

## THE BANK OF THE FUTURE, THE FUTURE OF BANKS

### *Digitalization proposals by the Hungarian Banking Association*

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A well-functioning banking system is one of the cornerstones of economic prosperity, and so implementing the sector's digitalization ambitions as fast and as efficiently as possible is of key importance for the national economy, too. That is why the Hungarian Banking Association strives to create an active partnership and collaboration with the legislator and the supervisory authorities and has compiled proposals to help achieve a legislative environment that supports the transition to digital banking.

### I. PROPOSALS TO SIMPLIFY AND REINFORCE DIGITAL BANKING PROCESSES

It has by now become clear that – similarly to other sectors – even the banking sector's success is fundamentally determined by the way it responds to the challenges of digitalization. In the period ahead, digital transition will continue in banking services as well. As a well-functioning banking system is one of the cornerstones of economic prosperity, implementing the sector's digitalization ambitions as fast and as efficiently as possible is of key importance for the national economy, too.

The members of the Hungarian Banking Association drew up a list of the focus points of digital transition in banking and formulated their proposals for how to support them. This document puts forward the points where we have identified digitalization-induced progress opportunities conducive for the banking sector and the national economy at the same time. Further, we are also making concrete proposals to the legislator whereby Hungary's digital competitiveness can be improved.

In our view, the following are the key points of digitalization in banking that also support economic growth:

#### 1. Reducing high cash use by digital payment solutions

By the end of 2018, **the amount of cash in circulation in Hungary rose to an all-time high** of 6000 B HUF, equivalent to an 18.7% percent increase over a year. In GDP terms, this amounts to almost **14.9%, the sixth highest ratio in Europe**,

**while the amount of savings held in cash is proportionately the highest.**<sup>1</sup> By July 2019, the amount of cash in use increased to 6,225 B HUF<sup>2</sup>. According to the estimation of experts, the high use of cash causes an income shortfall of at least 400-450 billion HUF to the central budget.

According to 2017 data available to us, cash use in the Hungarian economy is significantly more intensive than the average of even the Central-Eastern European (CEE) region.

The very high cash use is attributable to several reasons:

- low applicable money-market rate;
- transaction levy, which has made the use of non-cash payments (especially money transfers) more expensive;
- two free cash withdrawals of up to HUF 150 000 a month;
- the extensive nature of the black and grey economies;
- the high degree to which old age pension and similar benefits and allowances are paid in cash.

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## **2. Expanding and optimizing digital lending and customer service processes, reducing the administrative expenses of bank operations**

Over the recent years, beyond developments required for regulatory compliance, IT development in banking focused on working out customer service- and lending-related digital processes. Banks' commitment is well illustrated by the fact that several institutions launched their own innovation centres, and several successful partnerships evolved between domestic banks and FinTech companies. The sector has been able to adapt to the fast changing consumer habits with the necessary efficiency, i.e. beyond the fast proliferation of mobile applications facilitating digital banking, several institutions now offer a borrowing option to their

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1 Source: MNB Annual Report (2018), <https://www.mnb.hu/letoltes/eves-jelentes-2018-hun-digitalis.pdf>.

2 Source: Press release of the National Bank of Hungary on its statistical balance sheet, based on data from July 2019, <https://www.mnb.hu/letoltes/sajtokozlemeny-201907.pdf>.

clients that is online end-to-end. The new challenges triggered fast changes in the institutions' organizational structure as well, and the increasingly widespread agile mode of working provides an efficient framework for the implementation of digital developments.

In addition to the banking sector's commitment, the successful implementation of digitalisation initiatives also requires an operational environment conducive to digital transition:

- The openness of the regulator to this effect is proven – inter alia – by the Innovation Hub and the Regulatory Sandbox launched by the National Bank of Hungary (hereinafter: MNB);
- It is, however, important to underline at this point that in the European Union, Member States are involved in an increasingly fierce regulation competition, i.e. Member States putting in place a more flexible regulatory framework may soon enjoy a competitive advantage, while countries applying stricter than justifiable rules may soon find themselves at a competitive disadvantage.

It is in the essential interest of the Hungarian national economy to keep up with the regulatory race within the European Union and to avoid a competitive disadvantage towards Member States that have more flexible regulatory frameworks in place. The Hungarian Banking Association is ready to support the optimization of the Hungarian regulatory environment with all the tools at its disposal, in order to achieve the creation of a digital banking administration process that is digital from end-to-end.

