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Financial Regulation in Hungary

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Abstract: The paper aims to study the evolution of the financial regulation and supervision in Hungary from 1987, the year when the foundations of the two-tier banking system were laid. After a brief overview of the history of the Hungarian financial system we turn our attention to the history of the financial regulation. We investigate systematically the main areas of the national financial regulation and discuss the implementation of the financial directives of the European Union in Hungary. Our analysis on the development of the Hungarian legal system concludes that it is almost fully harmonized with the European legislation.

Key words: banking system, Hungary, financial crisis, financial institution, financial system, regulation

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1. Introduction

Owing to the market friendly attitude of Hungarian reform economists towards market-based economy and Hungary's relatively early joining to international financial institutions, the reform of the banking system in Hungary preceded both domestic political reforms and similar reforms in Poland (1989) and Czechoslovakia (1990) (Takata, 2005; Szikszai, 2008), so, the preconditions for the operation of a modern banking system were in place years before the actual transition from a planned to a market economy.

In 1985 MNB's lending and central banking functions were separated within the organization, which prepared the ground for more profound financial reforms in 1986 when these lending departments were separated from MNB's organization. The subsequent creation of the two-tier banking system in 1987 replicated the structure of Western European financial systems, in which the central bank endowed with the task of maintaining financial stability, providing liquidity, supervising banks, managing foreign exchange reserves and making monetary policy while commercial banks were entitled to provide households, corporates and municipalities with financial services (Honvári, 2008; Szikszai, 2008). Following the creation of the central bank, Hungarian State established three new big commercial banks in 1986, the Hungarian Credit Bank (MHB), the National Commercial and Credit Bank (OKHB) and Budapest Bank (BB), and some middle and small banks entitled them to extend loans to corporations. At that time, among commercial banks, besides state-owned banks there were already partly foreign-owned banks, such as CIB, Citibank, Unicbank. In the retail segment, Postbank, was set up in 1988 by the state-owned Hungarian Post and Dunabank, launched in 1987 by MHB, Merkantil Bank, registered in 1988 by OKHB and Takarékbank, established by savings cooperatives in 1989. However, none of these posed any real threat to National Savings Bank's (OTP) dominant position in the retail market. This latter was established in 1949 as MNB's retail sub-bank and had a monopoly position on the retail market. By the way, OTP, which also was the exclusive account keeping bank of municipalities up to 1991, managed to hold its dominant position in the retail segment even after the complete liberalization of the bank system.

While Hungary was a forerunner in the transformation of the financial system, it lagged behind other CEE countries in the speed of bank privatization. The sell-off of large banks already began in 1992 and 1993 in the Czech Republic and in Poland, respectively, whereas in Hungary the process only started in 1994.

In line with Hungary's goal to join the European Union, it signed in 1991 and ratified in 1994 together with other CEE countries the so called Europe Agreement, in which it obliged itself to open its domestic banking market to foreign competition (Agreement of 1993, §68, §83 and §98-103). The opening of the EU for aspirant CEE economies was announced in 1993 in Copenhagen, where the so called "Copenhagen criteria" including the economic standards of EU accession were published. These economic standards called for a restructuring of the banking sector to increase its competitiveness and enable it to operate in a highly competitive business environment. These documents provided incentive for CEE governments both to recapitalize domestic banks to prepare them for foreign competition from EU-based banks and to totally restructure the domestic business environment through privatization (Takata, 2005).

Indeed, Act LXIX of 1991 on Financial Institutions and Financial Activities included a passage that called for the decrease of the Hungarian State's share in the banking system to 25% by 1997. This passage and the early experiences gained from the inefficient operation of domestic banks led policymakers to believe that the privatization process should be accelerated. This task was, however, a difficult one. While state ownership in the banking sector was 39% in 1991, it increased back to 66% after the consolidation and even after the bulk of privatization had happened by 1997 it was still 37% (Várhegyi 1998). Between 1994 and 1999 the Hungarian State sold the biggest domestic banks and cashed in 160 billion forints (1.4% of 1999 GDP). While further smaller privatizations came afterwards, the privatization of Postabank in 2003 marked the end of the era of privatizations in the Hungarian banking sector.

Given the underdevelopment of the capital market at that time it was a widely held belief that a higher sales price could be attained by inviting strategic investors rather than

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financial investors, thus, this had come to be viewed as the main form of bank privatization. (Várhegyi, 1998).

The commitment to the specific form of bank privatization to strategic investors in the 1990s was a Hungarian specialty in the Central and Eastern European region. In Poland the number of initial public offerings through the stock exchange roughly equaled the number of sales to foreign strategic investors while the Czech Republic widely applied the alternative technique of voucher privatization in which previously distributed certificates could be exchanged for bank shares. The technique of employee buyout (EBO), in which the bank was sold to domestic owners, was used as an auxiliary method in only a few cases (Takata, 2005).

The only exception when this commitment to strategic investors was relaxed was the multi-stage public offering of OTP Bank shares to institutional investors in 1995. The main reason behind OTP's exceptional treatment was the fear that if one investor gets dominant position in OTP[1], it will have control over two-thirds of Hungarian household savings. As a consequence, OTP's ownership structure became highly fragmented, which ensured the lack of strategic ownership control over the management.

As a result of privatization process, foreign investors have got hold of overwhelming share of the banking sector, but the state stuck to its ownership in Hungarian Development Bank, Eximbank and MEHIB.

After the wave of privatization had passed the main trend in the banking sector was determined by the dynamics of the retail segment. Restructured domestic banks set out to compete with OTP for the retail segment. This new form of competition caused the rate of expansion of the credit stock to double from an average 10% in the second half of the 1990s to 20% by the mid-2000s. The engine of growth was, due in part to the appearance of interest-subsidized forint housing loans, the growth of housing and consumer loans, growing by 46% and 37% on average, respectively, from 2001 to 2006. The ratio of

[1] George Soros made a bid to buy 25% of OTP in 1994 but was refused.

household loans to GDP quadrupled from 8% to 33% between 2000 and 2008, which can be interpreted as convergence to West European levels (Szikszai, 2008).

In the meantime the state created legislation in 1997 that allowed its newly-established mortgage bank (FHB) to issue mortgage bonds in order to finance long maturity mortgage loans with preferential interest rates using the intermediation of domestic banks. FHB's monopoly to issue mortgage bonds was broken in 2001 on pressure from OTP, which led to the establishment of further two mortgage banks in 2002 (OTP and HVB). Because the subsidy of housing loans went through the issue of mortgage bonds, the main beneficiary of this development was the OTP which extended two-thirds of interest-subsidized housing loans. The group not only benefitted from the spread between its total interest revenue including subsidies and the interest paid on the mortgage bond but also from the spread between the latter and the interest paid on household deposits. This is because OTP Bank subscribed the mortgage bonds issued by OTP Mortgage Bank using deposits placed by its clients. (Szikszai, 2008).

After 2004, the dynamics of the retail segment slowed temporarily due to the gradual phasing out of housing loan interest subsidy scheme in 2004, the proliferation of more sophisticated risk assessment techniques and the climb of interest rates on forint denominated loans in 2004.

In an effort to revive the dynamics of the retail segment, banks turned to loans denominated in foreign currency. These were mainly Swiss franc denominated mortgage-backed housing or free-purpose loans. Although borrowing in foreign currency had already been very popular in the corporate sector, the spread of household foreign exchange loans were a new development, which was a consequence of the large interest rate spread, the relative stability of the exchange rate of forint and the overwhelming presence of well-funded, foreign-owned credit institutions, loose fiscal policy and the expected adoption of the euro. Thanks to these factors, banks' lending dynamics received new momentum from the household segment. In 2000 foreign currency loans only represented 4% in the total retail loan portfolio. By 2007 the shares of outstanding foreign currency loans had

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surpassed that of forint denominated ones, which made the Hungarian bank sector rather vulnerable.

2. Liberalisation of capital movement

Before the transition, the financial transactions using foreign currency were limited in Hungary. All forward instruments between the domestic currency (forint, HUF) and foreign currencies and exchange foreign currencies was limited. Only licensed financial institutions were allowed to serve currency exchanges. Non-resident agents were prevented from undertaking foreign exchange transactions in the local market, or invest directly in Hungary.

These restrictions were removed gradually. In 1988 the foreign direct investments in the most sectors in Hungary were allowed, but prior authorization was required for full or majority foreign ownership. (Act XXIV of 1988, Article 9) The prior authorization for full or majority foreign ownership was removed from 1991. (Act XCVIII of 1990, Article 1) As a result, the number of foreign investments increased rapidly.

Hungary joining the Organization for Economic Cooperation and Development (OECD) in 1996 and Hungary's aspiration to join the European Union, resulted in significant changes. At the time of joining the OECD, Hungary obliged that no further restrictions to those already in place in 1996 would be introduced, all restrictions would be removed by the time of the membership, and all other OECD members would be treated equally. Similar obligations were included within the agreement made with the European Union.

During the legal harmonisation process, Hungary had the opportunity to choose the areas that wanted to protect. Hungary and EU agreed that Hungary restricted direct investment related to the ownership of agricultural land for seven years, and the ownership of the secondary place of residence for five years from the day of accession. During this period, citizens of other Member States were allowed to own agricultural land only if they had been acting in the agriculture and residing in Hungary for at least three years. Nationals of other EU Member States had to ask for a licence to buy a secondary abode in Hungary, unless they had been living in Hungary for at least four years. The reason behind these limitations was that land and abodes were much cheaper in Hungary than the average price in the European Union. (Kolozs, 2008, pp. 285-300)

The limitations in foreign exchange were removed in 2001 by Governmental Decree 88/2001 (VI. 15.) on the Implementation of the Foreign Exchange Act. It perfectly liberalised the foreign exchange regime, and the Hungarian currency (HUF) became freely convertible and the barriers were removed. The main changes were the followings: (MNB, 2002, p. 74)

- repatriate foreign currency from abroad was no more prescribed,
- residents were allowed to maintain forint and foreign currency accounts abroad without the licence of the authorities,
- residents were allowed to use foreign currency without any restriction,
- not natural person residents may have hold foreign currency without restrictions,
- there were no normative conditions of direct acquisition of enterprises, prior reporting was no more required,
- residents did not have to apply for permission from the foreign exchange authorities, and they did not have to report about their foreign exchange transactions,
- gifts may have been given freely to non-residents,
- domestic and foreign currency may have been imported or exported to and from Hungary without limitations,
- payments in foreign currency within the territory of Hungary were allowed conditionally on the agreement between the parties, as forint remained the legal tender in Hungary.

Act XCIII of 2001 on the Elimination of Foreign Exchange Restrictions and on the Amendment of Certain Related Acts entered into force in 2002. Its most important provisions were the followings: (MNB, 2002, pp. 74-75)

- forint remained the legal tender of Hungary, which must be accepted as a mean of payment within the country,

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- any payment obligation to the State, or payments obliged by any authority or court must have been carried out in forint,
- legal transactions may have been made freely in foreign exchange, foreign currency or forint
- the Government was allowed to restrict international payments (excluding those which are related to bank accounts of natural persons) for at most six months in cases of economic difficulties, conditionally on the recommendation of the Hungarian central bank.

This act finished the harmonisation of the Hungarian measures on foreign currencies to the provisions of Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty.

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3. Cross-border competition and permitted activities

In Hungary the financial and the investment services are regulated by acts separately. The Banking Act[2] applies to financial services and auxiliary financial services, and the measures of the Act on the Capital Market[3] are applied to investment services and auxiliary investment services.

The notion of financial services and auxiliary financial services are introduced by the Banking Act in 1996. From 1997 the financial services are a) collection of deposits, b) loan operations, c) financial leasing, d) financial transaction services, e) issuing cash-substitute payment instruments and performing the related services, f) providing surety bonds and bank guarantees, g) commercial activities in foreign currency, foreign exchange (not including currency exchange), bills and checks, h) agency in financial services, i) custodian services for collective investment undertakings, j) account management and safety deposit box services, k) credit reporting services, l) fund management for voluntary mutual insurance funds. (Act CXII of 1996, Article 3(1)) The auxiliary financial services are defined by the Banking Act as a) currency exchange, b) clearing operations, c) money processing, d) financial brokering on the interbank market. (Act CXII of 1996, Article 3(2)) An amendment of the Banking Act widened the scope of the financial services: from 1998 money transmission, and from 2001 credit operations and fund management services for private pension funds are also taken as financial services. (Act CLVIII of 1997, Article 2(1); Act CXXIV of 2000, Article 3(1))

Up to 2001 the Hungarian laws about the cross-border financial services were ambiguous.

Act XXIV of 1988 on the Investments of Foreigners in Hungary did not allow cross-border services in any sector (not only in the financial one). It was amended by Act LXXII of 1998 on Foreign Private Entrepreneurs which permitted the cross-border services for some special

[2] Act CXII of 1996 on Financial Institutions and Financial Undertakings.

[3] Act CXX of 2001 on the Capital Market.

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activities (like education), but not for financial or investment services. (Act LXXII of 1998, Article 2(2))

The Banking Act came into force in 1997 stated that foreign credit institutions must not found branches or provide any cross-border financial services in Hungary. (Act CXII of 1996, Article 224) Its amendment came into force in 1998 declared that a foreign company may provide financial or auxiliary financial services only by its Hungarian branch. (Act CLVIII of 1997, Article 3) The permitted activities for branches of a foreign bank included almost all financial and auxiliary financial services if it had a license for such activities from the supervisory authority of its home country.[4] The permitted activities for branches of a foreign financial enterprise were almost the same if it had a license for such activities from the supervisory authority of its home country.[5] In order to found a branch office in Hungary, the foreign company had to submit an application for foundation to the Hungarian regulatory authority. (Act CLVIII of 1997, Article 14)

An amendment of the Banking Act came into force on 1 January 2001 permitted cross-border credit and loan operations and financial leasing for a foreign financial institution registered in a member country of the Organization for Economic Cooperation and Development (OECD) if such activities permitted by its home country supervisory authority. (Article Act CXXIV of 2000, Article 4(3)) Other articles of this amendment which came into force on 1 May 2004, permitted cross-border financial or auxiliary financial services[6]

[4] The exceptions were a) custodian services for collective investment undertakings, b) fund management for voluntary mutual insurance funds, and c) money transmission. (Act CLVIII of 1997, Article 4(3))

[5] The exceptions were a) collection of deposits, b) financial transaction services, c) issuing cash-substitute payment instruments and performing the related services, d) custodian services for collective investment undertakings, f) money transmission. (Act CLVIII of 1997, Article 5)

[6] This time the financial and auxiliary financial services included the most activities listed in the Annex of Council Directive 89/646/EEC except for the followings: a) trading in exchange and interest rate instruments, b) trading in transferable securities, c) participation in share issues and the provision of services related to such issues, d) advice to undertakings on capital structure, industrial strategy and related questions and advice and services relating to mergers and the purchase of undertakings, e) portfolio managements and advice.

without the authorization by the Hungarian supervisory authority for credit institutions registered in another member state of the EU and financial enterprises that satisfy some specified conditions. (Article Act CXXIV of 2000, Articles 4(4), 5, 13) From 1 May 2004, the rules of governing the permitted cross-border activities are equivalent to the relevant rules of Council Directive 89/646/EEC. (Act CXXIV of 2000, Articles 26-28)

The Hungarian legislation defined the investment instruments, investment and auxiliary investment services firstly in the Securities Act[7], later in the Capital Market Act. Investment instruments include a) transferable securities, b) money-market instruments, c) futures transactions involving securities, foreign exchange, indices and their derivatives, including equivalent cash-settled instruments, d) forward interest-rate agreements, e) interest-rate, currency and equity swaps f) options to acquire or dispose of securities, foreign exchange, indices and their derivatives, including equivalent cash-settled instruments.[8] (Act CXX of 2001, Article 82.) The investment activities are the following operations in connection with any one or more of the investment instruments: a) financial intermediation, b) trading activities, c) portfolio management, d) subscription guarantee, e) agency activities, f) services in connection with the marketing of securities and related services.[9] (Act CXX of 2001, Article 81(1)) The auxiliary investment services are a) safe-keeping of securities, b) custodian services for securities, c) investment loans to investors, d) financial consulting services to corporations, e) acquisition of participating interest in limited liability companies by public offer and related services, f) investment counselling, g) account

[7] Act CXI of 1996 on Securities Trading, Investment Services and the Stock Exchange

[8] Almost all investment instruments were listed also in the Securities Act, the only exceptions are money-market instruments, futures transactions involving foreign exchange, indices and their derivatives, and options to acquire or dispose of foreign exchange, indices and their derivatives. (Act CXI of 1996, Article 5).

