the Funding for Growth Scheme: while in 2015, 80 per cent of HUF denominated SME loans with over 1-year maturity were disbursed with interest rate fixation, this ratio was only 20 per cent in the last one year. Convergence to the ratios observed in the more developed European countries would be desirable.

Based on banks' responses to the Lending Survey, credit conditions eased in all company size categories in Q2. According to banks' perception, the easing in conditions was reflected in a decline in interest rate spreads, and was primarily attributable to increased competition and favorable developments in economic prospects. Corporate credit demand tended to strengthen in the segment of longer-term loans. Looking ahead to the next half year, banks expect these trends to continue.

During the past year, corporate loans outstanding increased in all of the countries in the region, but the highest growth was observed in Hungary. Interest rate spreads declined in all the countries in the region in Q2."

The Funding for Growth Scheme

Based on the study conducted by the MNB in September and on the experience gained from the Funding for Growth Scheme (FGS) and the Market-based Lending Scheme in recent years these programs contributed to incentivizing the SME lending market, however they did not have any significant impact on the lending structure. When the programs ended, the ratio of long-term maturity, fixed rate loans decreased. Based on the experiences of the past years, the facilitation of lending in a healthier structure by the central bank may be implemented by returning to the FGS in a more targeted manner, since this scheme was able to exert material favorable impact both on the volume and structure of lending. Therefore, at the beginning of 2019, the MNB will launch the ***Funding for Growth Scheme Fix (FGS fix),*** with a total amount of HUF 1,000 billion. In terms of its most important parameters and its operation, the new scheme will be identical with the previous phases of the FGS. Accordingly, the MNB will provide credit institutions with refinancing funds at 0 interest rate, which they lend further to SMEs to finance new investments in forint at a maximum margin of 2.5 percent

The Standardized Loan Application Interface

Based on the international and domestic experiences, the complexity of the loan application process causes problems to many small and medium enterprises, including also banks' different and occasionally vaguely communicated requirements. Simplification of the loan application procedure of the SMEs is very important to the MNB and they believe that it would enhance both appetite to borrow and bank competition if there were an ***electronic interface through which the micro and small enterprises could submit their loan application in the same format to several banks in parallel*** and the participating banks had to provide an offer within a few days in a comparable format. In order to create this, the SME working group consulted with MNB representatives several times during the quarter. Our working group members got the chance to fill out a ***questionnaire***, compiled by the MNB. The questionnaire was, on the one hand conceptual, having questions about business parameters, while also referring to data on the standardized loan application form (and the offer given by banks) on the other. After having assessed the collected opinions, the MNB consulted with the Hungarian Banking Association and other organizations concerned. The concept also includes the creation of a brochure that contains useful information on borrowing and a clear guide on each step of the loan application process.

IV. Retail sector

According to the August issue of MNB's Trends in Lending "in 2018 Q2, as a result of transactions, household loans outstanding increased by HUF 159 billion, mainly due to the contribution of the housing loan segment. Accordingly, the transaction-based annual growth rate rose to 4.1 per cent, representing the strongest expansion in the new credit cycle to date. The increase in loans outstanding is supported by the still rising volume of new loan contracts: annual average growth in new disbursement was 31 per cent, and within that the expansion in the value of housing and personal loans amounted to 39 per cent and 48 per cent, respectively. Lending dynamics are supported by the slight easing of borrowing standards and the expansion in demand. The contribution of the Home Purchase Subsidy Scheme for Families to borrowing for housing is positive. The scheme is still popular: 16 per cent of housing loans borrowed were related to this subsidy in terms of volume. The ratio of loans with longer interest rate fixation also increased compared to variable-rate loans or loans repricing within a year: this share already amounted to 82 per cent in Q2. Certified Consumer Friendly Housing Loan products became increasingly popular during H1, reaching a share of 53 per cent within the fixed-rate housing loans issued. Within new housing loans, the most popular product is the 5-year interest rate fixation, and with the spread of Certified Consumer-Friendly Housing Loan products the interest rate spread on loans with longer interest rate fixation declined in the period under review. Thus interest rate spreads on loans with 1-5 years initial fixation reached the level of variable rate loans, and in the case of loans with over 5 years fixation it approached to 0.2 percentage point of that level."

Consultation on fine-tuning the Payment to Income Ratio (PTI)

The aim of the ***Payment to Income Ratio (PTI)*** is to avoid excessive indebtedness. The PTI ratio demonstrates ***the percentage of income that may be mortgaged***. By modifying the PTI ratio the central bank of Hungary aims to manage the interest rate risk of household mortgages. Before it finalized the modifications, MNB held several rounds of consultations with the Banking Association. The relevant MNB decree will be amended in two parts with regard to its temporal scope. Starting from October 1, 2018 ***categories based on interest rate periods have been added*** to the Payment to Income Ratio, in addition to the differentiation categories according to the amount of income and type of currency. Furthermore according to the amendments, which will enter into force on July 1, 2019 the minimum income to be eligible for the higher PTI ratio will be raised from HUF 400 thousand to 500 thousand.

The table below shows the modifications made to the PTI ratio for HUF loans:

Monthly net income	Interest rate period		
	Variable interest -	Over 5 - 10 years	10 years - until the end of the

	under 5 years		periodicity
Under HUF 400 thousand (HUF 500 thousand from July 1, 2019)	25%	35%	50%
HUF 400 thousand or more (HUF 500 thousand from July 1, 2019)	30%	40%	60%

Source: MNB

In order to ensure a smooth transition and to answer practical questions, the HBA also commented on the ***Frequently Asked Questions*** documents.

The modification of the Certified Consumer Friendly Housing Loans tender

The conditions of the tender for Certified Consumer-Friendly Housing Loans were modified: the new conditions are valid from October 1st. The MNB consulted the Hungarian Banking Association several times in connection with the issue. According to the modifications, ***loan products with a 3 year maturity will be phased out, while products with a 15 year maturity will become certifiable***. In addition, it become possible to ***temporarily suspend individual loan certifications*** in the case of smaller, lighter breach of conditions, which are however in urgent need of correction. Other, smaller technical amendments were also made to the decree.

Interpretation of the law related to the Family Housing Allowance **(CSOK)**

In the third quarter, the Ministry of Finance issued ***professional guidance with a view to ensure uniform interpretation of the law related to state aid for housing purposes*** (the Family Housing Allowance) on the subjects of the calculation of useful floor area, the heatability of premises and the verification of the social insurance legal relationship obtained in the EEA state parties.
On the basis of this guidance on the calculation of ***useful floor area,*** both for second hand and new properties, the part of the net floor area is to be considered where the internal headroom is at least 1.9m, in a manner that provisions on the design of premises set out in *Government Decree 16/2016 (II.10.) on the housing aid related to the building and purchase of new flats* must also be taken into consideration. For second hand flats, premises with 1.9m headroom count towards the useful floor area; however, only premises listed in *Government Decree 17/2016. (II.10.) on the family housing allowance that can be applied for the purchase or extension of second hand flats* may be taken into account.
This guidance states that, with regard to the ***heatability of the flat's premises,*** in addition to the expectation of central heating, a heating system for each room may also be accepted where the heating equipment is an inseparable part of the flat.
With regard to the verification of a ***social insurance legal relationship obtained in the EEA state parties,*** the ministry sets the eligible forms of verification of the social insurance legal relationship in accordance with the decision of the European Commission.

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

Amendments to certain acts affecting the financial intermediary system for legislative harmonization purposes

The documentation on the ***amendments to certain acts affecting the financial intermediary system for legislative harmonization purposes*** was sent by the Ministry of Finance in three parts to the Banking Association for consultation; then a consolidated so-called „***omnibus act***" arrived from the Ministry of Finance, discussed by several working groups at the Banking Association (Legal Working Group, Payments Working Group etc.). On the basis of the observations received from the member banks to the partial materials and the omnibus act, we have made numerous proposals for amendment, which aimed, in their nature, at ***helping aw enforcement***, and ***strengthening the coherence between the EU and Hungarian legal acts***, in line with the practical needs. We made proposals, amongst others, in the context of the amendments to the *act on investment firms and commodity dealers and the rules of activities they can pursue*, *act on the provision of payment services*, *act on credit institutions and financial undertakings*, *act on consumer loans*, *act on the financial transaction tax,* and on the *act on capital markets*. Further to our observations, professional consultation also took place in the Ministry of Finance.

Securitization is a significant novelty in the Hungarian legal system, more precisely the specific regulation ***of true sale securitization other than STS securitization***[1]; the EU leg of certain general rules is the *Regulation (EU) 2017/2402 of the European Parliament and the Council*. During the consultations, we made proposals, amongst others, for the coherent identification of debt transfer in order to comply with the regulation corresponding to the structure of the true securitization, and at the same time for the deletion of the contract transfer, in the context of the operation of special purpose vehicles (SPVs) to expressly state in the Credit institution act the express exemption from bank secrecy with a view to spread such transactions, and for the liquidation of SPVs to stipulate a liquidator licensed for it.

With regard to the act *on the further development of the institutional system serving the safety of certain actors of the financial intermediary system*, we signaled, amongst others, that we ***do not support shortening the deadline allowed to remedy the obstacles to resolvability***, and that ***they wish to restrict the option to consult with the European Banking Authority***, if the assessment by the resolution authorities of the parent undertaking and the subsidiary for the MREL[2] requirement differs by 1 percentage point.

Consultations on the act on simplified private bankruptcy; amendment to the act on debt settlement procedure ("normal private bankruptcy")

The consultations on the *act on the simplified debt settlement of private individuals affected by a significant payment default* - ***the*** so-called ***simplified private bankruptcy*** – continued in the third

[1] simple, transparent and standardized securitization
[2]Minimum requirement for own funds and eligible liabilities: a minimum requirement for liabilities that can be written off or bailed-in upon resolution

quarter between the Ministry of Justice and the Banking Association. The draft law was discussed again by the Private Bankruptcy Working Group.

Parallel with the enactment of the act on simplified private bankruptcy, the Ministry of Justice plans to amend the ***private bankruptcy*** *act on the debt settlement of natural persons,* adopted in 2015 and unchanged ever since. The Banking Association has collected the opinions and proposals based on the experience related to that act from the experts of the Private Bankruptcy Working Group, and based on this it conducts consultation with the ministry with a view to ensure as simple and efficient as possible operation of debt settlement procedures after the amendment of the act.

Amendment to legislation on the procedure of public notaries

The Banking Association's Legal Working Group has discussed the proposal from the Ministry of Justice for the amendment of the *act on public notaries* and the *act on certain non-contentious procedures*. In connection with that amendment, on the basis of the observations received from our member banks, we made the proposal to allow not only for legal person parties acting with a legal representative to ***jointly request dispensation with the reading out of the document***, but also for ***natural person parties acting with a legal representative*** and also for ***legal person parties acting without a legal representative***. This solution would ensure greater flexibility for law enforcement, and at the same time it takes into account the circumstance that, in the event of a loan agreement with interest subsidy, the law has earlier not provided for a legal representative for the parties requesting dispensation with the reading out.

Adoption of a new Ministry of Justice Decree on the tariffs of public notaries

Decree 22/2018. (VIII. 23.) of the Ministry of Justice on the tariff for public notaries (hereinafter the new decree) was published on 23 August 2018 in the Official Gazette of Hungary, with an envisaged entry into force on 1 October 2018, when *Decree 14/1991. (XI. 26.) of the Ministry of Justice on the tariff for public notaries* would have been repealed. On the basis of the new regulation, a significant increase of public notary fees, payable by customers, would have taken place, which would lead to a significant increase in costs for customers taking out a mortgage loan.