According to our proposals

- through improving the quality and rate of use e-public administration,
- through minimising processes that still require paper-based administration, and
- through the most efficient use possible of the available data assets

the legislator may make significant progress in the transition to digitalization, in collaboration with the actors of the banking sector and the supervisory authorities.

### **3. Continuing to strengthen education that incorporates digital finances**

The Hungarian banking sector is committed to improving the Hungarian population's financial competences, a precondition indispensable for the proliferation of digital solutions. Hungary first joined the European Money Week initiative – taking place simultaneously in almost 30 countries across Europe – in 2015.

The program is intended to help students interested in finances increase their knowledge from a young age, and to raise their awareness about the need for daily conscious financial management. The Money Week (Pénz7) event series is composed of professional programs, special events held in schools and playful contests. Hungary is setting a genuine example by the cooperation its professionals have engaged in to implement the event series “Pénz7” linked to the European Money Week.

The event series “Pénz7” was launched between 2015 and 2016 by the Hungarian Banking Association as chief organiser, in cooperation with the Pénziránytű Alapítvány (Money Compass Foundation), with the professional support of the Ministry of Human Capacities. In 2017, the Ministry of Human Capacities – as the project owner – inserted Pénz7’s learning material in the school year’s official curriculum. In the 2017/2018 school year, the Ministry for National Economy supported the expansion of the program, and did so even after its transformation into the present-day Ministry of Finance. In the 2018/2019 school year, as the experience-based presentation of entrepreneurial competence-development and entrepreneurial foundation skills were also included in the program series, the Ministry of Innovation and Technology and the Junior Achievement Foundation also joined in in the support. In 2017, Pénz7 made its debut in higher education; the University of Miskolc organised a Professional Day dedicated to stimulating the culture of entrepreneurship and in 2018, Miskolc opened its Financial Culture Centre “FINTELLIGENCE” – primarily dedicated to spreading digital financial skills. Following in the footsteps of Miskolc, several other major cities also opened their own Fintelligence centres.

## II. GENERAL PROPOSALS

1. **The enforcement of the principle “same activity, same regulation” is of key importance** to help digital banking solutions gain ground as fast and as competitively as possible.
  - Having to comply with looser regulations – for obvious reasons – Fintech and Bigtech companies also offering financial solutions may gain market share more easily. Even the Bank of International Payments (BIS) mentions in its 2019 annual report<sup>3</sup> that „regulatory arbitrage” is a problem. This means that if FinTechs and BigTechs need to comply with fewer rules than banks, they may at first create the illusion of being more client-friendly. The more lenient data protection rules applicable to FinTechs

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3 BIS Annual Economic Report (2019), <https://www.bis.org/publ/arpdf/ar2019e3.htm>.

may give them an advantage in data analysis, and they may consequently provide better tailored services to their clients. More lenient rules also expose client data to more dangers. This is also why BIS has been promoting the “Same activity, same regulation” principle<sup>4</sup>.

- The regulatory and supervisory environment will be decisive for banking digitalization, too: if rules imposed on FinTechs/BigTechs are looser than the ones imposed on banks, digitalization will take place in a non-level playing field and with more risks for clients than what should be allowed.
- Due to this, the Hungarian Banking Association recommends the implementation of the “same activity, same regulation” principle when creating the legislative environment, as this will not only fundamentally influence the future of the banking sector, but is also in the important interest of the national economy.

**2. We recommend allowing the conclusion of stand-alone framework contracts for digital service provision.**

- In order to achieve technology-neutrality, financial institutions should be allowed to provide a service by which their clients can access the electronic channel used for contracting purposes in the most client-friendly and at the same time in the safest possible way.
- Client feedback indicates that there is demand for a digital framework contract also without the use of a specific financial service, and therefore it is justified to allow its conclusion and maintenance between the parties even if a financial service is not provided/used.
- For this reason, financial institutions should be allowed to name the digital service framework contract as one of their normal business services. Alternatively, this service could be classified as a supplementary financial service.

