



**HUNGARIAN BANKING ASSOCIATION**

# **REPORT**

---

**on Activities of the Hungarian Banking Association**

**3<sup>th</sup> Quarter 2017**

**Budapest, November 2017**

## Table of Contents

I. Executive Summary.....	4
II. Macroeconomic Outlook: the operating environment of the banking sector .....	9
III. Corporate sector .....	11
Market –based Lending Scheme.....	12
IV. Retail sector.....	12
Developments concerning the Certified Consumer-friendly Housing Loan product .....	13
The opportunity to use the National Tax and Customs Administration’s (NAV) income database for loan assessments .....	13
Banks’ proposals for modernizing the Home Purchase Subsidy Scheme for Families (HPS) .....	14
V. Further important regulatory developments influencing the operation of the banking sector .....	15
MIFID 2 implementation .....	15
Two HBA proposals to amend the Credit Institutions Act.....	15
Consultation on the draft decree on the sale of assets in a liquidation procedure.....	16
Amendments to the decree on the loan collateral register .....	17
Consultation on the draft law on the tax enforcement procedure (Avt.) .....	17
Proposed amendment to the Act on the Real Estate Register .....	17
Consultation on the amendment to the Info Act.....	18
Integration of legal counsels to the bar - Consultation on the Omnibus act and policies related to the Act on Lawyers .....	18
VI. Developments concerning the Magyar Nemzeti Bank (central bank of Hungary) .....	19
The activities of the MNB repo market working group.....	19
MNB recommendations concerning UCITS and AIFM remuneration policy.....	20
Other MNB recommendations, draft recommendations and draft decrees.....	20
Request for a resolution on certain provisions of Act LIII of 2017 on the Prevention and Combating of Money Laundering and Terrorist Financing (Pmt.).....	20
VII. Payments.....	21
Implementing the EU Payment Services Directive (PSD2).....	21
Developments in connection with the AZUR (instant bank transfer system) project.....	22
Information on the launch of the EPC’s SCTInst system .....	23
TIPS - Instant settlement mechanism of the ECB.....	23
Bank Cards.....	24
The MNE’s resolution with regard to opening bank accounts online .....	25
Visit to the Austrian Cash Logistics Centre .....	25
Response letter to the question from the Ministry of Justice on the use of cheques/bills of exchange .....	25
VIII Taxation, accounting .....	26
Consultation on draft legislation .....	26
Proposals for the amendment of the legislation .....	26
Ministry positions on the interpretation of tax legislation.....	26
Setting up a sub-working group for the taxation aspect of the transition to IFRS.....	27
IX. Developments within the Banking Association .....	27
Communications.....	27
Money Week – preparing for the 2017/2018 school year .....	28
Developments regarding the cessation of the Money and Capital Market Permanent Court of Arbitration .....	28

Other working committees and working groups .....	29
<b>ANNEX- INTERNATIONAL OUTLOOK: REGULATION AND SUPERVISION .....</b>	<b>32</b>
<b>I Global Regulation.....</b>	<b>32</b>
I.1 Financial Stability Board (FSB) .....	32
I.2 Basel Committee on Banking Supervision (BCBS) .....	34
<b>II. European Regulation.....</b>	<b>36</b>
II.1 General environment – Juncker’s speech on the state of the Union .....	36
II.2 European Single Rulebook: Developments concerning the Risk Reduction Package (RRP) of November.....	37
II.3 The Banking Union .....	37
II.4 The Capital Markets Union (CMU) .....	38
II.5 The European Commission’s proposal for a cybersecurity regulation .....	40
II.6 Other important documents published by EBA and ESA in Q3 .....	40

## ***I. Executive Summary***

In Q3 of 2017, ***following previous trends***, the ***world economy kept growing at an accelerated pace***. In October, the IMF raised its two-year prognosis for global GDP by 0.1 percentage point (3.6% for 2017 and 3.7% for 2018). Once again, contributors to global economic growth were the EU, Japan, emerging Asian countries, European countries (including Russia), while the Anglo-Saxon economies held back global growth. The main driving forces behind global economic ***growth*** are ***cyclical factors***, mostly the positive performance in industry output, investment and trade, although business and trust indicators also improved. Growth indicators vary greatly among countries; in particular main raw material and energy exporters are struggling. In developed economies considerable risks for growth are inflation that does not reach the target level, political uncertainties and geopolitical tensions.

The *US economy* may improve by one-tenth percentage point compared to its 2.1% year-on-year growth, however in the medium term, due to uncertainties in economic policy and to the expectations in connection with the Fed's interest rate policy, there are significant negative risks.

*The European Union's economy* continues last quarter's trend of slight growth. Monetary conditions within the Eurozone continue to be lax. The biggest problem is (as before) low investment activity. Due to the latest election results (Germany, Austria, Czech Republic), and the Catalan separatist efforts, uncertainty about the future politics of the Union has increased. Growth may also be halted by the slow progress of Brexit negotiations.

After the ***Japanese economy's*** exceptional growth in Q2, experts expect a correction, while ***China's*** economic policy has numerous further provisions to help prolong the slowing of the economy and to therefore avoid a hard landing. ***Russia's*** economy continued to stabilize, however its growth is still fragile.

In the first two months of Q3 ***the outlook of the Hungarian economy continued to improve in terms of the real economy***, due mainly to the recovery in the economic situation of Europe and Germany, which greatly influence us. According to experts' predictions, ***GDP growth may reach as much as 4%***. We do not yet have factual data for the third quarter; however the available data on GDP components look promising. Industrial production and the construction industry continue to grow, and the decisive increase in *investments* will contribute to GDP growth. Preliminary data on retail trade suggests that despite the substantial increase in real wages, a notable rise in consumption is yet to happen. Concerning the labor market, the rate of increase in employment remains significant, while the insufficient supply of workforce may limit several sectors, and therefore keep wage dynamics strong. *Inflation* calculated for the *year* has increased (2.5% in September), but still does not reach the 3% target value. Concerning *balance indicators*, compared to the same time period of last year, this quarter shows a less favorable budget, however it seems possible to keep to the 2.4% deficit-to-GDP target ratio, as well as to the 73% budget deficit-to-GDP ratio (if the EXIM debt is excluded) – a criteria that must be fulfilled due to EU regulations on debt. Owing to the steep rise in internal demand, the current account surplus will probably decrease. The Magyar Nemzeti Bank (central bank of Hungary) did not change its monetary policy. The EUR to HUF exchange rate continued to stay within a relatively narrow range, at a stronger level than in the previous quarter (302-312).

In the first two months of Q3 the ***aggregated balance sheet total of credit institutions grew by 0.7%*** (HUF 244 billion). On the *liability side* all important liability types grew or remained mainly stagnant. The *total gross deposit portfolio* expanded by HUF 269 billion (1.2%). After a significant increase in H1, there was no change in the total sum of *household deposits*, while the volume of the *deposits of non-financial enterprises* grew at a faster rate than in H1 (by 3.6%). The shortening of deposit maturity continued. Within *the asset portfolio*, growth continued in all other more important asset types besides debt securities (which decreased moderately). *Net credit portfolio* increased moderately in the last two summer months, by merely 0.8% (HUF 140 billion). The 0.5% gross

increase in credit is even less, which is once again due to the *reversal of impairment losses* in forint (HUF 39 billion), and in smaller part also due to the added value gained from *valuation difference*. The *gross value of household loans* grew moderately, the gross value of loans granted to non-financial enterprises shrank significantly, from an increase rate of over 5% in Q2 to that of 0.3% (HUF 27 million). The credit institutions sector's *net loan-to-deposit ratio* was 103% (88.1% without interbank loan portfolios).

The *profit* in July-August was less in proportion to the second quarter's, but still reached nearly HUF 89 billion. This granted the banking sector a 12.81% return on equity and a 1.39% return on assets. Not counting individual items, the return on equity and assets would approximately fall to 60% of the nominal value. There was no change compared to Q2 in interest profit rates in the last two months of the summer. The moderate improvement in the profit from fees and commissions continued, while the profit from financial activities slightly decreased. General expenses stayed at the same level as in the previous quarters.

In the second phase of the ***Market-based Lending Scheme***, banks raised their lending commitments for this year to almost HUF 230 billion, which accounts for roughly 6% of the outstanding loans to SMEs, and which projects continued positive developments in corporate lending.

In the summer work on the ***Certified Consumer-friendly Housing Loans (CCHL) products*** continued: the development and testing of the ***calculator for comparing banks' offers*** and the ***scripts that determine the offers of individual banks*** (these will have to be developed by the banks themselves). Several operational and legal uncertainties concerning the product have been uncovered during the design process and we sent the central bank a letter in late August to clarify these. We asked that the central bank increase the time limit for determining interest from 2 days to 15 days and that the disclaimer for the rules to be applied during the legally binding recommendation's publication, modification and annulment be displayed on the central bank's "CCHL webpage". Furthermore, we asked for modifications to be made to the sample obligatory recommendation attached to the tender, as well as to the legal notices for the comparison calculator and the webpages for uploading banks' applications. Up until the launch of the calculator in early September MNB made modifications to several points of the legal notice on the website in question. MNB's expert indicated that they wish to ***extend the fixing period*** (from 2 days to 15 days) and will initiate the ***fast-track introduction*** (1-5 days instead of 60) ***of the entry into force of the modifications to the tender***.

During the elaboration of the Certified Consumer-friendly Housing Loan product the idea arose that information asymmetry concerning the actual financial situation of clients could be moderated through creating a ***central database (based on the tax authority's data)***, and ***the loan assessment process could be automated, and thus sped up***. The comments made at the consultations on the possible content of the database based on tax returns showed that banks' needs are of a much wider range than what the central bank predicted and that banks require access to the NAV dataset for the assessment of all other loan products, in addition to housing loans. According to the current solution, the database would include data on the PIT returns of natural persons, BISZ Zrt. would be involved in managing data flow and clients would give their consent to the retrieval of their data at their creditor banks. In the current phase, MNB is negotiating with NAV on the feasibility of the system.

Banks' proposals made to ***update the rules for the Home Purchase Subsidy Scheme for Families (HPS)*** also serve to give incentive to and ameliorate the conditions of housing loans. Banks, which play a significant role in housing loans informed legislators about their experiences through an information package aimed at ***alleviating legislative requirements which complicate/prevent the use of the subsidy***, and ***simplifying the complicated administrative procedure for the loan application***.

With regard to the **implementation of MiFID 2**, it is especially important to highlight the position taken by the central bank, according to which the **fee paid by the Government Debt Management Agency (ÁKK)** to primary sovereign bond distributors is not covered by the MiFID 2 and Bszt. **provisions regulating incentives**. As the last step of the legislation procedure for the implementation of the directive, MNB completed its draft decree on the **personal conditions for the provision of investment services**.

In August, the Magyar Nemzeti Bank (central bank of Hungary) issued its **recommendation on the definition of special lending exposures and speculative real estate financing**, and during the final compilation of its text, the supervisory authority took into account many of the Banking Association's observations. During the third quarter, we commented on several **MNB draft decrees and recommendations** concerning, for example, data reporting obligations, disclosure, the remuneration policy of certain investment firms, managing credit risk, and implementing the IFRS 9 impairment loss regulations.

In addition, we asked for MNB's resolution (in its supervisory capacity) on the **interpretation of certain provisions of the new anti-money laundering act**.

The **questionnaire compiled by MNB's repo market working group** inquired about the framework contract and the legal direction to be applied, and banks' individual positions on KELER, the Government Debt Management Agency and central bank statistics concerning the market.

Regarding the legislative work which affects the operating conditions of the credit institutions sector, the **draft amendment to the Info Act** is most worthy of mention. The amendment of *Act CXII of 2011 on informational self-determination and freedom of information* became necessary due to the **changes in the EU law and law harmonization obligations**. A problem in connection with the draft is that the legislator wished to carry out the implementation of two other European laws (the **EU regulation** for processing personal data or *GDPR*, and the **EU directive** concerning the data processing for criminal offences) together with amending the Info Act. In its observation sent to the Ministry of Justice, the Banking Association drew attention to the fact that the **chosen codification solution will not help to enforce the requirement of the clarity of norms** and determining the Act's personal and objective scope is quite difficult. The draft law contains a restrictive regulation with regard to mandatory data processing, contrary to the regulation, and the wording for the legal basis of data processing is not in line with the regulation either. We proposed a separate law to transpose the Directive into domestic law.

We provided our opinion on the draft government decree **on the amendment of the provisions on the public sale of the debtor's assets in a liquidation procedure** and thus managed to achieve that creditors' rights will not be compromised upon the tender call, at the announcement of an auction, and when decreasing the minimum price.

Our proposal to amend the **Act on the Real Estate Register** was also made to protect the interests of creditors, and to ensure that the mortgage holder bank is notified if there is a change in the ownership of the real estate serving as collateral for the mortgage, and may as a result be able to notify its claim in the liquidation procedure of the new owner or business organization.

Some other items on the agenda of the third quarter were the **amendments to the decree on the loan collateral register** and consultation on the **draft law on the tax enforcement procedure**.

The **linked to the entry into force of the Act on Lawyer's activities** has the characteristics of an „**Omnibus Act**” and encompasses more substantial amendments to some other acts, such as the Act on Public Notaries, Act on Court Enforcement, Act on Probate Procedure, and Act on Civil Procedure. During this last period quite a lot of work was dedicated to the **integration of banking legal counsels to the bar**, and the preparation of **new bar policies**, as well as formulating opinions on these.