The banking sector was not involved in the adoption of the new decree in any form, thus it had no opportunity to express its opinion on also decreasing the costs of customers, and to make other observations or proposals. This procedure is not in line with the requirements on the consultation on legislation and the strategic partnership agreements. We have therefore requested the Minister in writing to provide the Hungarian Banking Association, in each case in the future, with the draft laws similar to the decree on public notary fees that have a significant effect on lending processes, for consultation. In addition we proposed that consultation should take place between the Ministry and the representatives of the Hungarian Banking Association in order to enable the ***mitigation of the negative effects of the new decree for the acquisition on housing properties***.

In view of the already started consultation, the Ministry of Justice has postponed the new decree's entry into force to 1 January 2019. New provisions will be developed instead of the tariffs, which will not enter into force, in which the opinion of the Hungarian Banking Association will be taken into account.

Amendment to the legislative provisions on private documents with full probative value

The seventh amendment to the Fundamental Law entered into force on 29 June 2018, which ***identified the citizens' right to privacy, respect for family life and home as a fundamental right***, by amending Article VI. According to the effective text of Article VI, the state grants legal protection to the peace of home. Everyone shall have the right to have his or her private and family life, home, communications and good reputation respected. Freedom of expression and exercising the right of association may not prejudice the private and family life and home of others.

The appearance of rights to privacy in the Fundamental Law justify amendments in the lower levels of the hierarchy of legal acts with the view to enforce properly the right to the protection of home and private life. The member institutions of the Hungarian Banking Association identified as an area in need of amendments ***the testimony rules for private documents with full probative value***, in which context the Banking Association has sent an amending proposal to the Ministry of Justice and to the Ministry of Finance with regard to the *act on the Civil Procedure*, *the act on the Real Estate Register*, and *the act on credit institutions and financial undertakings*.

In an eventual official procedure, ***the indication of the witness's address or place of residence*** is supposed to ensure that the witness may be summoned. Contracts between financial institutions and their customers are typically concluded in the form of a private document with full probative value, and ***mostly employees working in the branch act as witnesses***. Financial and social tensions accompanying the world economic crisis materialized in numerous cases as attacks against bank employees who acted as witnesses, occasionally going beyond verbal attacks. The primary locations for these attacks are bank branches; however, in numerous cases the private homes of bank administrators releasing their addresses became targets for harassment. Incidents jeopardize the administrators' private and family lives and homes, therefore it requires intervention from the legislator, in the Banking Association's opinion. Out of the two contrary interest - the protection of privacy and ensuring summonability - the latter may be achieved by other means, therefore the Banking Association suggested that, in transactions between financial institutions and their customers, ***the address of the employee and the personal identification official document's type and number would be jointly indicated*** rather than the address of the witness to the document. With this amendment, the protection of privacy afforded by Article VI of the Fundamental Law and the summonability of witnesses would also be ensured.

VI. Developments concerning the central bank of Hungary

Consultation on MREL regulation

It is the priority of the central bank of Hungary (MNB) to maintain the stability of the financial intermediary system, to strengthen its crisis management capacity and to build and sustain a sufficient backstop for stability. To fulfil these tasks the MNB's relevant directorate held a market consultation in July on the ***Minimum Requirement for Own Funds and Eligible Liabilities (MREL).***

To improve crisis management capacity the ***MNB in its role as a resolution authority***, started its ***preparations for setting the MREL***: it ***developed its concept for determining the requirement*** within the framework of relevant legislation and shared this with market players at the consultation.
Presenters at the consultation discussed the ***aim and timeliness*** of the MREL regulation, ***general and legislative frameworks*** for setting the MREL, covering the criteria of ***MREL competent requirements,*** as well as determining the ***recapitalization amount*** (RCA), and within this, the ***market confidence charge*** (MCC), and the ***loss absorbing amount*** (LAA). They also discussed the MNB framework for determining the ***quantity*** of MREL and the ***quality*** of MREL sources in detail. According to timing plans, the setting and communication of individual MREL, will take place in Q2 of 2019, parallel with the requirements set by the Banking Union's resolution authority. A ***4-year transition period*** (with intermediate targets and annual monitoring) will be provided to fulfil the requirements.
The definitive determination of the fundamental principles for setting MREL and the setting of the MREL themselves will be carried out after having consulted with the parties concerned and after having considered their opinions.

Recommendation for managing connected clients

The central bank of Hungary elaborated the ***MNB draft recommendation on determining the definition of a group of connected clients (client group) in accordance with the Capital Requirements Regulation***[3]. The goal of this is to implement the European Banking Authority's relevant guidelines (EBA/GL/2017/15) on clients in Hungary.
In compliance with the CRR, the recommendation will apply to credit institutions and investment firms (hereinafter institutions). Clients of institutions may belong to one client groups due to ***control*** and ***economic dependencies***. The MNB draft recommendation determines the main criteria for these based on the EBA guidelines. The CRR uses the term "group of connected clients" for ***determining the limit for great exposure***, however, according to the recommendation, it is useful to utilize the definition in all cases where the CRR mentions a group of clients. The MNB recommendation also sets out the expectation that institutions' decisions in connection with great exposure should be made at the highest decision forum for credit risk. According to the draft recommendation, the MNB expects institutions to implement the recommendation form January 1, 2019.

Based on banks' comments on the draft decree, the MNB called for an in-person consultation, where they discussed problems based on the following five issues raised by the vice-president of the HBA: (i) the consolidation of client groups, big risk limits are reached quickly; (ii) the definition of a client group may change; (iii) GDPR conformity; (iv) preparation time; (v) one client should belong to only one group.
The MNB stated that it will adhere to the EBA guidelines at all costs, but it does not wish to set extra requirements in addition to the ones stated in these. They expect institutions' efforts concerning client groups to be proportionate to their size.

Based on what was said at the consultation, the *MNB modified its draft recommendation* and ***sent it*** to the Hungarian Banking Association ***for comments***. The following items were added to the new draft:

- An institution needs to group those persons and organizations together towards which it is exposed according to the CRR, or with which it is planning to sign a contract that involves risk taking.

[3] Capital Requirement Regulation (CRR), Regulation 575/2013/EU, Point (39) of Article 4(1)

- It should be examined whether a relationship of control exists, primarily through public databases, clients' statements about the relationship of control, and information requested for the purposes of making decisions about risk taking.
- The MNB only demands the detailed examination of economic dependency when the aggregated exposure towards individual clients or clients identified as a client group due to the relationship of control ***exceeds 5% of the Tier 1 capital of the institution***.
- In relation to the evaluation of economic dependency, the ratios (determined in percentages) given in the 20th point of the draft recommendation are indicative.
- Financial institutions which have undertaken guarantees commercially or have undertaken joint and several guarantees do not need to be put into the same client group as the persons they have undertaken the guarantee or the joint and several guarantee for.
- The introduction of a ***de minimis rule*** with certain conditions for risk taking that involves ***1 percent of the Tier 1 capital or is HUF 100 million*** – having to choose the ***smaller value*** out of the two.
- The institution should examine the changes of the connection between clients during periodical credit supervision (or at least once per year) or if it is planning to significantly increase exposure or to raise the exposure limit.

The debtor's life partner/spouse was removed from the text, as well as the reference to close relatives. The MNB did not see justification in emphasizing ***substitutability***, since the text of the draft recommendation already clearly referred to it.
The sections of the recommendation referring ***to great exposure*** will have to be implemented from ***January 1, 2019,*** while the ***rest of its contents*** will have to implemented from ***July 1, 2019***.
We sent our comments with reference to the modified text in early October.

Reporting

In Q3 2018 the HITREG working group, ***established for the development of the analytical credit register of the central bank***, had a single meeting. Banking and central ban experts dealing with HITREG met on numerous occasions with a view to clarify technical issues. The Banking Association has collected the information on the envisaged technical background of the implementation as requested by the MNB. Reporting took place on a voluntary basis; it aims to establish the set of control rules for future reporting on a uniform platform.
Upon requests from member banks, the Banking Association asked the relevant deputy governors of the MNB ***to revisit the scheduling of the HITREG (Central Bank Analytical Credit Register) launch***. This request was justified by the fact that the HITREG Decree is expected to come out at the end of October, and any necessary developments at the banks may only be launched then. On the other hand, according to the valid schedule, the launch of HITREG and the Instant Payment System (AFR) coincides. The AFR uses the same development capacity that would also be needed for the HITREG project. According to the MNB's communication, the AFR enjoys absolute priority; its implementation may not be compromised by the introduction of a similar sized reporting task. In response to the feedback received a proposal will be put to the MNB directorate with the request to first complete HITREG reporting in February 2020 and with data from December 2019.

In early September, the MNB held a consultation day on the 2019 decrees. It was a serious innovation that ***eight new daily capital market reports*** would be imposed. With a view to interpret and coordinate these reports, we held a working group meeting for member bank reporting experts and forwarded our proposals to the MNB. By taking our observations into account, the central bank has ***revised the reporting package*** and decreased the number of daily reports from eight to six. At the end of September, we sent our new observation on the amended reporting package to the MNB.

In July 2018, OBA held a consultation day with the involvement of the Banking Association on the new reporting concepts of ***Total Deposit Portfolio (TB)*** and ***Consolidated Deposit Portfolio (KBB)***. We requested the opinion of our members on the new reports. One of our members developed an alternative proposal that contains simplifications compared to the OBA proposal, while respecting the supervisory objectives. All our members supported the alternative proposal and so we have forwarded it to the relevant OBA experts.

VII. Payments

Reporting and the Payment Accounts Directive (PAD[4])

After the Bank account fee transparency sub-working group successfully consulted with the relevant ministry on several occasions, the relevant government decree[5] was published, which includes many of our professional arguments. Among other things, the decree ***sets out rules for the obligations of payment service providers with regard to the fee registry and statement***. In addition, it ***nominates the MNB as proprietor of the national comparative website*** and determines rules for the website's function and operation. The annex of the decree includes the ***registry of the most typical services linked to payment accounts***. ***It consists of 20 items***, which have been determined within an international framework, in compliance with Article 3(5) of the Payment Accounts Directive.

To operate the website, the MNB wants to introduce reporting that is independent from the existing payments datafeed. With regard to this other reporting, it prepared and launched a consultation on the *draft* ***supervisory report*** *necessary for the operation of comparative, PAD compliant website, containing the fees for payment accounts opened and managed in Hungary by payment service providers for consumers*.
The working group voiced several comments during the consultation about the supervisory report. It asked for the clarification and complementation of the requirements. The MNB accepted and transposed most of these. The ***User Guide*** and the ***Fill-out Guide*** are indispensable for the proper completion of the future report. These will be sent out later, as will the rules for logos of the reporting payment service providers. These therefore still need to be processed.

Strong (secure) customer authentication: The activities of the SCA RTS sub-working group

With regard to PSD2[6] the pan-European standards for ***Strong Customer Authentication (SCA) and Common and Secure Open Standards of Communication (CSC) RTS***[7] defined and affected the professional banking significantly in the first quarter of 2018. The Banking Association wished to help

[4] Payment Accounts Directive: DIRECTIVE 2014/92/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 23 July 2014 on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features
[5] Government Decree 144/2018 (VIII.13.) on certain issues related to the information about the fees for consumer payment accounts
[6] Payment Services Directive: the second one
[7] Regulatory technical standards for Strong Customer Authentication (SCA) and Common and Secure Open Standards of Communication (CSC)

its member banks prepare for the new legislative requirement by creating a temporary sub-working group on ***strong customer identification***.
According to the original plans the sub-working group would have only met a few times (on 3-6 occasions) to discuss arising issues in a small groups with active experts who are expressly affected, however, there were so many issues raised and such complicated ones that the working group has already surpassed the number of originally planned meetings.
In issues where the sub-working group cannot find a clear and comforting solution, we asked for an opinion or position from the MNB. This quarter we had our first joint consultation with the MNB, but it has already become evident that further consultation will be needed.

