HUNGARIAN BANKING ASSOCIATION

REPORT

Activities of the Hungarian Banking Association in 2018

Budapest, March 2018

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I. Executive Summary

In 2018 the growth rate of the world economy slowed down, despite the favorable trends early on in the year. The trade war between the United States and China and the uncertainty of money and capital market conditions towards the end of the year both restricted growth. Mid-year, the IMF lowered its expectations for 2018's global growth by 0.2 percentage points (to 3.7%). Due to worries concerning in part demand, and in part supply, by the end of the year oil prices fell by more than they ever had in the past ten years.
The fiscal stimulus has a positive impact on the ***US*** economy, which performed well throughout the year. Annual real GDP growth rate was over 3%, and the effects of the imbalances caused by financing the recovery of the economy from the budget are not yet visible. Internal consumption is the main driving force behind growth, as well as business investments in the private sector, while net export and government sector expenses only had a moderate impact on it.
The economic growth of the ***European Union*** has been rising steadily since 2014, though it slowed down more and more towards end-2018. Annual GDP growth was 1.9%, half a percentage point less than in the previous year. Growth primarily relies on internal consumption, supported by a favorable labor market (unemployment is at is lowest in nine years, while the number of new jobs is at its highest). There are significant risks for a downturn in growth in the future.
The growth of the ***Chinese economy*** became gradually more moderate as the year went on. Internal consumption remains its main pillar, though the slowing of its rate, along with that of investment continues, with net export restraining economic expansion as well. In order to avoid a downturn in economic growth the government uses targeted measures to ease its carefully introduced fiscal and monetary tightening and supports the investments of provincial administrations. It has also mitigated its instruments to restrict credit growth from shadow banking.
As a result of unfavorable processes, the external environment of the ***Hungarian economy*** became less and less supportive in terms of growth and external balance prospects. Despite this, the seasonally and calendar adjusted Hungarian GDP grew by 4.9%. With regard to production, the performance of all important sectors contributed to growth; in addition to good industrial and construction industry production, markets services also increased significantly. As regards consumption***,*** its dynamics somewhat slowed down due to a strengthening base, it did however remain definitive. Investments continue to aid growth, while net export performed weaker than in previous years. Employment and unemployment improved minimally as regards the ***labor market***, although a lack of labor supply limits several sectors. The average annual ***rise rate of consumer prices*** stayed below the target level, increasing by 2.8% for the entire year - 4 percentage points more than the year before. The fact that inflationary pressure is quite moderate is reflected in the fact that core inflation also stayed under its target, at 2.5%. The ***government budget deficit*** was HUF 1,445 billion at the end of the year; calculated with the EU methodology (EU pre-financing adjusted) it took on a value of under approximately 2% by the end of the year, while the gross government debt decreased to 70.9% (calculated together with EXIM). ***External balance indicators*** were also favorable.
In addition to keeping the base rate level, the central bank of Hungary announced the transformation of its ***set of monetary instruments***: non-conventional instruments affecting short-term yields will be simplified, and the non-conventional set of instruments affecting long-term yields will be fine-tuned. In addition, it disclosed that it will start to prepare for the normalization of monetary conditions.
The ***aggregated balance sheet total of credit institutions*** grew by a nominal 8.4% (HUF 3,049 billion) to over HUF 39,000 billion. On the ***liability side,*** all important liability types increased. ***Total deposits*** grew considerably (by 10.1%, HUF 2,444 billion). Corporate and retail non-financial deposits increased at almost the same rate and by nearly the same amount, the former rising by 14.5% (HUF 1,146 billion), and the latter by one-tenth of a percentage point more (HUF 1,262 billion). Within ***assets,*** the main driving force behind growth was the expansion of the credit portfolio and interbank assets***.*** Debt securities basically stagnated. The ***gross loan portfolio*** grew by a nominal 10.7% (HUF 1,778 billion) not considering interbank credit. All sectors contributed positively to credit growth, with non-financial enterprises being the most prominent, having contributed the same amount as

last year (+13.2%, HUF 1141 billion). Gross ***household loans*** grew by 5.8% (HUF 338 billion). The ***net loan-to-deposit ratio***[1] of the credit institutions sector increased from 77% in the previous year to 79% in 2018.
Profit before taxes was close to HUF 757 billion, which is almost one-fifth less than it was last year (HUF 695 billion). Consequently, before taxes, the banking sector's average return on assets (ROA) was +1.5% (in 2017 this was 1.8%), and its return on equity (ROE) was +13.4% (in 2017 this was 16.2%). Not considering impairment and reversal of provisions, as well as the dividend of foreign subsidiaries, the ROA would be 1.1% (equal to that of last year's) and the ROE would be 9.7% (this was 10.2% in 2017).
In line with the principles of the Funding for Growth Scheme in January 2019 the MNB launched the ***FGS Fix*** with a facility amount of HUF 1,000 billion, the target of which remains the SME sector. According to the central bank's expectations, the FGS fix may raise the level of investments in 2019 and 2020 by 0.2 and 0.8 percentage points, respectively, and as a result of this it may contribute to the economic growth expected in 2020 by 0.2 percentage point.
The MNB initiated the introduction of an electronic interface, a so-called ***Electronic Loan Application Interface***, through which micro and small enterprises can submit their loan application in the same format to several banks in parallel and the participating banks have to provide an offer within a few days in a comparable format. The Interface is currently under preparation and will likely be launched in H2 of 2019.
With regard to ***retail lending***, one of the most important developments was that the Ministry of Finance issued its professional guidance with a view to ensure the uniform interpretation of the law related to *state aid for housing purposes* and the simplification of the rules of application for the *Family Housing Allowance Program* (CSOK). In addition, consultations were held on the possibility for banks to electronically access the *Tax Authority's income database*.
In the last trimester of the year, the judicial and financial omnibus act handled the introduction of the *exemption of the money on Széchenyi Recreation Cards from enforcement* and the *anonymized addresses of witness on banking certificates*, however no fully reassuring solution was found for the latter issue.
After the entry into force of the ***European Union's General Data Protection Regulation (GDPR)*** on May 25, 2018, the Ministry of Justice amended Act CXII of 2011 on the Information self-determination and the freedom of information. Sectoral legislation also needs to be amended in connection with the Regulation. To this end, the Ministry of Justice held several consultations with strategic partners, including the Banking Association; however, the proposal package was not discussed in the autumn parliamentary session.
The consultations on the act on the simplified debt settlement of private individuals affected by a significant payment default - the so-called ***simplified personal insolvency act*** – were conducted in the first three quarters of 2018. The Ministry of Justice also had plans to amend the ***personal insolvency act*** on the debt settlement of natural persons, adopted in 2015 and fundamentally unchanged ever since. In the end, the legislation proposal and amendment were not submitted to Parliament in 2018.
The new Decree of the Ministry of Justice on the ***rules applicable to public notary fees*** would have raised notarial fees for customers by a considerable amount. Taking into consideration the consultations launched on the management of this topic as well, the Ministry of Justice postponed the entry into force of the decree to April 1, 2019.
Following the practice of ***disclosure of bank secrets for national security and criminal investigation purposes*** which has existed for decades, the competent authorities have new demand for data due to digitalization and security challenges. The introduction of the signaling system through the amendment to the National Security Act (Nbtv. - in effect from January 2017) and the monitoring of payment transactions, integrated into the new Act on Criminal Procedure (Be.) and in effect from July 2018, have similar purposes in practice: the regular reporting of the transactions or a specific group

[1] Net loan-to-deposit ratio, without considering the interbank portfolio

of transactions on payment accounts and bank cards specified by the authority to the authority requesting the data. A solution was developed according to which the Special Service for National Security (NBSZ) will build a pilot system with one bank, to be examined by Hungarian National Authority for Data Protection and Freedom of Information (NAIH) and, if it is found adequate, the electronic data connection will also be established with the other banks concerned. Monitoring payment transactions according to the Be. may eventually pose data protection and feasibility problems similar to the above mentioned issues.

The methodology for determining the ***NDIF's fees*** and their payment will be modified on several points in the near future. One of these is the introduction of a new anticyclical indicator, which will allow for the consideration of macroeconomic cycles when determining fees. This change will not impact the 2019 fees. In addition, the beginning of the fee payment cycle will also change (from January 1st to October 1st), in order to increase predictability by determining fees based on audited data for the entire duration of individual cycles.

Simultaneously with the amendment of the Vocational Qualifications Act which took effect in July 2018, ***Sector Skills Councils*** were formed in 20 sectors, with the involvement of experts of companies representing the actors of the economy. The activities of the skill councils are coordinated by the Hungarian Chamber of Commerce and Industry (MKIK). As the government decree which contains the implementation was published with quite a delay in late November, the Sector Skills Council was not established officially and its members were not appointed by ministers. However, based on the request and organization of MKIK, the Council has bee operating informally from December 2017 and has carried out several developmental tasks.

The MNB announced the introduction of the ***Interbank Funding Ratio***, which entered into force on July 1st. Taking into account proposals previously mentioned at the consultations, during the calculation of the ratio certain refinancing sources are taken out from the sources to be used in the calculation or they may be assigned a preferential weight, and it now includes a de minimis rule. Linked to the new ratio, the MNB also modified the ***Foreign Exchange Funding Adequacy Ratio***, altering it to become a type of foreign currency NSFR.

In order to promote the diffusion of mortgage loans with longer maturities, the MNB modified the ***Payment to Income Ratio (PTI)***, complementing the ratio with categories according to interest rate periods. Consequently, a lower PTI ratio applies to loans with a shorter interest rate period.

During the year, the MNB reviewed the methodology for determining the ***Mortgage Funding Adequacy Ratio***, and by these means it wishes to introduce measures to deepen the mortgage bond market. The MNB plans to carry out the modification of the decree on the MFAR in two separate parts, with their entry into force in February and then October of 2019. The modified decree will raise the threshold of the MFAR, increase the original maturity of stable liabilities that can be considered, raise the de minimis and pricing, and will introduce credit rating for securities as well as institutions involved in the issuing process.

In addition to the above, the MNB also issued a ***decree on the detailed rules of the form and method of complaint handling in financial institutions***, which entered into force in early March. In addition, it re-regulated the requirements for the screening systems set in the act regulating the combating of money laundering by issuing a new decree, to enter into force in early 2019 (and on July 1st with regard to the application of automatic screening systems). Essentially, online customer due diligence, simplified customer due diligence and expectations for screening systems were re-regulated and training-related rules were complemented.

The central bank of Hungary elaborated, and following consultations, finalized its ***draft recommendation on the requirements for product approval applicable in the capital market*** based on the guidelines of the European Securities and Markets Authority (ESMA) of the same topic, as well as its ***draft recommendation on determining the definition of a group of connected clients (client group) in accordance with the CRR***, based on the European Banking Authority's (EBA) guidelines of the same topic. The former entered into force in mid-July. As regards the latter, the supervisory authority expects institutions to implement the parts of the recommendation referring to large exposures from January 1, 2019, while its other parts must be implemented from July 1, 2019.

