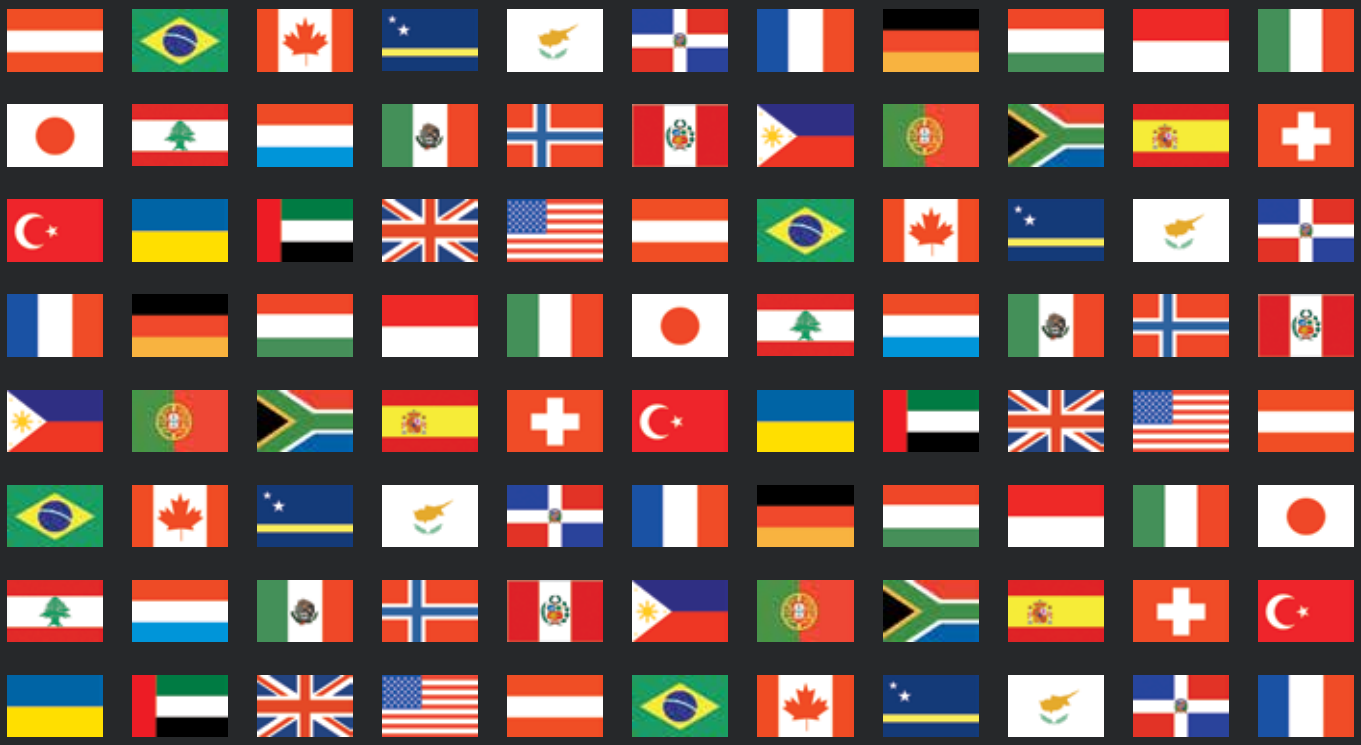
Banking Regulation

In 27 jurisdictions worldwide

Contributing editor
David E Shapiro



2015

GETTING THE DEAL THROUGH

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Banking Regulation 2015

Contributing editor
David E Shapiro
Wachtell, Lipton, Rosen & Katz

Publisher
Gideon Roberton
gideon.roberton@lbresearch.com

Subscriptions
Sophie Pallier
subscriptions@gettingthedealthrough.com

Business development managers
Alan Lee
alan.lee@lbresearch.com

Adam Sargent
adam.sargent@lbresearch.com

Dan White
dan.white@lbresearch.com

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Hungary

Zoltán Varga and Balázs Baranyai
Nagy és Trócsányi

Regulatory framework

1 What are the principal governmental and regulatory policies that govern the banking sector?

The main elements of regulatory policies related to the Hungarian banking sector are:

- governmental control (including authorisation and supervision);
- financial and monetary stability;
- strict capital and risk-management requirements as well as organisational regulations;
- insurance of deposits; and
- regulation of information in the interest of the protection of bank secrecy, transparency and consumer protection.

2 Summarise the primary statutes and regulations that govern the banking industry.

The most important regulations regarding the banking sector are:

- Act XXXVII of 2014 on the further development of the system of institutions strengthening the security of the individual players of the financial intermediary system (the Resolution Act);
- Act CCXXXVII of 2013 on credit institutions and financial enterprises (the Banking Act);
- Act CXXXIX of 2013 on the Hungarian Central Bank (the Central Bank Act);
- Act LXXXV of 2009 on the Pursuit of the Business of Payment Services;
- Act CIV of 2008 on strengthening the stability of financial systems (the Stability Act);
- Act CLXII of 2009 on Consumer Credits;
- Act CXXII of 2011 on Central Credit Information System; and
- Act CXXXV of 2013 on the Integration of savings cooperatives and amendments to economic related acts.