The current state of the Instant Payments Project, the GIRO Forum, the Information working group

GIRO organized an ***Information Forum*** in the first half of September, in order to give a status report on the current state of the ***AZUR[8] project***. The forum was also relevant, as there is less than one year until the new service will be launched (on July 1, 2019). The forum's participants included HBA staff working on the project as well as direct representation from most of our member banks.

The project manager summarized the ***specification and implementation phases*** of the work done so far. He discussed ***requests for changes that were accepted***, putting an emphasis on determining lower and upper thresholds, modifying the reference level, stopping automatic controls and checking the level of minimum liquidity with regard to liquidity management. Other accepted requests for change that he mentioned were the different reports during and at the end of the day, which the system guarantees to payment service providers. Among changes he talked about the "***retransfer transaction process"***, where the payee's bank initiates the retransfer transaction. After this, he showed participants the list of ***documents that support banks in joining***. Finally, he talked in detail about the ***time-bound phases of tasks remaining until the system is launched***. According to these:

- Technical tests for joining must be conducted from October 1, 2018 to December 31, 2018;
- Voluntary business test must be conducted from January 2, 2019 to March 31, 2019;
- Obligatory business tests must be conducted from April 1, 2019 to May 31, 2019.

The pricing for GIRO Zrt.'s future services were discussed in a separate presentation.
To conclude, GIRO's representatives evaluated the current state of the project and deduced that the introduction of instant payments is going according to plan. They confirmed that they remain dedicated to launching the service by the original deadline given.

When creating the Instant Payment System (AFR), MNB's Executive Board also decided on creating the ***long term payment brand*** for the basic service, for the sake of unified communication. The aim of this is to have the program's initiators, the MNB, the market players concerned, and last but not least the business and retail users get to know the essential parts, operation and basic opportunities offered by the system under the same name and through the same content. Together with its creative contract partner, the MNB's communication department began carrying out tasks. As their first step, they are collecting ideas and suggestion for a common name for the ***Instant Payment System***.

[8] An abbreviation for the Hungarian, **AZ**onnali **U**talási **R**endszer or Instant Transfer System, a GIRO project made to create the Instant Payment System

Development related to the payment application

Fulfilling the request from our member banks, the ***Payment Application Sub-Working Group*** has been set up, with 18 members, with the cooperation of GIRO Zrt. and the presence of a standing invitee from the MNB.

During the past period, the Sub-Working Group ***has developed the process for payment application (FK) also for the most complicated case, where there are different payment application providers and different banks (payment service providers) are both on the payer's and the payee's side*** in the message flow scheme and settlement scheme, in the center of which ***GIRO Zrt., providing the settlement mechanism,*** is to be found.

In the context of the FK, a decision was made on numerous issues. Thus, amongst others, the FK will be ***recallable***, and a response message will also be sent on the recall; furthermore, an FK will not be issuable for "0" HUF. An agreement was reached on the management of date, validity period and payment deadline. GIRO ***will not accept batch payment applications*** and ***the final payee will not be entitled to forward the*** FK. An FK ***may not be assigned a "value date;"*** it can only be enforced immediately. The need for ***taking over the transfer charge*** was also raised; however, this is already not possible according to the PSD1 rules. The FK's ***amount may be amended upwards and downwards***, depending on the sender's settings for this option. ***At the outset, no partial payment may be made*** for an FK. At the same time, it will be possible to transfer an amount higher than 10 million HUF between payment service provider partners that conclude a bilateral agreement on this. These agreements will be registered centrally by GIRO Zrt. Upon request, GIRO will also process intra-bank instant transfers.

Further to the closure of the above issues, GIRO ***will finalize the new version of the Rule Book***.

In addition to these results, numerous further issues are still to be decided or replied to. The bank's reaction to PISPs[9] to FKs submitted via the API[10], the content of the statements, complaint handling and fraud prevention need to be developed. The aim of this Sub-Working Group is to close any open issues by the end of the year.

Draft amendment to EU Regulation 924/2009 – regulating cross-border transaction fees

The ***proposal for amending the EU Commission's Regulation No. 924/2009*** intended for improving the situation that consumers are in saw the light of day for the first in the spring of this year. The amendment aims to improve the ***situation of*** clients, primarily ***consumers, with regard to Euro payments and bank card use***. According to one of the draft proposals, from January 2019 ***the same charges will apply to the service providers of member states outside of the Eurozone for Euro transfers, as they would for an equal amount of payment in national currency***. Another proposal deals the use of payment cards, more specifically with ***Dynamic Currency Conversion*** (DCC) when during use, the POS terminal or ATM has to present all exchange rates. Upon seeing these, the customer can decide if he or she would like to pay in the local currency or the currency that the card was issued with. According to the latest draft regulation service providers will have 3 years to prepare for the above requirements.

Realizing these proposals will require significant developments and will be costly for payment service providers. To counter this, the HBA took steps to mitigate these effects and to ensure a longer preparation period in the case of Euro transfers. At international level we and the V8 countries are arguing for a longer period of implementation since most institutions do not have as efficient of an infrastructure for Euro payments as they do for their national payment instruments; that is why uniformed charges may increase the cost of domestic services.

[9] Payment Initiation Service Provider
[10] application programming interface

Over 100 modification proposals to the draft were created in the European Parliament. At the voting in early November, EU representatives had to take into consideration the following alternatives: a considerable portion of the modification proposals would want to extend the equal charges principles to the currency of all member states of the EEA and several of the would suggest a two-year transition period. Others would suggest a short, three or perhaps six-month transition period for both (charges and DCC). Still, more would suggest a one-year preparation period. A new proposal suggested the extension of DCC requirements to money transfer transactions.

Bank Cards

According to the latest data published by the MNB on September 17, 2018, ***electronic payments continued to increase intensively*** in Q2 of 2018, with card payment transactions by over 25% with reference to both the number and the value of payments on a year-on-year basis. Online purchases conducted with payment cards increased by 36%. There are a total of ***9,095,243 issued bank cards in Hungary*** (out of these 7.789.938 are debit and 1,305,305 are credit cards), while the number of POS terminals was 146,271 at the end of H1, with 85% of these suitable for contactless payment. About three fourths of all bank cards are also suitable for contactless payment. ***The ratio of frauds to total turnover continues to be extremely low***; in this sense Hungary remains one of the safest countries internationally. According to data recently published by the European Central Bank's (ECB), from the EU member states, Hungary has the fifth lowest fraud ratio. With regard to online security, Card Not Present (CNP) payments are the most exposed to fraud.

At our Board meeting on July 2nd, participants consulted on the ***operational contradictions and possible risks of the bank card chargeback regulatory system***. Problems of applying the bank card chargeback regulatory system in the case of ***insolvency on the part of the vendor/service provider*** were also summarized, as were the legal risks and possible solutions associated with it. After having received authorization from the Board, the Bank card working group consulted on the issue directly with the competent staff of the bank card companies and tried to examine foreign best practices. The following can be concluded based on the above:

- During the consultations with the bank card companies no solution was recommended that would make it realistically possible to manage the examined risk through self-regulation.
- No international best practice was identified with regard to this topic.
- The working group did not examine the possibility of taking initiative towards the creation of a separate, national law by the legislator at this consultation.
- Seeking further information on possible forms of insurance was mentioned as a possible next step.

In addition to the above, the Bank card working group constantly monitors and supports member institutions' ***preparations processes for PSD2***, especially the introduction of strong customer identification and the amendment of EU Regulation 924/2009, with special attention dedicated to the DCC (spot exchange rate) implications for bank cards.

Developments regarding SZÉP cards

The new government decree of 20 April 2018 classifies the ***issuing of the Széchenyi Recreation Cards (SZÉP cards) as part of payment services***.
We consulted and will continue to consult with the Ministry of Finance and the central bank to lower the costs of this transition as much as possible. So far, the HBA achieved the following:

- According to the Ministry's position the exception rule of the RTS regulating the PSD2 strong customer identification is applicable; therefore ***SZÉP cards currently in use may continue to be used***.
- According to the modification of the government decree that we requested, instead of November 30, 2018, the transition must be completed by January 5, 2019 at the latest.
- Transforming the current system would mean higher ***financial transaction levy*** for employers. We therefore recommended that the ***SZÉP cards be exempt*** from this. The amendment was adopted and the SZÉP card issuers concerned created a regulatory framework which will simplify the exemption process at transferring banks.

Issues yet to be consulted on:

- According to the government decree the account tied to the SZÉP card will be ***a limited-use account***, meaning that transfers by authorities will not be possible. Due to this it is necessary to amend the Judicial Enforcement Act (Vht.). This will be initiated by the Ministry of Finance.
- In the recent past several ***payroll software developer*** firms (such as SAP or NEXON) inquired at our member banks about the changes to the government decree on SZÉP cards which are relevant to them. Consequently, the decision was made to compile and publish an information packet to help those concerned prepare their systems and services for the change.
- During the preparation process issues arose (the management of account balances during transactional corrections and expiration dates in inheritance cases) for which we must once again consult the Ministry on its position for clarification.

Developing cash trade

We contacted several IT developer firms asking for their offers, in order to complete the ***Feasibility Study (FS)*** targeted at developing interbank cash trade. The chair of the Cash working group and the FS project manager provided detailed information about the new trade process developed for the FS (this would be subject to IT development) to all the firms that were contacted. The offers received greatly differed in terms of their prices, completion deadlines, thoroughness and quality, and the experts of the Banking Association had to dedicate considerable time and effort to evaluating them. It is possible that we will negotiate with other IT developer firms and ask for more offers as well.
FS creators have begun to map out the ***legal background for founding and operating IT platform firms*** in the future. While clarifying competition law issues, it became apparent that a legal background which supports the platform for interbank cash trade would be very useful. Consequently, we contacted the relevant MNB representative.

SEPA regional meeting

For SEPA[11] matters we cooperate at continental level with the representatives of EEA member states' payment service providers and their associates within the framework of the EPC[12]. In addition to this, in the past 10 years a smaller, regional cooperation has been developing between a few neighboring member states, with regard to single Euro payments. The banking associations of Austria, the Czech Republic, Slovakia, Croatia and Hungary now meet annually to discuss current regulatory,

[11] single euro payment area
[12] European Payment Council: Európai Fizetési Tanács

infrastructural, innovational and development issues that concern the Euro. This year, their meeting was held at the STUZZA[13] in Austria.
The most important topic was current news on instant payment system projects: each country presented their own developments with regard to this. Austria has several hundred payment service providers, all of which joined the pan-European SCTInst[14] scheme created by the EPC at its starting point. These service providers therefore have almost a year's worth of experience in instant Euro payments. They expect that the TIPS[15] settlement system (operating within the framework of TARGET[16]) joining in this November will further increase demand for this type of service. In the Czech Republic a system capable of managing domestic instant payments in Czech crowns is being developed within the RTGS system operated by the central bank. Croatia is conducting similar work to Hungary: it is developing its current payment service system (launched with their domestic currency) in a way that will make it easily possible, with only a few changes, to eventually carry out Euro payments, when the time comes. The participants were interested to hear that AZUR will be able to manage secondary account identifiers and payment requests immediately, upon its launch.
Experts also exchanged opinions on changes to the data within SEPA messages (primarily changes to the length of information requesting transfers); on the readiness of PSD2 regulatory technical standards; on preparing for strong customer identification; on strategies planned for API by certain participants; and on progress made in preparing for the Payment Accounts Directive.