With regard to payments, the task of the highest priority in 2018 clearly continued to be the ***instant payment systems*** (AFR) project. Through their regular meetings, the relevant working groups of the Banking Association served as an independent complementation to the Project Steering Committee, and by involving representatives from GIRO Zrt. and the MNB they discussed issues concerning regulation, legal interpretation, operational and process engineering for the clearing system, the content of messages and their flow schemes, as well as secondary identifiers and connecting to the internal systems of banks, as well as those concerning liquidity and the optional request to pay service. The MNB took into account a large portion of the concepts voiced when amending its relevant decree as well as in its Recommendation, just as during developing the system. Two high-level CEO meetings of great importance took place, where central bank leaders reviewed and evaluated the current state of the national project, set the condition for the launch of the system on July 1, 2019, and presented the new pricing model for operating the GIRO AFR.
The implementation of the main principles and rules of the new ***Payment Services Directive (PSD2)*** began in both Hungary and Europe on January 13, 2018***.*** The implementation deadline of one of the most important new rules, the regulatory standard for strong customer authentication (SCA) was moved from January 1, 2019 to September 14, 2019. Consequently, up until September 13, 2019, when using the payment initiation service or the bank account information service, the liability and cover of damage rules set in the provisions (in effect from January 12, 2019) of the above mentioned law must be applied to the customer and the payment service provider managing his or her payment account. Another important task in payments regarded the Payment Accounts Directive and the implementation of the provisions of its regulatory and implementing technical standards. In addition to the above, special attention was also dedicated to the amendment of EU Regulation 924/2009, which contains two main elements: restrictions concerning payment service providers of member states outside the euro area with regard to charges applied to euro credit transfers, and restrictions with regard to dynamic currency conversion (DCC) for payment cards when payment is made in a currency that does not match that of the payment card. According to the agreement made at the Trilogue, the regulation for uniform charges on transactions will need to be implemented from December 15, 2019, while our member banks will need to implement rules in connection with DCC a year after. In February, the Board approved the production of a Feasibility Study (FS) concerning the ***development of interbank cash trade*** to be implemented in the framework of the Hungarian Banking Association. The aim is to develop an electronic cash-trade marketplace, where banks' supply and demand data may be published and to thereby make it easier for parties to find each other, to promote the fast and effective conclusion of transactions, and to increase trade efficiency by allowing the sector to save through connecting more potential parties than is currently feasible. The Feasibility Study has been completed, and the Board will discuss it in early 2019.
At the end of May 2018 the MNB published its position on the ***valuation of subsidized loans according to IFRS9*** in the form of a Q&A in order to promote the consistent application of the law, according to which, the proper way to proceed is to consider the amortized cost within the records***.***
The most important tasks in ***reporting*** were the timing of the introduction of the XBRL reporting format defined in the EBA ITS, the development of the analytical credit register of the central bank (HITREG) to be introduced from February 2020, the NDIF's new reporting concepts of Total Deposit Portfolio (TB) and Consolidated Deposit Portfolio (KBB), and the new capital market reports. In terms of ***taxation***, the most prominent topics were: issues in relation to the impact of the switch to IFRS on corporate income tax and local business tax; initiatives to reduce the special tax for financial enterprises; and the resolution of the technical problems associated with tax exemption from payment transactions between the customer accounts kept by the State Treasury and used by natural persons for sovereign debt trade and their payment accounts kept by another account keeper, introduced from 2019 on.
The European ***Money Week*** was organized in Hungary for the fourth time, from March 5 to 9, 2018, with an ever expanding number of participants: 1,200 schools, 202,000 students and 450 financial and corporate volunteers. These numbers indicate that out of all the Money Week programs initiated by the EBF in Europe, the Hungarian Pénz7 saw the most participants and is growing the most

dynamically. Other significant elements of the program series were the Money Week Academic Professional Day and the opening ceremony of the very first regional Fintelligence Financial Literacy Center at the University of Miskolc.

The lawsuit filed to review the Hungarian Competition Authority's (GVH) decision on the ***Bankadat case*** (Vj-8/2012) ended with the first instance success of the Hungarian Banking Association and the banks concerned. The GVH appealed against the first instance ruling. The proceedings led to the need for a ***competition law policy document***, which 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.

Important developments concerning the ***international relations*** of the Banking Association were the election of the Banking Association's Secretary General into the Board of Directors at the European Money Markets Institute (EMMI), and having successfully organized the Central European Covered Bond Conference in Budapest.

With regard to ***global regulatory bodies***, the ***Financial Stability Board's (FSB)*** main activities in 2018 rested on the priorities set in its work program, which sought to foster growth, through the following: 1. Vigilant monitoring to identify, assess and address new and arising risk; 2. Disciplined completion of the G20's outstanding financial reform priorities; 3. Shifting the focus from new policy initiatives to the assessment of existing regulations, as well as appropriately addressing unintended consequences; and 4. Optimizing how the FSB works in order to maximize its effectiveness. The ***Basel Committee on Banking Supervision's (BCBS)*** work program and the strategic priorities for 2018–2019 overlap with the FSB's activities in many areas: 1. finalizing existing regulatory initiatives and targeted regulatory recommendations; 2. ensuring full, timely and consistent implementation of the Committee's post-crisis reforms; 3. promoting strong supervision; 4. evaluating and monitoring the impact of post-crisis reforms, as well as gauging and assessing emerging risks.

Concerning ***European regulation*** a significant development was concluding the trilateral consultations on the ***banking regulatory package*** towards the end of the year. Additionally, important steps were taken in the legislation for the ***Capital Markets Union***, although it is unlikely that the regulatory processes set in the 2015 action plan will be completed by the 2019 deadline stated therein. The European Commission tried to speed up processes through two separate attempts, but achieved only temporary results. Thus, 10 out of the 13 regulatory dossiers were still pending at the end of the year. In reaction to the scandal involving terrorist attacks and the Panama documents, in July 2016 the European Commission submitted its proposal for the ***fifth anti-money laundering (AML) directive***, which aims to reinforce combat against terrorism financing and to increase the transparency of financial transactions. The directive entered into force in July 2018 and EU member states must transpose its provisions into their national law by January 10, 2020, at the latest. In relation to this and in response to money laundering scandals in member states, the proposal submitted in 2017 by the European Commission to ***alter the scope of the European Supervisory Authorities (ESAs)*** was complemented by the European Banking Authority's mandate in the context of anti-money laundering. Based on the decision made at the end of the year, this topic will be debated separately from the original proposal.

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

The ***global*** processes of 2018 started favorably, the global economy managed to continue growing at an accelerated pace, supported by the rise in investments, and global trade could not yet feel the effects of the protectionist measures of the USA. In the next period, however, brought growing uncertainty; market yields picked up robustly in the United States and the currencies of a number of economies with weak fundamentals fell under pressure. The differing monetary policy measures of leading economic nations lead to some uncertainty as well. The impact of high oil prices and the USA's trade policy measures became more and more noticeable towards the middle of the year. As a result, the IMF clearly lowered its expectations for global growth by 0.2 percentage points (to 3.7%). Towards the end of the year, the growth rate of the world economy slowed down, growth became more articulated in individual regions, as the trade war primarily between the United States and China was clearly having an effect on the Chinese and European economy, which were also facing structural difficulties. Money market conditions deteriorated at global level due to the strong fall in developed market exchanges, as opposed to the raising of interest rates by the ECB and the Fed for this year, which were completely priced out. Due to worries concerning in part demand and in part supply, by the end of the year oil prices fell by more than they ever have in the past ten years.

The fiscal stimulus has a positive impact on the US economy, which performed well throughout the year. Experts predict that the annual real growth rate will be over 3% in Q4, similarly to the previous quarters. Consequently the GDP grew at around the same rate over the entire year. Although the economic recovery financed from the budget adds to the imbalance, its effects are not yet visible on the US economy. Internal consumption is the main driving force behind growth, which is not surprising as alongside relatively stable wages the number of jobs and employment continued to expand significantly. Business investments in the private sector contributed significantly to growth, while net export and government sector expenses only had a moderate impact on it. The Fed gradually raised the reference rates from 1.5% at the beginning of the year to 2.5% towards the end.

The economic growth of the ***European Union*** has been rising steadily since 2014; however it slowed down more and more towards end-2018. Annual GDP growth was 1.9%, half a percentage point less than in the previous year. The main driving force behind growth is internal consumption, supported by a favorable labor market (unemployment is the lowest it has been in nine years, while the number of new jobs is at its highest). Towards the end of the year, the slowing of the Chinese and the global economy had a negative impact on net export performance, which had been favorable early on in the year. Inflation stagnated at its pervious level, and thus remained well below the ECB target level, while monetary conditions continued to be lax. The political risks of the previous time period also remained. Germany's new government took almost a half-a-year to set up after the elections, in Italy the new government was also established with several months of delay, while in France, despite the fact that the new administration was elected previously with a convincing majority, dissatisfaction led to a series of demonstrations.

The growth of the ***Chinese*** economy surpassed analysts' expectations in the first quarter of the year, however it became gradually more moderate, and GDP growth will, according to predictions, reach 6.6% on a yearly basis in 2018. Internal consumption remains the main pillar of growth, though the slowing of its rate, along with that of investment, continues, with net export restraining economic expansion as well. China is visibly preparing intensively for the trade war, although towards the end of the year a careful dialog was started with the USA, which is a favorable turn of events. In order to avoid a downturn in economic growth the government uses targeted measures to ease its carefully introduced fiscal and monetary tightening and supports the investments of provincial administrations. It also mitigated its instruments to restrict credit growth from shadow banking.

As a result of the above mentioned unfavorable processes, the external environment of the ***Hungarian economy*** became less and less supportive in terms of growth and external balance prospects. Despite this, the Hungarian GDP grew by 4.9% (adjusted by seasonal and calendar effects). With regard to production, the performance of all important sectors contributed to growth; in addition to good industrial and construction industry production, markets services also increased significantly, due to strong internal demand. As regards consumption*,* dynamics slowed down as a result of a strengthening base, but it remained a definitive factor of GDP growth. Investments continued to aid growth, with the real estate, industry and service provider sectors each playing their part. Net export performed weaker than in previous years, possibly due to the need for import as a result of the worse terms of trade caused by strong consumption, improving investments and high oil prices in the first half of the year.

Employment and unemployment improved minimally as regards the ***labor market***, the former grew by 1.1 percentage point, reaching 69.5% of the economically active population. The latter decreased by 0.5%, reaching 3.7% at the end of the year. Employment expands at a slow rate due to shrinking labor supply, the virtually sole cause of which is the job creation of the primary labor market. A lack of labor supply may actually limit several sectors, and its impact on market wage increase might remain significant.

The average annual ***rise rate of consumer prices*** increased by 2.8% for the entire year: 4 percentage points more than the year before. The main driving force behind this increase was the change in the prices of excise goods, food and fuel. An 11% increase in income and the subsequent rise in demand is still not noticeable in prices save for a few subareas. Its effects are likely compensated for by persistently low imported inflation and decreased wage and entrepreneurial burdens. The fact that inflationary pressure is quite moderate is reflected in core inflation staying under its target, at 2.5%.

The ***government budget deficit*** was HUF 1,445 billion at the end of the year. The primary reason for this value is that projects to be funded from EU sources were pre-financed from the budget. This amounted to a total of HUF 1,886 last year, while the EU only transferred HUF 1,430 billion in this period. Calculated with the EU methodology (EU pre-financing adjusted) it took on a value of under approximately 1.7-1.8% by the end of the year, while the gross government debt decreased to 70.9% (calculated together with EXIM).

Although the robust surplus of the ***external trade balance sheet*** became moderate due to a surge in internal demand, external balance indicators were favorable. The ***capital account*** improved significantly due to the increase in money transfers from the EU, which may contribute to ***external financing capacity*** rising above 5% of the GDP.