Furthermore, in some aspects Act CXX of 2001 on Capital Markets, Act CXXXVI of 2007 on the Prevention of Financing Money Laundering and Terrorism, Act CXXXVIII of 2007 on Investment Service Providers also have significant effects on the banking sector, Act CCXXXV of 2013 on Certain Payment Providers and Act XVI of 2014 on Collective Investment Trusts and Their Managers, and on the Amendment of Financial Regulations.

3 Which regulatory authorities are primarily responsible for overseeing banks?

The financial markets are exclusively supervised by the Hungarian Central Bank (Central Bank). While the Hungarian Financial Supervisory Authority (HFSA) was almost exclusively responsible for their supervision and had the necessary instruments for this responsibility, in 2013 the HFSA was integrated into the Central Bank. This means that the Central Bank assumed all functions, duties and responsibilities of the HFSA and the latter ceased to exist on 1 October 2013. Even though the HFSA ceased to exist without a legal successor, continuity was preserved as, according to the Central Bank Act, the rights and obligations (including authority over certain state assets) transferred to the Central Bank, and the Central Bank took the place of the HFSA in ongoing procedures.

The reformed Central Bank is responsible for mitigating and managing risks potentially arising in the financial sector at system level (macroprudential policy) and for overseeing the safety and stability of individual financial institutions (microprudential policy). It has also assumed the functions of consumer protection, market supervision, as well as capital and insurance supervision, while keeping its 'old' duties and responsibilities such as, naturally, the fundamental function of being responsible for monetary policy.

4 Describe the extent to which deposits are insured by the government. Describe the extent to which the government has taken an ownership interest in the banking sector and intends to maintain, increase or decrease that interest.

The Hungarian system for insuring deposits consists of two elements, one of which is deposit insurance. For this purpose the National Fund for Deposit Insurance (FDI) was established by Act CXII of 1996 on credit institutions and financial enterprises. This Act was recently replaced by the Banking Act, but the regulation has basically remained the same.

Each credit institution must be a member of the FDI (membership is a condition of foundation). According to the Banking Act, credit institutions shall, upon joining the FDI, pay a one-off affiliation fee at the rate of half per cent of its subscribed capital to the FDI within 30 days of receiving the authorisation.

In addition, credit institutions shall pay ordinary – and in some cases extraordinary – annual fees for the FDI. The amount of the annual fee to be paid shall not be higher than two thousandths of the aggregate total interest holdings indicated under accrued and deferred liabilities on deposits insured by the FDI and kept with the member institution on 31 December of the previous year and the deposits insured by the FDI.

In the case of deposits being frozen, the FDI undertakes to provide liquid assets to the credit institution according to general market conditions. The above undertaking may not be higher than the amount of deposits placed in the credit institution in question. Furthermore, only registered deposits will be insured by the FDI. The capital and interest amount of the deposits will only be reimbursed by the FDI up to €100,000 per person and per credit institution as compensation.

The other element, laid down in the Act CCVIII of 2011 on the Hungarian Central Bank, is the opportunity to receive extraordinary credit, which may be provided by the Central Bank for credit institutions and to the FDI in the event of emergency. For this purpose 'emergency' means that the insolvency of the credit institution endangers the stability of the entire monetary system. The Central Bank has discretionary power to provide such extraordinary credit.

The Hungarian government is determined to put the banking system into an ownership structure where 50 per cent of the ownership is Hungarian. The government wants the Hungarian banking system to be a firm base of financial stability and to regain its independence. Additional steps may be implemented by the government to further increase the state's ownership percentage within the Hungarian banking system.

5 Which legal and regulatory limitations apply to transactions between a bank and its affiliates? What constitutes an 'affiliate' for this purpose? Briefly describe the range of permissible and prohibited activities for financial institutions and whether there have been any changes to how those activities are classified.

In accordance with the Banking Act, an 'affiliate' means any company over which a parent company effectively exercises a dominant influence. All

affiliates of affiliate companies will also be considered affiliates of the parent company.

From the regulatory viewpoint a parent company or an affiliate will be considered a client; therefore, in cases of transactions between a parent company and an affiliate the general prudential rules of the Banking Act will apply, including the rules for limitation of exposure.

Furthermore, some indirect limitations also apply if the parent company qualifies as a credit institution and its affiliate is also a credit institution, financial enterprise or investment enterprise, or the parent company has a holding in such an institution, or if the credit institution's parent company is a financial holding company. In the above cases the companies are subject to supervision on a consolidated basis, which basically means that they must meet the prudential and exposure rules of the Banking Act both jointly and severally and this provision may influence the transactions between the companies concerned.