VIII. Taxation and Accounting

Taxation

In Q3 we sent two letters to the Ministry of Finance in the context of the amendment of tax laws.
The Ministry has not dealt with the substance of our proposals to restore the simplified and ***more favorable taxation*** of employee benefits and their professional justifications, since on the basis of the Government's decision it saw no room for this.
Furthermore, we requested the proportionate decrease of the special tax burden for financial undertakings, similarly to the earlier decrease of the special tax payable by credit institutions, as well as the full repeal of the financial transaction tax applicable to retail transactions, but these requests were also ignored.
However, our proposals made for the applicability of the IFRS standard, for the amendment of the financial transaction tax and corporate tax acts were included in the adopted laws.

After the clarification of numerous recent interpretation issues, the Taxation Working Group has requested the Hungarian Banking Association to initiate discussions with the Ministry of Finance on the transposition of EU Directive *2016/1164 regulating the* ***management of corporate tax avoidance*** into Hungarian law. The Directive provides for several options to Member States for exemption from deductibility of taxpayers' excessive borrowing costs (maximizing the deduction of net borrowing costs at 30% of earnings before interest, tax, depreciation and amortization (EBITDA)). It is in the interest of the financial sector ***to transpose all exemptions into domestic law***, in particular the option for financial undertakings. (For the purposes of the Directive financial undertakings are,

[13] Studiengesellschaft für Zusammenarbeit im Zahlungsverkehr Gmbh: az osztrák fizetési és elszámolási forgalom elméleti és gyakorlati kérdéseivel foglalkozó intézmény
[14] SEPA instant credit transfer scheme
[15] A TARGET eleme az azonnali euro átutalások kiegyenlítésére
[16] Az EKB által üzemeltetett nagy értékű valós idejű bruttó elszámolási rendszer

amongst others, credit institutions, investment firms, alternative investment fund managers, collective investment fund managers, insurers and re-insurers.)

In the last days of September, we were granted the opportunity to consult on the control reporting forms for year 2018, to be submitted in 2019, to the NTCA. The management of ***reporting on NYESZ (retirement savings) accounts*** will not be uniform for 2018 in those cases where the NYESZ account was transferred during the year between two service providers. Our proposal to amend the act was accepted but it will only enter into force from 2019. As such, NYESZ reporting will be uniform for the first time in 2019.

The effect of the KELER-Stock Exchange-MNB concept developed for the management of securities-related corporate events on the taxation tasks to be completed by the sector

In May, KELER, the Budapest Stock Exchange and the central bank of Hungary initiated discussions in the framework of the ***corporate event reform*** in the interest of compliance required for KELER's joining the international securities settlement system. A further objective is to increase the transparency and automation of processes and operation.
In Q3 2018, in accordance with the project scheduling, ***in a working group established for this purpose,*** a proposal was finalized with the support of the industry experts that would take over an implementation method applied in the taxation of interest income for payments arising from corporate events related to securities. The proposal also contains further simplifications. For example, the extension of the ***establishment of residency on the basis of client statements*** to a wider range than currently; and also that the payer would be able to opt for the "quick tax refund" in those cases where the client provides new residency information to the payer after the payment. According to the proposal, these amendments could be made in the monthly tax returns; no self-revision would be necessary. This would facilitate quicker and simpler customer service.
In addition to the proposals related to taxation tasks attached to corporate events, the working group also made proposals for the ***nominee shareholder***, and the ***generation and deletion of securities***. The amending proposal deals with the ***termination of the issuer with no legal successor*** and ***the invalidity of the company's securities,*** on the one hand, and serves ***the alignment between the company register and the central securities registration system***.

Accounting

Upon requests from our member banks, the Banking Association requested a consultation opportunity from the MNB in connection with the ***monetary policy purpose interest swaps*** (hereinafter the MIRS) introduced by the central bank in 2018. Namely, according to our member organizations, the ***accounting treatment*** of MIRS transactions is not uniform amongst our members and auditors. Accounting treatment is determined by the actual economic content of the transaction. We asked the MNB to provide a consultation opportunity on the economic background of MIRS transactions and monetary policy considerations for our members' professionals.
Also by member request, we addressed a letter to the Ministry of Finance, in which we requested the extension of ***auditors' mandates*** at credit institutions, financial firms, insurers and investment firms of public interest from 8 business years to 10 years, since the relevant EU Regulation *(537/2014/EU)* grants this option. Derogation from the 10 year rotating system introduced in the majority of European Union Members States could cause a competition disadvantage to domestic actors, because for international groups it cannot be ensured that the same auditor performs, also with international networks, the annual audit of the group. This will result in significant additional red tape and costs.

IX. Developments within the Banking Association

Creating and approving the HBA's Competition Law Policy

The Hungarian Competition Authority's proceedings in the BankAdat case (Vj-8/2012) led to the review and complementation of internal competition law policies within several of our member institutions. Previously, the HBA did not want to create new rules in an already regulated field, due exactly to the detailed rules of its members. Yet recently, several working group meetings have taken place where members refused to discuss a topic due to competition law concerns. Consequently, the need arose for ***a competition law policy document, specifically regulating work done at the Association***.
The statement was compiled based on the European Banking Federation's similar statement (renewed in late 2017) and by adequately supplementing internal rules made available to the HBA by its member banks, meanwhile seeking to include the most important principles and the practical rules essential to the operation of the HBA in the Competition Compliance Statement. We held several rounds of consultations with the HBA's legal working group, involving a greatly experienced competition law expert from one of our member institutions. The document also sets out important rules of conduct that promote compliance with competition regulations among HBA member representatives who participate in bodies, committees and working groups, in addition to the employees of the HBA. Due to this, we believe that these rules should be published ***in the form of a statement instead of Business Rules*** (the scope of which would only include working organizations).
The Secretary General published the Statement on the Hungarian Banking Association's website in early October after having received authorization from the Board.

BankAdat case – first instance success

The 10 September first instance judgment delivered by the competent court, also communicated in writing in mid-October, has ***set aside in full the challenged decision of the Competition Authority,*** and terminated the competition supervision proceedings without ordering the Competition Authority to perform a new procedure. With regard to the costs, the defendant was ordered to pay HUF 500,000 costs to each applicant. The first instance judgment is ***not final and enforceable*** yet; an appeal may be lodged against the judgment within 15 days after its service. Upon the short oral statement of reasons, the court stated that in the assessment of this case it applied ***the test developed by the Curia***.
It is important to highlight that the first instance judgment only contains the position of the first instance court so far, which would be subject to review in the second instance procedure if the defendant appeals (and it can be taken as certain that the defendant will appeal). In the best case scenario, the second instance final and enforceable judgment may be expected in the first half of 2019, but it may be extended and influenced in the merit if the Competition Authority initiates a preliminary ruling procedure at the Luxembourg EU Court.

Communications

Q3 of 2018 was a calm, more quiet summer period in terms of communications, although we were contacted regularly by the media. According to our statistics, during the quarter we were featured in online media approximately 116 times, 73 times in printed media and 34 times in electronic media. Throughout the entire quarter, ***the Hungarian Banking Association had approximately 223 appearances*** in Hungarian media.

During the quarter, we responded to banking topics that were addressed by the press and the public by releasing a number of interviews and statements. The most important communications topics of the quarter were ***card and ATM security*** due to seasonal travels during the summer holidays, while current professional news included the ***introduction of PSD2 and the GDPR*** and banking sector related issues in connection with its implementation, as well as retail lending, more specifically ***terminated foreign currency lending*** and the ***Certified Consumer-Friendly Housing Loans***. In addition, there was significant media attention towards the statements and comments of HBA leaders regarding the roaming conference of the Hungarian Economic Association.

Money Week: preparing for the 2018/2019 school year

In August, ***preparations for the 2018/2019 school year's Money Week program*** started. By now the event has become somewhat of a tradition, which the Ministry of Human Capacities announces to educational institutions as part of the official school curriculum. The ***fifth Money Week*** will take place from February 25^{th} to March 1^{st} in 2019. A new institution, the Ministry for Innovation and Technology (ITM), has joined the organizers, therefore a six-party contract must be prepared. (This year the organizers are the Hungarian Banking Association, the Ministry of Human Capacities, the Ministry of Finance, the Money Compass Foundation, the ITM and Junior Achievement Hungary.) The Cooperation Agreement will likely be signed in mid-November at the ITM, and it will be open to the media. The ***main topic*** of this year will be: ***investment and savings***. The ***family budget and the fundamentals of payments*** remain recommended and available topics. Curriculums have been prepared for four age groups and they have each been professionally reviewed by professionals of both banking and pedagogy (Hungarian Institute for Educational Research and Development). As before, mock teaching sessions have been conducted to ensure high quality education and professionalism. In addition to detailed lesson plans, teachers and volunteers have access to ***webinars and e-learning materials*** to help them prepare.
A definitive goal for the HBA for 2018/2019 is to ***increase the number of professional volunteers*** who apply and are present in the program. We ask our members to delegate as many bank experts as they can, especially to rural communities. On September 25, 2018 we held a working group meeting where we informed the communications leaders of our member institutions about preparations for the Money Week program and about opportunities to join in.
The banking sector is dedicated to improving financial literacy. We therefore think it regrettable that although the draft of the ***National Base Curriculum*** (put up for social consultation in August) ***includes the concept of the week-long programs***, ***it dedicates an even smaller portion of itself to developing fundamental knowledge about finance***. The Base Curriculum shows no sign and no consideration of the national strategy adopted by the government. The HBA Secretary General sent an official letter to the Ministry of Human Capacities and the editors of the Base Curriculum, which contained the HBA's professional comments, pointing out the scarcity of the Curriculum.

Visit from the Macau Association of Banks

In the second week of September a high-level delegation of nearly 20 persons visited us from The Macau Association of Banks. They were received by the HBA, MNB and Bank of China. The president and vice-presidents of the Macau Association of Banks, and the president of the financial supervisory authority of Macau were also part of the delegation. The topics of this meeting were presenting the economic performance and the banking sectors of Macau and Hungary, as well as providing insight into the tasks and operation models of the two banking associations.

Other working groups and working committees

- *Agriculture working group*

The Agriculture working group held several meeting throughout the quarter. In connection with the ***sorting and termination of lands under undivided joint ownership***, the working group consulted with the representatives of the Ministry of Agriculture about the creation of a government program. After the consultation the working group compiled and sent its package of proposals for the program.

The working group held its third ***Professional Day***, where representatives from the Hungarian Chamber of Agriculture provided information about the probable framework of the European common agriculture policy after 2020 (hereinafter CAP), on the EU Commission's drafts regarding the CAP after 2020, as well as on their publication entitled "Strengthening agricultural and food economy, a growing, prosperous countryside".

The representatives of the Rural Credit Guarantee Foundation (hereinafter: AVHGA) provided information on the current features and instruments of agricultural financing, as well as on the impact of changes to the EU common agriculture policy funds, and on the ***activities of AVHGA***. During the meeting they showed the positive changes in AVHGA guarantee, which is being launched now, such as: the possibility of a portfolio guarantee, faster application, more moderate expectations for collateral; the financing of poor debtors.
The manager of AVHGA said that the foundation's guaranteed stock more than tripled in the past 5 years and the current credit portfolio may exceed HUF 300 billion. Nearly half of all existing transactions are linked to loans to individual agriculture farms and 85% of applications received so far this year were submitted by micro enterprises. Extreme weather conditions, animal diseases, lack of trained labor force, change in generations, the introduction of precision farming due to IT development and increased dependency on international market prices resulting from globalization all present significant challenges. The new requirements of the post 2020 CAP system will present farmers with considerably more burdens, and the decrease in rural development funds may restrain investment activity. At the same time it does not seem that EU competition laws on the financing of agricultural enterprises will become more simplified (e.g. in terms of the management of aids to be recovered and aids not to be recovered, the agricultural de minimis limit, etc.). That is why it is especially important for financial institutions to keep providing smooth financing to this sector in the coming years as well. The AVHGA will support them in doing this.