**3. Rules regulating payment instructions submitted digitally should be accurately defined.**

- A more accurate definition of the security component requirements applicable to digital payments is indispensable for their safe use – and consequently for their ongoing expansion. Consumer consciousness must also be strengthened in this regard.
- Act LXXXV of 2009 on the Pursuit of the Business of Payment Services stipulates the obligations of clients and of payment service providers con-

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<sup>4</sup> BIS Annual Economic Report (2019), <https://www.bis.org/publ/arpdf/ar2019e3.htm>.

cerning payment instruments, thus Section 40 provides in general that clients shall use the payment instrument exclusively as defined in the framework contract. For the safekeeping of payment instruments and of the personal security instruments necessary for their use, the contracting parties may agree in the framework contract on the conduct generally expectable under the specific circumstances. Typically, the parties record in their payment framework contract the cases that are to be construed as serious negligence when using non-cash payment instruments.

- Disputes and abuses – the unavoidable consequences of increasing turnover – may reduce consumer confidence in digital solutions. To prevent these from happening and to enhance consumer consciousness, the cases and acts of seriously negligent conduct should be defined by legislation accurately, using clear criteria. Such criteria should be objective, free of discrimination and proportionate.
- In our view, the following cases require management in the first place:
  - issuance of one-off check codes or passwords to third parties (save the cases regulated in the PSD2 directive),
  - release of verification instruments and their biometric function to third parties.

**4. We recommend the simplification of the process used to produce certified electronic copies of paper-based documents.**

- With the advance of technology, new conditions now allow the conversion of paper-based statements into a digital format in a way that makes sure that their content is recorded in a recallable manner, remains unchanged and this happens electronically. This service must be reported to the Electronic Administration Supervision (Elektronikus Ügyintézési Felügyelet), and is governed by the general rules of supervision. As the process itself guarantees the authenticity of the electronic copy, the maintenance of the regulation requiring the archiving of the original, paper-based document once it has been converted into electronic format as described above is unnecessary. We recommend the abolishment of the rule stipulated in Subsection (12) of Section 58 of the Act on the National Bank of Hungary providing for the mandatory presentation of paper-based documents in supervisory authority procedures.

**5. Clients should be given the option to issue their privacy statements to their financial service provider on the institution's right to hand over client se-**

**crets (e.g. bank secrets, security secrets) to third parties, in a format that does not qualify as a conclusive private deed.**

- Thus, the statement should not be required to be an authentic instrument or issued as a conclusive private deed.
  - In the event of a more limited amendment to the legislation – to allow service providers to approach their customers with advertisements – we recommend that the electronic issuance of the client statement enabling data transfer among group members should be included among the exceptions, and we also recommend replacing authentic instruments or conclusive private deeds with the written format as the formal criterion.
6. We recommend amending the provisions of Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises on joint representation (Section 141) in such a way that **in online processes, authenticating documents by the use of electronic stamps should also qualify as joint signature on the Bank's side, also when the stamp is affixed to the document automatically, without human intervention, as the Bank's signature.** The recommended amendment is in compliance with the provisions of Regulation (EU) No 910/2014 of the European Parliament and of the Council of 23 July 2014 on electronic identification and trust services for electronic transactions in the internal market and repealing Directive 1999/93/EC (eIDAS).
7. **We recommend supporting transition to digital document handling.**
- Easing the legislative requirements on the storage of electronic documents and supporting access to closed-system archiving would significantly accelerate transition to digital document handling. We consequently recommend the simplification of Decree No. 1/2018 (VI.29) of the Ministry for Innovation and Technology on the rules of digital archiving.
8. **We recommend expanding the notion of conclusive private deed in the Code of Civil Procedure.**
- Subsection (1) of Section 325 of Act CXXX of 2016 on the new Code of Civil Procedure identifies the documents construed as conclusive private deeds.
  - In view of the technological specifications of the audited electronic telecommunication instrument – pursuant to Decree No. 45/2018 of the National Bank of Hungary – (closed system, identified issuer of statement, live video connection, statement of unchangeable content, archived and retrievable and/or available for review at any time), we find it justified

that the above referenced Section of the Code of Civil Procedure be supplemented by the option of statements issued via the audited electronic telecommunication instrument meeting the requirements set forth in the MNB Decree.

**9. We recommend expanding the notion of „written documents” in the Civil Code**

- to give more room for manoeuvre to service providers to work out the rules – fit to be applied in the electronic world – for their various banking services (e.g. services provided through the telecentre or telebank).