Members of groups that qualify as subject to the supplementary supervision – financial conglomerates – must also meet the prudential provisions both jointly and severally. Credit institutions subject to supervision on a consolidated basis and all other entities covered by supervision on a consolidated basis may enter into a group financial support agreement under which a party to the agreement is to provide financial support to any other party to the agreement affected by the measures, exceptional measures to be taken by the Central Bank upon the occurrence of events invoking such measures, exceptional measures.

Pursuant to the Banking Act financial institutions, in addition to financial services as determined by the Banking Act, are entitled to perform exclusively the following activities:

- activities auxiliary to financial services;
- insurance mediation services;
- securities lending or borrowing, acting as nominee for shareholders, pursuant to Act CXXXVIII of 2007 providing investment services, auxiliary services, intermediary activities and commodity exchange services;
- transactions in gold;
- keeping registers of shareholders;
- services related to electronic signatures;
- activities in support of the lending operations of the Student Loan Centre;
- recruiting new members for voluntary mutual insurance funds;
- activities relating to the management of collateral held in custody with a view to reducing or avoiding losses from financial services;
- use of assets subject to securities acquired for the purpose of abating deficit resulting from financial services;
- activities relating to management and enforcement claims as an agent;
- sale and purchase of information related to financial instruments; and
- conveyance of subsidies from the European Union.

Financial activities not listed above are prohibited activities with regard to financial institutions.

In addition, the provisions of the Banking Act limit certain market activities of financial institutions in the area of risk management in accordance with the relevant EU legislation. Such limitations include limitation of exposure related to the acquisition of ownership, and restrictions on investment activities, including real estate investment restrictions.

6 What are the principal regulatory challenges facing the banking industry?

Hungary is facing similar challenges to other EU countries. In line with the decision of the Basel Committee on Banking Supervision, the Central Bank will have a key role in facilitating and supervising that banks refill their liquid reserves and reach 60 per cent by 2015 and 100 per cent by 2019. The Central Bank is also expected to keep a close eye on internal audit systems and company-level management.

In terms of the purpose of the recent reform, the Central Bank will carry out more efficient macroprudential and microprudential supervision, thus it must take measures to prevent excessive lending, mitigate systematic liquidity risks, operate the countercyclical capital buffer and reduce the probability of default of systemically important financial institutions.

7 Are banks subject to consumer protection rules?

The CXXXIX Act of 2013 on the National Bank of Hungary states that it aims to protect the interests of parties using the services rendered by financial organisations and to strengthen the public confidence in the financial system. The main pillars of the consumer protection policy overseen and enforced by the Central Bank are the efficient supervision, efficient enforcement of sanctions and the protection of the defenceless groups of society.

The Central Bank upon request or of its own motion monitors compliance with consumer protection provisions of the Hungarian law and opens the proceeding. Proceedings for the protection of consumers' interests shall not be opened after a period of three years following the time of the infringement. The administrative time limit for these proceedings is three months. In this period the Central Bank has the power to carry out trial transactions and to conduct direct inquiries or thematic investigations. If the Central Bank finds any infringement it may impose sanctions such as:

- issue a warning for taking the measures necessary for compliance with the relevant legal provisions, and for eliminating the discrepancies detected;
- order the cessation of the infringement;
- prohibit any further infringement;
- order the infringer to terminate within the prescribed time limit the deficiencies and disparities exposed, and notify the Central Bank concerning the measures carried out to eliminate such deficiencies and disparities;
- ban or impose conditions regarding the pursuit of the activity or the supply of services involved in the infringement, until the infringement is eliminated; and
- impose a consumer protection fine.

The most common practices that have attracted the attention of the Central Bank are practices such as unilateral increment of fees and misinformation of the consumers.

8 In what ways do you anticipate the legal and regulatory policy changing over the next few years?

In Hungary the legal and regulatory policies regarding the banking sector correspond to related policies of western European countries and the European Union. The above regulations rest on three main principles: security (the main aspects of security are described in question 1), competition (securing equal conditions and fair competition) and consumer protection.

Future regulation, in correspondence with EU legislation , is likely to focus on enhanced liquidity and risk management of financial institutions and to expand regulatory control in the banking industry.

Also we should note, the European Bank Authority has issued its Single Rule Book which aims to provide a single set of harmonised prudential rules that institutions throughout the EU must respect. Moreover, it intends to ensure uniform application of Basel III in all member states. It aims to close regulatory loopholes and thus contribute to a more effective functioning of the Single Market.

Supervision

9 How are banks supervised by their regulatory authorities? How often do these examinations occur and how extensive are they?

The basis of supervisory control is regular disclosure of data and the supervisory procedure performed by the Central Bank. The banks and Hungarian branch offices of credit institutions established in other EU member states have to provide the Central Bank with a report at least once a year, and must report certain events (eg, an increase or decrease of capital; suspension, limitation and cancellation of certain financial services; and activities auxiliary to financial services). Furthermore, the Central Bank is entitled to compel the banks to supply data on certain issues. In the event that they are in danger of breaching the rules on prudence, banks are obliged to notify the Central Bank.