The central bank of Hungary announced the transformation of its ***set of monetary instruments***, the phasing out of certain instruments, as well as the introduction of one new one. In addition, it disclosed that it will start to prepare for the normalization of monetary conditions. At the same time, interbank forint liquidity, which remains significant, keeps short-term yields well under the 0.9% base rate. Non-conventional instruments affecting short-term yields will be simplified within the new set of instruments, and the non-conventional set of instruments affecting long-term yields will be fine-tuned. The three-month deposit instrument was phased out towards the end of 2018 and the minimum reserve will take over the role of lead instrument in the future. Looking forward it seems that the central bank wishes to create the monetary conditions necessary for sustainably reaching the target inflation through an optimal combination of two instruments – the swap portfolio granting forint liquidity and the interest rate corridor. In addition to this the monetary policy targeted IRS instrument and the mortgage bond acquisition program were both phased out by the end of 2018. MNB will sterilize the liquidity emerging within the Funding for Growth Scheme Fix through a preferential deposit design yielding interest at the base rate.

The ***EUR-HUF*** exchange rate jumped from around 310 HUF/EUR at the beginning of the year to approximately 330 HUF/EUR mid-year, and then stayed within a relatively narrow range towards the end of the year, varying between HUF 320 and 326 HUF/EURO.

The ***aggregated balance sheet total of credit institutions*** grew by a nominal 8.4% (HUF 3,049 billion) to over HUF 39,000 billion. The currency structure of this growth was balanced. Forint assets grew significantly, by 7.4%. Throughout the year, the forint weakened compared to all important foreign currency types: below 4% compared to the Euro, while the exchange rate was about twice this much for other currencies. Foreign currency assets rose by 5-6 percentage points more than the movements in the exchange rate.

On the ***liability side,*** all important liability types increased. ***Total deposits*** grew considerably (by 10.1%, HUF 2,444 billion). This was mainly caused by the increase in domestic deposits (by 10.1%, HUF 2,376 billion), while with regard to maturity, there was a significant rise in liabilities with immediate expiration of maturity (payment account deposits and sigh deposits – 11.4%, HUF 2,278 billion). Consequently average maturity within the deposits segment continued to shorten in 2018. Corporate and retail non-financial deposits increased at almost the same rate and by nearly the same amount, the former increasing by 14.5% (HUF 1,146 billion), and the latter by one-tenth of a percentage point more (HUF 1,262 billion). In contrast, the state deposits decreased by 18.5% and the deposits of non-monetary financial institution by 9.2%, although neither of them hit a HUF 240 billion nominal decrease. The 8.5% (HUF 662 billion) increase of ***interbank liabilities*** was due to a significant rise in interbank deposits (HUF 513 billion) and a more moderate expansion of interbank credit (HUF 149 billion). Altogether maturity grew in this segment. The total equity of credit institutions grew by nearly 5% (HUF 198 billion), while profit for 2018 was considerably less than in the previous year; reserves however grew by a significantly larger amount.

Within ***assets,*** the main driving force behind growth was the expansion of the credit portfolio and interbank assets***.*** Debt securities basically stagnated, while demonstrating growth due to the ad-hoc cause of share (foreign acquisition). The ***gross loan portfolio*** grew by a nominal 10.7% (HUF 1,778 billion) not considering interbank credit. 65% of growth is denominated in forint, 40% is denominated in Euro, while other foreign currency loans decreased significantly, increasing domestic and EEA loans by analogy, and decreasing lending outside the EEA. All sector contributed positively to credit growth, most prominently non-financial enterprises, who contributed by the same amount as last year (+13.2%, HUF 1141 billion), reaching HUF 9,806 billion in total. Impairment loss continued to decrease in this segment, although reversal was less than one-fourth of last year’s value (HUF 28 billion).

The gross ***household loans*** grew to nearly five times what they were in the previous year, reaching 5.8% (HUF 338 billion), increasing the portfolio to HUF 6,180 billion. Reversal on impairment loss still significantly affected this portfolio; impairment losses recognized during the year were one-fourth less than in the previous year, although they still reached HUF 106 billion.
As a result of the above effects, the ***net loan-to-deposit ratio***[2] of the credit institutions sector increased from 77% in the previous year to 79% in 2018.

Profit before taxes was close to HUF 757 billion, which is almost one-fifth less than it was last year (HUF 695 billion). Consequently, before taxes, the banking sector’s average return on assets (ROA) was +1.5% (in 2017 this was 1.8%), and its return on equity (ROE) was +13.4% (in 2017 this was 16.2%). There are however ad-hoc factors outside of the Hungarian banking system’s operation in the background of these profit indicators (such as impairment and reversal of provisions, as well as the dividend of foreign subsidiaries). Not considering these, the ROA would be 1.1% (equal to that of last year’s) and the ROE would be 9.7% (this was 10.2% in 2017), which, in light of the risk environment, is not significant. A low interest environment no longer has a decreasing effect on the net interest revenue for business-type returns; in fact, due to the expansion of the portfolio the downward trend was reversed (+4.8%, HUF 37 billion), and net fee revenues increased by around the same value nominally (+5.9%). The net revenue from financial transactions did not notably improve profit. In contrast, administrative expenses grew considerably (by 11.2%, HUF 74 billion), with labor costs showing the most prominent increase (+14%).

[2] Net loan-to-deposit ratio, without considering the interbank portfolio

III. Corporate sector

Funding for Growth Scheme

Although corporate lending continued to grow dynamically in 2018 H1, long-term, fixed-rate loans were not concluded in the SME credit market, therefore, with a view to shifting lending towards a healthier structure, the MNB launched the ***Funding for Growth Scheme Fix*** (FGS fix), with a facility amount of HUF 1,000 billion. According to the central bank's expectations the FGS fix may raise the level of investments in 2019 and 2020 by 0.2 and 0.8 percentage point, respectively, and as a result of this it may contribute to the economic growth expected in 2020 by 0.2 percentage point. The product was introduced on January 1, 2019.

Respondent banks participating in the ***Lending Survey*** reported the easing of credit conditions in all corporate size categories, while corporate credit demand increased further both for short-term and long-term loans. The absence of micro and small enterprises' willingness to borrow is explained primarily by the lack of investment plans and the aversion to loans and external financing, as well as fear of rejection.

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. 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. The concept also includes the creation of a clear guide that contains useful information. In order to elaborate the Standardized Loan Application Interface (SLAI) the SME working group met with MNB representatives several times during the fourth quarter of 2018. SLAI will probably be launched in H2 of 2019.

IV. Retail sector

Simplification of the CSOK laws and interpretation issues

One of the elements of **simplifying** the rules for applying for the Family Housing Allowance Program (CSOK) is the **‘**declaratory principle’, made possible in several cases by the legislator, in order to replace certain certificates and documents that previously had to be submitted on paper. In addition, the legislative amendment allows for the extension of the deadline for CSOK application and provides a more favorable situation for applicants returning home from abroad.

In 2018 the Ministry of Finance issued a **professional guidance** with a view to ensure uniform interpretation of the law related to state aid for housing purposes 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. A complemented professional opinion with regard to the heatability of the flat's premises was issued before the end of the year, which reflected on several previously indicated practical problems.

Possibility to electronically access the Tax Authority's income database

A fundamental pillar of responsible and prudent lending is credit scoring and as part of it, information about income. The opportunity to certify income data in a more modern manner (if the consumer volunteers) could be realized through providing full data protection. Several rounds of consultations were held on this, for now only at a conceptual level, with the participation of the authorities and social institutions concerned.

V. Important regulatory events influencing the operation of the banking sector

Financial and judicial omnibus acts

The proposal on the amendment of certain acts on judicial matters was sent by the Ministry of Justice to the Banking Association, and the draft was consulted by the Legal and the Workout Working Group. The Banking Association has made a proposal with regard to the obligation to open Széchenyi Recreation Cards and the exemption from enforcement of restricted payment accounts opened in the context of the earmarked nature of amounts deposited on them to amend Act LIII of 1994 on Court Enforcement; the relevant provisions are set out in Act XCI of 2018 on the Amendment of Certain Acts on Judicial Matters, published on 6 December 2018.

With a view to protecting the interests of employees in bank branches, the Banking Association initiated the amendment of the regulations applicable to the witnessing rules for private documents with full probative value to the end that the address of witness does not need to be necessarily indicated on the certificates. The relevant provisions are included in Act CXXVI of 2018 on the Amendment of certain acts on the financial intermediary system for the purposes of harmonization of law, published on 21 December 2018. The new provision now present in the Act on credit institutions does not however provide a reassuring solution to the issue, therefore, in order to form a common practice the Banking Association will initiate the clarification of this law in the 2019 spring legislation period.

Developments regarding data protection

After the 25 May 2018 entry into force of the European Union's General Data Protection Regulation (GDPR), the Ministry of Justice amended Act CXII of 2011 on the Information self-determination and the freedom of information by appointing the Hungarian National Authority for Data Protection and Freedom of Information as supervisory authority. The GDPR has a significant effect on banking processes, thus sectoral legislation needs to be amended in connection with the Regulation, in which context the Data Protection Working Group collected its proposals and observations. The Ministry of Justice held several consultations with strategic partners, including the Banking Association, on the comments and proposals; however, in the autumn session the package submitted to the Parliament was not discussed. At the end of Q4, the Ministry of Justice sent to the Banking Association its proposal on the amendment of certain acts in the context of the European Union data protection reform, for consultation; to discuss this, the Data Protection Working Group held a meeting and compiled its suggestions. In connection with this, an in-person consultation will place in the ministry in early 2019 with the participation of ministries in charge of the relevant legislation (Ministry of Finance, Ministry of Human Capacities, Ministry for Innovation and Technology).

Consultations on the act on simplified personal insolvency; amendment to the act on debt settlement procedure ("normal personal insolvency")

The consultations on the *act on the simplified debt settlement of private individuals affected by a significant payment default* - the so-called simplified personal insolvency act– were conducted in the first three quarters of 2018 between the Ministry of Justice and the Banking Association. The draft law was discussed and commented on by the Personal Insolvency Working Group of the HBA in several rounds. The purpose of the Act is to introduce a new simplified out-of-court debt settlement procedure for retail mortgage debtors with significant payment arrears, whose home is at risk.

Parallel with the enactment of the act on simplified personal insolvency, the Ministry of Justice plans to amend the personal insolvency *act on the debt settlement of natural persons,* adopted in 2015 and fundamentally 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 Personal Insolvency Working Group, and based on this it conducted consultations with the ministry with a view to ensure that the operation of debt settlement procedures will be as simple and as efficient as possible after the amendment of the act. Nevertheless, the amendments of the act on simplified personal insolvency and of the act on debt settlement of private individuals were not submitted to Parliament in 2018.

Amendment of the rules applicable to public notaries

On the basis of the new Decree of the Ministry of Justice on notarial fees, the charges to customers would have increased significantly, leading to a great increase in costs for customers taking out a mortgage loan. Considering the consultations launched with a view to resolving this problem, the entry into force of this new decree has been postponed by the Ministry of Justice from 1 October 2018 to 1 January 2019, then to 1 April 2019.

The implementation of the EU Regulation on Settlement Discipline

The EU Regulation on Settlement Discipline contains provisions for the tracking of failed settlement, the prevention and management of settlement failure, and encouraging settlement discipline. In view of the direct effect of that Regulation and its applicability as of 13 September 2020, KELER has started the preparation and consultations with market players and associations, in order to ensure a smooth preparatory process for its implementation and a smooth transition process from the current environment.