[9] The range of the investment services was regulated similarly in the Securities Act. The only difference between the legislation in 1996 and 2001 was that services in connection with the marketing of securities and related services was taken as auxiliary investment services in the law in 1996. (Act CXI of 1996, Article 4)

services to clients, h) securities accounts, i) securities lending and borrowing.[10] (Act CXX of 2001, Article 81(2)) Investment services and auxiliary investment services are subject to licencing by the Hungarian supervisory authority. (Act CXX of 2001, Article 91) Credit institutions and investment firms may apply for this licence. (Act CXX of 2001, Article 85(1)) Foreign investment firms are allowed to provide investment services only through their branches before the Hungarian accession. (Act CXX of 2001, Article 85(4)) After the accession investment service providers established in another state of the EU were allowed to provide cross-border services, and they are not required to apply for the licence of the Hungarian supervisory authority. (Act CXX of 2001, Article 85(5)) The same is true for the investment services provided by the Hungarian branch of such an investment service provider if licenced for the same activities by the supervisory authority in its home country. (Act CXX of 2001, Article 91(5)) From 1 May 2004 the rules of cross-border investment and auxiliary investment services provided by a firm of another member state of the EU are equivalent to the provisions of Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field.

[10] The scope of the auxiliary investment service was a slightly different: acquisition of participating interest in limited liability companies by public offer and related services, and securities lending and borrowing were not included, but services in connection with the marketing of securities and related services was involved. (Act CXI of 1996, Article 4)

4. Capital requirements

The first Hungarian provisions on capital requirements for credit institutions were motivated by the recommendations of Basel I. Later the changes in the regulation followed the relevant EU directives. The main idea remained the same: credit institutions, and later investment firms, too, had to maintain capital requirements to prevent risks. As the scope of the relevant risks has widened, the calculation methods became more complex.

4.1 The implementation of the recommendations of Basel I

Basel I – list of implementing laws:
Act LXIX of 1991 on Financial Institutions and the Activities of Financial Institutions
Act CXII of 1993 on the Amendment of Act 1991 on Financial Institutions and the Activities of Financial Institutions
State Supervisory Authority of Banking Sector Governor's Decree 1/1992 (PK 5.) on the Principles of Capital Adequacy and Its Calculation
State Supervisory Authority of Banking Sector Governor's Decree 3/1993 (PK 16.) on the Amendment of State Supervisory Authority of Banking Sector Governor's Decree 1/1992 (PK 5.) on the Principles of Capital Adequacy and Its Calculation
State Supervisory Authority of Banking Sector Governor's Decree 4/1996 (PK 13.) on the Amendment of State Supervisory Authority of Banking Sector Governor's Decree 1/1992 (PK 5.) on the Principles of Capital Adequacy and Its Calculation

The notion of capital requirements was introduced by Act LXIX of 1991 on Financial Institutions and the Activities of Financial Institutions (Financial Institutions Act) in Hungary. This law defined the minimal amount of subscribed capital, the calculation of own funds, introduced the capital adequacy ratio according to Basel I, and included provisions on general reserves and risk reserves. It prescribed the lowest amount of subscribed capital at HUF 1 billion (ECU 10.8 million) for banks, and at lower levels for other types of credit and financial institutions. (See Table 1 for the details.) It also stated that at least 50 percent of the subscribed capital must be paid up in cash. (Act LXIX of 1991, Article 10) The amendment of the Financial Institutions Act increased this limit to 100 percent in 1993. (Act CXII of 1993, Article 8(1))

Table 1

Minimal amount of subscribed capital for different types of credit institutions from 1991

	Minimum of subscribed capital
Bank	HUF 1 billion (ECU 10.8 million)
Specialized credit institution	HUF 500 million (ECU 5.4 million)
Cooperative credit institution	HUF 50 million (ECU 540 000)

Source: Act LXIX of 1991, Article 10

The provisions of the Financial Institution Act and its amendment in 1993 stated that the own funds were the sum of the core capital and the additional capital reduced by the value of the holdings in other credit and financial institutions, they defined the positive and negative items of these components of core capital, and gave an upper limit on the amount of the additional capital in terms of the amount of core capital.[11] Table 2 demonstrates the composition of core capital and additional capital before and after the amendment of the Financial Institution Act.

The provisions of the Financial Institution Act on the capital adequacy ratio stated that the ratio of the adjusted own funds – composition of which is shown in Table 3 – and the adjusted balance sheet total must have been at least 8 percent from 1993 as it is recommended by Basel I. The calculation method of the adjusted balance sheet total was defined by a decree of the supervisory authority. (State Supervisory Authority of Banking Sector Governor's Decree 1/1992)

[11] Appendix 2 of the Act LXIX of 1991 on Financial Institutions and the Activities of Financial Institutions stated that the amount of the additional capital cannot be larger than the amount of core capital, but with supervisory authorisation the additional capital may be at most 111 percentage of core capital.

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Table 2

Positive and negative items of core capital and additional capital from 1991 and 1993

From 1991	From 1993
Core capital	**Core capital**
+ Paid-up subscribed capital	+ Subscribed capital
+ Capital reserve	+ Capital reserve
+ Profit and loss brought forward	+ Profit and loss brought forward
+ Balance sheet profit or loss figure	+ Balance sheet profit or loss figure
	+ General reserve
– Intangible asset	– Intangible asset
– Subordinated assets if its book value exceeds 10 percent of the own funds	– Own shares
	– Unpaid subscribed capital
Additional Capital (< Core Capital)[12]	**Additional Capital** (< Core Capital)
+ Subordinated loan capital	+ Subordinated loan capital
+ General reserve	

Source: Act LXIX of 1991, Annex 2; Act CXII of 1993, Annex 1

The provisions of the Financial Institution Act translated the recommendations of the Basel I into the Hungarian law, and all of these measures went into force by the end of 1993. Although the Own Funds Directive[13] and the Solvency Directive[14] also were based on Basel I, one cannot say that these directives were implemented by the Hungarian provisions by 1993, because the Hungarian provisions were only motivated by Basel I and not by the directives of the EU. The first Hungarian banking law that was motivated by the translation of these directives of the European Union was Act CXII of 1996 on Credit Institutions and Financial Undertakings which went into force in 1997.

[12] With supervisory authorisation Additional Capital was allowed to be at most 111 percentage of the Core Capital.

[13] Council Directive 89/299/EEC of 17 April 1989 on the own funds of credit institutions

[14] Council Directive 89/647/EEC of 18 December 1989 on solvency ratio for credit institutions

Table 3

The positive and negative items of adjusted own funds as the numerator of the capital adequacy ratio

From 1991	From 1993
Adjusted own funds	Adjusted own funds
+ Core capital	+ Core capital
+ Additional Capital	+ Additional Capital
– Holdings in other financial institutions, investment firms, and insurance companies	– Holdings in other financial institutions, investment firms, insurance companies, and financial undertakings
	– Shortfall of provisions for liabilities and charges

Source: Act LXIX of 1991, Annex 2, Point 12; Act CXII of 1993, Annex 1, Section III

4.2 The implementation of the Own Fund Directive

Own Funds Directive – the implementing law:
Act CXII of 1996 on Credit Institutions and Financial Undertakings

The Own Fund Directive was translated into Hungarian law by Act CXII of 1996 on Credit Institutions and Financial Undertakings which went into force in 1997. This law includes provisions on the minimal amount of the subscribed capital, the equity capital and the own funds for credit institutions. The act stated that the subscribed capital had to be paid up in cash, and its minimal amount was HUF 2 billion (ECU 10,5 million), and lower for other types of financial institutions, the details are shown in Table 4. The own funds were defined as the sum of the core capital and additional capital the positive and negative items of which was listed. Table 5 demonstrates the detailed composition of core capital and additional capital.

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Table 4

Minimal amount of subscribed capital for the different types of credit institutions from 1997

	Minimum of subscribed capital
Bank	HUF 2 billion (ECU 10,5 million)
Specialized credit institution	HUF 1 billion (ECU 5,2 million)
Cooperative credit institution	HUF 100 million (ECU 520 000)
Financial enterprise	HUF 20 million (ECU 104 000)

Source: Act CXII of 1996, Article 9

Table 5 shows that the Hungarian legislation was more restrictive than the directive: the list of negative items of the own fund was broader than in the Own Fund Directive.[15] At the same time some of the limits prescribed by Article 6 of the Own Fund Directive were not applied this time in the Hungarian legislation[16].

[15] The Own Fund Directive did not required to take shortfall of provisions for liabilities and charges as a negative item of own funds.

[16] Although the directive limited the subordinated loan capital at 50 percent of the core capital, in Hungary this upper limit was not applied before 1998.

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Table 5

Positive and negative items of core capital and additional capital from 1997

Core capital
+ Subscribed capital
+ Capital reserve
+ Profit and loss brought forward
+ Balance sheet profit or loss figure
+ General reserve
– Unpaid subscribed capital
– Intangible assets
– Own shares
– Holdings in other financial institutions or insurance companies
– Subordinated loan capital provided to other financial institutions or investment firms
– Shortfall of provisions for liabilities and charges
– Interim losses
Additional Capital (< Core Capital)
+ Revaluation reserve
+ Subordinated loan capital

Source: Act CXII of 1996, Annex 5

4.3 The implementation of the Solvency Directive[17]

Solvency Directive – list of implementing laws:
Act CXII of 1996 on Credit Institutions and Financial Undertakings
Minister of Finance's Decree No. 28/1998 (X.21.) on the Solvency Ratio
Minister of Finance's Decree No. 13/2001 (III.9.) on the Calculation of the Solvency Ratio

The Banking Act stated that for credit institutions the solvency ratio had to be at least 8 percent. (Act CXII of 1996, Article 76(2))

The numerator of the solvency ratio was defined as the own funds. The positive and negative items of the own funds from 1997 are shown in Table 5. The Banking Act also stated that the denominator of the solvency ratio is defined by a decree.

The Solvency Decree I[18] of the minister of finance entered into force in 1998, and was modified by Solvency Decree II[19] in 2001. They gave the detailed methodology for deriving the denominator of the solvency ratio. Solvency Decree I made a distinction between countries of Zone A and Zone B identically to the Solvency Directive. It also gave risk weightings for the different asset items. Only those assets were mentioned the risk weightings of which were lower than 100 percent, and it was stated, that 100 percent was assigned to all other assets. The main difference between the two decrees was that the first one was a more restrictive: it assigned low weightings only to a fewer types of assets, and it did not include the condition for the claims on credit institutions that these were not components of the own funds of those institutions. Solvency Decree II included also the special rules for credit institutions maintaining a trading book and for those which did not maintain a trading book. Those credit institutions which maintained a trading book had to use the market pricing approach for the positions not included within the trading book. The

[17] Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit institutions.

[18] Minister of Finance's Decree No. 28/1998 (X.21.) on the Solvency Ratio.

[19] Minister of Finance's Decree No. 13/2001 (III.9.) on the Calculation of the Solvency Ratio.

other credit institutions – without a trading book – were allowed to choose between two methods, the market pricing approach, and the original risk approach.

4.4 The implementation of the Capital Adequacy Directive[20] and the Second Capital Adequacy Directive[21]

Capital Adequacy Directive – list of implementing laws:
Act CXI of 1996 on the Securities Trading, Investment Services and the Stock Exchange
Act CLI of 1997 on the Amendment of Act CXI of 1996 on the Securities Trading, Investment Services and the Stock Exchange
Act XL of 2003 on the Amendment of Act 2001 on Capital Market
Act LX of 2003 on Insurance Institutions and the Insurance Business
Act CXX of 2001 on Capital Market
Act CXII of 1996 on Credit Institutions and Financial Undertakings
Act LXIV of 2002 on the Amendment of Act CXII of 1996 on Credit Institutions and Financial Undertakings
Act XXXIX of 2003 on the Amendment of Act CXII of 1996 on Credit Institutions and Financial Undertakings
Governmental Decree 230/2003. (XII. 16.) on the Amendment of Governmental Decree 244/2000. (XII. 24.) on the Rules of Establishing the Capital Adequacy of Positions registered in the Trading Book, Foreign Exchange Risk, Large Exposures and Risks
Act XL of 2003 on the Amendment of Act CXX of 2001 on Capital Market
Governmental Decree 244/2000. (XII. 24.) on the Rules of Establishing the Capital Adequacy of Positions registered in the Trading Book, Foreign Exchange Risk, Large Exposures and Risks

[20] Council Directive 93/6/EEC of 15 March 1993 on the capital adequacy of investment firms and credit institutions

[21] Directive 98/31/EC of the European Parliament and of the Council of 22 June 1998 amending Council Directive 93/6/EEC on the capital adequacy of investment firms and credit institutions

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Second Capital Adequacy Directive – list of implementing laws:
Act XXXIX of 2003 on the Amendment of Act CXII of 1996 on Credit Institutions and Financial Undertakings
Act XL of 2003 on the Amendment of Act CXX of 2001 on Capital Market
Governmental Decree 230/2003. (XII. 16.) on the Amendment of Governmental Decree 244/2000. (XII. 24.) on the rules of establishing the capital adequacy of Positions registered in the Trading Book, Foreign Exchange Risk, Large Exposures and Risks
Act CXX of 2001 on Capital Market
Act CXII of 1996 on Financial Institutions and Financial Undertakings
Governmental Decree 244/2000. (XII. 24.) on the rules of establishing the capital adequacy of Positions registered in the Trading Book, Foreign Exchange Risk, Large Exposures and Risks

In Hungary, Directive 93/6/EEC and Directive 98/31/EC were implemented in parallel. (Seregdi, 2006, pp. 165-166)

Act CXI of 1996 on the Securities Trading, Investment Services and the Stock Exchange introduced the notion of an investment firm and gave the first capital requirements for them in Hungary. These requirements were about the calculation method of the own funds, and the minimal amounts of the subscribed capital and own funds for the different types of the investment firms.

The positive and negative items of the own funds of an investment firm were almost the same as for the credit institutions defined by the Banking Act. There were only two differences between the two acts: (1) the revaluation reserve was taken as a part of core capital for investment firms[22], (2) the shortfall of provisions for liabilities and charges was not a negative item of core capital for investment firms[23]. The own funds had to be at least 8 percent of the value of the risks of the investment undertakings. These risks were calculated by the investment firms daily according to the requirements of this act. These

[22] It was an item of core capital for banks.

[23] For banks, core capital had to be reduced by the Shortfall of provisions for liabilities and charges.

requirements were very simple, they were not equivalent to the prescriptions of the Capital Adequacy Directive.

One year later, an amendment of this act (Act CLI of 1997) introduced the concept of a trading book, stated that there were capital requirements for investment service providers maintaining a trading book. It was also stated that the market value of any position included within the trading book must have been evaluated on a daily basis. This act also defined those limits under which the credit institutions could have been relieved of maintaining a trading book. (Act CLI of 1997, Article 21) These limits were equivalent to the requirements of Article 4(6)-(7) of the Capital Adequacy Directive.

The detailed provisions for the maintenance of the trading book and for the capital requirements of the market risks were included within a governmental decree which came into force in 2001. (Governmental Decree 244/2000) The investment firms and banks had to use a trading book for their positions in those financial instruments that were held to make a profit on them[24]. The remaining business of banks was contained within the banking book.

The Trading Book Decree divided the market risk into four parts: (1) position risk, (2) counter-party risk, (3) commodities risk, and (4) the risk of large exposures. It also introduced the notion of the foreign-exchange risk. It imposed the capital requirements of position risk, counter-party risk, commodities risk, the risk of large exposures for firms maintaining a trading book, and the capital requirement of the foreign-exchange risk for all financial institutions. The financial firms and institutions had to calculate the capital requirements of interest-rate risks and equities risk only for the positions included within the trading book. The Trading Book Decree which came into force in 2001 required to calculate the capital requirement of the commodities risks only for those positions that were involved in the trading book (Governmental Decree 244/2000, Article 12(1)), but an amendment of the Trading Book Decree stated that the capital requirement of the

[24] There were further conditions of including a position within the trading book, e.g. the possibility of valuation on a daily basis.

commodities risks had to be calculated for all positions of the financial firms – irrespectively of maintaining a trading book or not – and institutions from 2003. (Governmental Decree 230/2003) The capital requirements of the foreign exchange-rate risks had to be derived for all positions of financial institutions and firms – included those which did not maintain a trading book – from 2001. (Governmental Decree 244/2000, Article 12(2), 12(6))

The Amendment of the Trading Book Decree in 2003 also gave the detailed methodology of calculating the capital requirements for those credit institutions and financial undertakings which were subject to supervision on a consolidated basis. Such provisions were not included within the Trading Book Decree in 2001, because the conditions of being subject to supervision on a consolidated basis were declared in the amendments of the Banking Act and Capital Market Act in 2003. (Act XXXIX of 2003, Article 16; Act XL of 2003, Article 17)

The Trading Book Decree gave the detailed methodology for the calculation of the capital requirements for the different types of the market risk. These methods were called standard methods for the calculation of the capital requirement. Subject to specified conditions, the supervisory authority was allowed to permit institutions to apply their own internal-risk management models to calculate the capital requirements for general interest-rate risk, general equity risk, commodity risk, and foreign exchange-rate risk. From 2003, under the permission of the supervisory authority the own internal-risk management models might have been used to derive the capital requirements for position risks, commodities risks and foreign exchange risks. The Trading Book Decree also gave the conditions under which the authorities might have allowed institutions to calculate their capital requirements applying their own internal risk-management models – these conditions were equivalent the those imposed by the Second Capital Adequacy Directive. (Governmental Decree 244/2000, Article 43; Directive 98/31/EC, Annex VIII, Point 2) The financial firms and institutions were allowed to decide to use their internal risk-management models in combination with the standard methods, too. So they had the

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opportunity to use their internal risk-management models to calculate the capital requirement for some types of risk, and the standard method for the other types of it.