**10. We suggest the abolishment of the levy on retail transactions**

- In order to end the competitive disadvantage of electronic bank transfers and to allow their inclusion in banking packages – a solution more favourable for the national economy as well.

**11. We propose the introduction of a banking tax allowance linked to digitalisation developments and IT system renewal.**

- A significant portion of the banking sector’s operating expenses is related to developments targeting digitalisation. The labour force connected to these developments is characterized by high mobility and by consistently high wage levels across the whole EU.
- It would be expedient to provide an allowance from the banking tax to eligible institutions in proportion to the developments they implement to increase the banking sector’s competitiveness in the region, to enhance the efficiency of lending and to strengthen the stability of the financial intermediary system.

### **III. PROPOSALS RELATED TO THE REDUCTION OF CASH USE**

The Hungarian Banking Association’s Digitalization Working Group analysed the reasons for the high use of cash in Hungary in a separate study, and also put forth recommendations to reduce it.

In its paper, the Working Group put forth the following recommendations, also related to digitalization:

## 12. Proposals for the reduction of cash use

- a) **Mandatory electronic payment option at online cash registers.**
- b) **Mandatory electronic payment option if a merchant's sales revenue exceeds a certain level.**
- c) **Preferring electronic payment to cash when customers wish to settle a payment using a yellow postal payment slip.**
- d) **Encouraging electronic payments between the state, the municipalities, companies and private individuals** (e.g. introducing cash usage limit for sale and purchase transactions, abolishing wage payment in cash, revisiting the rules for the two free cash withdrawals).

## IV. PROPOSALS RELATED TO THE FAMILY PROTECTION ACTION PLAN, THE REAL ESTATE REGISTRY, AND THE CAR REGISTRATION PROCESS

13. **The components of the Family Protection Action Plan ('CSOK' – Family Housing Allowance, Baby Boom Subsidy) should be made accessible via a digital application and a digital contracting procedure.** Also, the information provision and the issuance of statements under the relevant legislation should also be allowed to be made electronically.
  - We therefore recommend that the government decree on the baby boom subsidy should allow clients to replace the conclusive private deed with a statement made via an audited electronic telecommunications instrument meeting the requirements set forth in MNB decree No. 45/2018. Should this proposal be approved, we recommend that the government decrees on CSOK be also amended accordingly.
14. **We recommend introducing the option of electronic mortgage agreements and collateral agreements.**
  - This primarily requires the amendment of Act CLXII of 2009 on Consumer Credit, Act XXX of 1997 on Mortgage Loan Companies and on Mortgage Bonds and Act CXLI of 1997 on Real Estate Registration.
15. **We suggest simplifying the involvement of public notaries in the lending process.**
  - The role of public notaries is unavoidable in retail and corporate lending alike. In line with the contents of the Competitiveness Program drawn

up by the National Bank of Hungary composed of 330 points<sup>5</sup>, we agree with the conclusion that it would be expedient to review the position and the role played by public notaries in lending processes.

- Putting in place an integrated digitalized system and standardizing unilateral commitment statements would significantly increase the efficiency and transparency of lending processes, and could mitigate the administration costs clients incur in relation to a loan.

**16. We recommend the introduction of electronic administration in the Land Registry and in the official car registration processes:**

**a) Introduction of online land registry process in order to mortgage lending digital end-to-end.**

- For this purpose, we recommend the amendment of Act CXLI of 1997 on Real Estate Registration and Act CCXXII of 2015 on the General Rules for Trust Services and Electronic Transactions.)
- The possibility for an out-of-turn recording of the edge note should be worked out. The edge note should be recorded upon the disbursement of the loan, at the initiative of credit institutions. Likewise, the deletion of an institution's own mortgage right should be allowed out of turn, at the institution's own initiative, in order to make sure that reliable data be retrievable without delay. We also recommend that the data content of title deed copies and map copies should be made immediately accessible in Excel format.
- The data content of these documents should be released in editable Excel format rather than just issuing the title deed copies and map copies as electronic documents. At the moment, the above data content is only available in image files (as the title deed or the map copy is issued). Instead of the title deed, for the purpose of the real estate appraisal, it is also necessary to provide access to the database including the real estate data in edited format.

**b) It is advisable to simplify the official car administration process by establishing an online vehicle administration process.**

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<sup>5</sup> <https://www.mnb.hu/kiadvanyok/jelentesek/versenykepessegi-program-330-pontban>.