During the supervisory review, the Central Bank reviews the strategies, policies, processes and methods relating to the capital adequacy of credit institutions and evaluates their exposure in accordance with the Hungarian regulation and Regulation (EU) No. 575/2013. The frequency and extent of the review and evaluation are determined by the Central Bank, based on the size and the extent of the activity of the bank in question. It must, however, be updated on at least an annual basis.

The Central Bank may conduct comprehensive inspections and direct inquiry into financial organisations in connection with a specific problem or, if the same problem arises at several financial institutions, a general

inquiry. It may also conduct post-inspections or may request information concerning compliance with its resolutions. Comprehensive inspections and direct inquiries may take no longer than six months; in the event of general inquiries the deadline is nine months, but these may be prolonged by six months, if there is a good cause.

The Central Bank conducts a market surveillance procedure if a suspicion of unlawfulness arises, inter alia, if operations or services are conducted by a bank without proper authorisation or notification. The Central Bank may also conduct enquiries, ex officio or upon an application, into breaches of the consumer protection laws.

Credit institutions (financial holding companies) that are supervised on a consolidated basis must comply with the provisions concerning prudent operation, risk exposure and capital adequacy not only separately but also collectively.

10 How do the regulatory authorities enforce banking laws and regulations?

On the one hand, laws are enforced during an authorisation procedure by the rejection of authorisation and the withdrawal of authorisation; on the other hand, the Central Bank may choose between measures determined in the Banking Act according to the seriousness of the violation.

In the event of a bank violating the laws concerning it, the Central Bank will consider taking measures (eg, calling upon the bank to take the necessary reparatory steps, requiring extraordinary supply of data, obliging the financial institution to draw up and execute an action plan, or adopting a resolution to declare the fact of infringement). In the event of considerable violations of the provisions and where the Banking Act orders it to do so, the Central Bank will take the necessary measures prescribed in the Banking Act. In the event of any serious infringement, and where the Banking Act orders it to do so, the Central Bank will take the necessary measures or extraordinary measures (eg, delegate a supervisory commissioner to the credit institution, or limit or prohibit certain transactions and payments).

The Central Bank may (simultaneously with a measure or extraordinary measure or by itself) impose fines and penalties. Penalties may be imposed both on banks and executive officers failing to fulfil the provisions on operation, breaching their own internal regulations or an obligation set out by the Central Bank in its Resolution or late compliance with said provisions. The basic penalty is between 100,000 and 2 billion forints. The penalty varies according to the nature and severity of the violation; it could amount to 200 per cent of the supervisory fee (basic fee and variable fee) if this exceeds 2 billion forints. The penalties imposed on an executive officer may be between 100,000 and 20 million forints that cannot be paid off by the bank itself.

An inquiry by the Central Bank may be initiated by a foreign financial supervisory authority.

If the Hungarian branch of a financial institution established in another EU member state or the cross-border financial services and activities in the territory of Hungary of a financial institution established in another member state violate the provisions of Hungarian law, the Central Bank first calls upon the branch or bank to rectify the situation. If it refuses to comply, the Central Bank will notify the supervisory authority of the other EU member state and request that the supervisory authority take appropriate action. If the supervisory authority fails to act, the Central Bank may address the issue to the European Banking Authority.

If the Central Bank considers that the continuance of the anomalous situation presents a serious threat to the stability of the financial system or the interests of customers, it is entitled to act directly. In that event, the Central Bank informs the supervisory authority of the concerned member state about the measures applied, as well as any extraordinary measures, and the reasons for them.

11 What are the most common enforcement issues and how have they been addressed by the regulators and the banks?

The primary supervisory issues facing the Central Bank concerning the banking sector in 2015 are ensuring (if they need enforcing) the prudent operation of the sector, in line with EU rules ensuring the stability and uninterrupted operation of the financial markets; providing a framework for safe and competitive growth; identifying risks threatening certain financial institutions and handling (eliminating) already known risks; proactively and consistently protecting consumers' rights and interests; providing a forum for resolving disputes; educating consumers; strengthening public trust in the financial system; and helping the European level supervision.

As for addressing the issues, the fundamental reform of supervision in 2013 (ie, consolidating the duties and functions (extended and strengthened in recent years) into one organisation) will help to more efficiently eliminate and prevent unnecessary risks in the financial system.

12 How has bank supervision changed in response to the 2008 financial crisis?

First, the activity, the status, and the structure of the HFSA were changed, and subsequently, by the dissolution of the HFSA, supervision became the exclusive responsibility of the Central Bank.

The Financial Stability Council was established, thereafter integrated into the Central Bank.

The HFSA acquired certain responsibilities with regard to consumer protection; since 2011 it could conduct consumer protection proceedings ex officio, impose consumer protection fines and other sanctions and had the right to initiate consumer protection lawsuits at civil courts on behalf of consumers. The Central Bank has assumed these duties.

The president of the Central Bank has a right to adopt decrees, and such decrees are now at the same level of the hierarchy of norms as the government's decrees.