Data requests from authorities

Following the practice of disclosure of bank secrets for national security and criminal investigation purposes, which has existed for decades, the competent authorities have new demand for data due to digitalization and security challenges, and such demands were integrated into the legal regulations governing the operation of the authorities. The introduction of the signaling system through the amendment to the National Security Act (Nbtv. - in effect from January 2017) and the monitoring of payment transactions, integrated into the new Act on Criminal Procedure (Be.) and in effect from July 2018, have similar purposes in practice; the regular reporting of the transactions or a specific group of transactions on payment accounts and bank cards specified by the authority to the authority requesting the data. Based on the Nbtv. the solution developed by the Special Service for National Security (NBSZ), the data requested by any national security agency may be requested and provided by the banks through the automatic data collection established between NBSZ and the banking systems. In order to articulate data protection concerns, a CEO’s Forum was held in April at the Banking Association with the participation of the competent State Secretary of the Ministry of Justice and the Ministry for National Economy, the President of the Hungarian National Authority for Data Protection and Freedom of Information (NAIH) and the representative of Magyar Nemzeti Bank. A solution was developed according to which NBSZ will build a pilot system with one bank, to be examined by NAIH and, if it is found adequate, the electronic data connection will also be established with the other banks concerned. Monitoring payment transactions according to the Be. may eventually pose data protection and feasibility problems similar to the above mentioned issues. We indicated this to the bodies concerned, although the problems have not yet arisen owing to the current practice of authorities.

Methodological change in the National Deposit Insurance Fund's (NDIF) fees

In compliance with the legal framework, the NDIF Board develops the NDIF fee policy once a year within the relevant law's framework and presents it to credit institutions. In this process, it sets the fee rate, the basic fee and sets the level of the correction coefficient.

Based on the rules adopted in 2018, as of 2019, the NDIF sets the annual fees by 30 September in line with legislation after receipt of **audited data**; accordingly, the fee-paying period lasts from 1 October until 1 September in the next year. In the 2019 transition period, member institutions pay an advance fee. In view of the cyclic nature of the economy, as of 2019 a new variable will be introduced, aiming to make the entire fee payment anti-cyclical. The Macroprudential Directorate of the MNB decides on the economic environment allowing for the application of the **anticyclical indicator**, and at the same time it makes a proposal to NDIF to the level of that indicator.

The preparatory work of Sector Skills Councils

Simultaneously with the amendment of the *Vocational Qualifications Act* which took effect on 1 July this year, the practice of a number of advanced EU Member States was also adopted in Hungary and skills councils were formed in 20 sectors, with the involvement of experts of companies representing the actors of the economy. The activities of the skill councils are coordinated by the Hungarian Chamber of Commerce and Industry (MKIK). As the government decree which contains the implementation was published with quite a delay, in late November, the Sector Skills Council was not established officially, its members were not appointed by ministers, however based on the request and organization of MKIK the Council operated informally from December 2017. The Economic and Administrative Skills Council, which also represents the financial sector was established within the framework of this. The Council proposed a draft implementing decree regulating the operation of the sector skills councils, initiated and with the help of MKIK's experts, executed the occupational psychology analysis of the most important occupations and careers that can be pursued in possession of OKJ (National List of Qualifications) qualifications at present – concerning the banking sector, of financial suppliers. The Council will likely start operating officially in March 2019.

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

Introduction of the Interbank Funding Ratio (IFR) and the modification of the Foreign Exchange Funding Adequacy Ratio (FFAR)

The process of the ***IFR's*** creation, started in October 2017, was concluded in Q1 of 2018 after consultations with European authorities. The central bank announced the regulation on March 27th and it entered into force on July 1st. Taking into account proposals previously mentioned at the consultations, during the calculation of the ratio certain refinancing sources are taken out from the sources to be used in the calculation or they may be assigned a preferential weight, and as a de minimis rule, institutions with total assets of less than HUF 30 billion do not need to apply the ratio. Another important aspect is that Hungarian institutions belonging to the same group must comply with the ratio on a consolidated basis.

Parallel with the introduction of the IFR, the MNB's unit responsible for macroprudential regulations amended the rules of ***FFAR***. An important change is that MNB adjusted the terms of the Decree to the terms of the CRR and the regulation of the European Commission. In accordance with the NSFR rules, under the application of the draft decree, it broke down the short-term portfolios further and assigned different weights to foreign exchange liabilities and assets with a term shorter or longer than 6 months. By applying the same rules as applied to monetary financial institutions, it introduced more stringency into the consideration of funds and assets placed by non-monetary financial institutions. The central bank announced the IFR regulations in March and the FFAR modifications towards the end of June. They entered into force at the same time: on July 1st.

Debt limit regulations (Differentiations within the Payment to Income Ratio – PTI according to the interest rate period)

The MNB continually promotes the diffusion of mortgage loans with longer maturities, and to this end various debt limit regulations have been introduced or modified. In order to achieve its goal, in 2018 the MNB fine-tuned the rules applying to the ***Payment to Income Ratio (PTI)***, with the aim of preventing excessive indebtedness. The PTI is the ratio of the monthly debt obligation to the monthly income and in order to achieve the above mentioned goal more fully, the MNB complemented the ratio with categories according to interest rate periods in its relevant decree. Consequently, according to the new PTI requirements, ratios lower than before have been introduced for mortgage loans with a maturity of over five years, depending on the interest rate period of the loan.

Modification of the regulation regarding the Mortgage Financing Adequacy Ratio (MFAR)

MNB decree 20/2015 (VI. 29.) on the regulation of the forint maturity mismatch of credit institutions was reviewed in 2018 in order to promote the further inclusion of mortgage covered liabilities with a long-term maturity at systemic level and to thus achieve the further deepening of the mortgage bond market. According to the modification, from October 1, 2019 the **value of the MFAR** must always reach 0.25 (instead of the previous 0.2 minimum). In addition, the **original maturity** of the one and two-year liabilities within the items that can be taken into account in the numerator will change to three years. Mortgage bonds will from now on be **priced** in a way that the bonds held for this purpose may be considered as a reducing factor when calculating the ratio in specific cases and to a specific degree. **Credit rating** will be a new requirement, which must be fulfilled with regard to the security, the issuer or the institutions undertaking to pay.

Draft decree of the Governor of the MNB on the detailed rules of the form and mode of complaint handling in financial institutions

The decree regulates the process of making and investigating complaints, as well as defines the data and documents that can be requested, information obligations with regard to complaint handling and how to keep record of complaints. Our member institutions made a number of clarifications and minor supplementary remarks on the text of the decree, which the MNB took into consideration.
MNB decree 46/2018. (XII. 17.) will enter into force on March 2, 2019.

MNB decree on the detailed rules for the minimum requirements for the development and the operation of the screening system under the Pmt.

On the basis of a few months of experience of the practical application of the MNB Decree on the implementation of the Act on the prevention and combating of money laundering and terrorist financing relating to service providers supervised by the MNB and the minimum requirements of the development and operation of the filtering system specified in the Act on the implementation of the restrictive measures imposed by the European) Union and the UN Security Council related to liquid assets and other financial interests, the AML Working Group of the Banking Association has prepared and sent earlier, on two occasions, the corrections proposed by the sector. Rather than amending the decree, the MNB decided to re-regulate the issue, because although the re-regulation covered only a few topics, in view of their gravity and nature, codification considerations warranted the creation of a new law. In the framework of this review, essentially the online customer due diligence, the simplified customer due diligence and expectations for screening systems were re-regulated by the MNB, and also training-related rules were somewhat amended and complemented. The working group drafted its proposals to the text of the new decree in line with its earlier comments.

Recommendation for managing connected clients

The central bank of Hungary elaborated, and following consultations, finalized the MNB draft recommendation[3] on determining the definition of a group of connected clients (client group) in accordance with the Capital Requirements Regulation. The goal of this is to implement the European Banking Authority's (EBA) relevant guidelines (EBA/GL/2017/15) on connected 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 the same client group 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 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 parts of the recommendation referring to large exposures from January 1, 2019, while its other parts must be implemented from July 1, 2019.

Recommendation for the requirements of product approval applicable in the capital market

The MNB completed its draft recommendation on the requirements for product approval applicable in the capital market in May, prepared on the basis of the guidelines of the European Securities and Markets Authority (ESMA) on the same topic. In line with the practice of MNB conducted in the field, the draft is practically identical to the underlying ESMA guideline, and therefore during the review most of our proposals focused on the clarification of the text.
The MNB announced the recommendation at the beginning of July and it entered into force in the middle of July.

[3] Capital Requirements Regulation (CRR); 575/2013/EU Chapter 4 Section 1 Article 39.

VII. Payments

Instant Payment System

With regard to payments, the task of the highest priority in 2018 clearly continued to be the instant payment systems (AFR) project. Consequently, our member banks provided experts in large capacity to the Project Steering Committee, which was created and is operated by GIRO Zrt. as they did for the Banking Association's Payments working group. Through its regular meetings, the working group served as an independent complementation to the Project Steering Committee, and by involving representatives from GIRO Zrt. and the MNB it discussed issues concerning regulation, legal interpretation, operational and process engineering for the clearing system, the content of messages and their flow schemes, as well as secondary identifiers and connecting to the internal systems of banks. The conclusions derived form these were also built into the modification of MNB Decree 35/2017, based on the opinion given by the banking sector. The optional request to pay service was debated by experts in a separate series of consultations. The MNB took into account a large portion of the concepts voiced at these in its Recommendation. The Treasury working group of the Banking Association dedicated special attention to the principles and mechanism of the system's liquidity management, as a result of which the common needs that were indicated were incorporated into the system. Preparations for the testing of AFR already began this year; the experts of our member banks will also take part in these by attending the regular meetings of the Payment working group, specially dedicated to this topic. We also participated in the creation and organization of a Legal working group within the framework of the national project steering committee, the target of which is to elaborate the conditions for membership and the business rules of the system. There are two more, high-level CEO meetings to emphasize, where central bank leaders reviewed and evaluated the current state of the national project, set the condition for the launch of the system on July 1, 2019, and presented the new pricing model for operating the GIRO AFR. In addition, communications tasks associated with the preparation and design of the AFR brand are ongoing (brand name, visual features). The intensive information communications campaign will be completed in 2019, based on the communication strategy.

Preparing for PSD2

The implementation of the main principles and rules of the new Payment Services Directive (PSD2) began in both Hungary and Europe on 13 January 2018**.** The Banking Association presented detailed its arguments through which it requested the ministry responsible for legal regulation to amend the start date of the implementation of the regulatory technical standard for strong customer authentication (SCA – one of the most important new rules in terms of domestic implementation) from 1 January 2019 to the date of 18 months after the promulgation of the legal regulation, as is the case in the practice of the EU. As a result of the arguments compiled by the experts of the Payments working group, within the framework of the *Act on the Amendment of certain acts on the financial intermediary system for the purposes of harmonization of law* the modification of the questionable deadline was carried out, therefore the provisions with regard to SCA will need to be implemented from September 14, 2019. Consequently, up until September 13, 2019, when using the payment initiation service or the bank account information service the liability and cover of damage rules set in the provisions (in effect from January 12, 2019) of the above mentioned law must be applied to the customer and the payment service provider managing his or her payment account.

With regard to PSD2 the pan-European standards for Strong Customer Authentication (SCA) and Common and Secure Open Standards of Communication (CSC) RTS significantly defines or applies to the work in several professional banking departments. The Banking Association wished to help its member banks prepare for the new legislative requirement by creating a temporary sub-working group on strong customer identification, as well as with a workshop and with intensive preparatory work to process the arising issues with working groups that were affected indirectly (e.g. bank cards working group).