Comparing the national measures and the Capital Adequacy Directives, one can find that the national laws identically implemented the provisions of these directives in the most cases, but there were little differences induced by the specialities of the Hungarian financial system. (Seregdi, 2006, p. 166)

4.5 Implementation of the Capital Requirement Directives[25]

Capital requirements of Directive 2006/48/EC – list of implementing laws:
Act CXII of 1996 on Financial Institutions and Financial Undertakings as amended
Minister of Finance's Decree No. 53/2005 (XII. 28.) on the Scope of Data to be reported by Credit Institutions to the Hungarian Financial Supervisory Authority and the Manner of Reporting
Governmental Decree 196/2007. (VII. 30.) on Handling of the Credit Risks and Relevant Capital Requirements
Governmental Decree 380/2007. (XII. 23.) on Securitization Capital Requirements of the Financial Institutions
Governmental Decree 200/2007. (VII. 30.) on Handling of the Operational Risks and Relevant Capital Requirements
Act LI of 2007 on the Amendment of Act CXII of 1996 on Financial Institutions and Financial Undertakings and the Amendment of Laws on Specialized Credit Institutions

Capital requirements of Directive 2006/49/EC – list of implementing laws:
Act CXXXVIII of 2007 on Investment Firms, Commodities Exchange Service Providers, and Regulations on Their Operations
Governmental Decree 196/2007. (VII. 30.) on Handling of the Credit Risks and

[25] Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions, and Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions

Relevant Capital Requirements
Act CXX of 2001 on Capital Market
Governmental Decree 244/2000 on the Rules of Establishing the Capital Adequacy for Positions Registered in the Trading Book, Foreign Exchange Risk, Large Exposures and Risks undertaken
Governmental Decree 301/2008 on Credit Risk of Investment Firms

An amendment of the Banking Act in 2002 (Act LXIV of 2002) introduced the notion of the supplementary capital, and stated that the own funds is equal to the sum of the core capital, subsidiary capital and supplementary capital. The positive and negative items of these three components of the own funds are given in Table 6.

Table 6

The positive and negative items of core capital, additional capital and supplementary capital from 2003

Core capital
+ Subscribed capital
+ Capital reserve
+ Indivisible cooperative share from the tied-up reserve
+ General reserve
+ General risk provision, up to 1.25 percent of the adjusted balance sheet total
+ Profit brought forward
+ Balance sheet profit endorsed by audit
– Unpaid subscribed capital
– Intangible assets, not included in the tied-up reserve
– Dividend preference share subscribed and paid, also paying dividends unpaid from previous year(s) in the year in which there is profit
– Balance sheet loss endorsed by audit, or the interim negative result for determining the interim solvency margin
– Risk provision – excluding the general risk provision – and any shortfall in value adjustment, meaning the amount of risk provision and value adjustments let unrecorded because the evaluation of off-balance sheet items and assets was incorrect (including any shortfall in provisions and

unrecorded value adjustments uncovered during an auditor's or a supervisory audit
Additional Capital (< Core Capital)
+ Dividend preference share subscribed and paid and also paying unpaid dividends from previous year(s) in the year in which there is profit
+ Revaluation reserve
+ Subordinated loan capital to the extent that is does not exceed the 50 percent of the core capital
Supplementary capital
+ Subordinated loan capital above the 50 percent of the core capital
+ Subsidiary capital above the 100 percent of the core capital

Source: Act LXIV of 2002

Table 7

The positive and negative items of adjusted own funds as the numerator of the capital adequacy ratio from 2003

From 2003
Adjusted own funds
+ Core capital
+ Additional capital
– Book value of interests in other financial institutions, investment firms and insurance companies – if the credit institution has a qualifying participation – as well as the book value of subordinated loan capital provided to the above-specified companies
– Book value of interests not treated as qualifying participations in other financial institutions, investment firms and insurance companies, as well as the part exceeding 10 percent of the own funds from the total amount of the book value of subordinated loan capital provided to the above-specified companies

Source: Act LXIV of 2002

An amendment of the Banking Act (Act LI of 2007) implemented equivalently the most of the measures of Directive 2006/48/EC on the scope of the provision against risk (Directive 2006/48/EC, Articles 68-73) and on the calculation of the minimum level of own funds. (Directive 2006/48/EC, Articles 74-75; implemented by Act LI of 2007, Article 28(1)) The discretions in Article 69 has not been exercised, that is compliance on an individual basis is applied due to the high number of subsidiaries. Article 70 on the supervisory authority's discretion also has not been transposed.

An amendment of the Banking Act in 2007 stated that credit institutions may use the Standardized Method or may get the supervisory authority's permission to apply the Internal Ratings Based Approach calculating their risk-weighted exposure. (Act LI of 2007, Article 29-30) The conditions under which the supervisory authority may allow the usage of the Internal Ratings Based Approach are specified according to the provisions of the directive.

The main provisions of the Hungarian legislation on the Standardized Method and Internal Ratings Based Approach are equivalent to those in the directive, but one can find slight differences in the classification of the off-balance-sheet items and the classification of exposures in the case of the Standardized Method, and also in the conditions of supervisory authority's approval for introducing the Internal Ratings Based Approach in the credit institution sequentially. (Act LI of 2007, Articles 29-31, 34-37, Annex I. Point 12; Governmental Decree 196/2007, Articles 11, 17, 24-28, 30, 32-33, 38-39)

The Credit Risk Decree[26] came into force in 2007 gives the classification of the off-balance-sheet items equivalently to the measures of Directive 2006/48/EC. (Governmental Decree 196/2007, Article 17; Directive 2006/48/EC, Annex II) The decree gives the list of medium risk, medium/low risk and low risk off-balance sheet items almost equivalently to the measures of the directive[27], and states that any other off-balance sheet item has full risk.

[26] Governmental Decree 196/2007. (VII. 30.) on Handling of the Credit Risks and Relevant Capital Requirements.

[27] However there are some extra items among the low risk items like unconditionally revocable standby letter of credit and receivable of a credit granted at not own risk of the credit institution; and there are some additional items among the

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The exposure classes given in the Amendment of the Banking Act[28] not include the items belonging to regulatory high risk classes. (Act LI of 2007, Article 29) In the case of exposures to institutions only the central government risk weight based method is transposed, so weighting is not individual, but it is based on the rating of the government. (Directive 2006/48/EC, Annex VI. Part I, Points 26-28)

The amendment of the Banking Act gives the detailed conditions of the authorization of implementation of the Internal Ratings Based Approach to be carried out sequentially. Among these conditions one can find that the credit institution has to declare within the application for permission its commitment to use the Internal Rating Based Approach at least 60 percent of the risk-weighted exposure amounts within 2.5 years following the date of the permission, and increase this ratio to 100 percent within 5 years following the date of the authorization. (Act LI of 2007, Article 30(9))

The most of the provisions on credit risk mitigation are equivalently implemented. (Directive 2006/48/EC, Articles 90-93 and Annex VIII) Only the possibility of the competent authorities to waive the requirement for the credit institutions to comply with all conditions to recognise a real estate property as eligible collateral, because the Hungarian legislator does not wish to use the discretional right for it. (Directive 2006/48/EC, Annex VIII. Points 14-19)

The measures on securitisation (Directive 2006/48/EC, Articles 94-101 and Annex IX) and operational risk (Directive 2006/48/EC, Articles 102-105 and Annex X) has been implemented equivalently in the most cases, the only exception is Article 105(4), so an EU parent credit institution or financial holding company and its subsidiaries may be allowed to use Advanced Measurement Approaches based on their operational risk measurement if

medium risk items like guarantees/promissory notes for subscription of shares. One can also find that one medium risk item is missing in the Hungarian classification: warranties and indemnities (including tender, performance, customs and tax bonds), so these are taken as full risk items in Hungary.

[28] Act LI of 2007 on the Amendment of Act CXII of 1996 on Credit Institutions and Financial Undertakings and the Amendment of Laws on Specialized Credit Institutions.

the parent institution or company and its subsidiaries meet the qualifying criteria. These qualifying criteria are equivalent to the requirements of Directive 2006/48/EC, Annex X. Part 3.

The trading and trading book related provisions of Directive 2006/49/EC (Directive 2006/49/EC, Article 11 and Annex VII) have been almost all implemented[29] equivalently by the Investment Firms Act.[30] This act gives the definition of a financial instrument, which is a restrictive one: "Financial instruments are free of any restrictive covenants on their tradability AND able to be hedged."[31]

The provisions of Directive 2006/49/EC on own funds are fully implemented. (Directive 2006/49/EC, Articles 12-17) Only the provisions of Art. 13(2) on alternative determinations of own funds conditionally the permission of the supervisory authority has not been transposed, so the alternative determination method cannot been applied.

The transposition of Article 18(1) of Directive 2006/49/EC on the minimal amount of the own funds is restrictive: it states that the own funds shall not fall under the sum of

- capital requirements for position risk, clearing and counter party risk, and large exposures shown in the trading book,
- foreign-exchange risk and commodities risk in respect of all business activities,
- the capital requirements for credit risk in respect of all business activities,
- the capital requirements for the operational risk in respect of all business activities. (Act CXXXVIII of 2007, Article 105(1))

[29] The following provisions are not transposed: Annex III, Part B: Points 10 and 14, Part D: Point 3 of Directive 2006/49/EC.

[30] Act CXXXVIII of 2007 on Investment Firms, Commodities Exchange Service Providers, and Regulations on Their Operations.

[31] Act CXXXVIII of 2007, Article 103(7). The definition of the financial instruments in Directive 2006/45/EC says that they are EITHER free of any restrictive covenants on their tradability OR able to be hedged.

As the last two items are not mentioned in Article 18(1) of Directive 2006/49/EC, on can conclude that the Hungarian regulation is a more restrictive one than it is required by the EU.

The provisions of Directive 2006/49/EC on the calculation of the capital requirements for position risk, settlement and counterparty risk, foreign exchange risk, and on the internal models to calculate capital requirements have been transposed equivalently, but some options are not applied. (Directive 2006/49/EC, Articles 18-20 and Annex I-VI) Three of them are about the foreign exchange risk: in Hungary the competent authority may not allow institutions to provide lower capital requirements against positions in closely correlated currencies than those which would result from the standards, or to remove positions which are subject to legally binding intergovernmental agreement, and the institutions are not allowed to brake down their net positions in composite currencies into the component currencies. (Directive 2006/49/EC, Annex III. Points 3-4) In the case of using internal based model for calculating capital requirements against commodity risk, the option of Directive 2006/49/EC, Annex V. Point 13 which states that the competent authority may allow institutions to use empirical correlations is not applied, too.

The implementation of the Capital Requirement Directives was successful. The main provisions of the Directives have been transposed identically or equivalently to the requirements of the Directives. Comparing the Directives and the Hungarian laws one can find only slight differences between them. Most of the discretions of the Directives has not been exercised in Hungary.

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4.6 Implementation of the Second Capital Requirement Directive (CRD II)[32]

Second Capital Requirement Directive – list of implementing laws:
Governmental Decree 164/2008 (VI. 27.) on Publication of Information on Risk Management and Risk Assumption of Investment Firms
Governmental Decree 196/2007 (VII. 30.) on Handling of the Credit Risks and Relevant Capital Requirements
Act CXII of 1996 on Credit Institutions and Financial Undertakings
Act CXX of 2001 on Capital Market
Act CXXXVIII of 2007 on Investment Firms, Commodities Exchange Service Providers, and Regulations on Their Operations
Act CLIX of 2010 on the Amendment of Certain Financial Laws
Act CLVIII of 2010 on the Hungarian Financial Supervisory Authority
Governmental Decree 234/2007 on Disclosure Requirements of Credit Institutions
Governmental Decree 244/2000 on the Rules of Establishing the Capital Adequacy for Positions Registered in the Trading Book, Foreign Exchange Risk, Large Exposures and Risks undertaken
Finance Minister's Decree 27/2007 on Consolidated Own Funds and the Calculation of Consolidated Capital Requirements
Governmental Decree 380/2007 on the Calculation of Capital Requirement for Securitisation
Governmental Decree 381/2007 on the Management of Counterparty Credit Risk
Finance Minister's Decree 45/2008 (XII. 31.) on the Data to be Provided by Credit Institutions to the Financial Supervisory Authority of Hungary and the Method of Providing Data
Governmental Decree 301/2008 (XII. 17.) on the Credit Risks of Investment Firms
Governmental Decree 344/2010. (XII. 28.) on the Exposures to Transferred Credit Risk
Governmental Decree 349/2010. (XII. 28.) on the Amendment of Certain Governmental Decrees on Finance

[32] Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management.

During the transposition of the measures of CRD II the modifications of the Hungarian laws and decrees affected the following areas of capital requirements:

- eligibility criteria and limits for some types of hybrid capital instruments to involve them among the components of own funds of credit institutions,
- capital requirements for the risk arising from securitisation exposures.

In Hungary the hybrid instruments (called capital of mixed properties) are introduced as a component of core capital from 2011 by an amendment of the Banking Act. (Act CLIX of 2010, Annex 2 and 3 modified Act CXII of 1996, Annex 5 and Act CXXXVIII of 2007, Annex 2) The following restriction has been made:

- the subscribed and paid up capital of mixed properties and the core loan capital that must be converted into shares and other similar instruments through appropriate mechanisms determined at the time of issue in the event of any emergency jeopardizing the credit institution's financial and capital situation may not exceed 50 percent of the core capital, or if it is prescribed by the authority, that can be taken into consideration as core capital (if they are ranked last in the priority order in the liquidation proceedings, they do not carry an entitlement to any payment of dividend, share or interest predetermined relative to par value, and they are not considered cumulative with respect to any payment of dividend, share or interest carried over from the year or years before and which are due in the future)
- undated subscribed and paid up capital of mixed properties and core loan capital, where there is no provision for moderate incentive to redeem or call, may not exceed 30 percent of the core capital on the aggregate, moreover, their collective share may not exceed 50 percent of the core capital together with the instruments referred to in the previous subparagraph
- dated subscribed and paid up capital of mixed properties and core loan capital, where there is provision for moderate incentive to redeem or call, may not exceed 15 percent of the core capital in the aggregate, moreover, their collective share may not

exceed 50 percent of the core capital together with the instruments referred to in the previous two subparagraphs.

Introducing the hybrid capital as an item of the core capital the implementation modified the components of own funds according to Table 1.

Table 1

The positive and negative items of the core capital and additional capital from 2011

Core capital
+ Subscribed and paid-up capital, including the following types of shares (if they are ranked last in the priority order in liquidation proceedings, they do not carry entitlement to any payment of dividend, share or interest predetermined relative to par value, and they are not considered cumulative with respect to any payment of dividend, share or interest carried over from the year or years before and which are due in the future): - common shares - preference shares - employee shares - shares attaching other preferential rights - shares of cooperative societies - investor share certificates
+ Subscribed and paid up capital of mixed properties (hybrid capital instruments), including interest-bearing shares, redeemable shares and all shares and other similar instruments shown under subscribed capital which are not covered by the previously mentioned types and meet specified conditions
+ Capital reserve
+ Tied-up reserve
+ General reserve
+ General risk provision , up to 1.25 percent of risk-weighted exposure amounts
+ Profit brought forward
+ Balance sheet profit or interim endorsed by audit, if it contains no foreseeable payment of any kind, nor any dividend
+ Core loan capital

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– Own shares repurchased
– Intangible assets
– Loss brought forward
– Balance sheet loss endorsed by audit, or the interim negative result for determining the interim own funds
– Risk provision – excluding the general risk provision – and any shortfall in value adjustment, meaning the amount of risk provision and value adjustments let unrecorded because the evaluation of off-balance sheet items and assets was incorrect (including any shortfall in provisions and unrecorded value adjustments uncovered during an auditor's or a supervisory audit)
– The part of subscribed and paid up capital of mixed properties and core loan capital that cannot be used due to restrictions
– Valuation adjustment for less liquid positions booked in the trading book, if they give rise to material losses
Subsidiary capital (< Core capital):
+ Preference share subscribed and paid up, also the paying of unpaid dividends from previous year(s) in the year in which there is profit, furthermore, all other shares and similar instruments which are not taken into account in the core capital because of restrictions
+ Revaluation reserve
+ Subordinated loan capital
+ Subsidiary loan capital
+ Subscribed and paid up capital of mixed properties and core loan capital in excess of the specified limit
+ For credit institutions that are using the internal ratings based approach for the calculations of credit risk exposure, the value adjustments and risk provisions – other than general risk provisions -, net expected loss amounts, up to 0.6 percent of risk-weighted exposure amounts, if this difference is positive
Note: The ratio of core, subsidiary and subordinated loan capital with a fixed maturity that may be taken into account as subsidiary capital, and the total of dated shares and similar instruments that can be taken into account as subsidiary capital may not exceed 50 percent of the core capital.