The working group asked the public warehousing supervisory authority compile the ***report on the warehousing market for last year*** this year as well. The supervisory authority accepted this request and published its report on the Hungarian Trade Licensing Office's website, next to market supervisory data.

- *Internal control working group*

The ***decisions issued during the MNB's supervisory controls*** include many recommendations and expectations towards institutions. The Supervisory Authority expects internal control departments to cooperate in monitoring that these recommendations met. The working group consulted on several noted issues regarding current practices and ***compiled its proposals for rendering these practices more effective***.

At the consultation held on July 4, 2018 about the ***working group's proposals for rationalizing internal control tasks to conclude the supervisory recommendations***, the primary aim of representatives of the Internal control working group and the leaders of the MNB's Directorate of Credit Institutions Supervision was to rationalize current practices with regard to capacity and work organization problems that are caused by inspection deadlines.
In the majority of cases the ***30 days*** given to Internal Control ***until the inspection deadline*** is ***hard to keep to*** (especially due to the need for approval by directorates and supervisory boards) and requires that banks spend a significant amount of resources to fulfil, often leading to capacity problems. The HBA recommended that supervisory deadlines which are synchronized with the general meeting next quarter, after the issuing of the decision or request, would greatly ease these burdens. It is the primary aim of the MNB to manage identified risks as soon as possible, which is why in most cases it is not an option for them to postpose the deadlines by one quarter. They did however recommend that representatives of institutions should indicate their problems before the decision is issued and request the modification of the deadline during the monitoring process in cases where it is apparent ahead of time that the 30 days given for internal control will not suffice, due to the complexity of the tasks that need to be carried out. Critical areas can already be distinguished in this phase, although it is possible that this may change later on. Still, this method may be of help in several issues.
It was also mentioned at the meeting that it would be of great help to ***restructure and fine-tune the ERA inbox*** used by the MNB in order to have a clear system in which the different tasks and issues reach their destination. MNB representatives promised to, within the institution, forward all messages sent to institutional supervisors to the colleagues concerned in order to resolve the issue.
The consulting parties searched together for solutions to the issues raised, however the MNB saw it necessary to conduct an internal consultation and will inform the HBA about its results afterwards.

- *Digitalization working group*

At the inaugural meeting of the Digitalization working group held on July 24, 2018, members discussed the working group's goals, potential topics, its operation and its rules of procedure. The working group put all topics that were sent previously as well as those raised during the meeting under seven categories. Delegated colleagues could join the topic categories based on their interests and the category's relevance. The working group originally had 27 members at its launch, with 40 colleagues added to the correspondence list, however, more people registered later, raising the final number of members to 51, and lengthening the correspondence list to include 54 colleagues.

The Banking Association was contacted by the MNB, requesting that within the framework of the association, the HBA should examine possible cooperation between commercial banks and Alipay; examine how Chinese financial innovations could be introduced in order to serve Chinese customers; and what possibilities Hungarian banks have to collaborate with Chinese service providers in the domestic market. The Digitalization working group consulted with the MNB in connection with its expectations and also consulted with Italian firm carrying out the introduction of the above.

- *Credit guarantee working group*

At the Credit guarantee working group's meeting in Q3, representatives of Garantiqa Hitelgarancia Zrt. gave us information on the introduction of the ***reverse guarantee procedure***. Regarding what preceded the introduction, they said that last year the central bank of Hungary initiated a consultation of experts, the aim of which was to render institutional guarantee more effective, to put more emphasis on the management of risky lending to small and medium enterprises, and to be able to reach customers who have not yet taken part in the lending process. Within the reverse guarantee procedure guarantee institutions can contact potential clients directly through the ***"promissory note" containing the maximum guarantee limit, based on the preliminary credit rating of the enterprise***. After this, the enterprise can contact individual credit institutions by itself and the guarantee institution may automatically provide a guarantee for the loan granted by the other institution based on the "promissory note". The currently launched pilot program is regarded as a test version of the reversed procedure, where guarantee is not yet provided automatically based on the "promissory notes" sent through post or e-mail to enterprises. Instead, Garantiqa evaluates these applications through its normal procedure. This product will be further developed based on the feedback gained from the test procedure as well as its efficiency. At the working group's meeting members shared the content of the procedure as well as their comments and suggestions for it.

- *Mortgage bank working group*

The Mortgage bank working group continued to focus on the ***EU directive and regulatory legislative package on covered bonds***. Hungarian mortgage bond market actor support the EU initiative, the further deepening of previous regulations, and the sector also aims to create a single, competitive market, where the perception of Hungarian investment and credit rating papers can be further improved. Members of the Hungarian Banking Association welcome the ***directive's shift towards market needs*** (soft-bullet), as well as ***laying down the fundamental pillars of a single EU covered bonds market***. An important goal is creating a uniform competition neutral regulation, which applies also to issues that are to be settled nationally according to the directive.
The Hungarian model follows a separate institutionary structure, according to which mortgage credit institutions have the exclusive right to issue mortgage bonds. Therefore in many cases rules for credit institutions may not necessarily be applicable, due to the nature of their activities, which may lead to unjustified burdens on the sector. This is why we believe it is highly important to consider the particularities of mortgage credit institutions in the regulation-making process.

The ***working group tasked with real estate valuation*** discussed proposals for simplifying consumer mortgage lending and elaborated its comments on the ***review of the database for statistically based evaluation***, on the ***range of uses for the property deed***, as well as the ***evaluation of agricultural land***. In consideration of the international practice concerning real estate valuation, another item on the agenda at the working group's Q3 meeting was possibilities for ***valuation without on-sight inspection*** and its methods of use. Bearing in mind financial institutions' statistical data collection on properties acquired for collateral, we consulted on the possible creation of a ***central real estate valuation database***.
The ***Central European Covered Bond Conference (CECBC)*** will be held in Budapest on November 22-23, 2018: an initiative by the Hungarian Banking Association and its members. The goal of this conference is to have Central European countries share the current state of their mortgage lending and mortgage bond issuing activities, regulations, their experience with the market environment and the know-how of Easter European and Western European countries. The main organizer of this event are the German Pfandbrief Banks (Verband deutscher Pfandbriefbanken; VdP) and the Hungarian Banking Association. Guests at the conference will include presenters from domestic and foreign regulatory authorities and experts from the market.

- *KHR Working Group*

The working group prepared a proposal for the amendment of *Act CXXII of 2011* on the Central Credit Information System (hereinafter the KHR), and consulted the representative of the BISZ Zrt. on it. One of the sections in the package of proposals concerned ***the creation of a data transmission obligation by building societies to KHR in connection with building savings***. In the framework of this consultation, we have contacted the Association of Building Societies. In the Association's opinion, it is not justified to record contracts for saving plans for housing loans in the KHR, since ***customers' housing purpose savings may not be interpreted as a debt or liability***.

- *SME and Legal Joint Working Group - e-administration*

On the basis of *Act CCXXII of 2015 on General rules for electronic administration and fiduciary services,* ***real estate authorities*** also qualify as bodies providing for electronic administration. The ***SME and Legal Joint Working Group*** initiated consultations on two occasions with the Land and Geographical Information Department of the Ministry of Agriculture. In the first consultation, the practical issues of migration to electronic administration were discussed, while in the second meeting we received information on the introduction of electronic administration in real estate authority procedures and its real estate register aspect.

The Hungarian Chamber of Public Notaries (hereinafter MOKK) and the SME and Legal Joint Working Group have been working for months on the development of the ***succession search system*** referred to in *Section 118/A of Act XXXVIII of 2010 on Succession proceedings*. As a result of the cooperation so far, as of 1 July 2018 ***payment service providers may test the system*** already. Upon a request from MOKK, we reviewed the test feedback from banks and we made proposals for amendments with regard to the list of payment service providers maintained by MOKK. In addition to it, we have consulted with MOKK's representatives and made development proposals to them with regard to the ***content of the ÁNYK***[17] ***form*** under development in the context of requests from public notaries in succession cases; and the design of the ***IT framework for the response*** by financial institutions.

As a result of the earlier meeting between the Ministry of Interior and the SME and Legal Joint Working Group in the previous quarter, ***the authorization function was launched in the office and company gateway services***, based on ***manual and rule-based automatic labelling***. Through the establishment of rules, various conditions may be set for individual documents (for example: sender, addressee, document type, etc.), on the basis of which messages might be allocated labels in an automated manner.

- *Leasing working group*

The Leasing working group held several meetings in Q3. At one of the meetings a representative of BISZ Zrt. held a presentation on the ***current state of financing natural persons and enterprises, from the point of view of the Central Credit Bureau***. The presenter evaluated the current state of this in light of the ***Hungarian central bank's new convergence*** program. He showed where the Hungarian economy could be in 2030, more specifically, where the sector's retail and corporate lending could be, including the role that the Central Credit Bureau's could play in this.

EXIM Bank's new Export Recovery Leasing Program was introduced in July 2018. During the quarter the working group communicated its opinion on the ***sample contract for the program's refinancing credit line, the product description, customer information packet, and the calculator used to calculate added value***. Based on the comments received they created the leasing financial model table's version which already makes it possible to choose the new, personalized repayment schedule from the settings. After the program was launched, EXIM added the customer information packet to its website.

After discussing them at its meeting, the Leasing working group sent its comments on the ***introduction of electronic government office practices regarding the transfer of vehicle ownership***

[17] General Form Filling Program

and registering keeper's rights, as well as on the electronic creation of registration certificates and vehicle registration cards in the long term to the Transport Management and Registration Department at the Ministry of Interior. Our goal is to promote the digitalization of the entire vehicle administration process, since without this happening vehicle leasing application and contracting processes will not be digitalized either.

- *Documentary transactions*

In the Q3 meeting of the Working Group, the National Electronic Public Procurement Service and Consulting Kft. (hereinafter NEKSZT Kft.) presented the ***Electronic Public Procurement System*** (hereinafter the EKR) in the educational environment. The EKR, launched on 1 January 2018, is a uniform central IT system to be mandatorily used by all contracting authorities and bidders since 15 April 2018 under *Section 40 (1) of Act CXLIII of 2015*. The basic aim of the EKR is to reduce the red tape for economic actors participating in public procurement via a secure electronic platform, through which public procurers prepare documents and notices for all their public procurement procedures. During the consultation, several questions were raised; amongst other matters we discussed the issues related to the inclusion of a ***guarantee recorded in an electronic document*** into the EKR.

ANNEX – INTERNATIONAL OUTLOOK: REGULATION, SUPERVISION

I. Global Regulation

I.1 Financial Stability Board (FSB[18])

As set in its workplan, in Q3 of 2018 the FSB gave priority to assessing the reforms made after the crisis.

I.1.1

To evaluate the effects of the reform, the FSB first looked at its effects on financial intermediation, focusing on infrastructure finance. [19] In mid-July it published a consultation report on the ***effects of reforms on the financing of infrastructure***. It focuses on infrastructure finance that is provided in the form of corporate and project debt financing (loans and issuing bonds), for which the financial regulatory reforms are of immediate relevance. At the same time, the report concludes that the effect of the G20 financial reforms on infrastructure finance is of a second order relative to other factors, such as the macro-financial environment, government policy and institutional factors. The defining reforms, such as the Basel III capital and liquidity requirements and the reform of OTC derivatives ***had no significant (material) negative effects on the provision and cost of infrastructure finance.*** The evaluation further found that:

- The overall amount of infrastructure finance has grown in recent years after a temporary drop during the financial crisis. Market-based finance as well as non-bank financing has accounted for most of the growth in advanced economies in recent years.
- Lending spreads for infrastructure finance have returned to lower levels, but remain above pre-crisis levels.
- There are differences in the provision of infrastructure finance in emerging, developing and advanced economies. The former two tend to rely more on bank loans, have a higher proportion of cross-border financing, and use local currency in smaller proportion.
- The reforms have contributed to shorter average maturities of infrastructure loans by G-SIBs[20]. This effect is not necessarily unintended, given that reducing banks' maturity mismatch was one of the objectives of the reforms.
- The effects of the reforms on financial stability do not apply in the narrower context of infrastructure finance.
- The G20 banking reforms may have been one of the drivers of the fact that market-based financing has become prevalent.