The working groups (payments, bank cards, IT security, SEPA, anti-fraud) involved in the implementation of the **new Payment Services Directive** (PSD2) assessed and commented on the legislation, and supported banks' preparation through their active work. An important development is that the new regulation on the **responsibilities** of bank account managing and third party service providers will only have to be adhered to by January 1, 2019, at the latest.

The establishment process of the organization for **AZUR (the instant bank transfer system) project** has recently been completed. The **Project Management Committee** (PMC) was created with the participation of the HBA's representative and the leader of the national project has also been appointed. Various working groups (bank accession, services, regulatory and information working group) and sub-working groups are part of the project and have begun their work. An important development with regard to the evolution of the project is that the directorate of GIRO Zrt approved the **criteria for choosing the central clearing system**.

The **instant payments system (SCTInst) of the European Payments Council** will be launched from November 21, 2017, and will be joined by nearly 600 payment service providers. The **new electronic transfer system for the Euro** will allow for the transfer of up to 15 thousand Euros throughout the entire day and on every day of the year. When executing domestic and cross-border instant transfers, the transferred sum becomes available to the beneficiary in **less than 10 seconds**.

The European Central Bank will launch its TARGET Instant Payment Settlement (**TIPS**) service in November of 2018, which will ensure that **instant payments in Euros** are carried out and will be available to banks' clients in the 19 member states of the Eurozone.

The development of *fintechs* and bank *cybersecurity* come more and more into view among prudential regulatory authorities at both global and European level. This is proven by the fact that in August the Basel Committee on Banking Supervision (BCBS) published a consultative document on the implications of fintech developments for banks and bank supervisors, while the European Banking Authority published a discussion paper on fintechs. The BCBS also created a separate working document on the supervisory approach to reinforcing bank cybersecurity, while the European Commission, after President Juncker also discussed the issue in his speech, made the proposal for a cybersecurity regulation.

Concerning **global regulation**, the international regulatory bodies completed their *work plan on central counterparty recovery and resolvability*. Before the G20 summit in July, the **Financial Stability Board** (FSB<sup>1</sup>) also finalized its *principles on the internal total loss-absorbing capacity of global systemically important banks ('Internal TLAC')*, as well as the *Guidance on continuity of access to financial market infrastructures (FMIs) for a firm in resolution*. In addition to these, it compiled progress reports on *reducing misconduct risk in the financial sector*, on *the implementation of the principles for compensation*, on *managing the decline in correspondent banking*, and the *second phase of the G20 Data Gaps Initiative*. In September, the FSB published for the first time the *list of the key standards for the operation of sound financial systems*.

In early July, the **Basel Committee on Banking Supervision** announced a consultation on the *features and identification of simple, transparent and comparable short-term securitizations* and at the same time on its *capital requirement*. The BCBS issued an important working document on the *interplay of accounting and regulation and its impact* and signed a new *Memorandum of Understanding with the IFRS Foundation*.

An important development in **European regulation** was that the European Parliament's Economic and Monetary Affairs (ECON) supported the urgent amendment of the *capital requirement regulation concerning the transition to IFRS 9 and big risk*, and the *directive proposal on credit hierarchy*. At the

---

<sup>1</sup> The highest-level international financial regulatory body

same time the Vice-President of the European Commission, the commissioner of financial regulation does not agree with *postponing the fundamental review of the trading book* until a decision in Basel is made and the *reconsideration of the NSFR*, initiated by the European Banking Federation.

The ***most important goal*** aside from completing the banking union is ***establishing the Capital Markets Union as soon as possible***. With regard to this, exceptional significance is granted to the *management of non-performing loans*, for which the Council created an *action plan*, while the Commission held a consultation on the *development of secondary markets for non-performing loans and distressed assets and the protection of secured creditors*. In order to establish stronger and more integrated European financial supervision for the Capital Markets Union, the Commission also proposed *reforms to the European supervisory architecture*. Other important developments were: the *European Parliament adoption's of an own-initiative report on creating a pan-European covered bonds framework*; the *parliamentary rapporteur submitted her draft report for the Commission's directive for regulating bankruptcy (insolvency, restructuring, second chance)*; and the *European Banking Authority announced a consultation on significant risk transfer in securitization*.

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

In Q3 of 2017, **following previous trends**, the **world economy kept growing at an accelerated pace**. In October, the **IMF raised its two-year prognosis for global GDP by 0.1 percentage point** (3.6% for 2017 and 3.7% for 2018).

Once again, contributors to global economic growth were the EU, Japan, emerging Asian countries, European countries (including Russia), while the Anglo-Saxon economies grew by less than the average and therefore held back global growth.

The main driving forces behind **growth** are **cyclical factors**, mostly the positive performance in industry output, investment and trade, as well as the continued improvement of business and trust indicators. However, this recovery is not entirely comprehensive, growth indicators vary greatly among countries; in particular main raw material and energy exporters are struggling. In developed economies considerable risks that may stunt growth are inflation that does not reach the target level, political uncertainties and geopolitical tensions.

The **US economy may improve by one-tenth percentage point compared to its 2.1% year-on-year growth**, however in the medium term, due to uncertainties in economic policy and to the expectations in connection with the Fed's interest rate policy, there are significant negative risks. The labor market continues to be stable; with the unemployment rate at 4.4%, there is nearly full employment. Consumption is fueled by the stable rise in disposable income. The absence of inflationary and wage pressure make it uncertain if the Fed will raise interests further. The biggest risk is posed by the expectations towards the Trump administration's economic and trade policy measures; no truly thorough measures have yet been taken.

**The European Union's economy** also continues last quarter's trend, with a slightly higher **continued growth** rate than that of the USA's. To support growth, monetary conditions in the Eurozone continue to be lax. The biggest problem with the EU's economic development is (as before) low investment activity. Although radical forces have managed to take some seats in European parliaments (Germany, Austria, Czech Republic), no profound change is visible in terms of political balance. At the same time, due to the Catalan separatist efforts, uneasiness concerning the strengthening of independence seeking minority movements has increased in other member states as well, and thus so has uncertainty about the future politics of the Union. Growth may also be halted by the slow progress of Brexit negotiations.

After the **Japanese economy's** exceptional growth in Q2 (4% at an annual level), experts expect a correction, while **China's** economic policy has numerous further provisions to help prolong the slowing of the economy and to therefore avoid a hard landing. **Russia's** economy continued to stabilize, however its growth is still fragile.

**In the first two months of Q3 the outlook of the Hungarian economy continued to improve** compared to the last quarter **in terms of the real economy**, due mainly to the recovery in the economic situation of Europe and Germany, which greatly influence us. We do not yet have factual data for the third quarter; however the available data on GDP components look promising. The construction industry continues to grow significantly (by 22.7% in July and 36.8% in August), while industrial production increased by 6.8% after the weak output of the first two summer months.

According to experts' preliminary expectations, there will be a decisive **increase in investments**, which will contribute to GDP growth. The delivery after the construction of apartments and offices (started last year) will happen in the second half of the year. The now visible EU transfers also contributed to the upswing in investments, while the surge in state investments should happen in the near future. The investments of the private sphere are supported by long-term low interest rates, lower corporate tax and social contributions, as well as, paradoxically the lack of available

workforce and the increase in salaries that is present in all sectors, since enterprises are thus forced to invest in order to increase productivity and effectiveness. The steep rise in investments however is balanced out by their great import requirements; therefore it is probable that the **surplus in external trade will somewhat hold back the growth of the economy**.

**Preliminary data on retail trade suggest a slight increase in consumption** (5.2%, 4.2% and 4.6% in each month of the quarter). External trade may have a negative effect on growth due to rising internal demand and the above mentioned investment processes, and so could the depletion of stocks. Despite the **substantial increase in real wages**, a notable rise in consumption is yet to happen. The European economic outlook is also favorable, and according to experts' predictions **GDP growth may reach as much as 4%**.

Concerning the labor market, **the rate of increase in employment remains significant** and by now this is almost exclusively due to more jobs in the primary labor market, as public employment has started to decrease in the past months. Insufficient supply of workforce may limit several sectors, therefore **wage dynamics may stay strong**. Based on processes the unemployment rate may decrease from 4.2% in August by a further 1 or 2 percentage points by the end of the year, and the employment rate may even reach 70%.

**Inflation calculated for the year is still less than the 3% target value** (2.5% in September), the primary cause of its being the change in fuel prices. Core inflation, which is more indicative of pricing pressure is gradually increasing and, although barely, it also misses the target inflation. There is no inflationary pressure from the external environment either. The pricing pressure on the demand-side is expected to only build up gradually, despite strong wage dynamics.

Concerning **balance indicators**, compared to the same time period of last year, this quarter shows a **less favorable budget**, which is due in part to the upcoming elections, to increasing social transfers, to economy-stimulating measures and to having advanced the sum of EU sources from the state budget. Payment deficit was HUF 980 billion in late August, which is 84% of the entire sum planned for the year. This indicates a rise compared to the amount from one year before, although experts say that it is possible to keep to the 2.4% deficit-to-GDP ratio targeted by the government, as well as to the 73% budget deficit-to-GDP ratio (if the EXIM debt contested by Eurostat can be excluded) – a criteria that must be fulfilled due to EU regulations on debt.

Due to the steep rise in internal demand, the current account surplus will probably decrease; however, due to the fast-track use of EU sources our net external financing capacity can stay high, which could promote the faster reduction of foreign debt.

The Magyar Nemzeti Bank (central bank of Hungary) followed its previous policy and did not change monetary conditions. Accordingly, it kept its base rate level and displaced further liquidity from the three-month deposit asset portfolio (from HUF 500 billion to HUF 300 billion) and also decided on decreasing the limit by the end of the year (HUF 75 billion). The EUR to HUF exchange rate continued to stay within a relatively narrow range, at a stronger level than in the previous quarter (302-312). By the end of the quarter the forint became slightly weaker.

In Q3 of 2017 the **aggregated balance sheet total of credit institutions grew by 0.7%** (HUF 244 billion). During this period, the strengthened compared to the Euro and other important foreign currencies, by nearly 1% and over 5% (CHF, USD), respectively. As in Q2, the forint portfolio remained at the same level, while the forint value of currency holdings increased, despite the strengthening of the forint.

On the **liability side** all important liability types grew or remained mainly stagnant. The **total gross deposit portfolio** expanded by HUF 269 billion (1.2%). Interbank borrowed deposits decreased by 1%, while other deposits increased by 1.6% (by HUF 310 billion). After a significant increase in H1, there was no change in the total sum of household deposits. The volume of the deposits of non-financial enterprises grew at a faster rate than in H1 (by 3.6%, HUF 246 billion), while in the case of other

sectors there was a moderate, 1-2% rise. The shortening of deposit maturity continued; portfolio flowed into sight deposit and account money mainly from deposits with a maturity of less than a year (-2.6%) and into scriptural money, but long-term deposits also decreased by nearly the same amount (1.9%). Interbank borrowed credit and issued remained practically stagnant, while as a result of the improving profit, **equity** increased by almost 2%.

Within **the asset portfolio**, growth continued in all other more important asset types besides debt securities (which decreased moderately), most significantly in interbank deposits, which had continually decreased in H1. **Credit portfolio** increased moderately in the last two summer months; net credit portfolio grew by merely 0.8% during the quarter (HUF 140 billion), which is significantly slower than the dynamic 3% quarterly growth during the year, but is also probably due to seasonal effects. The 0.5% (HUF 88 billion) gross increase in credit is even less than before, which is once again due to the reversal of impairment losses in forints (HUF 39 billion), and in smaller part also due to the added value gained from valuation difference. The *gross value of household loans* grew by more than in Q2, but still moderately (by 0.9%, i.e. HUF 50 billion). The gross value of loans granted to non-financial enterprises shrank significantly, from an increase rate of over 5% to that of 0.3% (HUF 27 million). However, the change in the structure of this growth is an important development: the portfolio of loans granted to domestic enterprises grew by nearly 2%, while foreign loan portfolio shrank by 4.2%. The change in loans granted to other sectors, including the interbank market, is slight and did not considerably affect the loan portfolio. The *interbank account and the deposit portfolio* grew by 5% (HUF 243 billion) in total. Last quarter's trend of banks keeping the assets withdrawn from central bank deposits on bank accounts continued, but even so, the central bank's portfolio shrank by 7.2% (HUF 130 billion). On the other hand, there was a considerable increase (12.4%, HUF 373 billion) in portfolio allocated at other credit institutions, most substantially as compared with the EMU (20.4%, HUF 297 billion).

*Securities, which embody credit relations*, remained at the level observed towards the end of the last quarter, although there was a shift from long-term state securities towards short-term bank and state securities.

As a result of the above, the credit institutions sector's **net loan-to-deposit ratio** was 103% (88.1% without interbank loan portfolios).

The **profit** in July-August was less in proportion to the second quarter, but still reached nearly HUF 89 billion. This granted the banking sector a 12.81% return on equity and a 1.39% return on assets. Not counting individual items, the return on equity and assets would approximately fall to 60% of the nominal value (out of the HUF 486 billion profit before taxes improvement due to impairment loss and reversal on provisions amounts to a total of HUF 116 billion, while dividend income was HUF 100 billion).