Implementation of the regulations relating to the Payment Accounts Directive (PAD)

Another important task of the Payments working group regarded the three Regulations relating to the Payment Accounts Directive.
In early January the following were published:

- regulatory technical standards for the EU standardized terminology for most representative services linked to a payment account;
- implementing technical standards for standardized presentation format of the statement of fees and its common symbol;
- and implementing technical standards with regard to the standardized presentation format of the fee information document and its common symbol.

The working group identified the issues to be clarified and contacted the competent regulatory authorities about them. Later on discussions took place on the entry into force of the regulations, the comprehensive cost indicator, the initial date of making the fee information document and the statement of fees available to customers, the national list of the most frequent services, the differences in the use of the terms under the Regulations and the effective Payment Services Act, as well as the operator of the mandatory national comparative website and the data to be supplied to it.
As a result of the consultations the MNB considered our professional position on several points and published *'Hungary's final national list in relation to the comparability of the fees related to payment accounts',* wile the Ministry of Finance issued the government decree *on certain issues of information on the fees related to payment accounts kept for consumers.* The said decrees set out the creation of a national comparative website for consumers of which MNB will be the proprietor and to which data will be supplied by our member banks.

Regulating cross-border transaction fees – proposal to amend EU Regulation 924/2009

Starting from the end of the first quarter, several of our working group dedicated significant attention to the legislative work in connection with the EU Commission's proposal to amend Regulation (EC) No 924/2009 by collaborating both with domestic and international banking associations.
The original proposal contains two main elements. According to the first, the payment service providers of member states outside the euro area have to apply the charge to euro credit transfers as they apply for domestic credit transfers equal to the same amount. The other element concerns payment cards in the case of the so-called dynamic currency conversion (DCC): when using POS[4] terminals and ATMs[5], the PSPs must transparently indicate to consumers all charges and exchange rates to be applied in order that the consumer may at the place of payment decide whether to pay in the local currency or in the one on his or her account. Payment service providers have 3 years to prepare for meeting this last requirement.
We represented the banking sector's professional arguments with regard to the modification proposals through several official channels and via international interbank cooperation, under diverse EU presidencies. Among other things, we asked to be treated equally to other EU member states, which use the Euro as their official currency. However, the relevant EU organizations voiced opinions opposite to ours during the legislation process. Our arguments were heard in merit only

[4] POS: Point of Sale
[5] ATM: Automated Teller Machine

towards the end of the Austrian Presidency; those concerning the currency scope, the length of time and the feasibility of technical requirements needed to introduce DCC were taken into consideration.
On December 19, 2018, the draft regulation adopted by COREPER II at the end of the Trilogue accepted the suggestions of the banking sector on several points. According to the agreement established during the Trilogue, the regulation for uniform charges on transactions will need to be implemented from December 15, 2019, while our member banks will need to implement rules in connection with DCC a year after.

GIRO bank account switch

During the inspections conducted at the payment service providers, the MNB objected to the fact that the number of reasons for rejection is much higher in the documents relating to the *GIRO Bank switching service* than in *Government Decree 263/2016 on switching payment accounts*. According to the MNB's position, of the currently existing 13 reasons, the termination of a payment accounts could be lawfully rejected on the basis of only 3 reasons. In addition, with regard to the *P61 mandatory data supply*, it objected to the fact that '*other, specifically'* reason was indicated for rejecting the payment account switch in 2/3 of all cases in 2017. The MNB expressed an expectation *to terminate the 'other, specifically' option* and to instead, specify the possible reasons exactly.
In cooperation with the Hungarian Banking Association and GIRO Zrt., the payment service providers reviewed the currently used justifications for rejection and, in addition to the three reasons also recognized by the MNB, recommended to keep, revise or clarify three further reasons. The MNB accepted one of the proposed and clarified reasons (the payment account affected by termination functions as a repayment account). Solution proposals were elaborated for the *P61 data supply*; the MNB accepted these and asked for the introduction of further justifications.
Based on MNB's position GIRO Zrt. changed its implementation of the GIRO Bank account switch, which went live on December 28, 2018 after the year was closed. In addition, it simultaneously published its new Rule Book, Management Handbook, templates and forms.

Széchenyi Recreation (SZÉP) Cards

The Ministry for National Economy distributed for review the proposal for the *rules of issue and use of Széchenyi Recreation (SZÉP) Cards.* In order to implement the judgment of the European Court of Justice related to the SZÉP Card, the Ministry will amend the regulations on Széchenyi Recreation Cards by *changing the issue of the cards into a payment service*. The envisaged instrument raised problems in terms of legal, business and practical feasibility, and therefore we recommended not submitting the draft in its current form to the government decision-making bodies. We proposed a solution which, in our opinion, would be better for all parties concerned and would also comply with the judgment of the European Court of Justice. We presented and consulted on our proposals in a number of meetings with the Ministry, however the Ministry did not change its concept with reference to the fact that the European Court of Justice already accepted the solution described in the submitted draft government decree although it agreed with our proposal for the text of the draft on various points. The respective government decree was published on 20 April 2018.
In order to implement the most *cost-effective transition*, we conducted consultations with the Ministry of Finance and Magyar Nemzeti Bank on the following points in the practical implementation of the regulation with the achievements below:

- With regard to the replacement of SZÉP cards (more than 1.5 million SZÉP cards) according to the resolution issued by the Ministry 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*.
- The transition deadline was modified: it must be completed by January 5, 2019 instead of by November 30, 2018.

- The Judicial Enforcement Act (Vht.) was amended, based on which transfer to and from authorities is not possible.

Developing interbank cash trade

In February, the Board approved the production of a Feasibility Study (FS) concerning the development of interbank cash trade to be implemented in the framework of the Hungarian Banking Association. The aim is to develop an electronic cash-trade marketplace, where banks' supply and demand data may be published and to thereby make it easier for parties to find each other, to promote the fast and effective conclusion of transactions, and to increase trade efficiency by allowing the sector to save through connecting more potential parties than is currently feasible.
The steps taken and the results achieved are the following:

- the process of the new trade system to be conducted on the IT platform has been created;
- trade offers for the elaborated trade process were requested from IT development firms and then evaluated;
- competition law issues were examined and have been incorporated into to the expectations established towards the IT platform;
- during the consultations the MNB assured us that it would support the initiative and provided data on the cash flow that goes through the central bank to help estimate how much may be saved;
- calculations for returns have been made;
- The legal background for founding and operating IT platform firms has been mapped out.

The Board will discuss the Feasibility Study in early 2019.

The activities of the SWIFT User and Member Group (UMG)

The UMG continued its tasks and topics started earlier and stretching across a number of years and other extended issues. In terms of importance, cyber security and the implementation of the customer security program (CSP) continue to be at the top. Concerning the latter, SWIFT evaluated the results of the self-assessment conducted in 2017 and published its general findings in early 2018. The attendance of Hungarian parties was slightly higher than the international average; 95% completed the self-assessment appropriately and on time. The institutions (two in Hungary) which missed the deadline could still complete the self-assessment in Q1 2018. The self-audit exercise has not yet been concluded finally as, according to the program, by December 31, 2018 each institution had to repeat the procedure certifying full compliance with the mandatory security requirements issued by SWIFT. The results of this will be published in early 2019.
The other key issues are the SWIFT new correspondent banking development and service, known as Global Payment Innovation (GPI), which will allow for transparency and tracking of cross-border payments and will significantly shorten their completion time. The Standard Release published in 2018 obliges users to add a unique end-to-end transaction reference (UETR) number to the data of their payments, thus ensuring the exploitation of all advantages of the service. This measure may be interpreted as a step towards laying the foundation for the mandatory use of the service by members.

A new instrument among the SEPA tools and infrastructure: TIPS and the SCTInst model

The SEPA infrastructure has been expanded to include another element towards the end of the year: the TARGET Instant Payment Settlement service. The system and service developed by the ECB was launched in November 2018, with the specific purpose of clearing and settling instant euro payments in central bank money.

By the request of the ERPB the first Pan-European instant euro transfer model, developed by the EPC, first started operating in October 2017. At its launch, it already had five hundred active payment service providers (fundamentally credit institutions) as its members; by early 2018 this number grew to over one thousand and over the course of the year, once TIPS was launched, the number of participants rose to over two thousand.
TIPS is now capable of completing the final clearing and settlement of small-sum, cross-border (if needed) consumer transfers at Pan-European level of up to 15 thousand euros, in under just 10 seconds.
The ECB is applying the principle of full cost recovery while operating TIPS, while at the same time it does not charge its account holders a joining or maintenance fee. The new service is provided at 0,0002€/initiated transaction in the first two years, while the first ten million payments settled on each TIPS account before the end of 2019 will be free of charge.
Payment service providers from Spain, Germany and France were the first to join the service and to make use of the opportunity to aid the mass use and promotion of the service through innovative payment solutions.
The ECB's service is also capable of performing clearing and settlement services for other currencies of the EEA besides the euro.

Important developments concerning the cards market

According to the data published by MNB, in 2018 payment card transactions continued to increase. The number of physical merchant acceptance points once again grew (to 118,000 acceptance points; 145,000 POS terminals) and there was a significant (25 percent) increase in purchases by payment cards in Hungary, with 70% of total purchases made using the quick and modern contactless payment method. The number of payment cards issued in Hungary continued to grow, increasing by 95 thousand; thus 9.2 million were in circulation by the end of Q3 (the latest data available at the time this report was compiled).
The Bank card working group continually monitored and supported member institutions' preparation processes for PSD2, especially the introduction of strong customer authentication and the amendment of EU Regulation 924/2009, with special attention dedicated to the DCC (spot exchange rate) implications for bank cards, as well as the EU's amendment of the regulation on the Inter-regional Interchange Fee. In addition, the working group consulted with the authorities that inspect fraud cases and the competent representatives of card companies on several issues in the subject of fraud and card forgery, as well as following foreign fraud exposures and events with the help of EAST, and actively participating in rendering payment processes cash-free

VIII. Taxation, accounting and reporting

Accounting

MNB opinion on the valuation of subsidized loans in IFRS9
At the end of May 2018 the MNB published its position on the valuation of subsidized loans according to IFRS9 in the form of a Q&A. Although, the MNB has no competence in providing any legal interpretation for IFRS, in order to promote a consistent application of the law, they considered that the publication of the practice deemed good by the central bank would be practical. Under the IFRS9 standard the loans affected by state interest subsidy and fair banking regulations should be reported at amortized cost or at fair value (due to the multiplication factor included in the definition of the interest). The MNB considers records kept at amortized cost appropriate.

Taxation

A new obligation was introduced on 1 January 2018, according to which business associations registered in Hungary must notify the Hungarian Tax Authority of their bank accounts abroad within 15 days of opening them. Developed with the Tax working group, our request for a position drew the legislator's attention to unregulated details that warrant legislative amendments. For example, the types of accounts subject to mandatory notification were not specified (payment, technical, securities, etc. accounts) or how the terms defined in the Hungarian legal regulations could match the account types used abroad. In response to our request, the Ministry of Finance clarified the provisions of Section 1.24 of Annex 1 of Act CL of 2017 on the Order of Taxation when it modified the law during the summer.