Supplementary capital
+ Part of the subordinated loan capital that cannot be used due to restrictions
+ Part of the subsidiary capital that cannot be used due to restrictions

Source: Act CLIX of 2010, Annex 2-3

The notion of securitization has been defined by an amendment of the Banking Act in 2010. (Act CLIX of 2010, Annex 2) This definition states that it is a transaction whit the following three properties:

- the credit risk of an exposure or pool of exposures is tranched,
- the payments in the transaction depend on the performance of the securitized exposure or pool of exposures,
- the distribution of losses during the ongoing life of the transaction is determined by the subordination of tranches.

For those credit institutions and investment firms which are the originators of a securitization has to take into account the following two restrictions calculating own funds: (Act CLIX of 2010, Annex 2-3)

- net future gains arising from the securitized assets which improves credit quality of securitized positions cannot be taken into account as a positive component of the own funds,
- the core capital and the supplementary capital have to be decreased by 50-50 percent of that amount of securitization positions to which a risk weight of 1250 percent is assigned, if the credit institution does not take it into account in the risk-weighted exposure amounts.

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4.7 Implementation of the Third Capital Requirement Directive (CRD III)[33]

Third Capital Requirement – list of implementing laws:
Governmental Decree 131/2011 (VII. 18.) on the Application of Remuneration Policies with Regard to the Features Arising from the Size, Nature and Scope of Activities, and Legal Form of Credit Institutions and Investment Enterprises
Governmental Decree 164/2008 (VI. 27.) on Publication of Information on Risk Management and Risk Assumption of Investment Firms
Governmental Decree 196/2007 (VII. 30.) on Handling of the Credit Risks and Relevant Capital Requirements
Act CXII of 1996 on Credit Institutions and Financial Undertakings
Act CXXXVIII of 2007 on Investment Firms, Commodities Exchange Service Providers, and Regulations on Their Operations
Act LI of 2007 on the Amendment of Act CXII of 1996 on Credit Institutions an Financial Undertakings and Other Regulations Concerning Specialised Credit Institutions
Act CIV of 2008 on Promoting the Stability of the Financial Intermediary System
Act CLIX of 2010 on the Amendment of Certain Financial Laws
Act CLVIII of 2010 on the Hungarian Financial Supervisory Authority
Act CXCIII of 2011 on Investment Fund Managing Companies and Forms of Collective Investments
Act XCVI of 2011 on the Amendment of Certain Economic Laws
Act CLI of 2012 on the Amendment of Certain Financial Laws
Governmental Decree 234/2007 on Disclosure Requirements of Credit Institutions
Governmental Decree 244/2000 on the Rules of Establishing the Capital Adequacy for Positions Registered in the Trading Book, Foreign Exchange Risk, Large Exposures and Risks undertaken
Governmental Decree 345/2007 (XII. 19.) on the Amendment of Governmental Decree 244/2000 on the Rules of Establishing the Capital Adequacy for Positions Registered in the Trading Book, Foreign Exchange Risk, Large Exposures and Risks undertaken
Governmental Decree 348/2011 (XII. 30.) on the Amendment of Certain Financial Governmental Decrees

[33] Directive 2010/76/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for the re-securitisations, and the supervisory review of remuneration policies

During the implementation of CRD III the regulation on the calculation of capital requirements for credit institutions and investment firms changed in two aspects: the capital requirements of re-securitization positions are prescribed, and the standard for internal models used for the calculation of market risk capital requirements for the positions in the trading book became stricter.

The concept of re-securitization position is introduced in a governmental decree of 2011. (Governmental Decree 348/2011) It states that re-securitization is a securitization for which the credit risk of a pool of exposures is tranched where the pool of exposures involves at least one securitization position. The decree assigns higher risk-weights and higher capital requirements to the re-securitization positions than to the simple securitization positions. It also prescribes that the credit institutions and investment firms have to make a specified valuation for the risks of their re-securitization position without which a very high (1250 percent) risk-weight should be applied.

The credit institutions using internal models to determine the capital requirement of the market risk for the positions within the trading book has to introduce a new methodology to calculate the risks of their securitization positions.

5. Supervision on a consolidated basis

Supervision on a consolidated basis – List of concerned Acts
Act LXIX of 1991 on Financial Institutions and the Activities of Financial Institutions
Act CXII of 1996 on Credit Institutions and Financial Enterprises
Act CXXIV of 2000 on Amendment of Act CXII. of 1996 on credit institutions and financial enterprises
Act CXX of 2001 on Capital Market
Governmental Decree 244/2000. (XII. 24.) on the rules of establishing the capital adequacy of Positions registered in the Trading Book, Foreign Exchange Risk, Large Exposures and Risks
Act LXIV of 2002 on the Amendment of Financial and Capital Market Regulations
Act LX of 2003 on Insurance Institutions and the Insurance Business
Act XXXIX of 2003 on Amendment of Act CXII. of 1996 on credit institutions and financial enterprises
Act LXXXIV of 2004 on the Amendments of Financial Regulations Relating to the Supplementary Supervision of Financial Conglomerates
Act CIII of 2008 on the amendment of certain acts with effects on financial services

The principles of consolidated supervision of financial groups existing in Hungary is covered by the Act on Credit Institutions (in the course of amendments of the Act CXII of 1996, see the table above) and in the regulations of the Trading book (Governmental Decree 244/2000). Hungarian regulation of consolidated supervision can be divided into three main periods.

1) The first period from the 1987 modernization of the Hungarian banking system (when Hungary returned to the two-tier banking system)[34] to the first attempt of harmonization with EU directives in 2000. In this term legal rules of consolidated supervision did not exist in Hungarian law.
2) In 2000 there was a legal harmonization: the amendment (Act CXXIV of 2000) of the Act on Credit Institutions (Act CXII of 1996) introduced a new chapter on consolidated supervision into the Act. But the legal rules of consolidated supervision was not really consistent in the law and practice of supervision in Hungary as far as the

[34] See the Concise History of Hungary's Financial System (1987-2008) in the D2.02. Country Report on the Hungarian Financial System (FESSUD Working Package 2).

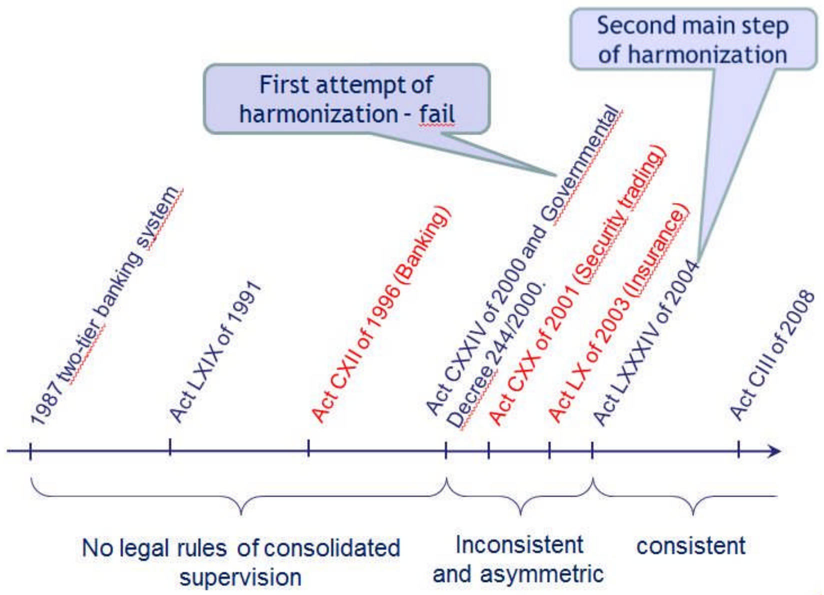
accession to the EU in 2004. As a next step forward, the trading book's regulations introduced similar prescriptions when formulating the capital requirements of market risks. Thus the provisions concerning group-wide supervision of credit institutions were formally harmonized. However, there were errors in both definition and procedure, which had the consequence that the substance of the Hungarian regulation did not meet either the purpose of legal harmonization or the goals of consolidated regulation. (Horváth and Szombati 2002, p.86)

3) The second main step of harmonization came into force in 2004 (Act XXXIX of 2003 on Amendment of Act CXII of 1996 on credit institutions and financial enterprises; and Act LXXXIV of 2004 on the Amendments of Financial Regulations Relating to the Supplementary Supervision of Financial Conglomerates). From 2004 the Hungarian regulation of these fields essentially corresponds with EU directives.

Figure 1

Essential milestones of the implementation of supervision on a consolidated basis in Hungary

(up to the crisis)



As we mentioned above, the first attempt of the harmonization became in 2000 when a new chapter was introduced on consolidated supervision into the Act on Credit Institutions. As a next step forward, the trading book's regulations introduced similar prescriptions when formulating the capital requirements of market risks. Thus the Hungarian legal rules of consolidated supervision of credit institutions would seem formally harmonized. However, these rules had some shortcomings, inconsistency and discrepancies, which had the consequence that the substance of the Hungarian regulation did not meet the goals of consolidated regulation in this term. A good signal of this problem, that the Hungarian Financial Supervisory Authority (in the Hungarian acronym: PSZAF) did not require consolidated data supply until 2002. Insufficiencies which deviated fundamentally from the logic of group-wide supervision, related basically to two areas: the scope of institutions to be consolidated with the purpose of prudential supervision and the method of calculation of consolidated own funds and capital adequacy. Only in 2002, the supervisory authority ordered an extraordinary supply of consolidated data[35], in line with the initiative of amendment legislation.

One element of inconsistency was the differences in definition of financial institutions (in Act CXXIV of 2000). The concept of financial institution, and the identification of financial holding company and mixed activity holding company were different in Hungarian provisions. In line with the EU regulation a financial institution is a non-credit institution undertaking with the main activity of acquiring participations or executing universal banking activities listed in Annex 1 of Directive 2000/12 with the exception of collecting deposits. But in Hungarian regulation the credit institution and the financial undertaking were denominated as a financial institution (executing certain activities from Annex 1 2000/12/EC), thus it included different sphere of institutions and different activities compared to the financial institution defined by the EU on the basis of activities.

[35] HFSA ordered an extraordinary report from Hungarian banking groups to reflect conditions as of December 31, 2001 with a July 31, 2002 submission deadline for the preparation of an impact study of the proposed legislative amendment related to consolidated supervision, and for the inspection of the compliance of banking groups with capital requirements and large exposure and investments limits on a consolidated basis.

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And in line with the EU regulation financial holding company is a financial institution, among the subsidiaries of which there are mainly or exclusively credit institutions and financial institutions, but at least one credit institution. While a mixed activity holding company is a parent institution, which is not a credit institution or financial holding company but there is at least one credit institution among its subsidiaries. While in Hungarian regulation financial holding company was defined as a financial undertaking, the exclusive activity of which is the ownership of financial institutions or investment firms, from among of which at least one is a credit institution. Exclusiveness like that is not prescribed in the EU rules.

The Act LXXXIV of 2004 (on the Amendments of Financial Regulations Relating to the Supplementary Supervision of Financial Conglomerates) changed these definitions of institution types. Although the definition of financial institution did not changed in Hungarian rules (thus it continue differs from EU definition), but the definitions of financial holding company and mixed activity holding company is already identical to EU's.

In the matter of mixed activity holding company, in the case of credit institutions also the person of owners was strictly regulated in terms of who may acquire considerable ownership or voting rights in the individual institutions in Hungary. This taxative rule was special for the Hungarian regulation (other rules defining organizational structure (exclusive or main activity, reporting obligation of acquisition, right of veto of supervision) were similar to the EU regulation). The Act on Credit Institutions restricted who might acquire a 15 per cent or higher ownership or voting right in a credit institution.[36] This provision reflected the intentions of the legislators that a not supervised institution should not acquire decisive ownership in a credit institution. Due to this rule, in Hungary mixed activity holdings might be set up, the leading body of which was an insurance undertaking,

[36] Only the Hungarian government; another credit institution; universal postal service provider; insurance undertaking; investment firm, financial holding company; and the Hungarian Deposit Insurance.

universal postal service provider or investment firm (whereas in the EU it can be any parent company).[37]

Another deficiency that "close link" was not defined exactly. Although certain elements of the EU directives and a simplified formulation of close link was reflected in the Amendment of 2000 of Act on Credit Institutions and the Act on Capital Markets. These Acts allowed for the supervisory authority to refuse a licence, if the activity of the applicant (owner or leading officer) endangers proper management of the credit institution or the financial undertaking, or if the activity, contacts or acquisitions of the applicant hinder the pursuit of efficient supervision. Even so, in contrast to the detailed explanations of the EU directives, it was not clarified what level of ownership participation and relationship might hinder efficient supervision and prudent management of the institution. Only the 2004 amendment of the Act on Credit Institutions introduced (Act XXXIX of 2003) the definition of 'close link'[38] and 'dominant influence'[39]. According to the applicable legal definitions, persons with either

[37] Overruled from 2003 by the Act LXIV of 2002 on the Amendment of Financial and Capital Market Regulations.

[38] "Close link shall mean a situation in which two or more natural or legal persons are linked by means other than a dominant influence or participating interest. If a person is linked to another person by way of a dominant influence, which constitutes a dominant influence over a third person, such third person shall also be regarded as closely linked with the person that is at the head of those persons. A situation in which two or more natural or legal persons are permanently linked to one and the same person by a control relationship shall also be regarded as constituting a close link between such persons." (Act XXXIX of 2003)

[39] "Dominant influence shall mean the controlling influence referred to under the definition of parent company in the Accounting Act, or a relationship between a person and a company:

a) under which the person with control has the capacity to decide on the distribution of the company s profits, the diversification of profit or losses to another company or the company s strategy, business or sales policies, or

b) that permits coordination of the management of the company with that of another company for the purposes of a mutual objective, regardless of whether the agreement is fixed in the articles of association (charter document) of the company or in another written contract, or

c) under which common management is effected through the board of directors, the supervisory board or the management comprised of all or some of the same persons (who provide the necessary decision-making majority), or

d) under which the person with control is able to exercise substantial influence in the operation of another company without any capital involvement." (Act XXXIX of 2003) controlling influence or participation are considered as having a close link relationship. The new definition of controlling influence (parent companies) expands the definition of parent companies as set forth in the Accounting Act as well as of the controlling participation as set out in the former Act of Credit Institutions to include considerable influence without capital relationship. Participation denotes either a voting rate or ownership share exceeding 20%.

Furthermore, there was an asymmetry among the different types of institutions for years (between 2000 and 2004). On the one hand for investment fund managers no prescription required the investigation of owners, the owners' relations and their activities, involving the possible refusal of a licence. On the other hand, the provisions of the Act on Insurance Institutions did not authorize the supervisory authority – in parallel with the notification requirement of acquiring ownership participation or voting rights – to refuse licensing due to the activity or relationships of the owner.