Pursuant to the Stability Act and to the Resolution Act, the Central Bank is entitled and obliged to examine the status of Hungarian credit institutions from the point of view of the banking industry's stability and the minister responsible is authorised to request reports from the above authorities if the solvency of one or more credit institutions endangers the stability of the financial system. Such a report includes, in particular:

- an examination of the effects of such situation upon the financial markets and the financial infrastructure;
- analysis regarding short, medium and long-term liquidity; and
- analysis regarding the fulfilment of capital adequacy requirements.

As a result of the above evaluation, if they deem it to be necessary, the Central Bank may mutually propose the application of the measures provided by the Stability Act and Resolution Act .

Furthermore, the HFSA had been more active in respect of banking sector governance with soft-law instruments. This practice has been continued by the Central Bank. The most common soft-law instruments are authorisation guidelines, supervisory guidelines, recommendations, CEO letters and other guidelines.

Resolution

13 In what circumstances may banks be taken over by the government or regulatory authorities? How frequent is this in practice? How are the interests of the various stakeholders treated?

In order to maintain financial stability, ensure the continuous availability of the critical functions provided by the financial sector, efficiently manage any institutional crises and minimise the use of taxpayer funds for crisis management purposes and establish a framework for the administrative restructuring of distressed financial Institutions, the Parliament has adopted the Resolution Act, according to which the Central Bank shall, in the case of a systemic crisis, notify the minister in charge of the regulation of the money, capital and insurance market if the objective of resolution has not been accomplished by way of the resolution actions applied by the Central Bank. Based on the notification in his decision the minister in charge of the regulation of the money, capital and insurance market may resolve that the state financial stabilisation instrument is to be applied. A state financial stabilisation instrument may take the form of a capital increase or take the form of temporary nationalisation of the shareholdings. Upon temporary nationalisation in the context of the state financial stabilisation instrument the shareholdings in the institution, financial holding company, mixed financial holding company or mixed activity holding company under resolution, having its registered office in Hungary, shall be transferred to the state or a solely state owned enterprise. In the course recapitalisation by the state and temporary nationalisation it shall be ensured that the institution concerned or the financial undertaking keeps operating on a commercial basis and that on the basis of the principle of private investment in the market the role of the state as the owner of the equity elements is taken over by market players via a public auction.

In 2014, the Central Bank appointed supervisory commissioner in two cases. According to the Banking Act, the Central Bank may appoint a supervisory commissioner if the dissolution procedure opens after the date

of the resolution – at the same time it passes the resolution of dissolution (if this has not happened earlier). The commissioner's assignment shall end at the time when the receiver takes over, and he shall have powers to stop all payments until the time of the opening of the dissolution procedure.

When taking the resolution actions and exercising the resolution powers, the shareholders of the institution under resolution bear losses first. No shareholder shall incur greater losses directly related to the application of the resolution actions than would have been incurred if the institution had been liquidated. After the execution of the resolution action it shall be assessed by the independent asset appraiser, whether the shareholders and the creditors would have been treated better by having the institution under resolution liquidated. That valuation shall be distinct from the independent valuation specified in the Resolution Act. If the assessment carried out determines that any shareholder or creditor has incurred greater losses than it would have incurred in the case of liquidation, it shall be entitled to indemnification.

14 What is the role of the bank's management and directors in the case of a bank failure? Must banks have a resolution plan or similar document?

If a bank failure is caused by reasons set out in the Banking Act, the Central Bank may pass a resolution in which it appoints a supervisory commissioner. In certain cases the Central Bank does not have the right to decide and must appoint a commissioner. The board of directors and members of the supervisory board have the right to seek remedy against such resolution of the Central Bank.

During the period of the supervisory commissioner's appointment, members of the board of directors cannot perform their duties or exercise their signatory rights as described in the statutory provisions governing business associations and cooperatives. For the period of appointment, the supervisory commissioner exercises the rights of board members described by law and the charter documents.

Since January 2011, credit institutions must have written policies and procedures for the identification, measurement, management and monitoring of liquidity risk (costs and benefits, too) over an appropriate period of time. With the same amendment to the former Banking Act credit institutions were required to distinguish between pledged and unencumbered assets that are available at all times, in particular during emergency situations. They will take into account the legal entity in which assets reside, the country where assets are legally recorded either in a register or in an account and their eligibility to be used as extra liquidity buffers; they will monitor how assets can be mobilised in a timely manner, and existing legal, regulatory and operational limitations to potential transfers of liquidity and unencumbered assets among entities, both within member states of the European Union and in third countries.

15 Are managers or directors personally liable in the case of a bank failure?

The liability of the members of the board and the supervisory board is regulated by different acts. The Hungarian Civil Code sets out the general rules, according to which the board and supervisory board members will act with due care and diligence bearing in mind the best interest of the company. The board and supervisory board members are both personally and financially responsible towards the company for any damages they have caused by breaching the rules, the charter document or resolutions of the general meeting or by breaching their managerial duties.

Concerning liability, specific regulations are laid down in the Banking Act.

The executive officers, members of the board and the supervisory board of the financial institution are liable to ensure that the financial institution carries out the licensed activities in accordance with the provisions set out by the Banking Act and other laws.