The IFRS Tax sub-working group held a consultation meeting with the Ministry for National Economy's experts on 22 February 2018. During the meeting, eight issues were closed in relation to the impact of the switch to IFRS on corporate income tax and local business tax. Of the resolved issues, it should be emphasized that the ministry confirmed the views of the experts of the sector that, during the switch to IFRS, the rules of IFRS 1 must be applied to calculate and estimate transition differences. Consequently, all estimates must be made on the basis of the information and data currently available and reasonably obtainable at the time of the estimates and no subsequently gained additional knowledge, data or information may be taken into account retrospectively. If the accounting estimate is based on the available and reasonably obtainable information, there is no need for any back-testing or self-audits. The need for self-audits arises when the inaccuracies in the estimates reach an extent which subsequently would be deemed an accounting error.

We asked to have the special bank tax for financial enterprises decreased in proportion to the previous moderation of the special tax to be paid by credit institutions during both the spring and autumn legislative cycles, as well as the complete elimination of the financial transaction levy imposed on retail transactions.

With regard to Section 3 (4) (r) of Act CXVI of 2012 on the financial transaction duty (hereinafter the Pti. tv.), effective as of 1 January 2019, we indicated to the Ministry of Finance that we consider its implementation impossible in technical terms, and we sent a proposed amendment to the text. Under the Pti. tv. as of January 2019, no tax is payable for payment transactions between customer accounts kept by the State Treasury (MÁK) and used by private individuals for sovereign debt trade and their payment accounts kept by another account keeper. In our amending proposal, we requested to exempt transactions between payment accounts of private individuals and the account kept by the treasury for sovereign debt trade, and that the amended provisions be applicable from 1 January 2019. In its response, the legislator indicated that they deem our proposals professionally viable from and we were promised that they would consider our comments during the next legislative cycle.

Our comments to the draft law on the amendment of the tax laws (T/2931), which was published on the Parliament's website on 19 October 2018 referred mostly to the option to enforce the net funding costs in the corporate tax base, due to the need to transpose the EU Directive against tax evasion (2016/1164). In addition, we expressed our comments on the rules of group registration for corporate tax, to be introduced from the 2019 tax year. In both cases, most of our clarification proposals were received well and incorporated in the final text of the act.

Reporting

Based on an MNB request, we conducted a needs assessment on the timing of the introduction of the XBRL reporting format. The majority of the respondents could comply with the new format if introduction took place after 1 January 2020. In its response, the MNB recognised the request and indicated that by the end of 2019 the reporting obligations can be performed in the usual, traditional format (excel, txt) and that the MNB would temporarily undertake conversion to the required format

and validation according to the taxonomy when the supply of all data begins to EBA. In 2019 the MNB will support downloading, uploading and acceptance of ITS reports in the traditional form.
The HITREG working group, established for the development of the analytical credit register of the central bank, met a total of seven times in 2018 with full attendance. After one year's preparatory work, the HITREG decree was published on 13 November 2018. In accordance with the earlier information from the MNB, the first reporting on the basis of this decree will take place on 17 February 2020, regarding 2019.
A new development for 2019 was the MNB's intent to require eight new daily capital market reports. With a view to interpreting and coordinating these reports, we held several working group meetings with member bank reporting experts and forwarded our proposals and comments to the MNB. By taking our observations into account, the central bank has revised the reporting package and decreased the number of required daily reports from eight to six.
In July 2018, NDIF 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). An alternative proposal was developed that contains simplifications compared to the NDIF proposal, while respecting the supervisory objectives. The alternative proposal was debated in December 2018 with the participation of NDIF, but no approximation of views took place. The NDIF expects contributions from member banks on the TB data model until 18 March 2019.

Corporate event reform initiative

KELER initiated a consultation with a view to ensure the national compliance required for KELER's joining the securities settlement system (T2S), and the further increase of transparency and automation in the field of processes and operation. The topics about the corporate event were identified and inter-institutional working groups were set up, led by KELER, to develop the details in connection with the topics of origination and cancellation of securities and nominee shareholder, as well as the payment of security yield, tax return and automatic rights compensation.

IX. Developments within the Banking Association

The General Meeting and Golden Beehive Awards

The Hungarian Banking Association's regular annual Assembly Meeting was held on 20 April 2018, and was attended by Minister of National Economy Mihály Varga and Deputy Governor of the Hungarian National Bank Ferenc Gerhardt as invited guests. The Meeting remembered Zoltán Urbán, former ex-CEO of Eximbank, ex-member of the Hungarian Banking Association's Board. During the event, the decision-making body elected Tamás Bernáth, Chairman & CEO of the Hungarian Development Bank, as a new member of the Board. In addition, the heads of member institutions of the Hungarian Banking Association once again adopted a common position - a communiqué of the Banking Association, which included an outlook on both the domestic and international economic environment and the challenges of the banking sector. As has become tradition, the Hungarian Banking Association once again recognized the work of colleagues from banks who have through their work significantly contributed to the operation and development of the credit institutions sector. The following people received the Golden Beehive Award at the 2018 General Meeting:

- Bence Gáspár (OTP Bank) for outstanding communication activities in the credit institution sector and for his commitment;
- Rita Jeges (Erste Bank) for the efforts made to constructively support the Hungarian Banking Association's work;
- Marcell Király (K&H Bank) for his outstanding work done in the fields of corporate financing and SME development in the banking sector;

- Róbert Nagy (Garantiqa Hitelgarancia) for outstanding and innovative activities that contributed to growth in guaranteed lending to small and medium-sized enterprises;
- Attila Rankó (Deutsche Bank) for outstanding professional activities performed in the fields of payments and the adaptation of European banking regulations.

Money Week (Pénz7): summary of the 2017/2018 school year preparing for 2018/2019

The European Money Week was organized in Hungary for the fourth time, from 5 to 9 March 2018, with an ever expanding number of participants: 1,200 schools, 202,000 students and 450 financial and corporate volunteers. These numbers indicate that out of all the Money Week programs initiated by the EBF in Europe, the Hungarian Pénz7 saw the most participants and is growing the most dynamically. The program series, one of the biggest triumphs of which is that it has been incorporated into the national curriculum, was realized through the project management of the Ministry of Human Capacities, and through the professional collaboration of the Ministry for National Economy (later the Ministry of Finance and the Ministry for Innovation and Technology) the Money Compass Foundation (within MNB) and Junior Achievement Hungary. The program's non-traditional classes focused on lending as a financial topic ("Becoming loan-savvy") and business ideas and collaboration as an entrepreneurial topic. We asked teachers and volunteers to provide feedback through a detailed questionnaire, handed to them following the end of the program series. 90% of respondents out of the 950 responses received said that the Money Week program series was either good or excellent. Schools found both the website and the interface for registering for Money Week to be adequate and teachers found the preparatory materials and the in-person preparation seminars to be outstanding. They felt that students were interested in classes and participated actively. The primary complementary program for the Money Week is the financial awareness quiz, initiated by the EBF in 2018 – joined by almost 30 countries in Europe, including Hungary. Another significant element of the program series was the Money Week Academic Professional Day, held at the University of Miskolc, together with the opening ceremony of the very first regional Fintelligence Financial Literacy Center. Following a successful program in the spring, we started preparations for organizing the program series of the next academic year during the summer.

BankAdat case – first instance success

The lawsuit filed to review the Hungarian Competition Authority's (GVH) decision on the Bankadat case (Vj-8/2012) ended with the first instance success of the Hungarian Banking Association and the banks concerned.
The GVH appealed against the first instance ruling. The Oppenheim Law Firm will continue to represent the Hungarian Banking Association and the institutions that wish to join it during the second instance proceedings.

Creating and approving the HBA's Competition Law Policy

The Hungarian Competition Authority's proceedings in the BankAdat case led to need for a competition law policy document, specifically regulating work done at the Banking Association.
The Competition Compliance 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. 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 published these rules 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.

The dissolution of the Standing Arbitration Court of the Money and Capital Markets

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

Communications statistics and current events

2018 was characterized by changing intensity, with exceptional activity in the fourth quarter in communications. According to our statistics, during the year we were featured in online media over 800 times, nearly 200 times in printed media and 136 times in electronic media. Throughout the entire year, the Hungarian Banking Association appeared a total of approximately 1140 times in Hungarian media. During the quarter, we provided a number of presidential, vice presidential and secretary general interviews, statements and communications responding to current issues, and prepared professional summaries from the viewpoint of the sector. One of the most frequent communication topics of the year continued to be managing mortgage loans with arrears. Moreover, we often dealt with basic bank accounts, switching banks, card and ATM security, mobile payment security and personal insolvency. The conditions of the Family Housing Allowance Program and the Certified Consumer-Friendly Housing Loans introduced by the MNB were also the constant subject of prioritized media attention. We participated in several communications activities and campaigns together with authorities (the Hungarian National Police Headquarters, the National Bureau of Investigation and the National Cyber Security Center) to raise consumer awareness of online bank card fraud and its prevention, to manage concerns about the possibility of contactless card fraud. In addition, we also joined the international information campaign for the prevention of money laundering. Other communications topics for banks during the year were the introduction of the PSD2 and the GDPR in 2018, and the preparations made for these. Concerning the future, we approached the developmental directions of the banking sector, the instant payment system, and the visible and predicted effects of digitalization.

International cooperation and conferences

- *European Money Markets Institute (EMMI)*

The Hungarian Banking Association has been a member of the European Money Markets Institute (EMMI) since 2017. EMMI plans to introduce its new hybrid methodology for EURIBOR (Euro Interbank Offered Rate) in the near future. Preparations for this started in 2013, and its testing phase has been completed recently. The replacement of EONIA (Euro OverNight Index Average) with ESTER (Euro Short-Term Rate) is also currently in progress. Both of the above changes are necessary as neither the applied methodology, nor the indices comply with the Benchmarks Regulation, adopted on January 1, 2018. In December 2018 the Secretary General of the HBA was elected into the EMMI Board of Directors, making him the first Central European member of the Institute.

- *CECBC conference*

In 2018, the Central European Covered Bond Conference (CECBC) was held in Budapest. The main organizers of the event were the Association of German Pfandbrief Banks (Verband Deutscher Pfandbriefbanken; VdP) and the Hungarian Banking Association, with the help of the Magyar Nemzeti Bank, who also provided presenters and the venue of the conference. A main topic of the conference was the new EU covered bond regulatory package, which was published by the Commission in March 2018. An advanced version of the text in the Parliament and the Council was already available at the time of the conference, which was discussed by domestic and foreign supervisory authorities, and regulatory and market actors. Other agenda items included triumphs and challenges concerning digitalization and possible instruments for developing the Central-Eastern European market.

Other working committees and working groups

This chapter summarizes the most important accomplishments of the HBA working committees and working groups. A more detailed account of their activities is available in the HBA's quarterly reports.

Agriculture working committee

As a result of the activities of the working committee, the opportunities for the establishment of mortgage for investment projects became wider under the Rural Development Program (hereinafter: RDP) and up until November 2018 a total of HUF 1,280 billion in commitments was realized. In response to the request of the working committee, the public warehousing supervisory authority compiled its report on the warehousing market for 2017, based on which it was apparent that the value of issued public warehousing tickets was HUF 77.33 billion in 2017, showing an increase compared to the year before. We held consultations on the creation of the government program handling and termination of lands under undivided joint ownership. In addition, the working committee consulted with the representatives of the Rural Credit Guarantee Foundation on the products that it currently has available. The foundation's guaranteed stock grew in the past 5 years and this year its guaranteed credit portfolio exceeded HUF 300 billion.