There was no change compared to Q2 in interest profit rates in the last two months of the summer. The moderate improvement in the profit from fees and commissions continued, however the profit from financial activities slightly decreased. In proportional terms, the reversal of impairment loss is more comparable to Q1, since it is considerably less than in Q2 (HUF 20 billion over two months). General expenses stayed at the same level as in the previous quarters.

### **III. Corporate sector**

According to the Magyar Nemzeti Bank's August 2017 report on *Trends in Lending*, in 2017 Q2, the transaction-based growth in corporate lending continued and it amounted to HUF 115 billion. In the last 12 months, loans outstanding increased by more than HUF 410 billion as a result of transactions, representing a growth of 7 per cent. Lending to the narrow SME sector, belonging to the corporate sector, grew by 8.3 per cent, while lending to the broad SME sector, including the self-employed,

rose by 13 per cent in annual terms. Overall, the expansion of credit to the entire corporate segment was also within the band of 5-10 per cent, deemed desirable by the MNB. Based on the Q2 data, the dynamics of lending to SMEs was able to persist even on market basis, after the closing of the FGS in the first quarter.

Based on the responses to the Lending Survey, the corporate credit conditions were eased in all enterprise size categories. The easing is primarily attributable to the improvement in the general economic prospects and the intensification of bank competition. This is primarily due to the improvement in general economic prospects and the intensification of bank competition. Banks projected further easing for 2017 H2, which may be reflected primarily in a decrease in interest rate spreads. Banks perceived rising credit demand from enterprises, primarily for short-term loans, which they expect to persist in 2017 H2 as well.

According to the MNB's summary based on personal interviews made with senior corporate loan officers, the Funding for Growth Scheme launched major borrowing activity in the past years, drawing the financing institutions' attention to SMEs. The phase-out of FGS causes no major difficulties for the enterprises, mainly due to the favourable interest environment and real economy processes. After the phase out of the FGS, demands for fixed-interest products remained high. MNB emphasizes that beside price competition, signs of risk competition can be seen, manifesting itself in easing collateral and/or own resource requirements. In the case of smaller companies, institutional guarantees have an increasing role; the credit institutions noted that the guarantee institutions try to satisfy market demands faster and more flexibly. Some of the actors fully preclude project financing (particularly commercial properties), while others see a growth opportunity in it. In financing institutions usually prefer residential property projects the most, followed by the office and hotel projects.

#### **Market –based Lending Scheme**

The Market-based Lending Scheme continues to support market-based lending. At the tenders announced in July within the framework of the second phase of the scheme, banks raised their lending commitments for this year to almost HUF 230 billion, which accounts for roughly 6 per cent of the outstanding lending to SMEs, and which projects continued positive developments in corporate lending. The maximum stock of preferential deposits in the banking system increased by HUF 150 billion. Banks will have the chance to make preferential deposits from August 2017.

#### ***IV. Retail sector***

According to the Magyar Nemzeti Bank's August 2017 report on *Trends in Lending*, in 2017 Q2 the household loans transactions amounted to HUF 73 billion, with a 2.8 per cent annual rate of growth on transaction basis. Disregarding the loans taken by sole proprietors, the decline in the outstanding borrowing was merely 0.6 per cent in annual terms. The value of new contracts amounted to HUF 350 billion in the quarter, and on average it rose annually by 46 per cent. Within the total volume, new housing loans increased by 35 per cent and new personal loans by 51 per cent over the past year. According to banks' responses to the Lending Survey, conditions for both housing and consumer loans remained practically unchanged in the quarter under review. Compared to the previous period, a larger ratio of the banks indicated the easing of the housing loan conditions for the second half of the year, which may be related to the introduction of the Certified Customer Friendly Mortgage products. In addition, banks perceived a pick-up in credit demand in both product ranges and they expect this trend to continue in the next half year as well. The rise in demand is still supported by the Home Purchase Subsidy Scheme for Families (HPS), and in Q2, 16 per cent of the

volume of new housing loans were linked to the HPS. Both the average APR and the interest rate spread on new housing loans declined in the period under review.

### **Developments concerning the Certified Consumer-friendly Housing Loan product**

In the summer MNB continued the development and testing of the **calculator for comparing banks' offers** and the **scripts that determine the offers of individual banks** (these will have to be developed by the banks themselves) on its website for Certified Consumer-friendly Housing Loans (CCHL). Several operational and legal uncertainties concerning the product have been uncovered during the designing of bank processes. To get clarification on these, we sent the central bank a letter in late August, which state that:

- According to the tender, the interests of individual offers have to be determined once per month, based on the benchmark from two days before the end of the previous month. Fulfilling this requirement and its IT criteria presents as an operational problem for a significant number of banks. In addition, it is not consistent with the time limit set for uploading the modified Product Information to the central bank's website. To solve these problems, we recommended that the central bank increase the original time limit **from 2 days to 15 days**.
- It presents a legal problem that based on the tender, it would suffice to state the criteria for the publication, modification and annulment of the legally binding offer within the financial institution's relevant internal rules (e.g. for lending). With regard to civil law this would create a situation where recalling the legally binding offer granted to a customer would be done in accordance with the internal rules of procedure, which the customer cannot be granted access to. Thus, a legally ambiguous situation would arise, as the customer would not receive information on the matter separately. Since the best channel through which attention can be called to it is the central bank's relevant website, we asked that the legal notice be shown there. In relation to this, we asked for further **modifications to be made to the sample recommendation attached to the tender**, as well as for the **legal notices** for the comparison calculator and the webpages for uploading banks' applications.

Until the launch of the calculator in early September MNB made modifications to several points of the legal notice on the website in question. It afterwards held an in-person consultation with bank experts on the problems arising from the different interpretations of the tender's requirements as well as those arising during use of the calculator, and collected information on the first sale experiences. MNB's expert indicated that they wish to extend the fixing period (from 2 days to 15 days) and he recommended the fast-track introduction (1-5 days instead of 60) of the entry into force of the modifications to the tender, provided that the actors concerned reach consensus. In response to MNB's request, banks' legal experts now have a change to propose content for the legal notices that will appear on MNB's websites. The proposals are currently being collected.

### **The opportunity to use the National Tax and Customs Administration's (NAV) income database for loan assessments**

During the elaboration of the Certified Consumer-friendly Housing Loan product the idea arose that **information asymmetry concerning the actual financial situation of clients could be moderated through creating a central database** (based on the tax authority's data), and **the loan assessment process could be automated, and thus sped up**. To achieve this, as a first step, MNB compiled a proposal for a dataset based on tax returns to aid loan assessment. Banks commented on this

through the Banking Association. The comments showed that banks' needs are of a much wider range than what the central bank predicted and that banks require access to the NAV dataset for the assessment of all other loan products, in addition to housing loans.

After consulting in writing, MNB held a professional meeting where it discussed the following issues with banks:

- whether the database would include only natural persons or enterprises as well (to progress gradually, the system would start by including only natural persons);
- whether the database should be launched with the annual PIT returns or the database should be more extensive at its launch and include employers' tax return data of employees (MNB recommends the first scenario, while banks recommend both);
- should BISZ Zrt. be involved as the organization managing data flow (banks were in favor of this);
- whether the client should give his or her consent to retrieval of his or her data at NAV (in this case his or her one-time consent would allow for later data retrieval as well and would be considered a permanent consent) or at his or her bank (this could be a one-time or permanent consent). (Banks chose the latter scenario, since this way, if consent is given, the tax data would be accessible immediately and the loan assessment could continue.)

After the verbal consultation banks sent MNB several further proposals (through the Banking Association), mainly for expanding data content. After considering these, the central will continue its negotiations on implementation with NAV.

### **Banks' proposals for modernizing the Home Purchase Subsidy Scheme for Families (HPS)**

After finding out that the regulation of the HPS would be modified, the Banking Association considered it useful to send its recommendations in advance (compiled based on the experiences gained since the introduction of the HPS) to the department preparing the legislation.

In our letter sent to the ministries concerned, we emphasized that the banking sphere is committed to the scheme, since over a quarter of home purchase transactions in the past were made through state subsidy and the collaboration of banks. Based on the recommendations of banks which play a significant role in housing loans, a package was compiled aimed partly at ***alleviating legislative requirements which complicate/prevent the use of the subsidy***, and partly at ***simplifying the complicated administrative procedure for the loan application***.

- We made a general recommendation to grant banks direct access (through an electronic channel) to the certificate that the applicant needs to obtain from a government authority/bureau (e.g. declaration of address, proof of the absence of public debts) if the client consents or if the legislation allows for it.

Among other recommendations, we indicated the following:

- the time frame of mandatory social security coverage should be shortened because citizens who work abroad (with alternating regularity) cannot fulfill the requirements currently in force;
- the requirement stating that previously utilized subsidies should be deducted from the current request, even if they have already been repaid is inequitable;
- if more companies take part in the construction of the home after each other there is no solution that allows the bank to accept all their invoices (and not just that of the last one).

At the time the present report was written no response had yet been given concerning the legislation in progress and therefore the acknowledgment of our proposals.

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

### **MIFID 2 implementation**

- *Sovereign bond distribution commission versus incentives*

In early July, we organized a high level meeting, in which took part, in addition to the CEO of the Government Debt Management Agency (ÁKK), the Chairman of the Association of Investment Service Providers (BSZSZ) and the Secretary-General of the Hungarian Banking Association (HBA), the experts from ÁKK, BSZSZ and HBA, who have already been consulted on this topic several times. The parties explained that, according to their essentially identical interpretation, the fee paid by ÁKK to primary sovereign bond distributors is not covered by the MiFID 2 and Bszt provisions regulating incentives. At the same time, the representatives of ÁKK disagreed with several points in the paper prepared by BSZSZ and HBA. The parties agreed on continuing the consultations with a view to developing a uniformly acceptable interpretation to be presented to the MNB by the professional associations representing primary distributors.

The consultation continued in August at a professional level and a specific draft started to take shape. In the meantime, before finalizing the Bank Association's paper, BAMOSZ addressed a similar question of interpretation to the MNB on the issue at hand and concerning fund manager fees.

The central bank stated its position at the end of September in Q&A form (frequent questions and answers). The ÁKK upheld, with regard to distribution fees, that they are not subject to the rules on incentives.

- *Draft MNB Decree on the personal conditions for the provision of investment services*

As the last phase of the MiFID II implementation, the MNB prepared the draft decree on professional capabilities and competences applicable to natural persons advising or informing customers on financial instruments, investment service activities or ancillary services, which was sent for consultation at the end of September. The MNB developed the text of the draft by taking into account the ESMA Guidelines on the Evaluation of knowledge and expertise, published in March 2016. This draft consists of three main parts. It sets out (1) the criteria on professional capabilities and competences of employees providing the relevant service, (2) details for the special training scheme for ensuring capabilities and competences, and (3) the rules for record-keeping and the obligation to cooperate. The central bank allowed a one month consultation period for the draft.

### **Two HBA proposals to amend the Credit Institutions Act**

Under the consultation on the *proposal on the amendment of certain acts in connection with insurance and payment-related harmonization* (see Chapter VII on payments) we proposed to amend Sections 108, 141 and 279 of the Credit Institutions Act (Hpt.):

- *Mandatory policies and rules to be adopted by the Board*

The current wording of Section 108 (1) of the Hpt. has been developed on the basis of Directive (EU) 2013/36; however, where the **Directive uses "strategy and policy", the Hungarian law mentions rules in addition to strategies.**

According to the wording of the Hpt. in force, the credit institution's management body with an authority to exercise control (i.e. the Board) shall approve in each case not only the comprehensive strategies but also rules on the listed topics (separation of tasks within the organization, prevention

of conflict of interests, assumption, measurement, management, follow-up and mitigation of risks. With regard to the separation of tasks within the organization and the prevention of conflicts of interests, it is typically addressed in the market by appropriately detailed rules for each one rather than by a strategy, hence mentioning rules in these areas is justified. However, for the assumption, measurement, management, follow-up and mitigation of risks, credit institutions typically develop numerous regulators with different purposes and contents. The depth of these ranges from comprehensive strategies and directives to operational rules of procedure. Our proposal aimed to ensure that, with the aim of reinforcing practicality and professionalism, the Board should mandatorily decide on comprehensive strategies only and, in the context of rules containing operational details, the credit institutions should be able to decide themselves on what level of the organizational hierarchy they wish to have decide on them (depending on their content). Considering that some of the market players could not see a clear opportunity for this under the current regulation, the amendment proposed by us would clarify the above interpretation.

- *Rules applying to signing for the company*

As of 1 July 2016m the legislation on electronic signatures has changed, under which an important change was that, under the eIDAS Regulation, **only sealing certificates rather than signature certificates can be issued for legal entities**, which they can use to create seals rather than signatures. In technical terms, the earlier and the new certificates, and the signatures/seals created by them are identical.

In terms of legal effects, the new regulation considers electronic signatures and electronic seals as equivalent, i.e. an electronic document with an affixed advanced electronic seal based on a qualified certificate on behalf of a legal entity has the same legal qualification for the legal entity as if it was signed by the company representative under his right to sign for the company.

In line with the above, we proposed to amend the Hpt. rules on signing for the company (sections 141 and 279), in view of the change in the legislative and the technical progress in such a manner that credit institutions can assume commitments and issue declarations (such as certificates, statements, offers) in an electronic document sealed electronically.