The executive officers and employees of the financial institution will act at all times with due diligence and expertise consistent with the professional requirements applicable for their respective positions, also in view of the interests of the financial institution and its customers, and in compliance with the relevant regulations.

The notification obligations described in the answer to question 18 will be fulfilled by the executive officers of the credit institution.

The case is different from the foregoing if a manager or a director is an employee of the credit institution, because in that case the rules of the Labour Code will apply to his or her liability.

Since the Central Bank continuously monitors the operation of credit institutions, it should notice when a credit institution does not operate prudently. In those cases the Central Bank tries to enforce the prudent operation and, as mentioned in question 10, it can impose penalties, including fines, on executive officers who fail to fulfil provisions or who breach the law or the internal regulations of the bank.

If any actions of executive officers breach any section of Economic Crimes of the Criminal Code, the officers will also be held responsible for such actions.

16 How has bank resolution changed in response to the recent crisis?

Changes introduced in recent years concerning bank resolution have aimed to increase the risk-handling ability of the banking sector and lessen the possibility of crisis situations having an impact on the real economy and on the financial sector. The purpose of the measures adopted is to ensure a higher level of prudent and transparent operation of the financial organisations.

As part of the aforementioned changes, from 2013 credit institutions with a balance of over 500 billion forints qualify as credit institutions subject to the public's interest and, as such, they must set up and operate an audit committee.

The HFSA issued guidance, which is still applicable, for financial organisations on how to lessen the risk related to the real estate market. It has communicated to financial organisations its strict expectations regarding choosing commercial partners. The HFSA also drew attention to generating data on consolidated deposits, emphasised the importance of fulfilling 'know-your-customer' (KYC) obligations prudently before entering into a contract with a customer and established which clients can be accepted as professional clients. Financial organisations' information obligation towards its clients and professional clients is also a clear expectation. In order to maintain financial stability, ensure the continuous availability of the critical functions provided by the financial sector, efficiently manage any institutional crises, minimise the use of taxpayer funds for crisis management purposes and establish a framework for the administrative restructuring of distressed financial institutions, Parliament has adopted the Resolution Act which regulates the institution of resolution regarding the credit institutions and investment firms established in Hungary, the financial holding companies, mixed financial holding companies and mixed activity holding companies established in Hungary, the financial undertakings established in Hungary which are covered by the consolidated supervision, and the Hungarian branch of an institution incorporated in a third country.

Capital requirements

17 Describe the legal and regulatory capital adequacy requirements for banks. Must banks make contingent capital arrangements?

Banks may be founded with a minimum subscribed capital of 2 billion forints. A branch office of a third-country credit institution may be established with a minimum of 2 billion forints in endowment capital.

The requirement of prudent operation as it relates to banks means that they have to manage the funds placed in their custody, as well as their own resources, so as to maintain liquidity and solvency at all times. Credit institutions shall have sufficient own funds at all times to cover the risks of its activities, covering at least the minimum capital requirement defined in article 92 of Regulation 575/2013/EU; the extra capital requirement prescribed in the framework of a supervisory review, but it may not be less than the minimum amount of subscribed capital prescribed as a precondition for authorisation.

The provisions concerning the equity capital, solvency margin, reserves, limitations of exposure (ie, limitations and restrictions on high exposure, investments, acquisitions, qualification of assets, risk reserves), collections of resources and the approximation of maturity and liquidity come within the requirement of prudent operation.

Banks must place 10 per cent of their annual after-tax profits into a general reserve to offset losses incurred during their activities. Upon request, a credit institution may be exempted by the Central Bank from the obligation to maintain general reserves. Credit institutions are allowed to use general reserves only to cover operating losses arising from their activities.

As Regulation 575/2013/EU and Directive 2013/36/EU influenced the Banking Act, in accordance with the cited EU legislation, credit institutions also have the obligation to maintain a capital conservation buffer and an institution-specific countercyclical capital buffer. Special rules apply to the capital buffers of global and other systemically important institutions.

18 How are the capital adequacy guidelines enforced?

Banks have certain notification requirements and data disclosure requirements towards the Central Bank with the special aim that the banks correspond to the capital requirements. The board of directors of a credit institution must immediately notify the Central Bank in writing:

- if the danger of illiquidity is imminent;
- in case of insolvency;
- if the solvency margin has diminished by 25 per cent or more; or
- if the credit institution has suspended its payments or it has stopped its operations or financial service activities.

Furthermore, the board of directors of a credit institution must notify the Central Bank within two business days in writing if the subscribed capital is reduced. Credit institutions operating as a branch office have additional reporting obligations.

Through the supervisory review, the Central Bank reviews the strategies, policies, processes and methods relating to the capital adequacy of credit institutions and evaluates their exposure.

Measures and extraordinary measures will also be applied (besides fines) in the case of infringement of capital adequacy requirements.