The amendments adopted in spring 2003 affecting regulations on consolidated supervision pertaining to financial groups concluded a regulatory process lasting for several years. The resultant new regulations are fully compliant with EU requirements and provide for the possibility that each financial group can be assessed and supervised as one single unit. "The adoption of modified regulations has been a must in all three financial sectors, as there have been amendments to Acts on Financial Institutions, the Capital Market and Insurance Companies alike. Regulations governing credit and financial institutions and the capital market have been brought in line with the regulatory regime of the EU. By contrast, the structure of and technicalities concerning regulations pertaining to insurance groups are still somewhat different." (MNB 2003, p.108)

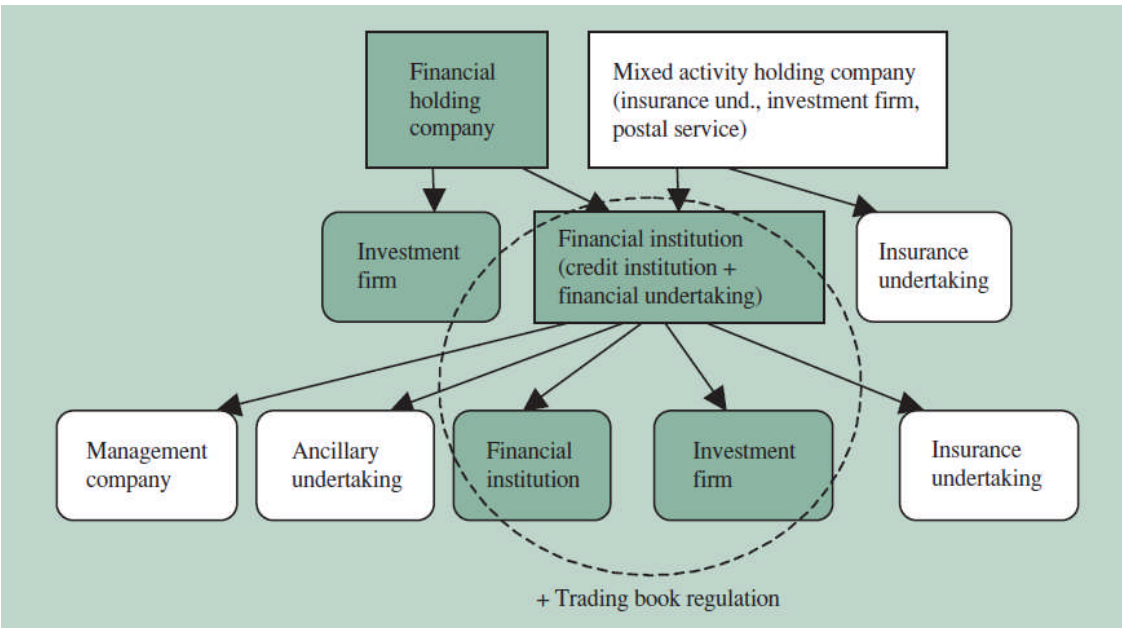
5.1 Ranges of institutions in consolidated supervision of financial groups

The amendment (Act CXXIV of 2000) of the Act on Credit Institutions regulated the consolidated supervision of groups including credit institutions on three levels, relating to different ranges of institutions. "*Data supply and the requirement of prudent operation* are to be met if there is at least one credit institution among the members of the group. This is the widest possible range of institutions and thus members of a banking group, a financial holding and mixed-activity holdings have to satisfy these requirements. A ***register*** is kept by the supervisory authority on banking groups and financial holdings, ***group-wide risk exposure and capital adequacy requirements*** were related to financial holdings or banking groups; the consolidated requirement stipulated in the trading book relates to investment firms or a financial institution controlled by a credit institution." (Horváth and Szombati 2002, p.90)

The institutions covered by Hungarian consolidated regulations (Act on Credit Institutions, Trading book regulations) are shown in Figure 2.

Figure 2

The institutions covered by Hungarian consolidated regulations (Act on Credit Institutions, Trading book regulations) (2000-2004)



Source: Horváth and Szombati 2002, p.90

Since until 2004 the financial holding companies were defined by the Act on Credit Institutions only, a holding company might be a financial institution, which owns exclusively financial institutions and investment firms, and at least one of them is a credit institution. Consequently, a holding company which owns only investment firms and investment fund managers was not a financial holding company and was not subject to consolidated supervision.

Hungarian regulation dealt with the controlling relationship only in the case of a banking group (group led by a credit institution) when, of the share capital, more than 20 per cent is owned by an undertaking belonging to a banking group or which was controlled by a person together with an undertaking belonging to a banking group. But a crucial deficiency, that institutions did not belong to a banking group could have 20 per cent or more of *voting rights*. And another main deficiency, that the supervisory authority did not have the possibility of using *discretionary instruments*.

These shortcomings and discrepancies was ceased by the 2004 amendment of the Acts concerned[40]. In the new regulation when a credit institution is either the parent or participating company of even one of the money and capital market participants listed above, or when the parent company of a credit institution is a financial holding company, such entities fall under consolidated supervision. In the latter case, due to the very existence of the relationship itself, all the participating companies or subsidiaries of the financial holding company must be consolidated. And an important development that the Supervisory Authority is entitled now to deem the relationships identified at on-site inspections or upon examining documents as a close link and request that the credit institution or investment firm comply with consolidation requirements and prepare its calculations accordingly.

[40] Act XXXIX of 2003 on Amendment of Act CXII of 1996 on credit institutions and financial enterprises; and Act LXXXIV of 2004 on the Amendments of Financial Regulations Relating to the Supplementary Supervision of Financial Conglomerates

Although the implementation of prudential consolidation is fundamentally governed by accounting rules, but in contrast to the type of consolidation set forth in accounting rules, the consolidation addressed in financial legal regulations seeks to identify and record shared risk-taking. As a result, there are certain differences in the method of consolidation as well as the group of entities consolidated, material differences may arise owing to the existence of the conflicting definitions of various relationships and that of differing groups of entities. The differences categorized as follows (Table 8):

Table 8

Departure from accounting consolidation[41]

AA	Parent	Participation	Participation	Neither parent, nor participation	Parent
ACI/ACM/AIC	Parent	Parent	Participation	Parent	Neither parent, nor participation
Difference in methods of consolidation and group of entities consolidated	ACI allows for the possibility of consolidation in proportion of capital share.	Either overall consolidations as per ACI or the method as prescribed by and set forth in respectively by the supervisory authority/AIC	Consolidation in proportion of capital share (e.g. four owners, with a 25% ownership share each)	Method prescribed by supervisory authority	ACI does not allow for the possibility of consolidation.
Reason(s) for difference	Different definition of parent companies-subsidiaries.	As well as capital relationship, there is also controlling influence.	Conflicting rules governing the method of consolidation	Controlling influence without capital relationship	Non-money and capital market entity

Source: MNB 2003, p.112

41 AA: Act on Accounting, ACI: Act on Credit Institutions, ACM: Act on Capital Markets, AIC: Act on Insurance Companies

6. Supervision of financial groups and conglomerates

The provisions of consolidated requirement were one-sided in the Hungarian regulation of the financial sector until 2003, since only the Act on Credit Institutions dealt with this problem (and the measure of capital markets or insurance institutions did not). Although from 2003 the Act on Capital Markets and Act on Insurance Institutions also were contained the same rules of consolidated regulation, but these rules applied only to homogeneous group members. The 2004 amendment of these acts introduced new chapters on supplementary supervision of financial groups and conglomerates into the legislation of these three fields (Act LXXXIV of 2004 on the Amendments of Financial Regulations Relating to the Supplementary Supervision of Financial Conglomerates).

Before 2004 financial undertakings not belonging to any credit institution were not subjected to group-wide requirements, even formally. Therefore, in financial groups with no credit institution there was no consolidated requirement either. Hence, consolidated reporting rules did not relate to homogenous groups of investment firms or groups controlled by an investment firm, nor to insurance undertaking and asset management company group members. Either Group-wide regulations relating to insurance undertakings did not exist in the Hungarian regulation until 2003. The definition of different institutions, like insurance holding company or mixed activity insurance holding company, was also missing in this period.

The example of investment firms and credit institutions demonstrates these asymmetric consolidation requirements (that characterized the Hungarian regulation until 2004). In the case where a credit institution controlled an investment firm, pursuant to the Act on Credit Institutions they had to comply with group-wide prudential limits, capital adequacy, and, according to the trading book regulations, the evaluation of market risks was made in a way as if they were one and the same institution. However, if an investment firm controlled a credit institution, they was qualified as a mixed activity holding and thus they had to satisfy data supplying requirements on an individual basis; on a group-wide level they had no prescription to meet. This opened the door for both institutions to multiple capital gearing, because they had the possibility of circumventing individual limits. And on the other hand, transactions towards each other was not exempt from large exposure limits (nor participations from investment limits and capital deductions), which might considerably deteriorate the organizational and economic efficiency of the holding. In view of this regulation asymmetry, it was a relevant question in Hungary whether a credit institution or an investment firm owned an investment fund manager. The first one created a banking group according to the Act on Credit Institutions, thus it had to supply data to the supervisory authority. The investment firm and the fund manager owned by it, on the other hand, were registered from the point of view of consolidated supervision as two independent institutions. (Horváth and Szombati 2002, p.93)

Due to the above-mentioned problems the scope of institutions and the relationship among institutions, on the basis of which individual market players were registered as groups and were treated as one entity from the point of view of risk exposures, was different in Hungary and the EU countries.

From 2004, intra-group transactions are not explicitly regulated. Thus rules relating to risk concentration are those which influence mutual risk exposure of group members. The provisions limiting risk concentration of different sectorial acts (Act on Credit Institutions, Act on Capital Markets, Act on Insurance Institutions) were established in the framework of EU legal harmonization: the quantitative limits completely correspond to the limits in the EU regulation.

2002/87/EC of the European Union required the amendment of the Acts on Credit Institutions and Financial Enterprises, on the Capital Market and on Insurance Institutions and the Insurance Business. Act LXXXIV of 2004 on the Amendments of Financial Regulations Relating to the Supplementary Supervision of Financial Conglomerates introduced new chapters on supplementary supervision of financial groups and conglomerates into the Hungarian regulation of these three fields. The previous amendments (in 2003) also provided for supervision on a consolidated basis, but these rules applied only to homogeneous group members. In 2004 adapted directive provided for the supplementary supervision of those groups which include insurance undertakings and credit institutions or investment firms simultaneously. Except for intra-group transactions, the new rules apply to those group members that have a parent–subsidiary company, participation or horizontal relationship. Thus, the rules cover those institutions that are considered parent and subsidiary companies from an accounting aspect and those that have a decisive influence on each other's operation based on the opinion of the supervisory authority. The legislation also covers institutions with a 'horizontal relationship', i.e. ones which are managed on a uniform basis or governed by a common executive body.

The amendments adopted contribute to sustaining the stability of the financial system mainly by the uniform and comprehensive regulation of institutions operating in all these three sectors and by the creation of a supervisory framework required for its control. The single European conglomerate legislation is based on and supplements existing prudential regulations in the fields of banking, investment and insurance. The effectiveness of new supervisory concepts is enhanced by the application of uniform notions and definitions, by capital adequacy requirements covering all three sectors and by enhancing supervisory cooperation under the direction of a leading or coordinating supervisory authority. The new legislation extended beyond the existing sectorial rules by providing a better overview for the supervisory authorities of the risks and their concentration arising in the three sectors. The new rules reduced the possibility of multiple gearing of the same capital elements and the acknowledgement of excessive leverage by assessing capital adequacy.

At the end of 2004, the HFSA identified 20 financial groups in Hungary. "In these groups, a total of 231 organizations operated under the (direct or indirect) management of a Hungarian parent company or common foreign owner. These groups comprised 17 credit institutions, 15 insurance companies, 4 investment enterprises, 40 financial enterprises, 124 investment funds and 31 pension and health funds. In 13 of these twenty groups, the parent company is a credit institution, in five, an insurance company, while in two cases, an investment enterprise. As these 20 groups represent a growing proportion of the capital mediated by the financial sector, amounting to 84.5% in 2004, furthermore, as there are 10 financial institutions on average within a group, the management of groups and of intra-group risks has significance of systemic importance." (HFSA, 2004 p.21) But only one group was identified as a financial conglomerate: "Pursuant to the Directive, in Hungary the OTP group is considered a conglomerate, and in their case, the Supervision acts as coordinator in the course of the supplementary supervision of the conglomerate." (HFSA, 2004 p.47)

The increasingly intertwined and complex relations among credit institutions, financial enterprises, investment service providers, insurance institutions and funds in terms of ownership and activities provided the institutional reasons for consolidated supervision. In April 2000 the Hungarian Financial Supervisory Authority was founded integrating several former separate supervisions.

Three predecessor institutions were since 1990's:

- Banking and Capital Market Supervision (that was also established through the early merger (1996) of Banking Supervision and Securities and Exchange Supervision),
- Insurance Supervision and
- Pension Fund Supervision.

Before the establishment of the single supervisory authority the regulation and supervision of these fields was fragmented with diverging level of operative independence, different approach and regulatory background to off-site and on-site examinations, low level and slow supervisory co-operation among institutions. The predecessor supervisory authorities employed different methods and had different supervisory cultures. The unification of supervisory methods has made it possible for the HFSA to conduct group-level inspections.

The organizational structure of supervisory authority is also serves the consolidated supervision of financial groups and conglomerates, since the supervision of each fields are not substantially divided (see Figure 3). The organizational structure of integrated supervisions can be implemented with different models. The divisions can be divided by sectors according to which the organizational units are set up to reflect the supervised sectors (credit institutions, capital markets, insurance services and pension funds). Or a functional structure also can be eligible where the organizational units are set up according to the activities performed (licensing, enforcement, or supervision, etc.). HFSA's organizational structure most resembles the matrix structure in which an attempt is made to combine the above two versions.

Since its establishment HFSA has been publishing recommendations, guidelines and methodological guidelines, wherein the non-obligatory expectations and good practices related to the supervised institutions are summarized by topics. HFSA emphasized in its supervisory recommendations that the institutions should develop and operate their risk management and internal audit systems focused on the group as well and not merely on individual institutions.

Unfortunately the independence of HFSA decreased from 2004: the Internal Operational Rules of the HFSA are proposed by the Board of HFSA, but approved by the Minister, furthermore the director general and the deputies are appointed by the Prime Minister (for fixed six year term), no regulatory power, legally binding regulations cannot be issued by the HFSA

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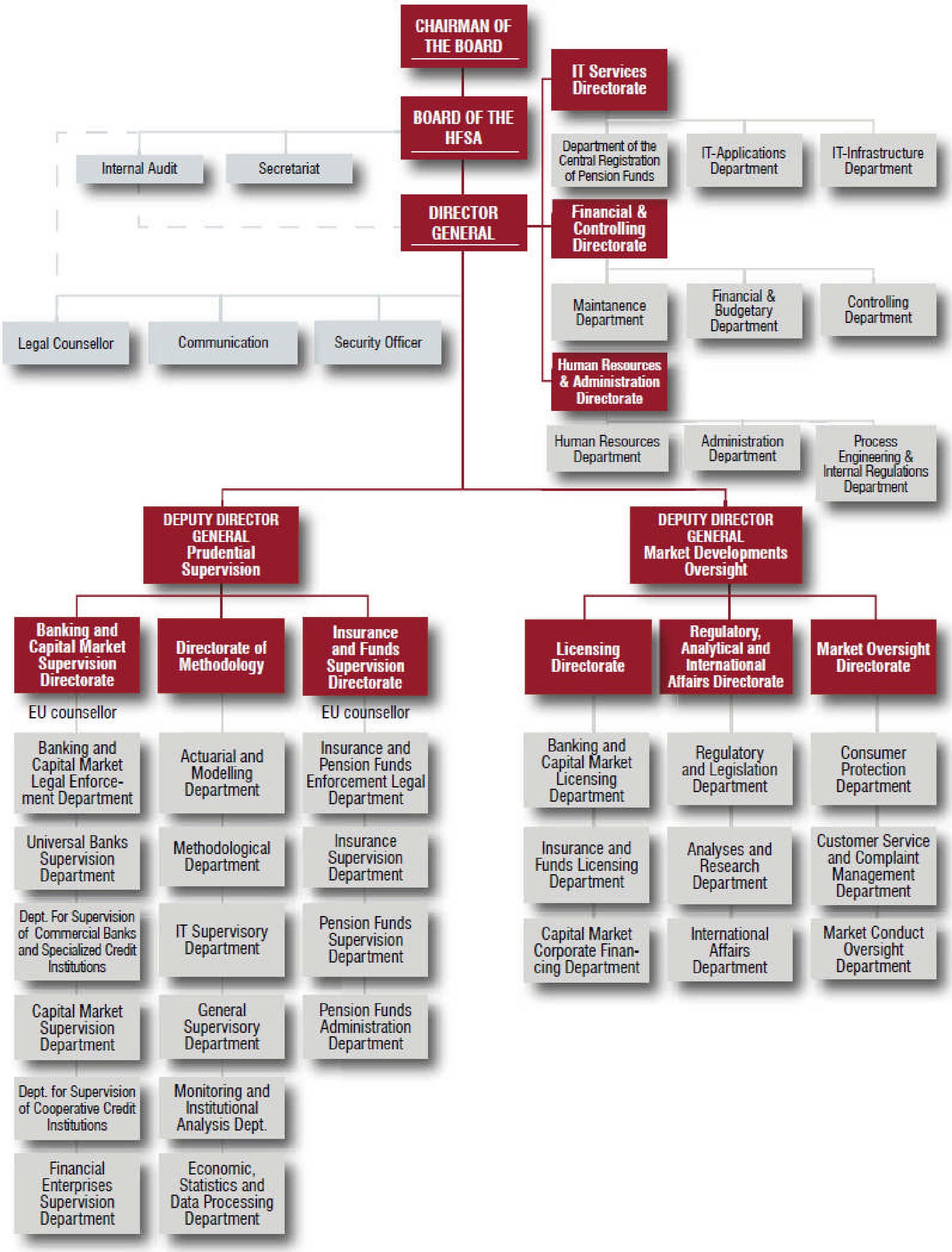
Figure 3

Organizational Structure of the Hungarian Financial Supervisory Authority



Source: HFSA, 2004 p.57

7. Large Exposures

Large exposure means exposures face to one debtor (partner, client or group of connected clients), which – due to their size – may jeopardize an institution's stability, if the debtor cannot meet its payment obligation. Regulation usually determines it as a certain percentage of the regulatory capital of the lending institution. In Hungary – in line with EU Member States – an exposures face to the same client or group of connected clients the amount of which reaches or exceeds 10 per cent of the regulatory capital is defined as a large exposure.