### **Consultation on the draft decree on the sale of assets in a liquidation procedure**

In this quarter, we provided our opinion on *the draft Government Decree on the amendment of the provisions on the public sale of the debtor in a liquidation procedure* in several rounds. The draft aims to set the **minimum price** applicable in the public sale, left by the Act on Bankruptcy to decree-level legislation. In our observations, we proposed to ensure the involvement of the creditors' committee and the representatives of creditors (in particular holders of a lien or security right registered in an authentic procedure for real estate or other asset) in setting the minimum price, in such a manner that they can make preliminary observations on the draft sale announcement. This is allowed if the liquidator sends the draft sale announcement to the creditors 15 days before its publication in the Company Gazette.

The newer version of the draft intended to provide for an obligation to notify creditors in advance for assets above a threshold value of HUF 500 million. Under this threshold, creditors would only be notified of the sale terms from the Company Gazette, thus **creditors' rights would be compromised upon the tender call and the announcement of an auction and decreasing the minimum price**. As a result of our intervention, the introduction of the HUF 500 million lower threshold was abandoned. Our proposal was also accepted to make the reduction of the minimum price conditional upon the consent of the committee, and the majority of creditors or, if there are creditors holding security, from the security holder. This decree was published in the 2017/168 edition of the Official Journal of Hungary under the number 300/2017. (X.17), and entered into force on 21 October.

## Amendments to the decree on the loan collateral register

The amendments to the Decree *on detailed rules for the loan collateral register and the public notary tariff* serve the implementation of the provisions of Act CCXXI of 2013 on the Loan Collateral Register (hereinafter the "Hbnytv.") amended as of 1 July 2017. As a consequence of this amendment to the act, **two new types of loan collateral declarations** have been introduced: declaration on the acquisition of a right and a declaration on registering succession. In view of the above, decree-level amendments became necessary. Under the feedback from the legal practice, the draft enables **making a loan collateral declaration to amend the rank**.

We made observations of a clarification nature to the draft amending the *Decree on laying down detailed rules for the loan collateral register*. With regard to the fee payment to the Loan Collateral Register, we proposed to put in place a bulk subscription on lump-sum fee payment for large companies in the practice. *IM Decree 10/2017. (VIII. 11.) on the amendment to KIM Decree 18/2014. (III. 13.) on laying down detailed rules for the loan collateral register and amending certain ministerial decrees on the subject of justice* entered into force on 12 August.

## Consultation on the draft law on the tax enforcement procedure (Avt.)

The new law intended to align **the rules for the enforcement procedures to be implemented by the tax authority** to the *draft laws on the Act on Taxation and the Act on Taxation Procedure*. Under this bill, the enforcement activities by the National Tax and Customs Administration will be expanded and, in addition to public dues to be collected as taxes, it will also be responsible for **administrative enforcement activities**. This law will need to be applied **in the enforcement of** statutory **payment obligations** established and registered by the state tax and customs authority, and the local government tax authority (hereinafter jointly "tax authority") as well as **in the procedure for tax discounts granted during the enforcement**. The basis of the rules for the enforcement procedures by the tax authorities is the rules for the court enforcement: unless it is otherwise provided in the Avt., *Act LIII of 1994 on Court Enforcement* applies as background legislation.

In our observations sent to the MNE, we proposed to **clarify the rules for maintaining electronic contacts** for enforcement actions performed under protective and interim measures. In addition to this, we made numerous clarification remarks, and made a proposal in the context of the mortgage holder's involvement in the enforcement procedure. This bill is discussed by the Parliament under No T/17782.

## Proposed amendment to the Act on the Real Estate Register

We proposed at the Ministry of Agriculture to amend the *Act on the Real Estate Register*. To discourage a certain type of abusive practice, we initiated **servicing any land registry decision on the registration of title not only to the owner of the real estate but also to the mortgage holder**. Namely, it is a frequent instance of asset concealment that a private individual debtor sells the collateral real estate burdened by a mortgage to a company. The mortgage holder bank is not notified of the change in ownership and the eventual liquidation of the new owner company. As such, it is unable to notify its claim in the liquidation procedure. The application of the existing bankruptcy monitoring systems provides no solution, since the mortgage holder bank is not aware which company's liquidation procedure should be monitored.

We made a further proposal in connection with the mortgage transfer, and requested exemption from the submission of a standing proxy for the land registry in each and every case.

## Consultation on the amendment to the Info Act

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

- *Regulation (EU) 2016/679 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC, (commonly known as GDPR<sup>2</sup>),*
- *Directive (EU) 2016/680 of the European Parliament and of the Council on the protection of natural persons with regard to the processing of personal data by competent authorities for the purposes of the prevention, investigation, detection or prosecution of criminal offences or the execution of criminal penalties, and on the free movement of such data, and repealing Council Framework Decision 2008/977/JHA*

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

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

## Integration of legal counsels to the bar - Consultation on the Omnibus act and policies related to the Act on Lawyers

At the end of June, *Act LXXVIII of 2017 on Lawyers' activities* entered into force. Certain provisions of this law will be applicable at later dates; however, the preparation already requires numerous deliverables from lawyers and legal counsels who intend to become bar members.

In July we organized a consultation on the provisions of this Act requiring interpretation and **on the organizational and other tasks related to joining the Bar**, with the participation of the legal working group, with the Chairman of the Budapest Bar (BÜK), the lawyer associate at BÜK in charge of codification work and BÜK's Head of IT. BÜK published the memo of this meeting on its website, with the questions and answers, and it set up a separate platform for resolving and publishing the issues related to the joining of legal counsels.

A more restricted working group was set up for the preparation related to the Act on Lawyers, with the involvement of legal counsels from a few large companies in the industry. This working group organized the involvement in the preparation of **new Bar policies** related to the Act, and joined, in a

---

<sup>2</sup> General Data Protection Regulation

self-organizing manner, the policy preparation work at the Hungarian Bar. The working group on document drafting developed a proposal to clarify the Act, which was sent to the Ministry of Justice. A detailed discussion was held by the working group on several **internal policies of the Bar** (election, document drafting, membership fee payment). The editing of several internal policies is still pending; the final versions of these policies will be adopted by the MÜK's Assembly, expected in November. We advised the legal working group on timely information related to the integration, considering that the accession application to the bar can be submitted electronically as of 1 October 2017. For an applicant to be admitted as of 1 January 2018, the application must be submitted by 31 October at the latest.

A separate draft law was prepared *on the amendment of certain acts related to the entry into force of Act LXXVIII of 2017 on Lawyers and other acts of justice subject*, which was circulated by the Ministry of Justice in September, in several rounds. This draft contains not only provisions closely linked to the entry into force of the act, but **as an "Omnibus Act" more substantial amendments to some other acts**, such as the *Act on Public Notaries, Act on Court Enforcement, Act on Probate Procedure, and Act on Civil Procedure*.

In our observation sent to the draft law, we challenged the expansion of the cases when the public notary has to read out the notarized deed to customers. Instead, for customers with a legal representative and parties concluding a consumer loan agreement, we proposed **to delete the reading out procedure**.

*The amendment on the Probate Procedure* provides for setting up a new reporting system supported by a nationally uniform IT system, to be operated by public notaries and the Hungarian Chamber and to serve as a channel for data flow between financial institutions, public notaries and the MOKK (Hungarian Chamber of Public Notaries). Due to the time needed for setting it up, we requested, in our opinion sent to the Ministry of Justice, that a later effective date be set, and the confidentiality provisions of sectoral legislation (Hpt., Bszt.) should be amended in view of this new system. We initiated a discussion on reporting to public notaries with MOKK. As of 1 January 2018, paper reporting will cease, thus, pending the time-consuming set up of the new system, it is reasonable to use electronic liaising under the *Act on E-administration*.

Out of the provisions amending the *Act on Civil Procedure*, we proposed to amend the definition of **private document with full probative value**, due to the special features of countersignature by legal counsels.

Unfortunately, our proposals were missed out from *Bill No. T/17563* tabled at the National Assembly.

## **VI. Developments concerning the Magyar Nemzeti Bank (central bank of Hungary)**

### **The activities of the MNB repo market working group**

The working group started its activities in early June by compiling a questionnaire, which was sent by the Banking Association to its members. The questionnaire asked about the following: framework contract to be applied (GMRA or GMRA with a Hungarian attachment or a Hungarian framework contract); the legal direction applying to the framework contract (English or Hungarian); and banks' individual positions on KELER, the Government Debt Management Agency (ÁKK) and central bank statistics concerning the market. The working group assessed the questionnaires' results at its July meeting, where they consulted with experts from KELER and ÁKK on how to solve technical problems. The most important out of these problems is that KELER's system is not capable of managing negative interest. It would therefore be advisable to include the clearing center in the framework contract as a central counterparty and would be important to expand the scope of repo-capable government securities.

In order to get clarification on the above legal issues, the working group posed further questions to its member organizations through the Banking Association. The responses received paint a diverse picture of banks' preferences.

### **MNB recommendations concerning UCITS and AIFM remuneration policy**

MNB sent its *draft recommendation on the remuneration policy for companies of Undertakings for the Collective Investment of Transferable Securities (UCITS) and Alternative Investment Fund Managers (AIFM)*. Behind the organizations are the Guidelines published by ESMA, based on Directive 2011/61/EU (the AIFM Directive) and Directive 2014/91/EU (the UCITS Directive) of the European Parliament and of the Council. The recommendations serve the ***implantation of ESMA's Guidelines into the Hungarian regulatory environment***.

The Guidelines affect only some of the Banking Association's member banks, and mainly through their subsidiaries. In their case it would be appropriate to handle remuneration uniformly at a group level. Therefore, in our response regarding the draft recommendations, we first of all asked for their ***harmonization*** with the *MNB recommendation on the rules of remuneration in credit institutions in concept and content*. In addition to this, we made several proposals regarding the application of the principles of proportionality, legal coherence and conceptual clarifications.

### **Other MNB recommendations, draft recommendations and draft decrees**

In August, the Magyar Nemzeti Bank (central bank of Hungary) issued *Recommendation 10/2017. (VIII.8.) on the definition of special lending exposures and speculative real estate financing*, which must be implemented by December 31, 2017. During the final compilation of its text, the supervisory authority took into account many of the Banking Association's observations.

During the third quarter, we coordinated the collection of comments on the following draft MNB decrees and recommendations:

- *the draft MNB decree for 2018 on MNB's data reporting obligations for carrying out its basic and supervisory tasks;*
- *the MNB draft recommendations on the general requirements for the disclosure practice of credit institutions and investment firms, and on the disclosure practice regarding liquidity risk;*
- *the MNB draft recommendation on measuring, managing and monitoring credit risk;*
- *the MNB draft recommendation on the issues regarding the implementation of IFRS 9 impairment loss regulations;*
- *the MNB draft recommendation on the specific requirements for the disclosure practices of credit institutions and investment firms.*

### **Request for a resolution on certain provisions of Act LIII of 2017 on the Prevention and Combating of Money Laundering and Terrorist Financing (Pmt.)**

During its work, the Hungarian Banking Association's working group for combating money laundering stumbled upon several issues with regard to interpretation where we found it necessary to consult

the Supervisory Authority and ask for its resolution on the matter. Based on the working group's decision, we also sent our questions to the relevant department of the MNE:

Can the bank ask its client to hand in a copy of a document appropriate for identifying the beneficial owner and can it keep this copy in its registry based on the provisions in effect in order to validate information in connection with the beneficial owner?

Based on Article 7, Section 2 of the Pmt., it is obligatory to obtain a tax identification number from clients. There are however organization in Hungary (collectives for example) and abroad, which do not possess a tax identification number. What should service providers do in these cases?

Currently the Pmt. does not distinguish between clients who maintain a long lasting relationship with service providers and ad hoc "clients". We asked for confirmation in the following: when carrying out an ad hoc commission that does not reach the limit for a client in a business relationship with the service provider, there is no need to ask for a PEP<sup>3</sup> statement.

## **VII. Payments**

### **Implementing the EU Payment Services Directive (PSD2)**

Trilateral (MNE-MNB-HBA) consultations on the transposition of the directive were finished by July 2017, and one of their most important results is that the central bank established its professional position on **which services they must provide to account managing payment service providers** according to the legislation. This was accompanied by a draft legislation regulation on the **undertaking of responsibility**. Account managing banks must make it possible for third party service providers (TPPs) to use the **client's online bank connection** (this includes the client granting his or her online banking code of access to the TPP). According to the draft legislation, the currently established responsibilities between the bank and its client will stay in force until January 1, 2019, the latest.

A payments practice (with several uncertainties) could have been created on top of the regulatory framework, however at the consultation between ministries (for clarification), we recommended that after the creation of the *EU regulation on the safe operation of TPPs* which includes the standards elaborated by the European Banking Authority, the new security requirements should not be applied in bank relationships with new TPPs for another 18 months (the planned preparatory time for the regulation). In the end, our proposal was accepted during the parliamentary phase of the legislation process, although with a 12-month preparatory period instead of 18.