Internal Audit working group

In addition to requesting written opinions, throughout the year the working group initiated several in-person consultations with the relevant departments of MNB. Out of these consultations the two most important ones were: proposing the review of the requirements for the annual audit of outsourced activities stated in the Hpt; and the consultation held during the MNB supervisory audit on the expected framework for collaboration with internal audit departments.

The working group also conducted benchmarking research, the results of which were discussed in detail by members at the last working group meeting in 2018 and were also complemented by discussing the practices in branch networks, agent networks and outsourced activities.

Digitalization working group

Based on the decision of the Board, the Digitalization working group was organized. The Banking Association asked its members to delegate bank experts to the 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 very first tasks of the working group were to, after having been contacted by the MNB, examine possible cooperation between commercial banks and Alipay within the framework of the HBA; to

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.
In addition, the working group consulted with IdomSoft Zrt on the possible opportunities for the use of the e-ID cards in banking and analyzed, together with its creator, the study compiled by Nézőpont Intézet which contains proposals for cash-free payments under the topic of "whitening" the economy.

EXIM working group

During the meetings of the EXIM working group and its product education days EXIM's representatives reported that, in line with EXIM's strategy and mission, it launched its new export recovery financing program for Hungarian exporters and their vendors as of 1 July 2018. The earlier schemes for advance financing of exports will be replaced by the export recovery current asset (framework facility and ad hoc), investment (ad hoc), and leasing re-financing products provided under the new lending program. Information was provided on the details of EXIM's amended Business Regulation which took effect in mid-June. The working group commented on the Programme's public product descriptions, as well as the drafts of the ad hoc investment loan facility agreement and the ad hoc non-revolving current asset loan agreement.

Credit guarantee working group

The COSME Counterguarantee Program has become available as portfolio guarantee from 2018, with the purpose of supporting viable SMEs, which would otherwise not be eligible for loans due to their higher risks or the lack of the collateral expected by financial institutions. A total sum of HUF 30.7 billion in guarantees has been granted under the Garantiqa COSME Program.
With regard to the importance of the issue, a joint meeting was held between the CEO Forum and the Credit Guarantee Working Group concerning the increased additionality of institutional guarantees. As a result of several months of collaboration between MNB, the Hungarian Development Bank and the Ministry of Finance, the package of proposals for fine-tuning the guarantee system was produced, the details of which were presented and which was introduced during the year.
At the Credit guarantee working group's meeting, representatives of Garantiqa Hitelgarancia Zrt. gave us information on the introduction of the reverse guarantee procedure, which was concluded on December 31st with guarantee undertaken for a total of HUF 13 billion in loans.

SME working committee

As of 1 January 2018, the use of Company Gateways is compulsory for economic institutions; in this context, the SME and Legal Working Group held several consultations with representatives of the Ministry of Interior and the National Infocommunications Service Company Ltd. (NISZ) on the legislative background of e-administration, on hosting for economic actors (Company Gateway), the obligations of entities providing electronic administration required to use electronic administration, and on Electronic Administration Supervision. Out of the enterprises required to use e-administration 490 thousand had registered for and used the Company Gateway by the end of 2018, with the number of submitted documents amounting to over 1.1 million by early November.

Leasing working group

EXIM introduced its Export Recovery Leasing Program on July 1, 2018. The working group provided its opinion for the product's documentation, i.e. 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. The working group sent its comments compiled at the WG meeting concerning the introduction of electronic government office practices regarding the transfer of vehicle ownership and registering keeper's rights, as well as on the electronic creation of registration certificates and vehicle registration cards (e-registration certificate, e-vehicle registration card) 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 working group

The Documentary Transactions working group shared experiences in connection with the joint guidance issued by the Hungarian Banking Association and the Compliance Verification Experts Body (TSZSZ). The guidance explains the role of TSZSZ in disputes about invoking bank guarantees for architectural/technical planning, building and construction contracts. After the consultation the working group prepared a proposal for amending the TSZSZ law in connection with cases that dispute the justification for other liabilities. Throughout 2018 TSZSZ received a total of 61 bank guarantee requests, out of which it refused 15 providing various justifications.

Mortgage bank professional working committee

The **Real estate appraisal working group** discussed the possibilities for creating a real estate database operated by MNB, possibilities for valuation without on-sight inspection, as well as starting to assess whether it is possible to reduce the area of residential real estate in a standardized manner. It consulted on the concept on the asset valuation expert register and its data protection aspects.

The working group also debated early accession to the Energy efficient Mortgages Action Plan (EeMAP) initiative, considering that energy efficiency mortgages may play a central role in Europe's new financial strategy for sustainability. The purpose of the EeMAP initiative endorsed by the EU is to elaborate an energy efficiency loan product for banks and borrowers through which more favorable loan schemes will be available to those who wish to invest into green (energy efficient) real estate.

In connection with the possibility of appraisal without an on-site visit, namely, the extent to which real estate value and credit collateral value could be determined by desktop appraisal in certain settlements and for certain types of real estate, the working group sent a letter to the MNB.

Furthermore, a combined consultation (extending to several working groups) was held in 2018 on concluding the e-calendar and on issues concerning lending for nearly zero-energy buildings.

The central bank of Hungary consulted with the Hungarian Banking Association's **Public Administration and Regulation working group** and its **Capital Markets working group** on the amendment of the MNB decree on the regulation of the forint maturity mismatch of credit institutions (MFAR) on several rounds.

Throughout 2018 the working group dealt with the European Commission's legislative package on covered bonds (published in March). In the fall, the European Council adopted the general approach to this, and the European Parliament's mandate was also adopted, therefore the trilogue began in November, with the participation of the European Commission. The working group participated in the preparation of the EU materials containing national positions for the European Covered Bond Council. These materials unified the comments on the text proposals of individual EU institutions.

In addition, the working group provided data to the European Covered Bond Council's annual Fact Book and Statistics on existing and newly issued mortgage bonds in Hungary.

ANNEX: INTERNATIONAL OUTLOOK: REGULATION AND SUPERVISION

The following will provide a summary of the most important prudential regulatory developments of 2018, with a separate discussion of the global and European processes. For a more detailed account of regulatory events, please see the annexes of the HBA quarterly reports.

I. Global Regulation

1 Financial Stability Board (FSB[6])

The FSB's main activities in 2018 rested on the priorities set in its work program, which sought to foster growth, through the following:

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

One important tool for monitoring risks is the biannual Early Warning Exercise conducted jointly with the IMF, as well as the risks arising from the rapid growth in crypto-assets' impact on financial stability. In collaboration with CPMI[7] the FSB developed a framework to monitor the developments in crypto-asset markets. Though crypto-assets do not currently pose a material risk to global financial stability at this time, there is need for vigilant monitoring in light of the speed of market developments.

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

Following the finalization of the Basel III regulatory reform package in December, the FSB concentrated on completing work in other regulatory areas, such as halting the ***decline of*** correspondent banking, as well as developing the corporate governance framework that is able to mitigate conduct risks**.** The regulatory work on market-based finance and central counterparties has also been completed. The cyber-security lexicon has been completed and the climate-related financial disclosure is being implemented voluntarily. Further steps have been taken towards promoting the implementation of the Unique Transaction Identifier (UTI), the Unique Product Identifier (UPI) and the Legal Entity Identifier).
The FSB paid special attention to the establishment of effective global resolution regimes and promoting the implementation of the rules on total loss absorbing capacity (TLAC). The authorities continue to work on eliminating the obstacles to resolvability, focusing on institution-specific, cross-border cooperation agreements. The FSB's work also includes the establishment of the disclosure requirements on resolution strategies and plans as well as the regulation of trading book wind-down.

3. *Shifting the focus from new policy initiatives to the assessment of existing regulations; appropriately addressing unintended consequences.*

The FSB seeks to assess whether the reforms work as originally intended, and to make any necessary adjustments without jeopardizing the initial goals and the appropriate resilience. During the year, the

[6] Financial Stability Board: the highest international financial regulatory body
[7] Committee on Payments and Market Infrastructures: Similarly to the Basel Committee on Banking Supervision, it operates within the framework of the Bank for International Settlements (BIS)

impact of financial reforms on infrastructure investment and the incentives for the central clearing of OTC derivatives was assessed. 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 regulatory reforms on the incentives to centrally clear OTC derivatives 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.
The second part of assessment of the effect of the reforms on financial intermediation will assess how they affect SME financing.

4. *Optimizing how the FSB works in order to maximize its effectiveness.*

In order to ensure that the FSB continues to function appropriately, the members thoroughly examined its work. The evaluation covered transparency, consultation practices, the mechanisms for setting the strategic agenda and the safeguarding of principled and efficient operation.
In preparation for the G20 Summit, in October the Financial Stability Board held a plenary session to review the vulnerabilities of the financial system and to discuss the reports to the G20 summit.
The Plenary found that the core of the financial intermediary system is much more resilient than before the global financial crisis, with strengthened bank capital and liquidity. At the same time, non-bank financial intermediation (NBFI) has grown, adding to diversity of funding, but with associated maturity and liquidity transformation risks, and concentrations in holdings of risky assets. New forms of interconnectedness have emerged that could, in some scenarios, act as channels for domestic and cross-border amplification of risks.
Plenary members discussed the fourth annual report on the implementation and effects of the G20 financial regulatory reforms and the work program for the coming year. The work program will focus on (i) finalizing and operationalizing post-crisis reforms; (ii) monitoring the implementation and evaluating the effects of post-crisis reforms; and (iii) addressing new and emerging vulnerabilities in the financial system.
Specific new initiatives include:

- An evaluation on the effects to date of reforms to end too-big-to-fail, which will be launched in early 2019 and completed in 2020.
- An initiative to explore ways to address the risk of market fragmentation.
- A project on financial stability implications of decentralized financial technologies.
- A project to develop effective practices relating to a financial institution’s response to, and recovery from, a cyber incident, on which a progress report will be published by mid-2019.

After the end of Chair Mark Carney’s mandate from 2011 to 2018, starting from December 2, 2018, the Plenary of the FSB appointed Randal K. Quarles (Governor and Vice Chairman for Supervision at the US Federal Reserve) as its new Chair and Klaas Knot (President of the Dutch central bank) as Vice Chair. The Plenary also agreed that after three years on 2 December 2021 Klaas Knot will take over as Chair for the next three-year term.

2 Basel Committee on Banking Supervision (BCBS)

The *BCBS work program and the strategic priorities for 2018–201*9 overlap with the FSB’s activities in many areas:

(i) finalizing existing regulatory initiatives and targeted regulatory recommendations,
(ii) ensuring full, timely and consistent implementation of the Committee’s post-crisis reforms,
(iii) promoting strong supervision,

(iv) evaluating and monitoring the impact of post-crisis reforms, as well as gauging and assessing emerging risks.

With regard to finalizing reforms, the *Fundamental Review of the Trading Book (FRTB) published in January 2016 was agreed to be revised in a targeted and limited manner*, and a related consultation was launched on 22 March. It was reaffirmed that the new rules have to be implemented from *January 2022*, as will the Basel IV[8] regulations adopted in December 2017.

In April, the BCBS and the International Organisation of Securities Commission (IOSCO) jointly published two documents on the *identification and capital requirement of simple, transparent and comparable (STC) short-term securitization*, and on its *identification* and *capital requirement*.

In July, the BCBS published *Global systemically important banks: revised assessment methodology and the higher loss absorbency requirement.* The revised methodology must be implemented in member jurisdictions by 2021.

As part of managing extraordinary monetary policy operations, the BCBS *amended the calculation of the NSFR - Net Stable Funding Ratio*. The technical amendment, effective immediately and provides greater leeway in applying central banks' extraordinary liquidity-absorbing toolkit.