The consultation on the issue ended on August 22nd. The final report will be published at around the time of the G20 Summit at the end of November.

I.1.2

In collaboration with other competent regulatory bodies (BCBS[21], CPMI[22], IOSCO[23]) in early August the FSB announced a ***consultation on the effects of reforms on incentives to centrally clear OTC***

[18] Financial Stability Board: the highest international financial legislative body
[19] The second part of evaluating the effects of reforms on financial intermediation will involve evaluating the effects on SME financing in 2019.
[20] Global Systemically Important Banks
[21] Basel Committee on Banking Supervision
[22] Committee on Payments and Market Infrastructures: Similarly to the Basel Committee on Banking Supervision, this Committee operates within the BIS framework.
[23] International Organization of Securities Commissions

derivatives. With regard to the OTC derivatives market, after the crisis G20 leaders agreed on taking regulatory steps in the following ***five areas***: trade reporting of TC derivatives; central clearing of standardized OTC derivatives; exchange or electronic platform trading, where appropriate, of standardized OTC derivatives; higher capital requirements for non-centrally cleared derivatives; and initial and variation margin requirements for non-centrally cleared derivatives. The consultative document evaluates how these reforms interact and how they could affect incentives. Based on these relevant standard-setting bodies will receive information on which areas need fine-tuning, bearing in mind the originals objectives of the reforms. Among other things, the recent second evaluation (which followed up on the first evaluation in 2014) found that:

- The changes observed in OTC derivatives markets are consistent with the G20 Leaders' objective of mitigating systemic risk and making derivatives markets safer.
- The relevant post-crisis reforms, in particular the capital, margin and clearing reforms, taken together, appear to create an overall incentive, at least for dealers and larger and more active clients, to centrally clear OTC derivatives.
- Non-regulatory factors, such as market liquidity, counterparty credit risk management and netting efficiencies, are also important and can interact with regulatory factors to affect incentives to centrally clear.
- Some categories of clients have less strong incentives to use central clearing.
- The provision of client clearing services is concentrated in a relatively small number of bank-affiliated clearing firms.

The analysis suggests that the reforms are achieving their goals of promoting central clearing, especially for the most systemic market participants. At the same time, the available quantitative and qualitative data suggests that the treatment of initial margin in the leverage ratio can be a disincentive for banks to offer or expand client clearing services.

Opinions could be sent to the consultation until September 7th and the final report for this will also be published at around the time of the G20 Summit in late November.

Another relevant development is that the CPMI and the IOSCO published a joint ***consultative report on the governance arrangements for data elements of critical OTC derivatives.***

I.1.3 Relevant to the above topic is the four standard-setting institutions' ***second report, which maps interdependencies between central counterparties*** and their clearing members was published in August. Central clearing houses are an increasingly important part of the financial system; analyzing the network of relationships is fundamental for identifying systemic risk. The first report on the topic was published in July 2017 and was based on data from September 2016. The results of the more streamlined data collection in October 2017 (conducted at the same 26 CCPs) showed stability over time and the results of the second report were broadly consistent with the previous analysis and suggest that CCPs are greatly interdependent. Analyzing the network of relationships between CCPs provides useful input for stress tests, and the resolution plans for CCPs.

I.1.4 Based on the request of financial ministers and central bank governors communicated at the G20 meeting in October, the FSB has compiled a Cyber Lexicon, the consultation for which it initiated on July 2nd. A lexicon could be useful to support the work of legislators and market actors in the following areas:

- Cross-sector common understanding of relevant cyber security and cyber resilience terminology;
- Work to assess and monitor financial stability risks of cyber risk scenarios;
- Information sharing as appropriate; and
- Work by the FSB and/or standard-setting bodies to provide guidance related to cyber security and cyber resilience, including identifying effective practices.

The FSB will finalize the lexicon for delivery to the G20 Leaders' Summit in Buenos Aires in November.

I.1.5 The FSB also published a report on the ***framework to monitor crypto-asset markets***, which it delivered to the meeting of the G20 Finance Ministers and Central Bank Governors on July 21-22. In collaboration with CPMI the FSB developed a framework to monitor the developments in crypto-asset markets. The report sets out the metrics used to monitor crypto-asset markets as part of the ongoing assessment of vulnerabilities in the financial system. While the FSB believes that crypto-assets do not pose a material risk to global financial stability at this time, it recognizes the need for vigilant monitoring in light of the speed of market developments.

Crypto-assets raise a host of issues around consumer and investor protection, as well as their use to shield illicit activity and for money laundering and terrorist financing. At the same time, the technologies underlying them have the potential to improve the efficiency and inclusiveness of both the financial system and the economy.

The various standard-setting bodies conducted significant work on the issue:

- CPMI conducted work on the applications of distributed ledger technology and the monitoring of payment innovations.
- The IOSCO has established an ICO[24] Consultation Network to discuss experiences and concerns regarding ICOs, to assist members in considering how to address domestic and cross-border issues stemming from ICOs that could impact investor protection. IOSCO is also discussing other issues around crypto-assets, including, for example, regulatory issues.
- BCBS assessed the materiality of banks' direct and indirect exposures to crypto-assets, clarifying the prudential treatment of such exposures, and monitoring developments related to crypto-assets for banks and supervisors.

The FATF[25] reports separately to the G20 on its work concerning the money laundering and terrorist financing risks relating to crypto-assets.

I.1.6 In addition to the above, the following relevant documents have been published in Q3:

- Statement on reforms to interest rate benchmarks
- Self-assessment questionnaire for prospective UPI[26] Service Providers
- Fifth update to the assessments of implementation monitoring of the Principles for financial market infrastructures (PFMI) (a document by CPMI and IOSCO)
- Thematic peer review on the implementation of LEI[27]
- Third progress report on the G20 Data Gaps Initiative (a document by the IMF and the FSB)

[24] initial coin offering: a cross between crowdfunding and initial public offering (IPO for short). The goal is for the issuer to obtain capital for financing his or her projects and company expansion through issuing cryptocurrency.
[25] Financial Action Task Force: an international organization against money laundering
[26] Unique Product Identifier
[27] Legal Entity Identifier

I.2 Basel Committee on Banking Supervision (BCBS)

I.2.1 The ***Basel Committee on Banking Supervision met in Basel on 19-20 September*** to discuss a range of policy and supervisory issues, and to take stock of its members' implementation of post-crisis reforms.

The Committee discussed:

- the ***results of the annual assessment exercise for global systemically important banks (G-SIBs).*** These were approved by the Committee and will be submitted to the Financial Stability Board before it publishes the 2018 list of G-SIBs. The Committee also agreed to publish the high-level indicator values of all the banks that are part of the G-SIB assessment exercise;
- progress on ***revising the market risk framework***. The Committee expects to finalize these revisions around the end of the year;
- banks' responses to regulatory change, including potential arbitrage transactions. The Committee will publish a newsletter on ***leverage ratio window-dressing behavior***, whereby banks adjust their balance sheets around regulatory reporting dates to influence reported leverage ratios. The Committee will consider Pillar 1 (minimum capital requirements) and Pillar 3 (disclosure) measures to prevent this behavior. The Committee also agreed to clarify ***the treatment of "settled-to-market" derivatives in the Committee's liquidity standards*** and has published a response to frequently asked questions on this topic; and
- the outcome of its review of the impact of the leverage ratio on client clearing. It also discussed the effects of post-crisis reforms on incentives to ***centrally clear OTC derivatives***, consistent with the G20 Leaders' commitments to reform OTC derivatives markets. The Committee agreed to publish a consultation paper next month to seek the views of stakeholders as to whether the exposure measure should be revised and, if so, on revision options.

The Committee also agreed to publish a ***revised version of its Principles on Stress Testing*** next month, following the consultation paper published in December 2017.

Members exchanged views on ***emerging conjunctural and structural risks***. Part of this discussion focused on banks' exposures to ***crypto-assets*** and the risks such assets may pose. The Committee agreed on further work on this topic.

Committee members reiterated their expectation of ***full, timely and consistent implementation*** of the Basel III standards for internationally-active banks. The next meeting of the Basel Committee is scheduled for 26-27 November 2018 in Abu Dhabi.

I.2.2 On July 5th the BCBS published ***Global systemically important banks: revised assessment methodology and the higher loss absorbency requirement.*** The revised methodology is expected to be implemented in member jurisdictions by 2021. Following the consultation in June 2017 the Committee reconfirmed the fundamental structure of the G-SIB framework. There is general recognition that the framework is meeting its primary objective of requiring G-SIBs to hold higher capital buffers and providing incentives for such firms to reduce their *systemic importance*.

The following enhancements were made:

- Amendments to the definition of cross-jurisdictional indicators (harmonization with the definition of BIS consolidated statistics);
- Introduction of a trading volume indicator and modification of the weights in the substitutability category;

- Extension of the scope of consolidation to insurance subsidiaries;
- Revisions to the disclosure requirements;
- Further guidance on bucket migration and associated higher loss absorbency surcharge when moving to a lower bucket;
- Transitional schedule for the implementation of these enhancements to the G-SIB framework.

When the Basel Committee first published the regulatory framework in 2011, it agreed to review it every three years. This intention has been reconfirmed, and it was emphasized that the Committee will pay particular attention to alternative methodologies for the substitutability category at its next review in 2021, so as to allow the cap to be removed at that time.

I.2.3 In August, the Committee released a technical amendment on ***additional Pillar 3 disclosure requirements for those jurisdictions implementing an expected credit loss (ECL) accounting model*** as well as those adopting transitional arrangement for the ***regulatory treatment of accounting provisions***.

In addition to the above, the BCBS issued responses to ***Frequently Asked Questions*** related on the ***liquidity risk treatment of settled-to-market derivatives*** when calculating liquidity ratios.

II European Regulation

II.1 General Framework: Juncker's speech on the State of the Union

In his speech about the State of the Union, the President of the European Commission said that instead of looking back, they will continue to improve the Union in the time left, and make efforts to create a more unified Europe. He emphasized that the EU needs to become a stronger global player because only a strong and united Europe makes it possible for its member states to achieve great things. He said that by the European elections, Europe must show that it can overcome differences between North and South, East and West and left and right. It must also prove that the EU member states can plant the seeds of a more sovereign Europe.

With regard to ***completing the Security Union***, he announced that the Commission will propose new rules in order to ensure that terrorist content is taken off the internet within one hour after it was put up. They are also proposing to extend the tasks of the newly established European Public Prosecutor's Office to include the fight against terrorist offenses. In addition, they also proposed measures to fight money laundering more effectively across EU borders. Concerning migration, they are proposing to further strengthen the European Border and Coast Guard and to further develop the European Asylum Agency.

Regarding ***international relations***, the President mentioned the new alliance between Africa and Europe, the special relations to be maintained with the United Kingdom after Brexit, and the partnership agreement ratified with Japan. He highlighted that the Union needs to do more to ***allow its single currency to play its full role on the international scene.*** The Euro must become an active instrument of new European sovereignty. Visible progress needs to be made in the ability to ***speak with one voice when it comes to foreign policy***.

According to the President, the time has come to move to ***qualified majority voting***, the bridging clause and "lost treasure" of the Lisbon Treaty.