Numerous other important issues were debated during the trilateral consultations, such as:

- How a bank could meet the requirement stating that the client should know in advance the sum of the fee/expense he or she will have to pay when withdrawing cash from an ATM. The fee/expense depends on the sum withdrawn and/or on the type of account the client has, and all this may in addition be influenced by whether he or she withdraws from his or her own bank's or another bank's ATM, whether the sum needs to be converted, etc. There is a risk of the client refusing to pay the fee if the information above is not available to him or her in advance;
- How can it be made possible for the client who is transferring money to pay the fees of both parties ("our option") instead of a mandatory split payment of the fee? Clients have indicated a real need for this, and according to their interpretation, the directive allows for this possibility;
- What kind of opportunities do banks have when determining fees for the closing of an account if the draft legislation guarantees no fees or expenses for clients. From banks' point of view it is acceptable that the closing of a bank account should have no attached fee,

---

<sup>3</sup> Politically Exposed Person

however there are considerable bank expenses when the sum that remains on the account (possibly a significantly large one) is transferred to a foreign account or is withdrawn abroad at a foreign ATM – in addition, this is significantly increased by transaction costs. It is unjustified that banks should bear such a heavy financial burden.

An important phase of the consultations will end when the law is adopted by Parliament, however getting acquainted with and consulting on the MNB decree on payments will be just as important. The details of this are not yet known.

The implementation of PSD2 concerns many working groups and departments of the Banking Association (payments, bank cards, IT security, SEPA, fraud), which have paid continued attention to the process and have actively supported it through their work.

### **Developments in connection with the AZUR (instant bank transfer system) project**

The establishment process for the **AZUR project** has recently been completed. The **Project Management Committee** (PMC) was created with the participation of the HBA's representative. The HBA also participated in the process of filling up the working groups with experts from banks. Furthermore, the leaders of individual working groups and the leader of the national project have been appointed and the first working group meetings also took place. In late September, the working group leaders and the leader of the national project informed the PMC on the work done in the working group so far.

Under the leadership of *Dr Mónika Iszály*, head of the **bank accession working group**, GIRO Zrt is operating five sub-working groups. Out of these, the business sub-working group has already held two meetings targeted at analyzing the *HCT Inst Rulebook*. This will be followed by a meeting about complementary services. The liquidity sub-working group discussed MNB's proposals. The first meetings of the IT and security and the testing sub-working groups will be held in November.

Under the leadership of *Mónika Németh*, the sub-working group under the **services working group** concerned with the **interoperability of services** held its first meeting in September. The task of the sub-working groups is to unify those bases, which will guarantee that as many complementary services can be built on the central system as possible. By the end of November, the sub-working group will have set its detailed aims and agenda based on the thorough analysis of international examples.

Under the leadership of *Gábor Dávidházy*, the **services working group's sub-working group** which deals with **opportunities for the use of services by the state** is currently processing the digital strategy of state organizations, which is at the moment still being elaborated. Anything that is included in this strategy will determine how state organizations operate in the future. The sub-working group is working on a service provision portfolio proposal made for state institutions.

Under the leadership of *Dr. Attila Kathi*, the **information working group** is working on providing adequate publicity for the project and its positive results. One of the most important issues regarding the internal communication of the project is ensuring proper information flow through the infrastructure. Another important task for the working group is to define the principles upon which the information strategy will be built. A task of priority will be informing users, while the working group also needs to decide on whether to treat instant payments as a brand.

The first to start its operation was the **regulatory working group**, under the leadership of *Lóránt Varga*, since the regulation of payments is an important instrument in incentivizing the evolution of the project. The regulatory concept and the normative text were created during the summer. The aim is to have the legislation ready by the end of the year.

*Gábor Bakati*, **head of the national project** informed us about the main work processes of the project at the payments working group's meeting. He also informed us about the current state of the regulation, the elaboration of the payment model, the creation of the liquidity management

processes, improving the level of service provision, informing the institutions and clients concerned and the central infrastructure.

An important development with regard to the evolution of the project is that the directorate of GIRO Zrt approved the criteria for choosing the central clearing system. All the providers it invited for the international tender already have a system that is functioning or is being introduced/developed. The procedure will have two phases: at the end of phase one the number of potential providers will be narrowed down according to previously determined criteria, while in phase two the final supplier will be chosen through a negotiation procedure. According to the agenda, the contract will be signed by mid-December. Early next year, the technical parameters for joining will become available to payment service providers.

### **Information on the launch of the EPC's SCTInst system**

The latest payment model of the European Payments Council (EPC), the instant payment model (*SCTInst*) becomes operational on 21 November 2017. This model will be the fourth in the row, alongside the operational transfer (*SCT Scheme*) and two collection models (*SDD core and business-to-business scheme*). This **new electronic euro transfer system** initially **enables the transfer of a maximum of 15 thousand EUR 24/7**, even on public holidays.

This model becomes operational with nearly 600 payment service providers (PSP), including Austrian, Estonian, German, Italian, Latvian, Dutch, and Spanish, **mainly banking** service providers. These PSPs can join the model by only being prepared to receive transfers only. However, in practice **90% of the participants are available for their customers as sending and receiving parties**. Customers of these PSPs (natural persons, small and large enterprises, and administrative bodies) can make their domestic and cross-border transfers that as a result of these transfers the transferred amount will be available to the beneficiary **within 10 seconds at the most**.

The model's operational area will later cover all 34 Member States, but participation continues to remain optional. Members participating in the initial model had one year for preparation; in 2018 and 2019 they are expected to be followed by further Belgian, Finnish, German, Portuguese and Swedish PSPs.

The EPC intends to further develop the model in cooperation with the affected communities in a manner that it will review the operational version annually, as of November 2018, in view of both the needs of the service providers and the customers using the services. First, it will consider the increase of the transaction volume.

The settlement of the instant transactions to be made under the model will be provided from the outset by **seven SCTInst compliant CSMs**, i.e. SEPA capable clearing and settlement mechanisms.

### **TIPS - Instant settlement mechanism of the ECB**

In the summer of 2017 the Governing Council of the ECB decided that it sets up, starting in *November 2018*, as part of TARGET2, for the banking customers of the 19 Eurozone Member States a proprietary service ensuring **instant euro payment settlement** under the name **TIPS<sup>4</sup>**. TIPS is available **24/7 for natural persons and businesses for small value payments real time settlement** (within seconds) for the customers of banks and clearing houses holding TARGET2 accounts. This means at the same time that TIPS will be a technical service provider; providing only settlement rather than clearing. (If they hold accounts, the settlement of transactions between two SCTInst members can also take place in TIPS from November next year.)

---

<sup>4</sup> TARGET Instant Payment Settlement

Although the ECB as central bank aims to further strengthen and deepen the euro payment integration by this service, participation in TIPS still will be voluntary.

They intend to set up this service in close cooperation with the European banking community. The costs of the system's development and operation will be borne by the ECB. The ECB as not-for-profit institution plans to set the transaction fee for the service at a maximum of 0.2 euro cent for the first two years.

TIPS will also use ISO message standards, which will be compatible with the SCTInst model in operation by the EPC by then.

## **Bank Cards**

According to MNB's data for the second quarter of 2017, the **rate at which bank card turnover increased** was higher than the **20% dynamic** shown in the previous year (even though this is already quite an attractive value). Payments made within the country by domestically issued cards totaled HUF 1066 billion through nearly 152 million purchase transactions, which shows a 26% and a 25% increase, respectively, compared to the same time period of last year. **Contactless payments are still on the rise**: two thirds of all purchases made through bank cards used this new technology. Bank card fraud continues to be extraordinarily low in proportion to electronic payment turnover.

On September 8, 2017 the **Bank Cards working group** elected its new **president** through its ordinary renewal process. After the approval of the HBA's Board, the Secretary General asked Gábor Fóti, head of department at K&H Bank Zrt to serve as president of the Bank Cards working group for the next three-year term.

The working group drew the legislator's and the central bank's professional department's attention to a special irregular state concerning **chargeback procedure**, which may pose a risk to the national economy and may affect both the national economy and payment turnover negatively in the future for several reasons, unless its is handled through legislation. The Secretary General sent a letter to the MNE to call its attention to the identified risks that arise in insolvency situations and their potential solution.

In connection with a new **service**, which was introduced by one of the **card companies** and is mandatory for our member banks, we called attention to the fact that the card company's internationally introduced product is not in accordance with the Hungarian legislative environment. A sectorwide waiver was announced until the issue is resolved.

We once again consulted on the government proposal for **blocking the payment transactions of illegal operators of games of chance**, when the supervisory authority for gambling (Szerencsejáték Felügyelet) contacted the Banking Association with the newest version of the draft legislation. After the verbal consultation (where the HBA's delegation was led by the Secretary General) we also responded to the draft in writing. Our main target continues to be to carry out the blocking of the bank cards effectively, through the **approval or so-called "white list" restriction**.

In order to assess the results of the **POS installation project**, the MNB asked for data from the Banking Association and its member banks in late August. The overall results are not yet known, but according to media news, the institutions concerned dedicate great attention to their work on completing the installation program, and the increase in the number of terminals is already noticeable among merchants. In the meantime, the MNE announced a new round of installation for the project.

## **The MNE's resolution with regard to opening bank accounts online**

Since the Ministry for National Economy (MNE) received many questions, requests from banks with regard to opening bank accounts online, the ministry asked the Banking Association to inform its members about its resolution concerning the subject.

The resolution emphasizes that the amendment to the act on credit institutions (Hpt.) of 2013 already provided for the **electronic contracting** of financial institutions, and it did so in **accordance with the new Civil Code**. However, in order to achieve the opening of bank accounts online in practice, the **new anti-money laundering act** needed to enter into force (which happened June 24, 2017). The new amendment to the Hpt. has to be implemented from July 1, 2017). Through **defining the identified electronic channel**, it ensured that the framework contract for the financial service (and thus the payment account contract as well), and the deposit contract can be "signed" online, without the prior obligation of the bank to sign a contract with its client on paper or via an electronic channel stated by the Civil Code.

## **Visit to the Austrian Cash Logistics Centre**

Organized by the Banking Association, the Cash Working Group visited the Austrian Cash Logistics Centre, where the institution's top management provided information to them on the operation of the institution. This detailed professional description included the following:

- the Centre has seven regional units in various parts of the country, thus providing great opportunity to diminish the logistical burden,
- due to the single currency, the euro, good business opportunities emerge with the neighboring Germany and Slovenia,
- nearly all retail banks are owners in the organization (although only in 5%, in aggregate), while the central bank owns 95% of it. This is one of the reasons for the flexible cash handling rules: they use customer-friendly solutions; this organization is not characterized by the wholesaler conduct, less advantageous for the domestic banks,
- cash processing machines used by the Centre are custom designed, high capacity, accordingly cash processing takes place there, cash-in-transit companies indeed are mandated by the money transport (unlike in Hungary), they are not responsible for cash processing,
- the Centre has updated data on the cash stock of the ATMs in its territory, and holding these data enables it to organize and optimize the refill processes of CIT-companies.

## **Response letter to the question from the Ministry of Justice on the use of cheques/bills of exchange**

Proposed by the NBH, the Ministry of Justice contacted the Banking Association **with regard to the future of the bill of exchange/cheque presentation locations**.

Presentation locations provide a **physical** location, set by the law, for cheque and bill of exchange holders where they can present their cheque/bill of exchange in a certified manner upon its due date, otherwise they lose their claim. Under the legislation in effect this role is played by the NBH, however, since the 1965 inception of the act no request was made. In the unitary banking system it had some purpose to allocate this function to the NBH, since it held accounts for economic players, therefore it could directly notify the entity subject to the payment obligation. Since the introduction of the two-tier banking system NBH cannot fulfil this role, this was the reason why the NBH

suggested to the Ministry of Justice to consult with the Banking Association *on maintaining the NBH's role as presentation location*. The Ministry also raised that the name of the account holding bank of the entity subject to the payment obligation should be included in the bill of exchange/cheque, based on a legislative requirement.

Since this issue has not come up in the practice of the member banks either, they practically have not supported the assumption of any task in this field.

In our response we indicated that we understand the aim of the Ministry of Justice i.e. that they intend to comply with the obligations arising from our earlier accession to the international agreement on bills of exchange and cheques, but we do not support a legislation to impose this task on any bank. At the same time we have not excluded the possibility that based on the agreement with the entity subject to the payment obligation one or several bank could take up this function, although we indicated that it has only a limited chance according to our survey.

## **VIII Taxation, accounting**

### **Consultation on draft legislation**

In Q3 2017 we provided an opinion on the following taxation related draft legislation, in consultation with our members:

- an MNE Decree on the record-keeping obligations related to the establishment of the customary market rates,
- the Act on Taxation and the Act on Taxation Procedure,
- the Act on the enforcement procedure that can be implemented by the tax authority,
- amendments to acts on individual taxes and other related acts.

In addition to the above, we were consulted on the control reporting to the tax authority related to investment service activities, as well as the related instructions to the forms.

### **Proposals for the amendment of the legislation**

During the summer, the MNE provided the opportunity to make proposals for the amendments to *Act XXXVII of 2013 on Certain rules related to international administrative cooperation in the matters of taxation and other public charges (Aktv.)*. By using this opportunity we forwarded numerous proposals and clarifications, which had been initiated and consulted on by our members, to the legislator.

In Q3 2017 we initiated an amendment to the legislation in the context of the *Act on the management of authorizations related to the transfer of "NYESZ-R" accounts and the local business tax returns and the acts on duties and the banking tax*, with the active involvement of the Taxation working group.

