CRD comments by the Hungarian authorities
(The central bank of Hungary – Hungarian Ministry of Finance – Hungarian Financial Supervisory Authority)

We would like to thank for the opportunity to comment the working document of the Commission Services concerning the proposed changes to the CRD.
We would like to mention as a general comment that due to the several existing and forthcoming initiatives to amend the CRD it is very hard to anticipate their aggregate effect to the industry of credit institutions. The Hungarian Authorities share the common view that before any strategic decision concerning the CRD it is important to have a comprehensive study on possible effects of the proposed changes.

We will follow the structure of the consultation document according to the organised four main areas.

1. Through-the-cycle expected loss provisioning

In principle we support the application of through-the-cycle expected loss provisioning but for Hungary we would need some more time for the introduction. Our banks are in the middle of the implementation of internal models for loan loss estimations, although the majority of the banking assets are still reported under the standardised method. Since internal model projections are valid only for a one year period we believe that banks need more time and knowledge to prepare for the projection of loan losses for complete business cycles.

We would like to have more clarity in this very important issue. Unfortunately it is still unclear whether the proposal is a prudential or an accounting measure.

In case of a prudential approach the issue could be handled more quickly and there would not be any uncertainty about the IFRS rules which would be the case for an accounting approach by the modification of Directive 86/635/EEC. Another reason for clarification is that although the Spanish measures are accounting provisions, the proposed methodology is based on the CRD (e.g. it desires to recognise the dynamic buffer on risk exposure level, the beta would be ascertained on risk exposure level, whether the buffer is to be capped. These questions are not possible to be handled on accounting side.).

Due to the above-mentioned reasons, it is important to decide whether the dynamic buffer given is to be a capital requirement or should function as an accounting reserve/provision, and according to this should one separate the regulation conditions. At the same time, one has to keep in mind that there should be consistency between the two regulation systems with regard to the treatment of this buffer.

We are on the view that there are substantive questions and problems to be solved, e.g.:
- lack of detailed rules concerning the provisioning and its use (measure, frequency, method);
- if the dynamic provision is a globally recognised buffer and not recognised on individual level, what is its relationship with the impairments and provisions accounted for on individual item level of the exposure class – in order not to have overlaps;

- lack of historical data;
- the definition of the countercyclical factor determined by the competent authority;
- could the provision be included in the sum of own funds;
- why should an accounting provisioning rule be incorporated into the CRD-regulation;
- how banks using IFRS can handle the dynamic provision;
- the provisions should apply for only the IRB-users or for every institution;
- in case of the Spanish regulation set out as the example, the situation of a negative provision could occur in a period of decline, which is untreatable from an accounting point of view.

Even if one desires to create the buffer entitled dynamic provision on the accounting field, it is expedient to regulate this issue in the subject of “fund for general banking risks” under Article 38 of Directive 86/635/EEC. This entails also that the buffer is counted into the own funds, too, according to the CRD.

The implementation of a through-the-cycle expected loss provisioning in emerging countries can be problematic due to the lack of adequate data. In the case of Hungary we have a two tier banking system only for 20 years. For the proper application of these methods, one requires data on the cyclicality of the economy and the banking behaviour preferably for at least two whole business cycles. In Hungary it is not possible yet because of the short time series. We do not know exactly how long and how deep our business cycles are, and that is why we do not have enough data to calculate the forward looking provisions properly.
In our view the same difficulties regarding the available data are present in the majority of Member States who joined the EU after 2004.
We are afraid that this can provoke a level playing field issue.

In our view the implementation of the methodology is inopportune because due to the financial crisis the banking system is not yet in an upturn stage where the provisioning could be made. The criteria of the upturn period should also be clearly defined for the provisioning.

2. Specific incremental capital requirements for residential mortgages in a foreign currency

We agree with the Commission that residential mortgage lending in foreign currency has higher risk than lending in the domestic currency.
First of all it should be clear that foreign currency lending is relevant regarding the domestic currency of the borrower.
We are on the view that this risk should be treated by the introduction of stricter risk management requirements including but not exclusively a proper LTV ratio.

In this vein we find it appropriate the loan-to-value (LTV) ratio of FX residential mortgage loans is lower than the LTV for residential mortgage loans in domestic currency. For FX residential mortgage loans denominated in currencies other than the euro a 50% LTV is acceptable, but for the euro – due to the lower exchange rate volatility especially in those Member States that are on the way to join the Euro zone – a higher LTV level is justified.

We can agree with the introduction of additional capital requirement for residential mortgage lending in a foreign currency above a certain LTV level, but only in the case of reductions in the proposed risk weights. In our view the risk weighting to be assigned to the part of exposures above the LTV level are extremely excessive and are not proportionate to the incremental risk of these exposures. Additionally, we draw the attention to some pitfalls in the present suggestion for modification.