At the end of his speech, the President stated his belief in democracy and the protection of the rule of law, while respecting legal norms and court decisions. He concluded: "We are all responsible for the Europe of today. And we must all take responsibility for the Europe of tomorrow."

II.2 Banking in Europe: 2018 Facts and Figures

In September, the European Banking Federation published ***Banking in Europe; the 2018 Facts and Figures***, its annually updated publication. The publication is a multi-faceted digital resource with key data about banking in Europe. It also includes data on the European economy. The data is based on publicly available information from the European Central Bank, the European Commission, Eurostat, the European Banking Authority and the EBF and its members. For the first time, this year's edition also includes descriptions of national banking sectors by a number of EBF associate members.

The data shows that the ***contraction*** in the European banking sector, both ***as measured in terms of staff numbers and branches***, continued in 2017 as the industry continued to improve efficiency while enhancing its profitability. The total number of credit institutions in the European Union fell by 5% in 2017 to 6.250 institutions, down by 2.275 since the contraction began in 2009. Last year's decline was led by Germany, Italy, Hungary and Austria. The number of credit institutions increased in the United Kingdom and Sweden last year. The number of bank branches declined to approximately 183,000, with about 5,900 branches closed, down 3.1%. Compared to 2007 the total number of bank branches has declined 21%, or by almost 50,000, reflecting the rapid uptake of online and mobile banking services in recent years. In 2017 more than half of all people in the EU, 51%, used Internet banking, compared to 29% in 2008. The number of people working for credit institutions in the EU fell to the lowest level since the ECB started measuring it and stood at approximately 2.74 million people at the end of 2017, compared to 2.78 in 2016. This compares to 3.13 million in 2009.

Last year, deposits from households rose 2.9%, while business ***deposits*** increased 6.7 percent in the Eurozone. The value of ***loans to EU households*** increased 2.5%, led higher by loans to households in the euro area, which grew for a third consecutive year. The value of loans to households in the Eurozone has risen by some €500 billion since 2014.

The special theme section in this year's edition is dedicated to ***non-performing loans (NPLs)***. EU NPL stocks declined considerably in recent years due to enhanced loan selling activities of banks. In fact, as of 2017, the ratio for the EU stood at 3.7%, down from an EU-wide peak of 7.5% in 2012 and just below the world average of 3.74%, showing that NPLs are no longer a specific European problem.

II.3 The Risk Reduction Package: The European Banking Federation's position in the trilateral negotiations

After the Council and the ECON[28] approved the ***Risk Reduction Package (RRP)*** of November 2016, ***aimed at reducing risks in the banking sector***, the trilogue (Council – Parliament – Commission) began at the end of the summer.

The European Banking Federation (EBF) reviewed its previous proposals to the package, in light of the Parliament's opinion and text proposal. According to the EBF, policymakers need to continue to keep in mind the following main points, when adopting the package:

1. Regain a competitive profile in the global financial market
2. Support market liquidity and short term financing activities
3. Take full advantage of the EU Single Market and the Banking Union
4. Finance the European economy and innovation
5. Making regulation and supervision fit for purpose and avoiding unnecessary burdens for banks

Based on the five principles states above, the EBF gave the following main lobby points for the RRP prudential regulations:

(1)

- Adhering to the Basel timeline on FRTB[29];
- Allowing capital instruments issued by subsidiaries located in third countries to be counted towards the consolidated capital requirements whenever they comply with local regulations that are as stringent as the EU regulation;
- Adapting staff remuneration caps for digital banking employees (ensuring more flexible remuneration opportunities for IT staff);
- Requiring the review of the Standardized Approach of the Counterparty Credit Risk as soon as possible;
- Support efficiency in regulatory reporting requirements;

(2)

- recalibrating the NSFR[30] to support market liquidity with symmetric treatment of repos and reverse repos;
- recalibrating the NSFR to support trade finance and similar short term trade receivables financing techniques like factoring,

(3)

- recognizing the Eurozone single constituency in the banks' systemic scoring;
- supporting capital and liquidity waivers and make liquidity waivers at solo level automatic and not discretionary for NSFR purposes within the Banking Union;
- granting preferential treatment for intragroup transactions;

[28] Economic and Monetary Affairs Committee
[29] Fundamental Review of the Trading Book: felülvizsgált kereskedési könyvi szabályozás
[30] Net Stable Funding Ratio

(4)

- maintaining and extending the SME Supporting Factor (SF);
- supporting bank lending for infrastructure projects;
- supporting bank lending for sustainable finance;
- Treatment of equity securities hedging derivatives in the NSFR;
- exempting all export credit exposures from the Leverage Ratio;
- adjusting the risk weight exposure amount for investment in private equity in the form of units or shares in a Collective Investment Undertakings (CIU);
- removing the deduction of software from banks' regulatory capital;
- Maintaining consistency with prudential supervisory expectations;

(5)

- alleviating the administrative burden on small and non-complex institutions;
- removing daily reporting requirement for NSFR in case of breach;
- keeping current simplified methods for counterparty credit risk;
- keeping current well-functioning large exposure regime;
- aligning remuneration policies and practices with effective risk management;
- Maintaining transitional measures for the Danish compromise;
- Not imposing an unnecessary reporting burden for the Leverage ratio, by requiring a daily calculation;
- Aligning and limiting public disclosure with agreed requirements.

The EBF's main lobby points for the RRP resolution rules:

- Ensure grandfathering provisions without time restrictions (or at minimum 10 years) are in place for existing own funds and eligible liabilities.
- The eligibility criteria should be clarified for callable instruments where there is no incentive to redeem.
- Frame the resolution authority's discretion to adjust the recapitalization amount upward or downward with clear criteria and based on the bank's resolution strategy. Also limit the market confidence buffer to relevant buffers post resolution.
- Limit the subordinated part of MREL according to the TLAC[31] Term Sheet to maintain a level playing field.
- Adapt internal MREL to take account of the TLAC standard and of the EU single market and banking union.
- Make MDA[32] restrictions non-automatic in case of MREL breaches.
- Limit the moratorium tool to the international agreed time frame of 48 hours and the point of FOLF[33]).
- Maintain workable conditions for waivers for the contractual recognition of bail-in.
- Regulate the sale of MREL eligible liabilities to retail customers through existing securities and investor protection regulations and not through the eligibility criteria in CRR2 as banks are unable to control and monitor sales to retail customers.
- A general permission as a workable solution for a potentially high volume of redemptions that do not breach MREL.
- Ensure the alignment between resolution and insolvency hierarchies.
- Recognize the MPE[34] strategy in the Capital Requirements Regulation (CRR).

[31] total loss absorbing capacity

[32] *Maximum Distributable Amount*

[33] Failing or Likely to Fail

- Should the UK leave the EU with no equivalence agreement including mutual recognition of bail-in regimes, EU policy makers should consider further grandfathering own funds and eligible liabilities without requiring a contractual bail-in clause.

When adding the points on prudential and resolutions regulation and the detailed comments relevant to them, the EBF primarily tried to address areas where the EP and the Council position were not identical.

II.4 Developments in Europe concerning the finalization of the Basel III standards

In compliance with the call for advice, in early July the European Banking Authority (EBA) released the ***quality indicator survey templates to assess the impact of the finalized Basel III standards.*** Banks who volunteered to participate had to send the data requested by June 30, 2018. Contrary to its usual practices, the EBA only gave a few days until the deadline for commenting on the templates. Data collection was postponed to later than originally planned, and banks will receive the final templates in mid-August. The requested data had to be sent by the end of October. The EBA made the templates public and available for download, for the purpose of information.

II.5 The Banking Union

II.5.1 The Single Supervisory Mechanism (SSM)

(1) In his speech at the ACPR[35] Banking Supervision conference, held in Paris in September, Mario Draghi, the president of the European Central Bank (ECB) discussed ***the advantages granted by the Single Supervisory Mechanism***. Draghi emphasized the three main advantages of the European supervision as opposed to the fragmented system of national supervision:

- European supervision ***unifies and harmonizes supervisory practices***. It gives banks with equivalent risk profiles similar capital requirements.
- The European supervision adopts a ***system-wide perspective*** when monitoring and mitigating risks. Supervisors can draw on a comprehensive dataset and information on banks across the Eurozone.
- European supervision ***reduces fragmentation in the supervisory framework***. In the past, broad discretion in applying EU rules led to significant differences in key prudential aspects, such as the definition of funds or capital and liquidity requirements.

Despite having a single supervisor and more harmonized rules, the banking market in Europe remains fragmented. 86% of euro area bank lending to firms and households is domestic. In addition to legal and cultural differences, the ***treatment of legacy assets*** and ***restricted allocation of regulatory capital within cross-border groups*** also pose obstacles to deeper integration. Currently, the international regulatory framework does not recognize the euro area as a single jurisdiction for the purposes of ***calculating G-SIB buffers***. In order to overcome these weaknesses ***progress must be made in completing the Banking Union – namely, harmonizing options and discretions, completing resolution, and laying the groundwork for the creation of effective deposit insurance.*** These steps are essential and president of the ECB is confident, that they will be taken soon.

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[34] multiple point of entry

[35] Autorité de contrôle prudentiel et de résolution: the French authority responsible for prudential supervision and resolution

Similar to Draghi ***Deutche Bank's CEO, Christian Sewing,*** also believes that to have a competitive edge versus the Americas and Asia, the Banking Union must be competed. A level playing field must also be ensured against tech giants as well.

(2) In July, the ECB, which is the single supervisory authority of significant institutions in the euro area announced further steps to be taken to ***reduce the stock of existing NPLs***:

- To reduce the stock of NPLs the ECB will set ***bank-specific supervisory expectations*** for the ***provisioning*** of NPLs;
- The aim is to achieve same coverage of NPL stock and flow over the medium term;
- Bank-specific expectations are guided by individual banks' current NPL ratio and main financial features in a consistent way across comparable banks.

The decision the ECB announced fits with its previous measures. The NPL ratio of significant institutions decreased from 8% in 2014 to 4.9% at the end of 2017. Nevertheless, this is still far too high compared to international standards, therefore further efforts are necessary to reduce the NPL stock.

Compliance with the ECB's loan loss provisioning expectations will largely affect the Pillar 2 capital requirements resulting from the 2021 SREP[36] onward.

(3) Also in July, the ECB published a ***report*** on ***recovery plans***. The purpose of the report is to share lessons that the ECB Banking Supervision has learned and the ***best practices*** it has identified after three successive cycles of analyzing recovery plans in order to help significant institutions (Sis) further shape their plans and make them even more operational.

The report does not impose additional requirements on banks, but expects compliance with existing regulations (BRRD, the relevant Commission Delegated Regulations, and EBA guidelines).

(4) In September the ***SSM thematic review on profitability and business models*** was published. The review was a ***key priority within the SSM*** in light of the situation that EU banks are in after the crisis and the challenges they face. After the crisis, these institutions face low profitability and pressure on revenues from the economic environment, low level of interest rates and high competition, elevated levels of NPLs and the need to clean up balance sheets, digitalization and new competitors (fintech and big tech companies) as well as tougher regulation and the need to adapt to it. The thematic review had the following objectives:

- To provide tools and methodologies to facilitate consistent business model analysis at firm level by the joint supervisory teams (JSTs);
- to assess banks' ability to steer strategically their business models;
- to monitor the consequences of weak profitability for banks' risk-taking behavior; and
- to enrich horizontal analysis by integrating JSTs' insights in a consistent way across banks

At the beginning of the year the joint supervisory teams engaged in a dialogue with banks, communicating the findings and main conclusions of the thematic review. The findings from the individual firm-level analysis feed into the SREP 2018 cycle, while the report provides an overview of the findings.