The 92/121/EEC directive has been implemented in Hungarian law by the Act CXII of 1996 on Financial Institutions and Financial Undertakings (Section 79). Until December of 1996 a credit institutions exposure to a single client or a group of connected clients should be considered a large exposure where its value is equal to or exceeds 15 per cent of its own funds and the sum of large exposures may not exceed six times the amount of own funds.. From 01.12.1996 Hungarian regulation corresponds to EU legislation; somewhere is more rigorous, because it does not contain several exemptions. The 2006/48/EC and 2006/49/EC directives have been implemented in Hungarian law by Act LI of 2007 on the Amendment of Act CXII of 1996 on Financial Institutions and Financial Undertakings and the Amendment of Laws on Specialized Credit Institutions. Several exemptions was not implemented (Article 113(3), first subparagraph, points (j)-(t) of the 2006/48/EC): according to the Hungarian legislator the present practice of the sector does not give a rise for implementation of these exemptions.

A credit institutions exposure - that is to be taken into consideration for the calculation of capital requirement for credit risk using the standardized approach - to a single client or a group of connected clients shall be considered a large exposure where its value is equal to or exceeds ten per cent of its own funds (Act CXII of 1996, Section 79 (1)). The combined value of a credit institution's exposures to a single client or a group of connected clients, after taking into account the effect of the credit risk mitigation: a) may not exceed twenty-five percent of the credit institution's own funds, or b) where that client is a credit institution, investment firm or where a group of connected clients includes one or more credit institutions or investment firms, forty-two billion forints or the amount defined in point a), whichever the higher, provided that the sum of exposure values, after taking into account the effect of the credit risk mitigation, to all connected clients that are not credit institutions or investment firms does not exceed twenty-five percent of the credit institution's own funds (Act CXII of 1996, Section 79 (2)).

If a credit institution is under a dominant influence or a company holds a participating interest in a credit institution that has a dominant influence or participating interest in another credit institution or in a financial enterprise, investment firm or ancillary services company (hereinafter referred to as multiple dominant influence or participating interest), calculations on a consolidated basis concerning the requirements for capital adequacy and for the control of large exposures must be made separately by each credit institution and financial holding company that is subject to supervision on a consolidated basis. (Act CXII of 1996, Section 93)

Hungary is one of a few countries that do not operate either a national, non-profit, or a profit oriented business-based complete mandatory credit information system (credit register), that would be a useful instrument to control large exposures. Although a partial credit register has been in place in Hungary: BISZ Ltd (owned by Hungarian financial institutions) was founded in 1994. BISZ Ltd (Interbank IT Services) is a private corporation, for the development of the credit information database. BISZ was expected to design and operate the Interbank Debtor and Credit Information System (IDCIS). This partial database covers the most important data about all corporate loans (both performing and non-performing), but this database is not used in supervision. HFSA reclines upon its own collection of data.

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deadline for the preparation of an impact study of the proposed legislative amendment related to consolidated supervision, and for the inspection of the compliance of banking groups with capital requirements and large exposure and investments limits on a consolidated basis. So the first survey the adequacy of large exposure requirement was in 2002. The total value of large exposures taken on a consolidated basis was far below the statutory limit of eight times the regulatory capital, similarly to what was seen in case of individual banking calculations. The average is about 1.5 times the regulatory capital.[42] The ratio of large exposures on regulatory capital was only 3.4 and 3.7 even in case of the two banking groups with the highest figures. But from 2003 the HFSA had to provide against contravention of large exposure limits in every year at least in one case.

[42] True, it is partly due to the fact that short-term exposure to credit institutions is only weighed at 20 percent.

8. Investment services

Upon accession into the European Union, community legislation ensuring the obstacle-free operation of the internal market also entered into effect in Hungary. These laws provide a European Single Passport to all investment enterprises seated in a member state, allowing them to operate throughout the EU on the basis of authorization obtained from their home supervisor for investment services and supplementary services subject to mutual recognition. Prudential supervision of the founder investment enterprise (which the branch office is an integral part of) shall be the responsibility of the competent authorities in the institution's home member state, including the supervision of activities for which the investment enterprise has a licence. This way, the operations of a Hungarian branch office (e.g. rules of organization and operation, internal auditing) are primarily subject to the legal provisions of the parent institution's home member state. The requirements set out in the Act CXXXVIII of 2007 on Investment Firms and Commodity Dealers, and on the Regulations Governing their Activities, the Act CXX of 2001 on the Capital Market and other financial regulations should only be applied where the legal provisions concerned explicitly provide so. (HFSA, 2012, p.23-4)

As host supervisor, the HFSA scrutinizes whether the branch office complies with regulations on consumer protection and on the prevention and combating of money laundering and terrorism financing. In cases referenced in Sections 176-177 of the Act CXXXVIII of 2007 on Investment Firms and Commodity Dealers, and on the Regulations Governing their Activities, the HFSA may take measures or notifies the competent supervisory authority of the home EEA state. (HFSA, 2012, p.24)

Pursuant to the interpretative provisions of the Act CXXXVI of 2007 on the Prevention and Combating of Money Laundering and Terrorist Financing, branch offices qualify as investment service providers and as such they are required to develop internal rules and submit them to the HFSA for approval. The branch office's activities to prevent and combat money laundering are subject to scrutiny by the HFSA. (HFSA, 2012, p.24)

Pursuant to Section 2 of Government Decree 284/2001 (XII.26.) on the Mode of the Generation and Forwarding of Dematerialized Securities and the Relevant Rules on Safety, as well as on the Opening and the Keeping of the Security Account, the Central Securities Account and the Customer Account, dematerialized securities are only allowed to be generated, recorded and forwarded subject to rules approved by the HFSA and using an approved computer system and storage media that ensures compliance with the referenced government decree. The same requirements apply to the related data management efforts. Therefore, a branch office performing duties in relation to the generation, recording and forwarding of dematerialized securities must have HFSA-approved rules in place. (HFSA, 2012, p.24)

Pursuant to the provisions of Government Decree No. 22/2008 (II.7.) on the Mandatory Elements of the Rules of Business at Business Organisations Providing Investment Services, Auxiliary Investment Services and Commodity Exchange Services, the branch office of an investment enterprise seated in a Member State must have in place General Contract Terms and Conditions, a Rules of Business and a Rules of Complaint Management document, with the latter outlining the procedure for managing potential customer complaints. (HFSA, 2012, p.24)

Pursuant to the provisions of Government Decree 22/2008 (II.7.), the branch office of an investment enterprise seated in a Member State must have in place General Contract Terms and Conditions, a Rules of Business and a Rules of Complaint Management document, with the latter outlining the procedure for managing potential customer complaints. (HFSA, 2012, p.24-5)

Sections 79-81 of the Act CXXXVIII of 2007 on Investment Firms and Commodity Dealers, and on the Regulations Governing their Activities set out mandatory provisions for investment enterprises that outsource activities. As the branch offices discussed herein operate in Hungary and serve Hungarian customers, in this respect they must also comply with regulations pertaining to outsourcing. As provided by law, the branch office needs to report to the HFSA on a regular basis the company name and principal office of its outsourcing partners along with the description of outsourced activities and the duration of outsourcing. Further, it must submit the outsourcing contract to the HFSA within 3 days after signing it. (HFSA, 2012, p.25)

Branch offices are entitled to use pending agents for their activities. In case a branch office already registered in the territory of Hungary intends to use, in the territory of the host Member State, the services of a tied agent seated or permanently residing in Hungary, it shall inform the competent home supervisor of this. The home supervisor shall pass on this information to the host supervisor. When a tied agent is contracted for the intermediation of investment services, the HFSA must be notified of this within 5 days after contract conclusion. The notification must include the agent's name and principal office along with the description of intermediated services. (HFSA, 2012, p.25)

Pursuant to HFSA decree 9/2011 (VI.17.) on mandatory data provision by investment service providers, providers of services supplementing investment services and commodity exchange service providers, branch offices must report data to the HFSA on a monthly, quarterly and ad-hoc basis. (HFSA, 2012, p.25)

The branch office of a service provider seated in another Member State is not required to join the Investor Protection Fund (IPF) if it is a member to an investor protection system as per Directive 97/9/EC of the European Parliament and of the Council. Otherwise it should join in order to obtain supplementary insurance. (HFSA, 2012, p.25)

If either the maximum amount or extent of indemnity granted by the IPF or the scope of insured receivables exceed the corresponding maximum amount, extent or scope of indemnification available to the service provider's branch office under the investor protection system it is a member to, the IPF will, on the a branch office's request, provide supplementary insurance on the excess part, provided the branch office complies with conditions pertaining to IPF members. Indemnification pursuant to such supplementary insurance can only take place if the competent home supervisor of the branch office notifies the IPF that the preconditions of indemnification are fulfilled. (HFSA, 2012, p.25-6)

Although certain countries have, in the framework of the MIFID, approved almost the entire set of implementation regulations, due to delays in their respective legislative processes many European countries (including Hungary) were not in a position to apply the entire range of regulations by the original launch-of-implementation deadline of November 1, 2007. Harmonization took place only from 2008 through Act CXXXVIII of 2007 on Investment Enterprises and Commodity Exchange Services and the rules governing the activities they perform and Act CXXXV of 2007 on the Hungarian Financial Supervisory Authority.

Infringement proceedings started against Hungary in 2010 due to the not complete implementation of 2004/39/EC and the regulations of it (2006/73/EC and 1287/2006 Regulation.) Hungary incorrectly transposed several provisions, including provisions relating to definitions, market transparency and licensing regime for investment firms (passport) and relating to the protection of investors. As a result, Hungarian firms do not provide services in other Member States. Consequently, the chance is smaller for the Hungarian financial sector for economic growth and job creation. In addition, the investors are not guaranteed the same high level of competitiveness and the protection of the financial markets, as elsewhere in the EU.

9. Deposit guarantee

Credit institutions seated in Hungary are required to join the National Deposit Insurance Fund (NDIF - OBA). Pursuant to Act CXII of 1996 on Credit Institutions and Financial Enterprises, the branch office of a credit institution seated in another Member State is not required to join the NDIF if it has taken out deposit insurance as per Directive 94/19/EC of the European Parliament and of the Council. Vice versa, if said branch office does not have such deposit insurance as described above, it is required to join the NDIF in order to take out supplementary insurance as per Para (7) in Section 97 of the Act CXII of 1996 on Credit Institutions and Financial Enterprises. (Act CXII of 1996)

When notifying the HFSA of the establishment of a branch office, the competent supervisory authority of the member state where the credit institution is seated shall also inform the HFSA on the scope of deposit insurance taken out by the founder credit institution. In case the branch office joins the deposit insurance system of its home member state, it must draw up a Hungarian-language guide outlining the range of deposit types insured by that other deposit insurance fund, the scope of insurance, the terms and conditions of indemnity payment and the procedure of enforcing claims. Detailed regulations on the NDIF are set out in Sections 97-127 of the Act CXII of 1996 on Credit Institutions and Financial Enterprises. (Act CXII of 1996)

Since July, 1993 National Deposit Insurance Fund of Hungary exists. Previously the deposits of the citizens were guaranteed and by establishing this institute the state extended this protection to the corporates. This state-guarantee was almost entirely harmonised with the later implemented EU legislation (94/19/EC). Act CXII of 1996 on Credit Institutions and Financial Enterprises (§97-137) entered into force with the amount of the deposit guarantee to HUF 1,000,000. Hungarian regulation in this way became compatible with the 94/19/EC directive. Main difference was the lower amount of deposit guarantee, in Hungary it was only one-fifth of the EU-value at that period. The National Deposit Insurance Fund of Hungary's main task is to start compensating the depositors within 15 days of their frozen (and insured) deposits at NDIF's member institutions. The indemnification period must be finished within 3 months. Credit cooperatives were not able to join to NDIF. Regular and compulsory contributions paid by credit institutions into a financial fund. Connection fee was 0,5% of the share capital of the given institute. In case of insolvency of financial institutes or freezing deposits NDIF make payment to the depositors from the fund. NDIF can make payments both in national and foreign currency, but solely on registered deposits. (Act XV of 2003 on the Prevention and Combating of Money Laundering declares that only registered deposits can be marketed in Hungary from January 1st, 2004. This Act was modified by Act CXXXVI of 2007 on the Prevention and Combating of Money Laundering and Terrorist Financing (entered into force on January 1st, 2010).

Act LVI of 2008 on the Amendment for raise of coverage of Act CXII of 1996 on Credit Institutions and Financial Enterprises. Compensation can reach maximum 13 million HUF. Act XLI of 2009 on the Amendment of deposit guarantee of Act CXII of 1996 on Credit Institutions and Financial Enterprises raised the amount of deposit guarantee further to €50.000. Act LVI of 2008 also were on the base of €50.000 but on 260Ft/1€ exchange rate. Thanks to this change the compensation amount increased to 15 million HUF (due to the fact the exchange rate became 300Ft/1€ in the meantime). Deposits in foreign currency are also protected up to EUR 50.000 in total. At the same time the deadline of indemnification reduced from 3 months to 20 days. These 20 days were extendable once, maximum with 10 days.

The deposit insurance covers all deposits which were placed at the member institution of NFID by clearly identifiable person or legal entity. Exceptions are the government agencies, credit institutions, insurance companies and mutual funds. These institutions expected to have professional risk assessment. Bonds and Depositary Receipts issued after January 1st, 2003 are also protected. Client should not have to report the claim, the OBA payments are paid on the basis of the banking system records. The base of compensation is the sum of the capital and interest of frozen deposits of an individual. The relevant foreign exchange rate is the Hungarian Central Bank's exchange rate on the day preceding the indemnification.

The clients' all deposits (and their interests) located at one credit institutions should be added together and this is the amount on which NFID pays compensation. To increase the protection two methods exist in Hungary: savings or deposit should be handled at several financial institutes or the number of owners should be increased. More owners increase the protection but more trustee is not (only at those deposits, for which the authorization was generated before December 31st, 1996).

Act CLIX of 2010 on the Amendment of certain financial acts (§55, Para 1) in accordance with 2009/14/EEC increased the coverage to €100.000. (Act CLIX of 2010).

10. Crisis management schemes

Act IL of 1991 on Bankruptcy Proceedings, Liquidation Proceedings and Voluntary Dissolution sets the basis of winding up procedures and the supplements for financial institutes can be found in the following detailed at Act CXII of 1996 on Credit Institutions and Financial Enterprises. Act CXII of 1996 on Credit Institutions and Financial Enterprises characterize such cases which can be considered as crisis situation. Supervisory authorities should take (not defined) actions when the financial institution:

- a) has own funds that is less than 50% of the capital requirements specified in this Act,
- b) wishes to pay or pays dividends in a situation where its own funds is below 50% of the capital requirements specified in this Act,
- c) fails to meet its obligation to create provisions or the obligation of value adjustment, has insufficient provisions and inadequate value adjustments, meaning that the evaluation of off-balance sheet items and assets was incorrect, as a consequence of which its solvency ratio falls below 4%, because the solvency margin were reduced by the amount of unaccounted accumulation of provisions and value adjustments,
- d) by non-observance of the regulations for ensuring liquidity and the approximation of maturities of assets and liabilities, severely endangers the maintenance of the liquidity of the credit institution,
- e) regularly or substantially violates the regulations on exposures and thus severely endangers the credit institution's liquidity, solvency or ability to produce income,
- f) regularly performs activities prohibited by law or for which it is not authorized,
- g) is unable to satisfy the requirements for authorization described in this Act during its operation,
- h) operates without the necessary accounting, management information or internal control system, or these systems are inefficient to indicate the credit institution's actual financial position,

- i) in the course of its resource collecting activities, determines an interest value significantly differing from the market value representing increased risks for the credit institution or the deposit-holders,
- j) enters into illicit or bogus contracts in order to gain pecuniary benefits or to alter its balance-sheet result capital requirement,
- k) employs an auditor who fails to inform the Commission, the board of directors and the supervisory board of the financial institution about any severe infringement, deficiencies and other problems found at the financial institution and endangering the prudent operation of the financial institution,
- l) repeatedly infringes the regulations specified in this Act within 5 years of the operative date of the measure taken by the Commission or the resolution imposing a penalty,
- m) fails to fulfil the provisions of the supervisory measures taken for any severe violation of regulations. (Act CXII of 1996)

None of any measures use the term crisis situation. Act IV of 2006 on Business Associations characterize of such circumstances which can be interpreted as crisis situation:

- a) the company's equity capital has dropped to two-thirds of the share capital due to losses;
- b) the equity of the company has dropped below HUF 5 billion (in case of banks this amount is HUF 2 billion);
- c) the company is on the brink of insolvency;
- d) the company has stopped making payments and its assets do not cover its debts. (Act IV of 2006)

Act XXXIX of 2003 on the Amendment of Act CXII of 1996 on Credit Institutions and Financial Enterprises clarified the definition of large exposures. Prior to July, 2003 large exposures were where the risk-taking was more than 10% of solvency rate and not reaching 10%. (Act XXXIX of 2003)

Act CXII of 1996 on Credit Institutions and Financial Enterprises declares some measures, which HSFA should apply in different situations.