### **Ministry positions on the interpretation of tax legislation**

At the beginning of the year, we addressed a request for the position of the Ministry for National Economy on *Act CXVI of 2012 on the Financial Transaction Tax (hereinafter: Pti)* with regard to its Section 8 (3) to (10) as effective from 1 January 2017. Under the above law, any payment service provider who increases its customer receivables portfolio arising from financial services by at least

20% in two years can decrease the financial transaction tax in a manner specified by the Act. Our question concerned the **calculation of the customer receivables portfolio**. In its response received at the end of July, the Ministry explained that customer receivables can be taken into account at the net book value recognized in the financial statements. This position covered our questions related to FX conversion, handling the consolidation within the banking sector and sanctions. The legislator confirmed that FX customer receivables can be taken into account in a manner recognized in the financial statements at the year-end exchange rate, and that it is sufficient to demonstrate, in order to prove the exercise of rights as intended, that the increase in customer receivables was generated by actual customer demand, a business objective based on actual economic interests, and the transactions did not serve the aim of obtaining the tax advantage.

Under the act on the special tax for financial organizations it was possible **to deduct the amount of the future payable special tax by up to 50 per cent**, by the amount of subsidies granted for a beneficiary purpose. The 2017 banking tax return could be self-audited without penalty by 10 September 2017. According to the MNE position, this deadline was considered as **a limitation period**; however, it was extended until 10 December 2017 in the September draft Tax Package, with aim of reaching the intended objective.

Upon the request of the Hungarian Banking Association, the MNE confirmed that new states can still only be included in Annex No. 1 to *Act CXC of 2015 on the Promulgation of the Multilateral Agreement of the Competent Authorities of OECD countries on the automatic exchange of financial account information (hereinafter The Act promulgating the Agreement)* from 1 January each year. This is relevant for the sector, since if the list of participating states could be extended when the agreements take effect, our members would only be able to comply with the screening and reporting obligations provided for in the Aktv, and the taxation tasks based on them, with more and very expensive and time-consuming developments.

### **Setting up a sub-working group for the taxation aspect of the transition to IFRS**

The IFRS-Tax sub-working group was established in September 2017, operating as part of the Taxation work group and meeting every two weeks until the end of the year, with the participation of taxation and accounting professionals delegated by the members.

In the context of the IFRS transition, significant (accounting, and therefore taxation) transition differences occur, primarily due to the different recognition and valuation of assets and liabilities, also involving tax effects. The tasks of this sub-working group include the analysis of the tax effects (corporate tax, local business tax), the interpretation of special taxation rules related to the transition, making common proposals to regulators and requesting positions that affect the sector.

## **IX. Developments within the Banking Association**

### **Communications**

Due to the summer season, Q3 of 2017 was an exceptionally quiet period in terms of communications, with **much less media interest than average**. According to our statistics, during the quarter we were featured in online media 53 times, 12 times in printed media and twice in electronic media. Altogether, the Hungarian Banking Association was featured in Hungarian media 67 times, informing the media and the public about the sector's expert views.

The main banking communications topics for this quarter were the Certified Consumer-friendly Housing Loans, the Home Purchase Subsidy Scheme for Families, private insolvency and switching from one bank to another. In addition to this, the media's attention was turned towards typical summer topics: the use of bank cards abroad and how safe it is, and the security of ATMs and mobile payments. Furthermore, we received several inquiries from reporters regarding the probable entry into force of PSD2 next year, and therefore were also concerned with future developmental directions of the banking sector and the visible and potential effects of digitalization.

### **Money Week – preparing for the 2017/2018 school year**

With help in project management from the Ministry of Human Capacities and through the professional collaboration of the Ministry for National Economy, the Hungarian Banking Association, the Money Compass Foundation/MNB and JAM, preparations have been started for the week of financial and entrepreneurial topics i.e. Money Week for the 2017/2018 school year. ***In Hungary, the Money Week program series will take place from March 5<sup>th</sup> to 9<sup>th</sup>.*** One of the defining elements of the program's effectiveness is that the Money Week has been incorporated into the national curriculum this year. Schools can register from October 16, 2016 for 6 weeks, which will be followed by a period of organizing volunteers from the financial sector, until mid-January. We await volunteers for the programs from banks starting early December.

The ***financial topic*** of the 2018 Money Week will be entitled ***"Becoming loan-savvy"***, which is an exceptionally important topic in everyday finances. Just as last year, this year's Money Weeks will also include entrepreneurial topics, under the title ***"Business ideas and collaboration"***. During the program, financial curriculum materials from previous years will once again become available. Schools joining the initiative will be able to use these, according to their location and the level of knowledge that their students possess. The newest lesson plans for classes and their teaching materials have been developed by the Money Compass Foundation and with the support (proofreading) of experts from our member banks. The mock practice classes have already started. The new teaching materials for the current year are accessible exclusively to the teachers of registered schools.

As initiated by the EBF, in 2018 a ***financial awareness quiz will also be incorporated into the European events.*** Based on preliminary applications, 26 countries will participate in this, including Hungary.

### **Developments regarding the cessation of the Money and Capital Market Permanent Court of Arbitration**

Based on *Act LX of 2017 on Arbitration*, the Money and Capital Market Permanent Court of Arbitration (PTÁV) will cease to exist with effect as of December 31, 2017. Before its formation on October 1<sup>st</sup>, the Preparatory Committee, which has since been established according to the Act on Arbitration, in order to prepare a ***list of recommended arbitrators*** as well as the text of the ***Order of Business and the Rules of Procedure for the court of the Arbitration Court, which will function in addition to the Hungarian Chamber of Commerce and Industry***, held a preliminary meeting, as required by the Act on Arbitration.

The Founders have held the consultations on the cessation of PTÁV, together with the different ministries. In addition to this, priorities for the quarter included preparations for the list of recommended arbitrators and documents necessary for the process of cessation.

## Other working committees and working groups

- *Data protection working committee*

The main activities of the Data protection working group continue to be preparations for the implementation of *Regulation (EU) 2016/679 of the European Parliament and of the Council on general data protection (GDPR)*. During the summer, we drew attention to several individual positions in NAIH (Hungarian National Authority for Data Protection and Freedom of Information) and we sent NAIH's position on the data protection links in connection with blockchain technology to the task force.

The Deloitte Legal law firm held a presentation on the implementation of the GDPR, which was followed by a consultation. It was general opinion that converting to GDPR implementation also raises several issues in corporate management and therefore the fundamental question: ***who is responsible for adhering to GDPR within the enterprise?*** The working group is of the opinion that the employee responsible for internal data protection can only carry out his or her tasks if he or she has an apparatus and works directly under upper management, relatively independently. His or her activity influences the entire company: he must also ***carry out "internal control" tasks linked to data protection***, at the same time he or she also has a special ***"data protection risk manager"*** function.

These duties cannot be carried out effectively by a legal advisor or by perhaps the physical security department or the legal apparatus, in addition to their other tasks.

- *Agriculture working group*

The agriculture working group held several meetings during the third quarter. At its first meeting in Q3 a representative of the Prime Minister's Office held a presentation on the implementation of the ***Rural Development Program for 2014 to 2020*** and on the approval process and situation of its tenders. At its second meeting, a representative of the State Aid Monitoring Office informed us about the ***EU regulations on state aid for the agriculture and forestry sector***. He gave detailed information on domestic regulation, on the rules on cumulating aid, and the individual steps of the decision making process for approving aids. In relation to this topic, the representative of the Prime Minister's Office informed us on the ***state aid classification of individual calls for tender of the Rural Development Program*** and its display in the state-aid approving document and the evaluation procedure for investment-type applications.

To facilitate the establishment of mortgages related to the tenders of the Rural Development Program, consultations were held with the Prime Minister's Office, as a result of which an information packet to ***facilitate the establishment of mortgage related to the Economic Development and Innovation Operational Program*** was issued.

The working group asked for the Hungarian State Treasury's resolution in connection with the agricultural support provided by the Ministry of Agriculture and Rural Development for the ***time frame of the operative budget***.

The working group's meetings were followed by detailed consultations and the thorough discussion of technical proposals.

- *Mortgage Banks working group*

The working group held consultations with the relevant organizations in order to develop *real estate appraisal* and the professional skills of real estate appraisers.

After finding out more detailed information, the working group prepared to establish its position towards the ministry's departments on the ***covered bonds directive and regulatory package***, to be possibly issued in Q1 of 2018.

In addition to the above, the working group was reorganized and its list of members was updated.

- *SME working group*

Business organizations must use the “**Company Portal**” (Cégkapu) as of January 1, 2018 and **NISZ Zrt.** will start the **service** from December 2017. The Company Portal is an electronic host that qualifies as a secure delivery service address related to electronic delivery services, and through which companies can stay in contact with authorities as well as each other.

In Q3, the SME working group and the Legal working group consulted with representatives from the Ministry of Interior and NISZ Zrt. in connection with the **introduction of the Company Portal** and the probable changes to electronic interface of the “**Bureau Portal**” (Hivatali kapu – Cégkapu’s predecessor).<sup>5</sup> The Company Portal offers **free electronic host services through mandatory registration** to all legal business organizations. In addition to the General Terms and Conditions (time period, hosting space), the Portal also allows for the official receiving and sending of office files, messages and documents.

General information about the Bureau Portal services was given at the consultations, as well as on the functional changes to be applied to its interface, and the new, modified or affected relevant functions. They informed us that the e-Litigation Portal (Perkapu) service will terminate at the start of the Company Portal. Registrations should have been completed by the end of August in accordance with the *e-administration act*, however, the act also allows for a temporary preparatory grace period, and therefore registrations can continue until December 31, 2017 without any legal consequences.

- *Leasing working group*

In Q3, the Leasing working group held consultations with the representatives of the Prime Minister’s Office, the Ministry of Interior and the Ministry of National Development in order to debate issues in connection with **the Office of Government Issued Documents’ (OGID) practice regarding the entering of road traffic records into the registry**. In past years, clients had to face the **differing practices of OGID’s** concerning motor vehicle proprietary transfers and the registration of operational rights into the road traffic registry. The working group collected several issues, which were discussed in detail at the consultation. Based on the discussion the working group compiled and sent its proposals to the Prime Minister’s Office to amend Government Decree 304 /2009 (XII. 22.). The working group received information on modifications to the EU regulation on general data protection, insolvency proceedings and winding-up proceedings, as well as on the proposals sent to the Ministry for National Economy to amend *Act CCXXII of 2011 on the Central Credit Information System*.

- *Documentary Credits sub-working group*

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

At the consultations **experiences concerning customs guarantee** were debated and so was **paragraph 3 of Article 60/A of Act XIII of 2016 on the implementation of EU customs**: “If, according to the agreement made between the credit institution and the customs authority, the credit institution

---

<sup>5</sup> The Company Portal service is a version of the Bureau Portal which is accessible and tailored to the needs of business entities

notifies the customs authority electronically about the irrevocable sum paid to it by the client, the declared tariff and other charges must be regarded as guaranteed and the items may be released". The possibility for exchanging electronic messages is now provided by 9 credit institution through the introduction of the **Electronic Banking Messaging Service module**.

Hungary undertook to introduce the **electronic public procurement system** by December 31, 2017, by which it wished to satisfy the new EU public procurement directives. The working group consulted with representatives from the Prime Minister's Office several times on the possibility of introducing the guarantee undertaken by banks into the electronic public procurement system, in order to allow for the offering parties to grant the collateral offered electronically from then on.

Within the Documentary Credits sub-working group experiences gained after issuing the common guidelines made by the **Hungarian Banking Association and the Piece-ratesystem Performance Expert Organization (TSZSZ)** were exchanged.

The guidelines, which convey the role of TSZSZ in debates on the exercise of bank guarantees for construction and technical planning and the fulfillment of construction and contractor contracts, was published a year ago. Up until now, TSZSZ received a total of 37 requests for exercising bank guarantees; in 2016 the Organization examined 10 bank guarantee exercising requests, and 3 in H1 of 2017. The sum of the debated (exercised) guarantees amounts to nearly HUF 1.4 billion, out of which HUF 800 million was not justified according to acting experts.

- *Workout working group*

The representatives of the Banking Association met with the new management of the **Hungarian Association of Insolvency Practitioners and Asset Controllers** and ascertained that although the interests of creditors and insolvency practitioners differ on several points, it is worthwhile consulting regularly in order to promote more effective collaboration between the two sides. Consequently, the consultation did take place when opinions were given about amending the *draft government decree on the provisions for the public sale of the debtor's assets during the liquidation process*.

In addition to this we consulted on the *new provision of the insolvency act (in effect from July 1, 2017)* in the issue of **providing data to liquidators through electronic channels** together with the Ministry for National Development and the Association of Investment Service Providers (BSZSZ). According to the current practice the liquidators simply contact payments and investment service providers via e-mail. The supervisory authority is responsible for compiling the list of financial institutions where the liquidator should make inquiries and the collection of the electronic contacts to these. The National Judicial Office forwards these lists to the tribunals, which publish them on their homepages. The registry of the institutions to be contacted needs to be updated and must be narrowed down to institutions that actually manage the debtor's properties and financial assets. Financial institutions must only respond to these inquiries if the company in question about to be liquidated is truly their client.