The *large exposure regulation* adopted by the Basel Committee in April 2014 *must be implemented from 1 January 2019.* The limits should be applied not individually but to (groups of) connected counterparties by taking into account the on- and off-balance sheet items in the banking and the trading book.

To finalize the reforms, the BCBS updated its *Pillar 3 disclosure requirements*. The revised Pillar 3 framework pertains to the following areas: credit risk, operational risk, the leverage ratio and credit valuation adjustment (CVA) risk; risk-weighted assets (RWAs) as calculated by the bank's internal models and according to the standardized approaches; and an overview of risk management, RWAs and key prudential metrics. In addition, the updated framework sets out new disclosure requirements on asset encumbrance and on capital distribution constraints. These requirements, together with the updates published in January 2015 and March 2017, complete the Pillar 3 framework, which seeks to *promote market discipline* through regulatory disclosure requirements. The implementation deadline for the disclosure requirements is *1 January 2022*, which accords with the introduction of the finalized Basel III standards. The implementation deadline for the disclosure requirements for asset encumbrance, capital distribution constraints and the prudential treatment of problem assets is end-2020.

In order to avoid regulatory arbitrage and window-dressing behavior the *disclosure requirements for the leverage ratio* will be reviewed as part of the consultation announced at the end of the year. In addition Committee launched a consultation on the *treatment of client cleared derivatives when calculating the leverage ratio.*

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*.

The Committee continues to work on the introduction of the *evaluation methods for Basel III*. Starting from 2012 it publishes, twice every year, its *monitoring report on the changes in banks' main indicators as a result of the Basel III reforms.* In addition, they also regularly evaluated the *implementation of the Basel III standards in individual jurisdictions within the framework of RCAP*[9]*.* The latest report also considered the decisions made in December 2017. The assessment of consistent implementation is carried out on a *voluntary basis.*

[8] Basel IV is the name commonly used for the package adopted in December 2017. The BCBS itself refrains from using "Basel IV" and insists on using "the finalization of Basel III".

[9] Regulatory Consistency Assessment Programme

The Committee also continuously monitors and assesses the implementation of the *Principles for effective risk data aggregation and reporting*. An annual status report is compiled with regard to the above, based on the self-assessment of G-SIB supervisory authorities.

In the spirit of promoting strong supervision, the BCBS adopted a *report on early supervisory intervention practices*.
In addition to banks' internal stress tests, the *Stress Testing Principles* serve as guidelines for applying supervisory tests and for using them as monitoring tools.
The document entitled *Framework for supervisory stress testing of central counterparties* pertains to the stress tests affecting multiple central counterparties and performed by one or more supervisory authorities.
The document analyzing *the impact of fintech development* also depicts the supervisory aspects of fintech.

The *Committee on Payments and Market Infrastructures (CPMI)* compiled a report on *cross-border retail payments*, according to which there is ample room to improve the infrastructure of small-sum cross-border payments. In its report on improving the infrastructure of wholesale payments, the CPMI urges banks, money market infrastructures and other financial institutions to pursue a *common strategy to improve the security of wholesale payments.* The CPMI and the IOSCO continue to *monitor* the implementation of the *Principles for Financial Market Infrastructures (PFMI),* which contains the international standards on payments, settlement and trade repositories.

The CPMI compiled a report on *Central bank digital currencies (CBDC),* which concludes that the introduction of CBDC requires careful consideration in all jurisdictions.
The Bank for International Settlements (BIS), the "parent institution" of the BCBS and CPMI, provided a detailed *analysis and assessment of cryptocurrencies* in its 2017 annual report. Overall, the analysis is rather negative in its assessment of cryptocurrencies: confidence in them, which is key, is quite fragile, and they can simply stop functioning and lose all their value.
Furthermore, in December the BCBS published a report in which it presents the range of observed bank, regulatory and supervisory *cyber-resilience specificities and diverse practices* across jurisdictions.

European regulation

Banking (risk reduction) regulatory package

Towards the end of November the negotiating parties of the trilogue came to an agreement about the details of the risk reduction package. The EU Economic and Financial Affairs Council reinforced this at its meeting on December 4th. The final approval of the legislation by Parliament is predicted for April 2019.
The following compromises were made on the issues that were open prior to the agreement.

Issues concerning prudential regulation

- According to the agreement, *capital requirement would be decreased for pension and salary-backed loans* (from 75% to 35%) with the aid of certain guarantees and risk reducing factors, in consideration of their low default risk.
- Small non-complex institutions would get the advantage of a simplified disclosure and reporting obligations. The EBA was authorized to create the framework for this. The EBA's targeted a minimum of 10% reduction of expenses for the above, up to a target of 20%, if possible.

- In order to support derivatives backed by margins, trade financing and similar short-term trade financing techniques such as factoring, the Net Stable Funding Ratio (NSFR) will be recalibrated, and a *simplified NSFR* (sNSFR) will also be introduced, to be applied by small-sized, non-complex institutions.
- The currently applied supporting factor for loans to SMEs would be increased.
- Changes made to requirements on own funds:
  - A transitional period is provided for that would allow institutions not to deduct certain types of insurance holdings until 31 Dec 2024;
  - Profit and loss transfer agreements will be recognized upon adherence to certain criteria;
  - An exemption from deductions of *certain intangible software assets* is granted from own fund items provided that certain requirements are fulfilled. The mechanics and details of the non-deduction will be set out in an EBA regulatory technical standard.
- In connection with sustainability requirements, the EBA was mandated to produce a report on the prudential treatment of "green" and "brown" assets (penalizing RWA factors for assets posing environmental risk).
- The introduction of "only" new reporting requirements with regard to the new standards concerning the FRTB[10]. The final standards should be implemented as soon as they are finalized at international level.
- Large non-EU banking groups with two or more subsidiary institutions in the EU would be required to establish an intermediate parent company to consolidate all their activities in the Union under that intermediate parent undertaking (this might have considerable significance if Brexit happens without an agreement).
- The EBA also received authorization to conduct a study to assess the feasibility of an integrated reporting system for all EU banks.

Issues concerning rules on resolution

- If the MREL requirement is not fulfilled MREL related MDAs[11] will be applicable following a grace period of nine months, with no automaticity.
- As regards massive asset disposals, the new provisions would help banks with high level of non-performing loans to dispose of them with no impact on their capital requirements, subject to certain requirements and within a pre-determined timeframe.
- Two alternatives to be chosen under own discretion were given to member states to *safeguard the sale of MREL instruments to retail customers*:
  A. Option A: retail investors with an investment capacity below EUR 500,000 may only invest a minimum initial amount of 10,000 EUR in those instruments representing not more than 10% of their investment capacity;
  B. or – Option B: a minimum denomination of EUR 50,000 (for member states with a smaller capital market this may be EUR 10,000).

According to current documents the new regulations will enter into force on the twentieth day following their official announcement. In accordance with standard practice they will need to be implemented by member states two years after their entry into force.

Developments in connection with establishing the Capital Markets Union

A key target of the 2014-2019 European Commission is to lay the foundations of the Capital Markets Union, the steps of which it executed through an action plan. The action plan included the establishment of the Level 1 rules (directives, regulations) for 13 regulatory topics. The Commission submitted the proposals for the parts of the package concerning the cross-border trade of

[10] Fundamental Review of the Trading Book
[11] Maximum Distributable Amount

investment funds, covered bonds and EU passports for crowdfunding service providers in March 2018. At the same time it called the attention of institutions participating in the legislation process to the fact that they must make the necessary efforts in order to complete the action plan and to conclude the 10 pending regulatory processes below on time:

- Creating an EU covered bonds framework;
- Facilitating the cross-border distribution of collective investment funds;
- Regulating crowdfunding;
- Introducing a Pan-European Personal Pension Product (PEPP) regulation;
- The prudential regulation of investment firms (IFD, IFR), which will include the prudential rules for non-systemic investment firms, which will in turn be pulled from regulations on capital requirements;
- Modifications to promote SMEs' financing through capital markets;
- Review of the licensing, supervision and recognition of CCPs within the framework of amending EMIR;
- The law applicable to the third-party effects of assignments of claims:
- Modification of the regulations on insolvency (concerning the preventive restructuring frameworks, second chance, and measures to increase the efficiency of insolvency and discharge procedures);
- Re-regulating European supervisory authorities and the ESRB (with the relevant complementary tasks and scope of application of these authorities added in as a result of the Maltese, Estonian and Danish money laundering scandals).

As they could not effectively conclude the relevant regulatory dossiers during the remainder of the year and only 2 of them (insolvency procedures and Pan-European Personal Pension funds) are in the trilogue phase, to be completed quickly, the Commission repeated its call in a communication in November. The directive on insolvency procedures was approved by the end of the year, and the trilogue on the regulations for covered bonds and the cross-border trade of investment funds.

The Fifth anti-money laundering (AML) directive

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 EU 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 in July 2018 and EU member states must transpose its provisions into their national law by January 10, 2020, at the latest.

Developments with regard to modifications to the scope of European financial supervisory authorities

In June 2017 the European Commission submitted a proposal to reform the scope of European Supervisory Authorities (ESAs***)***. As a result of the Maltese, Estonian and Danish money laundering scandals, in September it complemented its proposal, initiating stronger supervision of financial institutions in order to improve the combating of money laundering and terrorist financing. 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. 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.
Although the original proposal still contains the significantly opposing views of member states, by the end of the year the Council reached consensus on how to complement it, therefore the trilogue started in early 2019 will be considered separate from the original proposal.

The European Commission's 2019 Work Program

The Commission work program for next year was issued towards the end of October and does not contain any initiatives that would deeply impact the banking sector's regulatory issues. In contrast, the REFIT[12] initiatives envisage the review of three new legislations, and the regulatory amendment proposals resulting from it will directly influence the activities of financial service providers:

- The evaluation of the consumer credit and the directive on the distance marketing of consumer financial services will look into the functioning of the consumer credit market and the distance marketing and selling of retail financial services. It will primarily deal with the elements of providing information to consumers, such as that of examining the information provided about sales, including basic information found in advertising or the lack thereof (APR, interests, expenses and other important information).
- The Fitness Check of supervisory reporting will analyze cross-sectoral reporting requirements to supervisory authorities stemming from EU Financial Services Legislation (e.g. Capital Requirements Directives - CRR/CRDIV, Markets in Financial Instruments Directive - MiFID/MiFIR, European Market Infrastructure Regulation - EMIR etc.).
- The Fitness Check of corporate reporting will evaluate corporate reporting requirements including the Accounting Directive, the Non-financial reporting Directive, the Transparency Directive, and the International Accounting Standards Regulation (IFRS).

In addition to the above, the Work Program ambitiously undertakes to complete currently open regulatory packages concerning banking and the Capital Markets Union. The regulations and reviews to complete are the following:

- the banking Risk Reduction Package (RRP);
- Review of the recovery and resolution of central counterparties (CCP);
- Amending the Capital Requirements Regulation (CRR) with regard to the minimum loss coverage for non-performing exposures;

[12] Regulatory fitness and performance (REFIT) programme - the Commission's program for targeted and effective regulation

- Regulatory dossiers to promote the Capital Markets Union;
- Finishing the modifications made in connection with the review of the European Market Infrastructure Regulation started in 2015;
- Finalizing the new directive on the representative actions for the protection of the collective interests of consumers.

In December 2018 agreements were reached during the trilogue on the two banking regulatory dossiers.