In the event if any violations of regulations or deficiencies are established - if these do not severely endanger the prudent operation of the financial institution -, the following measures should be considered:

- a) call upon the financial institution within the framework of negotiations held with an executive officer to take the necessary steps in order to eliminate the revealed deficiencies and to maintain or improve its financial position,
- b) advise the financial institution to provide further training to its employees (managers) or to hire employees (managers) with the appropriate professional skills, and to change its business management concept,
- c) stipulate the fulfilment of obligation for extraordinary supply of data,
- d) oblige the financial institution to draw up and execute an action plan,
- e) issue a disciplinary warning to the executive officer of the financial institution. (Act CXII of 1996)

In cases of severely endangered prudent operation the authority shall apply the following measures:

- a) delegate - one or more - on-site inspectors to the financial institution,
- b) oblige the financial institution to adopt internal rules and regulations, provide professional training for employees (managers) or hire employees (managers) with the appropriate professional skills, conduct an investigation in the interest of determining responsibilities for the damages caused and initiate proceedings against the responsible person. Reduction of operating costs, accumulation of sufficient reserves, drawing up and implement a restoration plan, electing another auditor can be forced in order to achieve and maintain a solvency ratio that is greater than 80% but no more than twice the statutory requirement,
- c) it may prohibit, limit or make subject to conditions
  - 1) payment of dividends,
  - 2) payment of remuneration of executive officers,

- 3) raising of loans by the owners of financial institutions, or rendering services to them by credit institutions which involve any exposure,
- 4) extension of loans by financial institutions to enterprises belonging to the sphere of interests of the owners or executive officers,
- 5) extension (prolongation) of deadlines specified in loan or credit agreements,
- 6) performing certain financial service activities or activities auxiliary to financial services,
- 7) opening new branches, starting new financial services as well as starting up new activities (business lines) within a financial service. (Act CXII of 1996)

These events which seriously violate the Act and the prudent operation could be performing any activities prohibited by law or for which there is not authorization, or inability to continuously satisfy the requirements for authorization during operation. When the institute wishes to pay or pays dividends in a situation when its solvency ratio is below the prescribed limit, or has failed to set aside general reserves during the year; it does not have sufficient provisions and the valuation of its assets is inadequate, as a consequence of which its solvency margin must be reduced by the amount of unaccounted accumulation of provisions and adjustments also infringes the rules.

If the asset retention index of a credit institution operating as a branch office falls below 100% the parent foreign credit institution obliged to bring the branch office into compliance with the provisions on capital maintenance ratio. (Act CXII of 1996)

Extraordinary measures

There are possibilities to take extraordinary measures - in addition to those measures mentioned above - in lieu of bankruptcy proceedings. The extraordinary measures may be taken for a specific period of time but not more than one year; this time limit may be extended on one occasion for a maximum period of six months. These measures:

- a) may stipulate to sell the credit institution's assets used for purposes other than banking operations or may stipulate for the credit institution to settle its capital structure within the deadline and in compliance with the requirements prescribed by the Commission,
- b) may limit or prohibit the credit institution to conclude transactions between the owners and the credit institution, and the effect payment of deposits and other repayable resources, or undertaking commitments,
- c) may determine the highest rate of interest that may be charged by the credit institution,
- d) may compel the board of directors to convene the general meeting, and may advise these bodies to discuss specific items on the agenda and to the necessity of making specific decisions,
- e) may delegate a supervisory commissioner to the credit institution. (Act CXII of 1996)

In addition to the extraordinary measures described above the authority may simultaneously call upon owner of the credit institution entered into the register of shareholders - in the case of credit unions, into the register of members - having a direct ownership interest reaching or exceeding 5% to take the necessary measures. Legal rights exist to suspend the voting rights of the owners of the financial institutions belonging into its sphere of authority for a specific period of time, but not more than for a period of one year if the owner's activity or influence exercised on the financial institution, based on the available facts, endangers the financial institution's reliable and prudent operation.

11. Accounting

Act XXXVII of 1875 on Commerce can be considered as the first recorded step of the development of Hungarian accounting. International rules, in practice the German law and trade patterns were adapted to the Hungarian economic relations. The provisions of the Act were gradually repealed from the existing rights at first by the Decree-Law no. 33 of 1968 on the Accounting. This Decree-Law was the first independent law on accounting which regulated the bookkeeping, cost accounting, balance sheets obligations and the reporting system. The second annulment entered into force by the Decree-Law no. 34 of 1986 on Certain Provisions of Economic Associations. All the provisions remain in force of the Act XXXVII of 1875 on Commerce repealed by the Act VI of 1988 on Business Companies.

Act C of 2000 on Accounting must be modified to adopt the EC 1606/2002 Regulation on the Application of International Accounting Standards. Related Government Decision no. 2072/2003 (IV. 9.) provided- as part of the program of harmonization and implementation- a legislative program to ensure full compatibility with Community law of a review of the applicable law and accounting changes prior to our accession to the European Union.

Act LXXXV of 2003 on the Amendment of Act C of 2000 on Accounting entered into force on January 1st, 2004. The regulation entrusted the member states of the application possibility of extension regarding of non-listed companies' consolidated annual accounts and individual accounts. The Regulation after our EU accession (May 1st, 2004) became directly part of domestic law. Further regulation of the accounting law is required only on those cases, where there is not specific ordinance or where we can have option or possibility to choose. Act LXXXV of 2003 on the Amendment of Act C of 2000 on Accounting applied the possibility of extension. Non-listed parent companies can prepare their consolidated accounts according to the Regulation. However, in the case of individual statements this option does not exist.

Act XCIX of 2004 on the Amendment of Act C of 2000 on Accounting issued to fulfil the requirements of the 2003/51/EC Directive. Hungary has taken over all the provisions and options are offered by the Directive into regulation. Act XCIX of 2004 on the Amendment of Act C of 2000 on Accounting clarifies the accounting standards for provisioning accordingly. The provisioning can take place only at such payment of liabilities and expected future costs where their existence or future occurrence is likely to be assumed on the date of the balance sheet. The Amendment expands- in accordance with the provisions of the Directive- the contents of text part- the scope of data, the scope of information and details of them- should include in the Business Report. Additional adaptations of the Directive are the regulations on the independent audit and the obligations related to the independent auditor's report as well. Further amendments to the international rule system approach are introduced in the rules on the goodwill, on the calculating exchange differences of the outstanding long-term investments in foreign currency, on the exempted parent company in the case of higher-level parent company at consolidation and on the disclosures on websites. In the case of goodwill the Amendment serves rectification at handling special effects on expected returns. It arranges the case when the goodwill value grows throw running business activity, as well as it eliminates the possibility of "inside" goodwill value at transition. The Amendment clarifies the law regarding the preparation of the consolidated financial statements of the exemptible parent-company in the case of higher-level parent-company. It also determines that specific information which should be presented separately during exemption. (Act XCIX of 2004)

12. Corporate governance

Act CXXXVIII of 2007 on Investment Firms and Commodity Dealers, and on the Regulations Governing their Activities applies to persons and bodies established in Hungary regardless their operating territory is Hungary or other Member States of the European Union or in States that are parties to the Agreement on the European Economic Area with activities:

a) investment service activities,

b) ancillary services,

c) commodity exchange services. (Act CXXXVIII of 2007)

According to Act CXXXVIII of 2007 investment firms shall structure their organization to contain separate divisions governed by a set of regulations and policies arranged under a structural scheme of operations with facilities to ensure the adequacy and effectiveness of their systems, internal control mechanisms and arrangements, and to take appropriate measures to address any deficiencies, having regard to the investment firm's size, scale of operations and to the range of activities. Between others the most important ones:

a) to ensure that their activities and functions can be carried out and discharged independently and that the relevant powers and authorities are defined clearly and predictably,

b) to define a system for management and department heads to function independently from one another, without superior and subordinate positions, with a view to reducing the eventuality of any corruption among personnel,

c) to permit access to information only for authorized personnel, with a view to reducing the possibility of misuse of any information obtained through internal administrative channels,

d) to function in a transparent environment,

e) to strengthen the control procedures incorporated into operating procedures, and thereby to increase objectivity. (Act CXXXVIII of 2007)

Investment firms and commodity dealers must introduce measures to prevent the investment firm or the commodity dealers, or their employees engaged under contract of employment or otherwise from using the financial instruments held on behalf of or belonging to clients - in the absence of the prior consent of the client - as their own in any way or form. The Act also requires from these institutes to take the necessary steps to prevent the use of any confidential information pertaining to securities without proper authorization, or for reasons other than for which such information was intended and they must have facilities to keep records of transactions conducted by their employees engaged under contract of employment.

Investment firms are required to set up a department of risk management as well to enforce the procedures contained in the protocols designed to identify, manage, control and mitigate the risks relating to the firm's activities, changes in the economic environment and its investment lending operations. They have to report to the investment firm's management and supervisory board at least once a year. Investment firms shall periodically

a) monitor compliance with the risk management protocol,
b) assess the level of conformity between the risk management protocol and the investment firm's operations and activities,
c) monitor and evaluate the enforcement of policies and procedures designed to detect any risk of failure by the investment firm to comply with its obligations a) and b), and to restore operations in accordance with the risk management protocol. (Act CXXXVIII of 2007)

A department of risk management is not required if the average value of the orders executed in a month during the previous calendar year did not exceed 5 billion HUF. Existing of this department is also not compulsory if the total value of the orders executed during the previous calendar year did not exceed 60 billion HUF. Firms shall appoint a manager to ensure compliance with the relevant legal regulations, and to ensure that the investment firm's policies and protocols are in harmony with legal regulations. The employees of the investment firm directed by this manager must not be involved in the performance of investment service activities or in the provision of ancillary services which they monitor and the method of determining their remuneration must not compromise their objectivity. (Act CXXXVIII of 2007)

Personnel criteria

The investment firms incorporated as public limited companies shall be managed under contract of employment by at least two officers with three years of professional experience, who shall produce an official certificate for the purpose of verification of having no prior criminal record. The staff of executive employees of the Hungarian branches of non-resident investment firms - exclusive of the branches of investment firms established in other EEA Member States - shall include at least one Hungarian citizen who is considered a resident according to foreign exchange laws and who has had a permanent residence in Hungary for at least one year. Investment firms shall appoint one of the executive employees to the post of senior executive officer to oversee operations.

The commodity dealer shall appoint a person with two years of professional experience - also without criminal record- to direct business operations. Investment firms and commodity dealers incorporated as limited companies must have two executive officers appointed as their authorized representatives vested with joint powers to sign documents in their name and on their behalf, including access to their current accounts. The signatory rights and the powers of representation may be transferred according to charter document or bylaws of the investment firm or commodity dealer.

The executive employees or the close relative of the executive employees of investment firms and commodity dealers:

a) may not hold any share, whether directly or indirectly, as a natural person in another investment firm,

b) may not function as an executive employee of a body that holds any share, whether directly or indirectly, in another investment firm,

c) may not function as an executive employee or employee of another investment firm,

d) may not function as an executive employee or employee of an issuer of securities admitted to trading on a regulated market. (Act CXXXVIII of 2007)

Remuneration policy

Schedule No. 4 to Act CXXXVIII of 2007 details the remuneration policy, which was hardly amended (only two sentences) in Act CLIX of 2010 on the Amendment of certain financial acts in order to implement Annex V of Directive 2010/76/EU. Core of the text is mostly the same as the EU legislation. Some Hungarian specialties are:

a) the provisions on remuneration policy shall apply to all entities to which supervision on a consolidated basis applies jointly with the investment firm in question,

b) investment firms whose balance sheet total for the previous year exceed HUF 200 billion are required to establish a remuneration committee that shall be responsible for overseeing the remuneration of the senior officers in the risk management and compliance functions, and for the preparation of decisions regarding remuneration, taking into account the long-term interests of shareholders, investors and other stakeholders in the investment firm. The Chair and the members of the remuneration committee shall be members of the management body who do not perform any executive functions in the investment firm concerned. If the management body of the investment firm concerned does not have at least three members who do not perform any executive functions, independent members of the supervisory board may participate in the remuneration committee,

c) at least 50 per cent of any variable remuneration shall consist the same items in both legislation, but in the Hungarian one the "appropriate balance" is not required,

d) where the financial performance of an investment firm is subdued to an extent defined by the internal policy due to the excessive risk-taking behaviour of any executive employee or member of staff, the total variable remuneration of this executive employee or member of staff shall be contracted,

e) 60% portion of the variable remuneration component shall be deferred in the case of a variable remuneration component of an amount above the limit specified in the internal policy, while in Directive 2010/76/EU particularly high amount is defined,

f) the deferred variable remuneration component paid at the time the employment is terminated if employed for less than three years, or (as the same in EU legislation) over a period which is not less than three to five years in other cases. (Act CXXXVIII of 2007 and Act CLIX of 2010)

Governmental Decree 131/2011 (VII.18.) on the Application of Remuneration Policies with Regard to the Features Arising from the Size, Nature and Scope of Activities, and Legal Form of Credit Institutions and Investment Enterprises declares when the institution's balance sheet total does not exceed HUF 500 billion and there is not any executive officer or employee with higher annual income than HUF 300 million (from the activities at the firms and its partners), the institution relating to the remuneration policy can fulfil its obligations (after identifying the scope of the special persons and the key performance indicators) in cash. Special persons are at least the chief executive, leader responsible for the risk management and the board members leading Departments. Performance indicators for instance are changes in share of non-performing loans, changes in liquidity risk measurement indicators, level of compliance to the capital requirements and the achieved profit before tax. (Governmental Decree 131/2011 (VII.18.))

13. Antitrust enforcement / competition policy

Act LXXXVI of 1990 on the Prohibition of Unfair Market Practice was the first legislation regarding competition policy. Hurt or jeopardize the reputation or credibility of a competitor by making or spreading false allegations, by presenting true facts in the wrong light or by any other conduct was prohibited in first place. Obtain or use a business secret in a dishonest manner or to reveal it to others or publish it without authorization was illegal. It shall also be regarded as obtaining a business secret in a dishonest manner if the business secret has been obtained, without the consent of the authorized person, through the collaboration of a person having relations of trust or business dealings with him. It is prohibited to make a dishonest appeal to others that is expressly intended to disrupt economic relations with a third party or to hinder the establishment of such relations. It is prohibited to manufacture or distribute goods and services without the consent of a competitor when the characteristic appearance, packaging or designation or the name are used by which the said competitor or his goods are typically recognized. Withdraw or withhold goods prior to a planned price increase or for the purpose of bringing about a price increase is also banned. Make the supply or acceptance of goods contingent on the supply or acceptance of other goods is forbidden. (Act LXXXVI of 1990)

Chapter II of Act LXXXVI of 1990 is about consumer deception, which was prohibited. The following in particular constitute consumer deception:

(a) assertion of untrue facts or of true facts in a manner liable to deceive as to the essential characteristics of goods—especially regarding their composition, use, effect on health and on the environment, as well as their treatment, origin and place of origin, provenance or mode of acquisition—or provision of other deceptive or inadequate information on the essential characteristics of the goods,

(b) comparison of goods in a manner liable to deceive and publication of the comparison in other advertising or information material,

(c) concealment of the fact that the goods do not conform to legal specifications, State standards or the general requirements imposed in respect of goods, or that their utilization requires the observance of conditions that differ substantially from what is customary,

(d) providing the goods with trademarks liable to deceive as to their utilization or any other essential characteristics, origin, place of origin, provenance or mode of acquisition,

(e) advertising goods that are not available to consumers or are available in insufficient quantity or variety, except where the consumers are informed of the situation in the case of advertising to introduce new goods or to sell off stocks of goods that are difficult to sell. (Act LXXXVI of 1990)

Chapter III of Act LXXXVI of 1990 gives details about prohibition of agreements restricting economic competition. Coordinated conduct or agreement between competitors that could lead to the restriction or elimination of economic competition is prohibited irrespective of whether or not the agreement was concluded on the territory of Hungary.

Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices changed some phrases in the text of previous act. "Consumer deception" changed to "unfair manipulation of consumer decisions" and prohibited the disclosure of untrue facts with respect to the price and essential qualities of the goods or the misrepresentation of true facts with any false implication, the fitting of goods with misleading marking, or the provision of any information intended for misleading consumers in respect of the essential qualities the goods. (Act LVII of 1996)

Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices was substantially amended by Act CXXXVIII of 2000 on the Amendment of Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices on December 2000. The amendments which entered into force in February 2001 were inspired by the four-year experiences collected with the application of the 1996 Competition Act, indicating the necessity for fine-tuning certain provisions of these rules. The incorporation of some principles established by the law enforcement practice into the Act and the wording and rewording of some definitions proved to be rational. Investigative power of the Office of Economic Competition

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(OEC) was increased as well with development in the field of procedural law. (Act CXXXVIII of 2000)

The most important items of the amendments were as follows:

In the field of substantive law:

a) hard-core restrictions among competitors (price-fixing, market allocating agreements) cannot qualify as agreements of minor importance (*de minimis*),

b) individual exemptions are granted exclusively for a definite period of time,

c) under certain circumstances the OEC is authorised to withdraw the benefits of block exemption regulations and deprive agreements of the benefits attached to the application of *de minimis* rules,

d) the definition of „dominant position" has become simpler,

e) the definition of „part of an undertaking" has been added,

f) it is stipulated clearly, that an acquisition of control within the same economic entity does not qualify as concentration,

g) a distinction between conditions and obligations has been made in order to facilitate the more frequent application of these means both in the case of exempting restrictive agreements and authorising M&As. (Act CXXXVIII of 2000)

Act XXXI of 2003 on the Amendment of Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices, and Act LXVIII of 2005 on the Amendment of Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices as well as Act XIV of 2009 on the Amendment of Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices changed the wording and shaping of legislation and reached its actual version in Act LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices (last amendment on 1 April, 2010)

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14. Conduct of business rules

Regarding conduct of business rules Act CXII of 1996 on Credit Institutions and Financial Enterprises declares the most important requirements of capital, personnel and infrastructure.

A bank may be founded with a minimum initial capital of HUF 2 billion. Credit institutions set up as cooperative societies may be founded with a minimum initial capital of HUF 250 million. Financial enterprises - with the exception of financial holding companies and payment clearing houses - may be founded with a minimum initial capital of HUF 50 million. Hungarian branch of a third-country credit institution may be established with a minimum of HUF 2 billion in endowment capital. In respect of financial institutions incorporated as branches, the initial capital shall be understood as the endowment capital. The same initial capital (HUF 2 billion) required for founding financial holding companies. Payment institutions shall have at least HUF 37,5 million of initial capital for taking up payment services activities. Payment institution whose sole business is the provision of money remittance services shall have at least HUF 6 million only; and whose sole business is the provision of services related to payment transactions executed by means of any telecommunication, digital or IT device shall have at least HUF 15 million in initial capital. Multiple special services intermediaries shall have at least this latter amount (HUF 15 million) and electronic money institutions shall have at least HUF 100 million forints of initial capital for taking up the business of electronic money issuance. (Section 9 of Act CXII of 1996)

Act CXII of 1996 on Credit Institutions and Financial Enterprises defines the personnel and infrastructural requirements of financial institutes. Financial service activities may only be taken up and pursued in compliance with the statutory accounting and records systems and with the internal rules and regulations in accordance with prudent operation as well as with the relevant personnel requirements defined by specific other legislation for providing financial services. There are requirements relating to infrastructure, information technology, technical and security background, and to premises suitable for carrying out the activities and relating to controlling procedures and systems, and - with the exception of financial enterprises engaged exclusively in group financing - to property insurance. Financial institutes must have information and control systems for reducing operating risks, and a plan for handling emergency situations and clear organizational structure. Financial institutions and payment institutions - with the exception of financial holding companies and financial enterprises engaged exclusively in group financing - may only operate in places that meet security requirements. (Section 13 of Act CXII of 1996)

In due observation of the provisions on data protection, credit institutions shall be authorized to outsource the activities connected to financial services and activities auxiliary to financial services as well as the management, processing and storage of data. The outsourcing service provider must satisfy - to a degree corresponding to the risk - the personnel, infrastructure and security requirements concerning the outsourced activities that are prescribed by law for credit institutions. Upon entering into an outsourcing contract, the credit institution shall notify the authority within two days of the contract executed, the name and address (corporate or residence) of the outsourcing service provider and the duration of outsourcing. (Act CXII of 1996)

15. Conflict of interest rules

Act CXII of 1996 on Credit Institutions and Financial Enterprises defines the cases of conflict of interest. According to this legislation Executive officers are:

a) in the case of banks or specialized credit institutions operating as joint-stock companies, the chairman and the members of the executive board and the supervisory board, and the managing director,

b) in the case of cooperative credit institutions, the chairman of the executive board, the chairman of the supervisory board, and the managing director,

c) in the case of financial enterprises operating as joint-stock companies or cooperatives, the chairman of the board of directors, the chairman of the supervisory board, and the managing director,

d) in the case of branch offices, the person appointed by the foreign-registered financial institution to lead the branch office, and his deputy. (Act CXII of 1996)

The executive officer of a financial institution may be elected or appointed upon the prior authorization of the HSFA (Section 44, Para (1) of Act CXII of 1996). Refusals of the appointing to executive officer in general (a, b, c) and further refusals at credit institution or a clearing house for credit institutions (d, e, f) are:

a) having a qualifying participation in or being the executive officer of a financial institution

1) in the case of which insolvency can only be avoided by extraordinary measures taken by the HSFA,

2) which was liquidated due to its operating permit being revoked and whose personal responsibility for the development of this situation has been established in a definitive decree,

b) persons who have seriously or systematically violated the provisions of this Act or another legal regulation pertaining to banking or the management of financial institutions and such has been determined by the Commission, another authority or a court in a final resolution dated within the previous five years,

c) having a criminal record,

d) have at least three years of experience in banking or business management, or in financial or economic management in government administration,

e) shall not act as auditor for another financial institution,

f) shall not hold another office or position which may hinder performance of his professional duties.

No person who has been indicted by the public prosecutor for any criminal acts or who has been indicted abroad for a property or economic crime that is punishable under Hungarian law may be employed as an executive officer until the conclusion of the criminal procedure, and such persons shall be suspended from the performance of such duties and responsibilities. (Act CXII of 1996)

Act CXII of 1996 on Credit Institutions and Financial Enterprises declares in its Chapter VIII about the Incompatibility An executive officer shall immediately notify the Commission

a) when elected member of the board of directors or supervisory board of another financial institution or when terminating such office,

b) when acquiring a qualifying participation in a company or when terminating such share,

c) when indictment in a criminal proceedings. (Section 56 of Act CXII of 1996)

An executive officer or an employee authorized to make business decisions may not participate in the preparation or passing of decisions relative to any commitment by the financial institution if he holds an executive position or has a qualifying participation at the customer on behalf of whom the risk is assumed. An executive officer, and an employee or appointed expert of the financial institution may not participate in the preparation and passing of decisions in which such officer, employee or expert or their close relatives or the enterprise owned by such persons, whether directly or indirectly, has any business interests. An executive officer may not assume any contractual obligations and may not enter into any sales contract with the financial institution in which he is a member of the board of directors or supervisory board, or is a managing director thereof, unless the board of directors has granted prior consent by unanimous decision. (Section 57 of Act CXII of 1996)

Insider person who is an executive officer and any person who is regarded as a manager or executive officer by this Act and the financial institution's internal rules and regulations as well as who performing official and expert's activities and having access to insider information in the course of his activities connected with the financial institution with their close relatives. Any person who has obtained insider information, including the head or employee of a foreign financial institution also regarded as insider person. Insider person may not use his position and the information obtained through such position in connection with the financial institution's operations and customers, nor may he convey such information to unauthorized persons or allow unauthorized persons access to such information. It is prohibited to conclude any deal, to give any order for transactions or to give any investment advice on the strength of insider information. (Section 58 and 59 of Act CXII of 1996)

16. Customer suitability requirements

Financial institute is obligated to collect information prior to the signature of the contract or - in the case of a framework agreement - before the execution of orders. It should evaluate the client's or potential client's knowledge and experience in the investment field relevant to the financial instrument or transaction, his risk profile to determine whether it is appropriate to enable the client to take investment decisions on an informed basis. Client's or potential client's financial situation and his investment objectives are also inevitable so the firm is able to recommend to the client or potential client the transactions and financial instruments that are suitable for him.

Clients should fulfill a "fitness test" at the financial institutes. For instance the investment firm providing investment advice or portfolio management services to the client in order to assess as to whether the specific type of service recommended is suitable for the client's investment objectives. Firm should evaluate the degree of risk related to the specific type of service recommended, even though it meets the investment objectives of the client, is such that the client is able financially to bear it. Institute must assess that the client has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio.

As regards the client's financial ability the firm shall obtain information concerning:

a) the source and extent of the client's regular income,

b) the extent of the client's assets, including liquid assets, investments and real property, and his regular financial commitments,

c) the source and extent of the client's regular liabilities. (Act CXXXVIII of 2007)

As regards the experience and knowledge the firm shall check the following:

a) the types of service, transaction and financial instrument with which the client is familiar,

b) the nature, volume, and frequency of the client's transactions in financial instruments and the period over which they have been carried out,

c) the level of education, and profession or relevant former profession of the client for the purpose of making an assessment. (Act CXXXVIII of 2007)

In connection with carrying out the fitness test the firm shall ask the client to provide a written statement of his financial situation - and the documentary evidence to support it - as well as to disclose any relationship with other financial service providers. Before the firm undersigns the contract it should categorize their clients and treat them according to such categorization. Eligible counterparties or professional clients are the institutional investors and those who meet certain size requirements of enterprises. Anyone who does not belong to an eligible counterparty or a professional client considered as retail customer. Qualification as professional client is available upon request of a customer who meets the criteria specified in the legislation. (Act CXXXVIII of 2007)

17. Interest rate ceilings on loans

In 2012 interest rate ceilings on loans has been introduced in Hungary. It has the form of an interest cap, that is it is linked to a reference rate. This reference rate is the central bank's base rate, but in some case banks are allowed to base the annual percentage rate of the loans on other specified types of rates.

The regulation entered into force in 2012 states, that with exceptions, APR (effective annual percentage rate) cannot exceed the Hungarian central bank's base rate increased by 24 percentage points. Exceptions are the followings: credit card credit, lines of credit connected to payment account, credit provided for the purchase of durable consumer goods (other than motor vehicles), including services and credit secured by an antichresis, for which the credits may not exceed the central bank base rate increased by 39 percentage points. (Act CXLVIII of 2011, Article 3)

The APR of mortgage loans also may be related to a reference rate, like the three-, six-, or twelve-month BUBOR for Forint loans; the three-, six-, or twelve-month EURIBOR in the case of euro-based loans; the three-, six-, or twelve-month CHF LIBOR for Swiss Franc-based mortgage loans. In the case of Forint loans the average gain of the three- or five-year government securities also allowed to apply as a base of the APR of a mortgage loan. (Act CXLVIII of 2011, Article 4)

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18. Conclusion

Hungary's financial system has undergone significant changes since 1987, the year when the foundations of the two-tier banking system were laid. Since the wave of privatization of state-owned banks between 1994 and 1999, large, foreign owned, universal credit institutions have become the backbone of the financial system. Today not only do banks represent two-thirds of all institutional assets in the financial system and have substantial presence in all markets of financial intermediation but they also own major stakes in the capital market, insurance and fund sectors.

One of the key points in the financial regulatory changes in Hungary during the last two decades was the introduction and changes of the capital requirements. The introduction of capital requirements for the bank was motivated by Basel I in 1991, later its changes were induced by the EU directives on capital requirements. The idea was that the Hungarian banks and later investment firms, too, had to maintain capital requirements to prevent risks. The scope of the relevant risks has widened and the calculation methods became more complex.
The first provisions about the capital requirements on banks in 1991 gave the minimal amounts of subscribed capital for various types of banks. By 1997 the initial capital and own funds, the solvency ratio for credit institutions were defined. The minimal amount of the subscribed capital for various types of banks, and the minimal solvency ratio also were regulated.

CAD and CAD2 were implemented at the same time, in 2001. From this year the notion of a trading book was introduced, and the capital requirements of position risk, counter-party risk, commodities risk, the risk of large exposures for firms maintaining a trading book, and the capital requirement of the market risks and foreign-exchange risk for all financial institutions were imposed. The concept of internal risk-management model was introduced. The conditions under which the authorities may allow institutions to calculate their capital requirements applying their own internal risk-management models were equivalent the conditions imposed by Directive 98/31/EC.

In 2007-2008 the provisions of CRD were implemented by Hungarian laws and decrees. The new Hungarian provisions were equivalent in the most points of these directives, but in some cases the Hungarian acts were a bit more restrictive ones than the EU directives. The most of the discretions were not applied.

During the transposition of the measures of CRD II the modifications of the Hungarian laws and decrees affected the eligibility criteria and limits for some types of hybrid capital instruments to involve them among the components of own funds of credit institutions, and the capital requirements for the risk arising from securitisation exposures.

During the implementation of CRD III the regulation on the calculation of capital requirements for credit institutions and investment firms changed in two aspects: the capital requirements of re-securitization positions are prescribed, and the standard for internal models used for the calculation of market risk capital requirements for the positions in the trading book became stricter.

Hungary was in delay in the legislative process of implementing MIFID. Harmonization took place only from 2008 through Act CXXXVIII of 2007 on Investment Enterprises and Commodity Exchange Services and the rules governing the activities they perform and Act CXXXV of 2007 on the Hungarian Financial Supervisory Authority. Infringement proceedings started against Hungary in 2010 due to the not complete implementation of 2004/39/EC and the regulations of it (2006/73/EC and 1287/2006 Regulation.) Hungary incorrectly transposed several provisions, including provisions relating to definitions, market transparency and licensing regime for investment firms (passport) and relating to the protection of investors. As a result, Hungarian firms do not provide services in other Member States. Consequently, the chance is smaller for the Hungarian financial sector for economic growth and job creation. In addition, the investors are not guaranteed the same high level of competitiveness and the protection of the financial markets, as elsewhere in the EU.

Credit institutions seated in Hungary are required to join the National Deposit Insurance Fund. In case the branch office joins the deposit insurance system of its home member state, it must draw up a Hungarian-language guide with all the relevant information. Concerning legislation changed several times, the current compensation amount is 15 million HUF and for deposits in foreign currency is EUR 50.000. The deadline of indemnification is 20 days, which can be extended once, maximum with 10 days.

None of any Hungarian measures use the term crisis situation, but Act IV of 2006 on Business Associations characterize of such circumstances which can be interpreted as crisis situation. Act CXII of 1996 on Credit Institutions and Financial Enterprises also declares some measures, which HSFA should apply in different situations. These measures have different levels according to the seriousness of the situation.

The Hungarian legal system is almost fully harmonized with the European legislation. Certain part of the implementation took place slowly and still there are topics where in some aspects we can realize divergences (for instance MIFID). However, these differences haven't impact on the general attitude and financial institutes and customers as well can safely perform their activities.

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THE ABSTRACT OF THE PROJECT IS:

The research programme will integrate diverse levels, methods and disciplinary traditions with the aim of developing a comprehensive policy agenda for changing the role of the financial system to help achieve a future which is sustainable in environmental, social and economic terms. The programme involves an integrated and balanced consortium involving partners from 14 countries that has unsurpassed experience of deploying diverse perspectives both within economics and across disciplines inclusive of economics. The programme is distinctively pluralistic, and aims to forge alliances across the social sciences, so as to understand how finance can better serve economic, social and environmental needs. The central issues addressed are the ways in which the growth and performance of economies in the last 30 years have been dependent on the characteristics of the processes of financialisation; how has financialisation impacted on the achievement of specific economic, social, and environmental objectives?; the nature of the relationship between financialisation and the sustainability of the financial system, economic development and the environment?; the lessons to be drawn from the crisis about the nature and impacts of financialisation? ; what are the requisites of a financial system able to support a process of sustainable development, broadly conceived?'

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1 (Coordinator)	University of Leeds	UK
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3	School of Oriental and African Studies	UK
4	Fondation Nationale des Sciences Politiques	France
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