(5) On September 7th the ECB ***launched a public consultation on its guide to internal models***. The draft includes the chapters on ***credit risk, market risk and counterparty credit risk***. These risk-type

[36] supervisory review and evaluation process

specific chapters, which complement the previously published guide focus on providing transparency regarding the way the ECB understand the applicable regulations. The guide was drafter in close cooperation with national competent authorities (NCAs) and draws on experience gained from on-site investigations in the context of the TRIM[37] project. It also draws on the feedback received from institutions on the first version of the guide (published on February 28, 2017).

(6) On September 21st, after having concluded its public consultation on the same topic, the ECB published the ***guide to on-site inspections and internal model investigations***. The objective of the Guide is to promote the single supervisory practice and to explain how the ECB conducts its inspections, in order to increase transparency. The Guide applies to the inspections conducted in significant institutions as well as less significant institutions (LSIs).

(7) The number of too big to fail banks in the euro area increased from seven to eight, since ***Nordea Bank moved its headquarters from Stockholm to Helsinki***. The bank giant has a balance sheet of USD 670 billion and has made the decision to move in order to be a part of the Banking Union, and to fall under the scope of the Single Supervisory Mechanism.

II.5.2 The Single Resolution Mechanism (SRM[38])

(1) The Single Resolution Board (SRB) published its ***2017 annual report*** in early July. This last year marked a milestone for the Board, since the resolution of Banco Popolare (which was generally regarded as a success) was the SRB's first resolution decision. The Resolution Board also made significant progress in other domains, in order to fulfil its mandate by improving resolution planning policies, refining MREL policy, further operationalizing resolution instruments, strengthening international and regulatory cooperation and improving its own operational processes. The SRB focused its work on the following five main operational areas:

I. Strengthening the resolvability for SRB entities and less significant institutions;
II. Fostering a robust resolution framework;
III. Preparing and carrying out effective crisis management;
IV. Operationalizing the Single Resolution Fund (SRF);
V. Establishing a lean and efficient organization.

According to the annual report, the SRB reached its objectives set for 2017.

(2) Experience gained up until today suggests that in order for the SRM to function adequately it is important to ***provide the necessary liquidity***, in addition ***to a financial backstop*.** For this, the FSB suggests recommends establishing temporary public backstop funding mechanisms. Such a tool does not currently exist in the Banking Union, and Elke König, the Chair of the SRB, believes that ***central banks may be able to provide this*** under strictly defined conditions**.**

According to the SRB Chair, in order to complete the Banking Union, it is essential to create and to put in place ***a liquidation regime at EU level***.

(3) Institutions find it difficult to comply with the SRB's request to introduce changes to their outsourcing and supplier contracts, in order to ***ensure that these suppliers will continue to provide the services in case the institution is subject to a resolution measure***. The SRB requests changes to,

[37] Targeted Review of Internal Models
[38] Single Resolution Mechanism

in particular, contracts with suppliers of critical functions and considers the absence of such provisions ***an impediment to resolution***. An SRB-issued guidance on the minimum terms that should be observed in the contract clauses and the standardization of outsourcing and supplier contracts would be very helpful to the sector (this would also facilitate the signing of contracts with large, global suppliers).

II.6 The Capital Markets Union (CMU[39])

As time goes on it becomes more and more dubious if the goals set out for the completion of the Capital Markets Union will be achieved on schedule: before the end of the mandate of the Commission and the Parliament. ***Out of the 13 legislative proposals submitted*** by the Commission since 2014, ***the Parliament and the Council approved only three***, even though the EU elections will be held in a little over half-a-year: a well-justified reason to speed up the processes.

(1) A breakthrough has been achieved with regard to the Insolvency Directive[40]: on October 11th the Justice and Home Affairs Council approved the "General Approach". The European Parliament already made its decision about the directive on August 21st; therefore they are ready to start the trilogue on the directive.

The European Banking Federation wrote a letter to the Commission and the Austrian Minister of Justice and Minister of Finance before the Council approved the directive. The letter drew attention to the fact that some of the proposals submitted to the Council ***may have a very detrimental effect on the supply of secured lending and may increase the cost of future loans***, especially to SMEs, which have a weaker credit score. A stay of enforcement longer than 90 days, the ability of illiquid debtors to enter the stay, the possibility for lower-ranking creditors to cram down secured creditors and the management of netting arrangements may also have a harmful impact.

The text approved by the Council did not reflect on the EBF's comments.

(2) The discussion on the European Commission's proposal on the handling of ***covered bonds*** continues in the Council and the Parliament, and will hopefully come to a successful conclusion by the end of this year.

The European Banking Federation supports the proposal that promotes the further integration of the European financial markets and the development of the CMU. They specifically welcomed the consistency of the proposed supervisory regime with a focus on covered bond public supervision and investor protection. According to the EBF, the approach taken is balanced and covers all necessary elements for a sound covered bond product, thus achieving the objective of justifying a preferential treatment in terms of capital requirements. However, the proposal ***reveals some uncertainties*** (regarding its scope, the definition and use of hedging derivatives and the composition of cover pools) that may hamper the well-functioning and cost-efficient market we have today.

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[39] Capital Markets Union

[40] Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency

II. 7 Regulation against money laundering

II.7.1 The issuing of the Fifth anti-money laundering (AML) directive and its entry into force

In July 2016, after the scandal involving terrorist attacks and the Panama documents, the European Commission submitted its proposal, which is part of its Action plan of February 2016, to reinforce combat against terrorism financing. The ***Fifth anti-money laundering directive*** defines several measures for ***rendering the battle against terrorist financing more effective and increases the transparency of financial transactions***:

- enhance the powers of EU Financial Intelligence Units and facilitating their increasing transparency on who really owns companies and trusts by establishing beneficial ownership registers;
- prevent risks associated with the use of virtual currencies for terrorist financing and limiting the use of pre-paid cards;
- improve the safeguards for financial transactions to and from high-risk third countries;
- enhance the access of Financial Intelligence Units to information, including centralized bank account registers.
- ensure centralized national bank and payment account registers or central data retrieval systems in all Member States.

The directive entered into force on July 8, 2018 and EU member states must ***transpose*** its provisions into their national law by ***January 10, 2020, at the latest***.

II.7.2. Further strengthening anti-money laundering supervision

In September, the European Commission proposed to ***further strengthen the supervision of EU financial institutions to better address money-laundering and terrorist financing threats***. As amended by the ***pending proposal to review the ESAs, the Commission will clarify the European Banking Authority's mandate*** in the context of anti-money laundering in order to make it more explicit and comprehensive, accompanied by a clear set of tasks, corresponding powers and adequate resources.

The amended regulation will:

- ensure that breaches of anti-money laundering rules are consistently investigated: the EBA will be able to request national anti-money laundering supervisors to investigate potential material breaches and to request them to consider targeted actions - such as sanctions;
- provide that the national anti-money laundering supervisors comply with EU rules and cooperate properly with prudential supervisors. The EBA's existing powers will be reinforced so that, as a last resort if national authorities do not act, the EBA will be able to address decisions directly to individual financial sector operators;
- enhance the quality of supervision through common standards, periodic reviews of national supervisory authorities and risk-assessments;
- enable the collection of information on anti-money laundering risks and trends and fostering exchange of such information between national supervisory authorities (so-called data hubs);
- facilitate cooperation with non-EU countries on cross-border cases; and
- establish a new permanent committee that brings together national anti-money laundering supervisory authorities

Out of the three European Supervisory Authorities, the EBA will be entrusted, as it is in the banking sector that money-laundering and terrorist financing risks are the most likely to have a systemic impact.

II.7.3 The case of Danske Bank

The relevance of the problem was demonstrated by the ***money laundering scandal*** at ***Danske Bank***, the largest bank in Denmark, which revealed in September. The majority of the money laundering transaction was conducted at the bank's Estonian branch, and affected EUR 22 billion and 15 thousand clients. After the scandal the Danish Parliament voted through an eight-fold increase in the maximum fines for money laundering – making it one of the toughest jurisdictions in Europe. Even though the new legislation is not retrospective, Danske Bank will still have to face a fine of billions of dollars, imposed by Danish, European and US authorities.

I response to the scandal, the ***Finance Denmark compiled and published a collection of 15 measures*** in order to prevent such scandals in the future.

II.8 Joint Committee Report on Risks and Vulnerabilities in the EU Financial System

The Joint Committee[41] Report identified three main areas of risk:

- risks that abruptly increasing yields generate substantive asset price volatility and lead to losses across asset classes have remain both imminent and high;
- risks related to the repricing of risk premia and increasing interest rates directly affect financial institutions and retail consumers;
- the need to prepare for the United Kingdom's withdrawal from the EU without a withdrawal agreement, including preparing for the risk of reduced access to market infrastructures and contract continuity issues, have become critical for firms.

In light of the above mentioned uncertainties, supervisory vigilance and cooperation across all sectors remains key. The Joint Committee advises the following policy action by the European Supervisory Authorities, national competent authorities, financial institutions and market participants moving forward:

- Against the backdrop of rising interest rates and the potential for sudden risk premia reversals, it remains crucial to conduct and develop further stress test exercises across all sectors.
- Supervisory authorities need to pay continued attention to the risk appetite of financial institutions. Banks should accelerate addressing their stocks of NPls and adapt business models to sustainably improve profitability.
- Macro- and micro prudential authorities should contribute to further address possible contagion risks and they should continue their efforts in the monitoring of lending standards.
- It is also crucial that EU financial institutions and their counterparties, as well as investors and retail consumers plan appropriate mitigating actions in a timely manner, to prepare for the UK's withdrawal from the EU. Preparations should address relevant risks that inconclusive agreements on withdrawal terms would pose.

[41] Joint Committee: az Európai Felügyeleti Hatóságok (ESAs); azaz a bank-, az értékpapír-piaci és a biztosításfelügyeleti hatóságok (az EBA, az ESMA és az EIOPA) közös fóruma

II.9 Relevant EBA's and ESAs' documents in Q3

Consultation papers

Consultations on supervisory reporting

Regulatory and implementing technical standards

Final draft technical standards on risk retention for securitization transactions (EBA/RTS/2018/01)

Final draft technical standards defining the homogeneity of the underlying exposures in securitization (EBA/RTS/2018/02)

Final draft technical standards on home-host cooperation under PSD2 (EBA/RTS/2018/03)

Guidelines

Guidelines on the management of interest rate risk arising from non-trading book activities (EBA/GL/2018/02)

Guidelines on the revised common procedures and methodologies for the supervisory review and evaluation process (SREP) and supervisory stress testing (EBA/GL/2018/03)

Guidelines on institutions' stress testing (EBA/GL/2018/04)

Final Guidelines on fraud reporting under PSD2 (EBA/GL/2018/05)

ESAs' further guidance on the Key Information Document for PRIIPs[42]

Extension of the Joint Committee Guidelines on complaints-handling (JC/2018/35)

Reports and other documents

Report on the impact of FinTech on incumbent credit institutions' business models

Report on the prudential risks and opportunities arising for institutions from FinTech

Report on the peer review of the RTS on passport notifications

Risk dashboard data as of Q1 2018

Report on the monitoring of CET1 instruments issued by EU institutions - first update

Report on monitoring of Additional Tier 1 instruments - third update

Assessment of European Secured Notes

Report on the functioning of resolution colleges in 2017

Updated XBRL taxonomy 2.8

Updated data used for the identification of global systemically important institutions (G-SIIs)

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[42] Packaged retail investment and insurance products

Joint Committee Report on the results of the monitoring exercise on 'automation in financial advice' (JC/2018/29)

Revised list of validation rules

Revised standardized NPL data templates

Report on funding plans

2018 EU-wide transparency exercise