19 What happens in the event that a bank becomes undercapitalised?

If the amount of equity capital of a bank falls below the minimum amount of subscribed capital prescribed by the Banking Act, the Central Bank may give the credit institution a maximum of 18 months to bring its equity capital to compliance level. If the amount of equity capital of a bank falls below the amount of the subscribed capital, the Central Bank may compel the financial institution's board of directors to convene a general meeting. In this case, the general meeting will decide whether the financial institution should reduce the subscribed capital or the owners who have a qualifying holding should provide for the financial institution's equity capital to be restored to at least the level of the prescribed subscribed capital.

Undercapitalisation is also a condition for the appliance of the measures provided by the Stability Act.

20 What are the legal and regulatory processes in the event that a bank becomes insolvent?

The Banking Act does not explicitly define the concept of insolvency and does not specify which requirements must be violated or to what extent for a bank to be considered insolvent.

The Central Bank applies extraordinary measures in lieu of bankruptcy proceedings; for example, it may:

- prescribe the selling of certain assets of the credit institution;
- set a deadline for the financial institution to settle its capital structure;
- prohibit certain transactions and payments;
- compel the board of directors to convene the general meeting;
- delegate a supervisory commissioner; or
- call upon the owner of the financial institution to take the necessary measures.

If the board of directors fails to convene the general meeting, the Central Bank can convene the court of registry.

If the bank becomes insolvent, the board of directors must immediately notify the Central Bank in writing. In the event of insolvency, liquidation proceedings will ensue. The liquidation proceedings can be initiated either by the bank in question itself or the Central Bank at the Metropolitan Court.

The Central Bank initiates liquidation proceedings against the bank or the branch office of a third-country financial institution in the event that the Central Bank withdraws the credit institution's authorisation on the basis of it failing to pay any of its undisputed debts within five days of the date on which they are due, or it no longer possesses sufficient funds (assets) to satisfy the known claims of creditors. Furthermore, liquidation proceedings will commence if the person in charge of the dissolution procedure of a credit institution informs the Central Bank that the assets of the credit institution will not cover the claims of the creditors and the owners or members do not pay the outstanding amount, or, in the case of a branch office, if insolvency proceedings have been initiated against the foreign financial institution that is operating the branch office in Hungary. The Hungarian branch office of a credit institution established in another EU member state may not be liquidated under Hungarian law.

The court must decide on the request for liquidation within eight days of its submission.

During the liquidation of a financial institution, creditors shall present their claims within 60 days of the publication of the court ruling ordering liquidation.

The court appoints the liquidator in the order adopted on the liquidation. The Central Bank may, from the submission of the request for liquidation, order prohibition of all payments until the starting date of the procedure (the date of the promulgation of the order in the Official Gazette).

The court must then arrange a meeting to negotiate a composition at the request of the debtor bank. The court will confirm this composition by an order only if solvency of the debtor bank will be restored through the composition and the composition is in conformity with legal regulations. The permission of the Central Bank is also required for approval of the composition during the composition process if the further operation of the bank constitutes a condition of the composition. If no composition has been settled or the court refuses to confirm the composition, the court issues an order about, inter alia, the satisfaction of the creditors, the conclusion of the liquidation and the dissolution of the debtor and any subsidiary of it.

Special rules apply to credit institutions that operate branch offices in other EU member states or provide cross-border services. In their cases the Central Bank immediately informs the supervisory authorities of the EU member states where the credit institution under liquidation proceedings operates any branch offices or provides cross-border services. The effect of the order on liquidation applies to the entire EU territory.

The provisions of the Act on Bankruptcy and Liquidation Proceedings will apply in the case of issues not covered by the Banking Act.

21 Have capital adequacy guidelines changed, or are they expected to change in the near future?

The Banking Act has been amended in order to conform with Regulation (EU) No. 575/2013 and Directive 2013/36/EU; the first amendment is the Capital Requirements Regulation (CRR), the second is the Capital Requirements Directive (CRD). These legal acts comprise the new Capital Requirements Directives (CRD IV). The CRD is the legal framework for the supervision of credit institutions, investment firms and their parent companies in all member states of the European Union and the EEA. The CRR has been in force since 27 June 2013, while the supervised entities within its scope are subject to it as of 1 January 2014. The CRR is directly applicable to anyone in the European Union and is not transposed into national law, though the Banking Act makes references to it and complies with its provisions. Much of the CRR is derived from the Basel III standards issued by the Basel Committee on Banking. It includes most of the technical provisions governing the prudential supervision of institutions.

Ownership restrictions and implications

22 Describe the legal and regulatory limitations regarding the types of entities and individuals that may own a controlling interest in a bank. What constitutes 'control' for this purpose?

According to the Banking Act, in the Hungarian regulation 'qualifying holding' has the same meaning as laid down by Regulation (EU) No. 575/2013. It means a direct or indirect holding in an undertaking that represents 10 per cent or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of that undertaking.

In respective of the acquisition of a qualifying holding, the Banking Act does not discriminate between persons or types of entities. The acquirer must obtain the permission of the Central Bank.