The provisions regarding the risk weighting in the proposal show inconsistencies with the principle in Article 93 (2) of the Directive. According to this provision „No exposure in respect of which credit risk mitigation is obtained shall produce a higher risk-weighted exposure amount or expected loss amount than an otherwise identical exposure in respect of which there is no credit risk mitigation." indicating that for retail clients the 75% risk weighting for unsecured exposures shall be applied when the collateral is not taken into account and disregarding the currency denomination.

We would also draw your attention to the importance of the scope of application of the new proposals because any limitations or restrictions for the lending activity of credit institutions have to be effective for all types of incorporations with lending rights (non bank financial institutions) in order to keep the level playing field and to prevent regulatory arbitrage.

3. Removal of national options and discretions in the CRD

As a general comment we would like to emphasize that regarding the maximum harmonization we agree that the historically formed specificities of Member States should remain national competency. As the Commission's proposals are based on the recommendations of CEBS we would like to have more information on whether and how the future regulatory reform and the changing of its status will have effects on the proposals.

References to CEBS
We agree with the changes which were introduced concerning the Regulation of CRAs. However for a great number of other cases (e.g. - Annex VI, Part 1 point 44a; Annex VI, Part 1 point 6; Annex VII, Part 2 point 5) we are on the view that the references to the guidelines of the Committee of European Banking Supervisors should either be removed or clearly set out their non-binding nature.

Article VI, Part 1 the points 9.1, 9.2
We welcome the Commission's proposal about strengthening the criteria for preferential treatment in mortgage lending, especially in the residential real estate segment. Nevertheless we see the concrete proposal too severe and together with the proposed framework for the treatment of FX based mortgage lending overly complex without any concrete reasoning.

We are having the impression that the Commission Services did not make any consideration about the joint effects of the proposed modifications in mortgage lending in general and in the FX based mortgage lending in particular. We also lack the consistency with the conditions for uncovered lending.
In our view based on the risk characteristics of the different residential loans the risk weights also should reflect the ascending order for:

- Covered loans in local currency
- Covered loans in foreign currency
- Uncovered loans in local currency

— Uncovered loans in foreign currency.

However, according to the proposed text, covered loans in local currency bear more risk than in foreign currency (40% LTV vs. 50%LTV), covered loans in foreign currency bear more risk that uncovered loans (even below LTV 60% the RW grows above 75%) and no differentiation is made between uncovered loans in local or in foreign currency (75% RW for both).

We are on the view that the inconsistencies should be handled rapidly otherwise the basic principles behind capital requirements would be put at risk.
Referring to the concrete proposal in Annex 3 under point 17.(p) we deem the proposed 40% LTV limit for residential mortgages too restrictive and overly conservative about the movements in the property prices during the horizon of a typical mortgage loan. Based on our calculations the joint effect of price movements and the potential fire sales does not warrant such a severe limitation for mortgage lending that would result from a 40% limit. We also believe that mortgage banks will have to bear some risk in relation to the price charged for these loans so the total elimination of risk can not be the aim of the regulations. On the other hand, from the demand side of these loans we also deem the requirement of 60% down payment from the borrowers' side extremely severe and unjustified. Such a requirement would restrict the availability of mortgage credit for a small segment of the potential borrowers and would curb mortgage lending and financial intermediation.

In our opinion the regulation should follow a step by step approach by introducing a more favourable LTV limit for the residential mortgage segment, based on the fact that no limit had existed beforehand. We would propose to consider the current practice in different member states and first introduce something that is consistent with current practice and make revisions later. Based on our information in European countries where an LTV limitation exist they apply an LTV limit at around 70% which reflects the uncertainty in price movements in residential property prices for a longer horizon.

Annex VII, Part 4 point 44
In our view the definition of default can not be unified as it contains several subjective elements. We support the deletion of the past due 180 days at the same time we would like to use beside the 90 days past due the use of three months interval which would allow to filter out several technical defaults.
In our position the definition of default can not be unified until 2012.

Solo level adequacy: Article 84 (2); Article 105 (4)
We are on the view that for ensuring the prudent functioning it is crucial to keep the solo level adequacy and control as otherwise the supervisory authority of the host country can not force its requirements due to the lack of legal background.

Article 154 (6)
We are on the view that only information with general characteristics can be made public.

4. Simplification of the Branch Accounts Directive (89/117/EEC)

We support the Commission's legislative simplification aim so we do not object to the proposed amendment to remove the additional information disclosure by branches of credit institutions established in other Member States.

5. Other issues

Regarding the timing of the measures of the package we would favour the introduction by 01/01/2011 rather than 31/12/2010. We would like to have more information on whether the new proposed provisions are to be applied for the whole portfolio or only for the new items.
Regarding definitions we would very much welcome a right conception on the notions yet undefined of this proposal as well as a similar initiative to define the yet undefined notions of the CRD because the lack of clear definitions could hinder their proper use.