## V. PROPOSALS FOR INVESTMENT PRODUCTS AND CURRENCY EXCHANGE

### 17. Clients should be able to open a pension savings account electronically.

We believe that digitalizing the process of entering into contract may help promote the willingness of the population to provide for their future. This proposed goal would be achievable through amending Subsection (2) of Section 3 of Act CLVI of 2005.

18. In relation to currency exchange, it would be helpful to **amend Point 92 of Subsection (1) of Section 6 of Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises**, in such a way that would allow the exchange transaction to be completed by the use of the Instant Payment System, by transfer, executed personally in the money exchange offices.

## VI. ACCESS TO EXISTING CENTRAL DATABASES

19. We recommend that **financial institutions be allowed to take advantage of services available under the e-administration law**, i.e. primarily the safe delivery service related to the electronic identification service, the use of the related storage space and electronic identification by e-IDs.
- The Client Gateway is an already existing infrastructure used by a large number of clients (according to the information of the Ministry of Interior, 3.7 million<sup>6</sup> people had registered for the service by December 31st, 2018.). Through this infrastructure, financial institutions could forward electronic documents to their clients in a safe way, and clients could administer the documents related to their finances on a well-known platform. In connection with the above, it would also be expedient to take advantage of the Primary Identification Agency (KAÜ) **for the purpose of money laundering-related identification**.
  - We believe that as for the up-to-date nature of data, it is necessary to **make sure that digital processes are competitive in terms of their fees, duties and costs** compared to the conventional modalities requiring personal appearance. For this it is necessary to significantly reduce the retrieval fees – recorded in legislation – charged for the retrieval of client data from databases.

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<sup>6</sup> [https://nyilvantarto.hu/letoltes/statisztikak/2018\\_evi\\_adatokat\\_tartalmazo\\_monitoring\\_jelentes.pdf](https://nyilvantarto.hu/letoltes/statisztikak/2018_evi_adatokat_tartalmazo_monitoring_jelentes.pdf)

**20. We suggest to create and use a central database for real estate evaluations.**

- The discontinuation of site visits – albeit not generally across the board – could speed up as well as reduce the costs of the lending process.

**21. We ask to work out the National Tax and Customs Authority’s income database in detail**, also in relation to the content of itemised statements of earnings (e.g. social security benefit, old-age pension, legal relationship). **Furthermore, we propose to create a central database of clients defaulting on their utility bills and access to this database** – This solution is already working successfully in the Czech Republic.

**22. We recommend the introduction of a positive debtor’s list (positive Central Credit Information System) based on mandatory data transmission.**

- We believe that using a generally accessible positive credit register for credit scoring would lead to better founded decisions and would help decrease lending risk. It would also have a positive effect on retail interest margins and would contribute to sustaining a lending volume that supports the growth of the national economy.
- In the recent past as many as two studies by the National Bank of Hungary noted that the extent of information asymmetry linked to lending risk bears exceptional significance in the lending activity of banks. According to central bank experts<sup>7</sup>, greater accuracy of predictions for expected credit loss has a positive influence on the value of interest, however, it is absolutely indispensable for the creditor to evaluate the solvency of its client based on data with as much detail as possible. An important conclusion drawn by another analysis<sup>8</sup> is that in the countries observed by the central bank where the countries applied positive debtor’s lists, the interest margin of housing loans was lower than in those where, just as in Hungary, no similar debtor’s list is required.

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7 ACZÉL ÁKOS – BANAI ÁDÁM – BORSOS ANDRÁS – DANCSIK BÁLINT (2016): Identification of factors determining the spread of housing loans in the Hungarian banking system [A lakáshitelek felárát meghatározó tényezők azonosítása a magyar bankrendszerben]. *Hitelintézeti Szemle*, 15(4), 5–44.

8 DR. ALEXANDRA DOROTTYA BÉRES – GABRIELLA GROSZ (2016): Mandatory positive list of debtors: This can make loans cheaper [Kötelező pozitív adólista: ettől lehetnek olcsóbbak a hitelek], <https://www.mnb.hu/kiadvanyok/szakmai-cikkek/devizahitel/dr-beresalexandra-dorottya-grosz-gabriella-kotelezo-pozitiv-adoslista-ettol-lehetnek-olcsobbak-a-hitelek>.