The act on insolvency does not discuss what kind of IT system should be used and which security measures should be taken when providing data. The working group consulted on the information that has to be provided for liquidators and financial institutions and on the sample messages for data requirement, as well as on the **correctional proposal for amending the insolvency act**. According to *Section 58 of the Act CCXXII of 2015 - on the General Rules for Trust Services and Electronic Transactions* data should be provided to the liquidator **in accordance with the rules for secure electronic contact**, within 15 days and free of charge.

## **I Global Regulation**

### **I.1 Financial Stability Board (FSB)<sup>6</sup>**

#### **Recovery and resolution of central counterparties**

In early July, before the G20 summit, the international regulatory bodies (FSB, CPMI<sup>7</sup>, IOSCO<sup>8</sup> and BCBS<sup>9</sup>) declared their work plan on central counterparty (CCP) resilience, recovery and resolvability (created in April 2015) completed after having published three guidances and two reports.

The CPMI's and IOSCO's **CCP resilience guidance** complements the previous **Principles for financial market infrastructures** (PFMI) regarding financial risk management for CCPs (governance, credit and liquidity stress testing, coverage, margin, contributions to losses).

The **CCP recovery guidance** updates CPMI's and IOSCO's 2014 guidance to provide clarifications in four areas: (i) operationalization of recovery plans; (ii) replenishment of financial resources; (iii) non-default related losses; and (iv) transparency with respect to recovery tools and how they would be applied.

The FSB's **guidance on CCP resolution and resolution planning** complements the **guidance on Key Attributes of Effective Resolution Regimes** and gives guidance on implementing the Key Attributes for CCPs. It sets out powers for resolution authorities to maintain the continuity of critical CCP functions, discusses the use of loss allocation tools, the establishment of crisis management groups, and developing resolution plans.

The above mentioned four international regulatory bodies also completed their first report on the **analysis of CCP interdependencies**. The comprehensive data collection covered 26 CCPs from 15 jurisdictions, based on the data collected from these the interdependency of CCPs, clearing members and other financial service providers was analyzed.

The Chairs of the FSB Standing Committee on Supervisory and Regulatory Cooperation, CPMI, IOSCO and BCBS completed a common report on the implementation of the tasks set in the workplan.

On July 24th the authorities also disclosed the **review of the responses received for the public consultation** (announced in February) on the resolution and resolution planning of CCPs.

#### **The resolution of global banks**

Before the G20 summit in July, the FSB finalized its **Principles on the internal total loss-absorbing capacity of G-SIBs ('Internal TLAC')**, which define the minimum requirement for the instruments that should be held by global systemically important banks and readily available for bail-in within resolution.

Based on the public consultation announced in December, **the Guidance on continuity of access to financial market infrastructures (FMIs) for a firm in resolution** was also finalized.

(The review of the responses received during the two public consultations was also published in the second half of the month.)

---

<sup>6</sup> Financial Stability Board

<sup>7</sup> BIS Committee on Payments and Market Infrastructures

<sup>8</sup> International Organization of Securities Commissions: the international organization for the supervision of securities

<sup>9</sup> Basel Committee on Banking Supervision

The FSB compiled a report for the sixth time on the implementation of resolution reforms. The report entitled Ten years on- taking stock of post-crisis resolution reforms summarizes the experience gained from the reforms, and reports finding of the resolvability assessment processes for systemically important banks and insurers.

### **Reducing misconduct risk in the financial sector: progress report**

In May 2015 the FSB created a work plan to reduce misconduct risk. The progress report on fulfillment of the work plan, created for the G20 summit, summarizes the actions taken since September of last year:

- Measures to strengthen financial institution governance;
- Action directed at authorities' capacity to address misconduct risk;
- Actions directed at improving market structures and practices.

### **Further reports compiled prior to the G20 summit**

In accordance with its work plan, the FSB (prior to the G20 summit of state and government officials) published the following report:

- Fifth progress report on Implementing the FSB Principles for Sound Compensation Practices and their Implementation Standards
- Action plan to assess the decline in correspondent banking: progress report
- Correspondent Banking Data Report

### **Key Standards for Sound Financial Systems**

In September, the FSB published for the first time the list of the key standards for the operation of sound financial systems. The list notes the ***most important FSB standards for the sound operation of the financial sector*** in relation to the following three topics:

- Macroeconomic policy and data transparency
- Financial regulation and supervision
- Institutional and market infrastructure

The list (accessible through the link below) is updated according to developments in international regulation.

[http://www.fsb.org/what-we-do/about-the-compendium-of-standards/key\\_standards/#market](http://www.fsb.org/what-we-do/about-the-compendium-of-standards/key_standards/#market)

### **Second phase of the G20 Data Gaps Initiative (DGI-2): Second Progress Report**

The report by the FSB and the IMF reviews progress on implementation of the second phase of the G20 Data Gaps Initiative (DGI-2) and was delivered to the G20 Finance Ministers and Central Bank Governors ahead of their meetings in Washington D.C. in October.

The DGI was created in 2009 to aid in analysis and risk management. Following its first six-year implementation, in September 2015 it was agreed that the DGI work should continue into a second phase (DGI-2), and a second progress report was compiled. Its twenty recommendations are clustered under three main headings: (i) monitoring risk in the financial sector; (ii) vulnerabilities, interconnections and spillovers; and (iii) data sharing and communication of official statistics. The report shows substantial progress, despite challenges in implementation. It also discusses special results and obstacles in individual jurisdictions. It is intended that all DGI-2 recommendations will be fully implemented by 2021.

## **I.2 Basel Committee on Banking Supervision (BCBS)**

### ***Simple, transparent and comparable (STC) short-term securitizations***

In early July BCBS and IOSCO jointly announced a consultation on the *features and identification of STC short-term securitizations*. The short-term STC criteria maintain and build on the principles set in the document on criteria for identifying STC securitizations issued by BCBS-IOSCO and take account of the characteristics of asset-backed commercial paper (ABCP) conduits, such as (i) the short maturity of the commercial paper issued, (ii) the different forms of program structures (iii) the existence of multiples forms of liquidity and credit support facilities. The criteria aim to assist the financial industry in its development of STC short-term securitization and are designed to help investors evaluate the risk associated with these products.

At the same time, the BCBS also started a consultation on the *capital treatment for STC short-term securitization*. The consultative document sets out additional guidance and requirements for the purpose of applying preferential regulatory capital treatment for banks acting as investors in or as sponsors of STC short-term securitizations, typically in ABCP structures. According to the additional requirements:

- investors have access to key monthly information on the performance and key characteristics of the ABCP structure;
- the redemption risk of the underlying assets is addressed from the sponsor's perspective; and
- the transactions funded by the conduit have an enforceable legal structure and that the relevant information is disclosed by the sponsor to investors.

The proposed treatment is also consistent with the Committee's July 2016 revisions to the securitization framework.

### ***The interplay of accounting and regulation and its impact***

In March 2013, the Basel Committee's Research Task Force initiated that research be conducted on the interplay of accounting and regulation and its impact on bank behavior. More specifically, their task was to identify ways in which the interaction between prudential and accounting rules provides incentives that affect the risk taking of financial institutions. The task force commenced research on aspects of loan loss provisioning after credit loss, disclosure rules, fair value accounting, and prudential filters.

As the previous ones, the working document published in July reached the conclusion that that both in the context of loan loss provisioning and the valuation of banks' assets, there is a tension between backward-looking and forward-looking measurement, the optimal approach may be an adequate mix of the two. Further research is needed regarding, for example, the impact on the prices of financial instruments.

### ***Memorandum of Understanding (MoU) signed by the BCBS and the IFRS<sup>10</sup> Foundation***

In early September the BCBS and the IFRS Foundation announced that a new cooperation agreement has been made to foster long-term financial stability, enhance market discipline and further develop the sharing of information. The agreement, in the form of a Memorandum of Understanding, formalizes the mutual interaction and strengthens the existing relationship between the two organizations at the strategic and working level, focusing on the development of IFRS standards, the interaction between the standards and the BCBS framework and the manner in which they are

---

<sup>10</sup> International Financial Reporting Standards

applied in practice. Through its standard-setting body, the International Accounting Standards Board, the IFRS Foundation is developing global accounting standards (used in over 125 countries around the world) to help promote the transparency, accountability and efficiency of financial markets.

### ***Implications of fintech developments for banks and bank supervisors***

Towards the end of August, the BCBS released a consultative document on the implications of fintech for the financial sector. *Sound practices: Implications of fintech developments for banks and bank supervisors* assesses how technology-driven innovation in financial services, or "fintech", may affect the banking industry and the activities of supervisors in the near to medium term. Various future potential scenarios are considered, with their specific risks and opportunities.

Banking standards and supervisory expectations should be adaptive to new innovations, while maintaining appropriate prudential standards. Against this background, the Committee has identified observations and related recommendations on the following supervisory issues for consideration by banks and bank supervisors:

1. the overarching need to ensure safety and soundness and high compliance standards without inhibiting beneficial innovation in the banking sector;
2. the key risks for banks related to fintech developments, including strategic/profitability risks, operational, cyber and compliance risks;
3. the implications for banks of the use of innovative enabling technologies;
4. the implications for banks of the growing use of third parties, via outsourcing and/or partnerships;
5. cross-sectoral cooperation between supervisors and other relevant authorities;
6. international cooperation between banking supervisors;
7. adaptation of the supervisory skillset;
8. potential opportunities for supervisors to use innovative technologies ("suptech");
9. relevance of existing regulatory frameworks for new innovative business models; and
10. key features of regulatory initiatives set up to facilitate fintech innovation.

The consultation period ended on October 31, 2017.

A separate working document was compiled on the supervisory approach to enhancing banks' cyber security frameworks. In addition, CPMI initiated consultation on *reducing the risk of wholesale payments fraud related to endpoint security*.

### ***Other relevant documents***

In September, the Committee once again published the results of its ***Basel III monitoring exercise*** based on data acquired until late December. The results proved that the banks participating in the exercise (including on a fully phased-in basis) greatly exceed minimum requirements for capital and liquidity.

The BCBS reviewed and complemented the ***Frequently Asked Questions (FAQ) in relation to the Basel III definition of capital***, published in July 2011.

CPMI and IOSCO released a joint guidance on the ***harmonization of the Unique Product Identifier (UPI)*** to be applied to OTC derivatives transactions.

## II. European Regulation

### II.1 General environment – Juncker’s speech on the state of the Union

On September 13, in Strasbourg, Jean-Claude Juncker, President of the European Commission gave his state of the Union 2017 speech in front of the European Parliament. In his speech he presented his priorities for the coming year and discussed his ideas for the future of the European Union (up until 2025). In addition, he introduced the document, entitled “roadmap for a more united, stronger and more democratic union.

[https://ec.europa.eu/commission/sites/beta-political/files/roadmap-soteu-factsheet\\_en.pdf](https://ec.europa.eu/commission/sites/beta-political/files/roadmap-soteu-factsheet_en.pdf)

The motto of the State of the Union 2017 speech was **Catching the wind in our sails**. *“Ten years since the crisis struck, Europe’s economy is finally bouncing back. And with it, our confidence. Our EU27 leaders, the Parliament and the Commission are putting the Europe back in our Union. Together, we are putting the Union back in our Union.”* The President clearly stated that he believes **continuing in the present direction** would be best.

The president discussed the following topics separately:

- Trade (“I want us to strengthen our European trade agenda”);
- Industry (“the Commission wants to make our industry stronger and more competitive.”)
- Fight against climate change (“I want Europe to be the leader when it comes to the fight against climate change.”)
- Cybersecurity (“I want us to better protect Europeans in the digital age.”)
- Migration (“We are now protecting Europe's external borders more effectively. Europe is and must remain the continent of solidarity where those fleeing persecution can find refuge.”)

Regarding the future of Europe he discussed his own, personal “*sixth scenario*”. *He stated that Europe “has always been about values” and that “Europe extends from Vigo to Varna”. He stated his belief in respecting the rule of law and in expanding the Schengen area.* Concerning the **Eurozone** he emphasized: *“If we want the euro to unite rather than divide our continent, then it should be more than the currency of a select group of countries. The euro is meant to be the single currency of the European Union as a whole.”* Juncker also wishes to “*maintain a credible enlargement perspective for the Western Balkans.*” He finds it necessary to **create the position of European Minister of Economy and Finance** to promote and support the structural reforms in member states. He also deems it favorable for Europe to take on a stronger global role. Within the framework of an institutional reform, in order to achieve better operation, Juncker would support the merging of the positions of presidents of the European Council and the European Commission. *“Having a single President would simply better reflect the true nature of our European Union as both a Union of States and a Union of citizens.”* With regard to legislation he highlighted that in several issues, the power must be returned to individual states and EU-level legislation is only necessary when it grants added value.

Together with the speech, President Juncker and First Vice-President Timmermans also sent a Letter of Intent to the President of the European Parliament and the Presidency of the Council, which set out in detail the actions the Commission intends to take by means of legislation and other initiatives until the end of 2018.

In relation to Juncker’s speech, the European Commission adopted **concrete initiatives** with regard to trade, investment screening, cybersecurity, industry, data protection and democracy.

## II.2 European Single Rulebook: Developments concerning the Risk Reduction Package (RRP) of November

The European Parliament's Committee on Economic and Monetary Affairs (ECON) supported the urgent amendment to the **capital requirement regulation** (CRR, No 575/2013) concerning the transition to **IFRS 9 and big risk**, which must enter into force by January 1, 2018, the latest.

The ECON reporter also supported the **directive proposal on** the ranking of unsecured debt instruments in insolvency proceedings i.e. **credit hierarchy**. The proposal requires for member states to create an **additional layer of non-preferred senior debt instruments**, which fulfill the requirements for subordination. This will facilitate the cross-border implementation of EU recapitalization rules.

The proposal and its urgent management was also supported by the European Banking Federation (EBF), which emphasized that as few modifications as possible should be made in order to speed up the adoption process.

As discussed in the previous quarterly report, the EBF asked the Vice-President of the European Commission to **postpone the Fundamental review of the trading book (FRTB)** until a decision in Basel is made, and to **reconsider the NSFR**. Valdis Dombrovskis defended the implementation of the FRTB and the NSFR and stated that he did not agree with delaying them, mentioning that European specificities should be considered.

## II.3 The Banking Union

### II.3.1 The Single Supervisory Mechanism (SSM)

#### ***ECB consultation for on-site inspections and internal model investigations***

In August, the SSM's supervisory authority published a draft guide to on-site inspections (OSI) and internal model investigations (IMI). The aim of the draft guide is to increase transparency for supervised institutions and on-site supervisors. The guide was created with the participation of competent national authorities and consists of three main chapters: general framework for inspections, inspections process, and the applicable principles for inspections.

### II.3.2 The Single Resolution Mechanism (SRM) (BRRD)

The SRB<sup>11</sup> published its **2016 annual report** in July, which emphasizes that the SRB reached its main objectives identified in its working priorities for 2016. Its activities were carried out in the following fields:

- ensuring resolution readiness and developing resolution plans,
- the setting up and managing of the Single Resolution Fund (SRF)
- fostering and broadening cooperation,
- consolidating the structure of the organization.

The SRB assumed its full resolution power, covering 141 banks. Together with the national resolution authorities, the SRB drafted and adopted 92 resolution plans in 2016. The SRB increased its organizational framework capability to make decisions quickly and decisively by establishing 76 internal resolution teams, by establishing 26 resolution colleges, as well as by joining eight crisis management groups. With assistance from the national resolution authorities, the SRB collected data relevant for resolution planning using the Liability Data Template (LDT) for banks.

---

<sup>11</sup> Single Resolution Board

They finalized the Cooperation Framework Agreement (COFRA) between the SRB and the national resolution authorities, as well as the internal arrangements connected to it. In addition, the Resolution Committee, the Fund Committees and the Administrative and Budget Committee were set up in 2016 as the main platforms for developing methodologies and common approaches within the SRM along with sharing experiences with national resolution authorities.

The Single Resolution Fund received €6.4 billion from banks in 2016. (Together with the contributions for 2017 that were made in June, the Fund exceeded EUR 17 billion.) The Board adopted the Fund's first investment strategy and an outsourcing model for investment activities. The SRB also signed Loan Facility Agreements with 16 of the 19 participating in the Banking Union.

The SRB took part in all resolution-related groups of the Financial Stability Board and evaluated eight European G-SIBs through the Resolvability Assessment Process (RAP). The SRB also participated in regulatory discussions on the transposition of the Total Loss-Absorbing Capacity (TLAC) Agreement into EU legislation, financial market infrastructure resolution, and in professional debates with EDIS<sup>12</sup>, and about the common backstop of the SRF.

In late September, the SRB held a conference on establishing the conditions for resolution.

## II.4 The Capital Markets Union (CMU)

### II.4.1 Managing non-performing loans (NPL)

#### ***The Commission's consultation on the development of secondary markets for NPLs and distressed assets and the protection of secured creditors***

As part of a series of efforts to manage non-performing loans in early July the Commission announced a consultation on the ***development of secondary markets for NPLs and distressed assets and protection of secured creditors from borrowers' default***. Through the consultation, the Commission wished to find out the opinions of stakeholders and use the information gained from them to elaborate legislative measures which would make it possible to eliminate or decrease the operational constraints of secondary markets for non-performing loans and which would facilitate their development. They were awaiting responses to how and on what conditions non-performing loans should be transferred to a third party from lender banks.

The Commission also wanted feedback on a potential initiative for a legislative measure that would allow for an increase in the opportunities of creditors to recover value from secured loans granted to enterprises and entrepreneurs. In addition, the Commission asked for feedback on the possible introduction of a new EU security right, the so-called "accelerated loan security", which would primarily facilitate borrowing for SMEs.

The consultation period ended on October 20, 2017.

#### ***The Council's action plan for managing non-performing loans***

On 11 July 2017, the Council agreed an action plan to address the problem of non-performing loans in the banking sector. The plan outlines policy actions to help ***reduce stocks*** of non-performing loans, which remain at high levels, and to ***prevent*** their future emergence in the EU.

The financial crisis and ensuing recessions have left banks in some member states with particularly ***high levels*** of NPLs. These can generate negative cross-border spill-overs and can ***affect market perception*** of the EU banking sector. High NPL levels can drag heavily on investment, and

---

<sup>12</sup> European Deposit Insurance Scheme (No significant progress was made in Q3 regarding Pillar IV of the Banking Union.)

hence on the economy. Resolving NPLs, on the other hand, can help **reduce financial fragmentation** and **facilitate capital flows within the single market**.

On the basis of an expert report, the Council highlighted the need for action as regards:

- Bank supervision;
- The reform of insolvency and debt recovery frameworks;
- The development of secondary markets for non-performing loans (“distressed assets”);
- Restructuring of the banking industry.

According to the report, prepared by a sub-group of the Council's financial services committee, non-performing loans amounted to **nearly €1 trillion** at the end of 2016. That is the equivalent of roughly 6.7% of the EU's GDP and 5.1% of total bank loans. However, there are large variations within the EU, where **ratios of non-performing loans range from 1% to 46%**. Another difference is, that in some countries NPLs are concentrated in real estate, whilst in others they are scattered across the economy.

Persistently high NPL levels pose a problem, as they are a drag on bank profitability, pose a risk for the viability of high-NPL banks and lock up capital to back unproductive assets, thus weighing down on monetary policy transmission and on the financing of the economy.

Banks are primarily responsible for restructuring their business models and resolving their non-performing loan issues. However, given their current magnitude, NPL stocks in some member states may not decline at a sufficient pace, despite the economic recovery. The Council agreed that measures to address the issue would be **beneficial for the EU as a whole**. Incentives for banks to deal with NPLs proactively should be enhanced, whilst avoiding the disruptive effects of fire sales.

The Council agreed to revert to the issue regularly, to take stock of the evolution of NPLs in Europe and of actions taken.

## II. 4.2 Creating a stronger and more integrated European financial supervision for the Capital Markets Union

With further financial integration and completing the Capital Markets Union in mind, on September 20<sup>th</sup> the European Commission proposed **reforms to the European supervisory architecture**. The **proposals** will complement the **mandate, as well as improve the coordination system and financing of European Supervisory Authorities (ESA): the European Banking Authority (EBA)**, the European Insurance and Occupational Pensions Authority (EIOPA), and the European Securities and Markets Authority (ESMA). To ensure a uniform application of EU rules and to promote the Capital Markets Union the proposals also entrust ESMA with direct supervisory power in specific financial sectors. In addition, the Commission is proposing changes to the composition and organization of the European Systemic Risk Board (ESRB). The changes will also regard non-EU supervisory relations.

The Commission's proposal aims to **strengthen the coordination of supervision across the EU**. The ESAs will set EU-wide supervisory priorities, check the consistency of the work programs of individual supervisory authorities with EU priorities. They will also monitor authorities' supervisory practices in allowing market players to delegate and outsource business functions to non-EU countries. In addition, EIOPA will have a stronger role in promoting convergence in the validation of the internal models used by insurance companies.

**ESMA's scope of capital markets supervision will be extended**. ESMA will authorize and supervise the EU's critical benchmarks and endorse non-EU benchmarks for use in the EU. ESMA will also be in charge of approving certain EU prospectuses and all non-EU prospectuses, and of authorizing and supervising European investment funds<sup>13</sup>. In addition, the organization will receive a greater role in coordinating market abuse investigations.

---

<sup>13</sup> Parallel to the Commission's proposal, the European Parliament approved the modification of the regulation on EU label Venture Capital Funds and Social Entrepreneurship Funds.

The decisions made by European Supervisory Authorities will be more independent from national interests. Under the new governance system, ***newly created Executive Boards with permanent members*** will lead to quicker, more streamlined and EU-oriented decisions. The reform will also make the ***funding of ESAs independent from national supervisors***, the necessary financing will come from the EU budget's funding and contributions from the financial sector.

During the implementation of the reforms, the ESAs will act in consideration of sustainable finance and supporting FinTechs. Consumers, investors and the industry will all benefit from creating stronger and more integrated financial markets, and the reforms to the supervisory architecture.

#### **II.4.3 Further steps towards developing the Capital Markets Union**

In early July, the ***European Parliament adopted an own-initiative report on creating a pan-European covered bonds framework***. According to the report, a more integrated covered bonds market should be created in a way that does not undermine the quality existing frameworks, continues to allow the diversity of products and does not come with unfavorable, unintended consequences. More integrated European frameworks must be limited to a theoretical approach, which set targets, but leave the choice of methods and instruments to be made through the transposition into national legislation.

The EP's own-initiative report does not directly impact the Commission's legislative proposal, but representatives will use it during their (consultancy- type) communication with the Commission.

In September the parliamentary rapporteur submitted her ***draft report for the Commission's directive for regulating bankruptcy (insolvency, restructuring, second chance)***. The report suggests limiting stay to two months with a possibility of extension of up to six months. (The Commission's proposal stated 4 to 12 months). According to the modifying proposals only liquid debtors could file for the stay and cross class cram downs would only be possible when approved by the majority of classes of affected creditors.

The Parliament's draft report is a good starting point for the upcoming negotiations.

In late September, the European Banking Authority announced a consultation on ***significant risk transfer in securitization***. During its monitoring activity, EBA found that further regulatory specifications may be needed with regards to the proper process of significant risk transfer assessment. The analysis also covers the significant risk transfer in the securitization of non-performing loans. The consultative document is based entirely on the newly created European securitization frameworks (the preferred simple, transparent and standardized, STS, management of securitization).

#### **II.5 The European Commission's proposal for a cybersecurity regulation**

In September, the European Commission presented a legislative package on cybersecurity strategy. In addition to the communications and reports, the package includes a proposal for a regulation on cybersecurity. The proposal names ENISA (the EU's cybersecurity agency), which is a European body that deals with cybersecurity affairs. Its task is to unite national authorities and to coordinate their work concerning certificates.

#### **II.6 Other important documents published by EBA and ESA in Q3**

##### ***Guidelines***

Final Guidelines on Professional Indemnity Insurance under PSD2 (EBA/GL/2017/08)

Final Guidelines on authorisation and registration under PSD2 (EBA/GL/2017/09)

Final Guidelines on major incident reporting under PSD2 (EBA/GL/2017/10)  
Joint Guidelines to prevent terrorist financing and money laundering in electronic fund transfers (ESAs/GL/2017/16)  
Final Guidelines on internal governance (EBA/GL/2017/11)  
Joint EBA and on the assessment of suitability of management body members and key function holders (EBA/GL/2017/12)

### **Consultation papers**

Consultation paper on the implementation of the EBA Guidelines on methods for calculating contributions to deposit guarantee schemes (EBA/CP/2017/10)  
Consultation paper on guidelines on uniform disclosure of IFRS 9 transitional arrangements (EBA/CP/2017/11)  
ESAs' consultation paper on amendments to technical standards on the mapping of ECAIs (JC/CP/2017/31)  
Consultation paper on the future EBA register under the Payment Services Directive (EBA/CP/2017/12)  
Consultation paper on fraud reporting requirements under PSD2 (EBA/CP/2017/13)  
Consultation paper on amendments to technical standards on supervisory disclosure (EBA/CP/2017/14)

### **Regulatory and implementing technical standards**

Final standards specifying information requirements for the authorisation of credit institutions (EBA/RTS/2017/08), (EBA/ITS/2017/05)  
Final technical standards on MREL reporting by resolution authorities (EBA/ITS/2017/06)

### **Opinions**

Opinion on measures to address macroprudential risk (EBA/OP/2017/10)  
Opinion on the design of a new prudential framework for investment firms (EBA/OP/2017/11)

### **Discussion Papers**

Discussion Paper on FinTech (EBA/DP/2017/02)

### **Decisions**

Revised Decision on the quality of unsolicited credit assessments of certain ECAIs<sup>14</sup> for the assignment of risk weights (EBA/DC/2017/195)

### **Reports and other documents**

Risk Dashboard Data as of Q1 2017  
Reporting framework 2.7 - Amended supervisory reporting standards due to FINREP IFRS 9  
Supplementary data collection to support the new prudential framework for investment firms  
Additional information on DGS data  
Report on results from the second EBA impact assessment of IFRS 9  
Roadmap to strengthen the monitoring of ECAIs  
ESAs advise on Packaged Retail and Insurance-Based Investment Products with environmental or social objectives  
Report on asset encumbrance  
Updated list of public sector entities for the calculation of capital requirements  
Updated data used for the identification of global systemically important institutions (G-SIIs)  
Revised list of ITS validation rules  
Report of CRDIV CRR Basel III monitoring exercise

---

<sup>14</sup> External Credit Assessment Institutions