According to the Banking Act, any person who wishes to acquire a qualifying holding in a credit institution must be independent of any influences that may endanger the institution's sound, diligent and reliable (collectively, 'prudent') operation, must have goodwill and the capacity to provide reliable and diligent guidance and control of the credit institution, and also its ownership structure as well as business connections must be transparent so as to allow the competent authority to exercise effective

supervision over the credit institution. Moreover, the legitimate source of the remuneration paid for the qualifying holding must be proved.

If the credit institution is a public limited company the provisions of the Act on Capital Markets regarding acquisition of a qualifying holding will also apply.

23 Are there any restrictions on foreign ownership of banks?

There are no restrictions.

24 What are the legal and regulatory implications for entities that control banks?

Once the permission described in question 22 is obtained in accordance with the Banking Act, there are no further special implications for entities that acquired a qualifying holding. However, the requirements specified above will also be fulfilled during the course of the credit institution's operation.

25 What are the legal and regulatory duties and responsibilities of an entity or individual that controls a bank?

The essential requirements against persons and entities with a qualifying holding are diligent and reliable operation, goodwill, transparency and guidance and control of the financial institution (see question 22).

For this purpose the main duty of acquirers is to provide the credit institution's capital. The amount of the credit institution's own funds may not be less than the minimum amount of initial capital prescribed by the Banking Act. The owners will, however, not be – directly – compelled to provide further capital contributions; the prudent operation is basically not the owners' responsibility. Therefore, if the amount of a credit institution's own funds falls below the minimum level of the initial capital, the Central Bank will give the credit institution (in essence, the owners) a maximum of 18 months to bring its own funds into compliance, or it may compel the financial institution's board of directors to convene a general meeting. In this case, the general meeting will decide whether the financial institution should reduce the subscribed capital or if the owners who have a qualifying holding should provide for the financial institution's own funds to be restored to at least the amount of prescribed initial capital.

Pursuant to the Banking Act, the Central Bank may also take certain measures and necessary exceptional measures if the owner of a financial institution violates the Banking Act itself, the legal provisions on effective, reliable and independent ownership and prudent operation, or obviously conducts its activities without due care. For example, the Central Bank must consider the need for such measures if the credit institution's own funds fail to reach the capital requirements described by the Banking Act, or the owners violate any of the regulations on exposures, on the determination, analysis, evaluation and definition of exposures, on the management of exposures, or on the management and reduction of risks. There are also certain circumstances when the Central Bank must take measures or exceptional measures against the credit institutions or the owners.

In the foregoing circumstances the Central Bank may, inter alia:

- stipulate an extraordinary supply of data;
- require the credit institution to take measures for reinforcement of the arrangements, processes, mechanisms and strategies relating to its internal control mechanism, corporate governance functions, risk-management procedures and internal models for the assessment of capital adequacy; or
- prohibit, limit or make subject to conditions payment of dividends, raising of loans by the owners of financial institutions, or rendering services to them by credit institutions that involve any exposure.

When applying exceptional measures, the Central Bank may limit or prohibit the credit institution concluding transactions between the owners and the credit institution. The Central Bank may also simultaneously call upon the owner of the financial institution that has a qualifying holding to take the necessary measures.

26 What are the implications for a controlling entity or individual in the event that a bank becomes insolvent?

For insolvency the regulations do not contain special implications for entities or individuals with a qualifying holding; therefore, the general regulations for the owners will apply.

In the event of insolvency, basically the same measures and exceptional measures described in question 25 may be taken by the Central Bank, such as the compelling of the financial institution's board of directors to convene the general meeting and the calling upon of the owner of the financial institution with 5 per cent or more holding to take the necessary measures.

Following the foregoing call upon the owners, the credit institution's board of directors must take immediate action to ensure that deposits and other receivables of the owners due from the credit institution are blocked, that lending to companies in the sphere of interests of the owners is suspended and that no financial services involving exposure of the owners are rendered.

The board of directors of the credit institution must keep these restrictions in effect until the owners terminate the cause for taking the measures or the liquidation of the credit institution is ordered by the court.

If the financial institution fails to comply with the supervisory measures, the Central Bank may initiate the convening of the financial institution's general meeting at the court of registry.

If the measures taken by the Central Bank were insufficient to prevent the insolvency, the Central Bank must initiate the liquidation of the credit institution pursuant to liquidation rules governed by the Act on Bankruptcy and Liquidation Proceedings (see also question 20).

Changes in control

27 Describe the regulatory approvals needed to acquire control of a bank. How is 'control' defined for this purpose?

For this purpose, 'control' is defined as in question 22.

According to the Banking Act, the Central Bank's permission must be obtained before executing a contract regarding the acquisition of a qualifying holding in a credit institution, as well as regarding the acquisition of additional qualifying holding by which 20, 33 or 50 per cent of ownership share or voting rights would be reached. Accordingly, the owner of a credit institution may only enter into contracts regarding ownership rights, voting rights or to secure advantages in excess of such rights with the Central Bank's permission.

Finally, the Central Bank's permission must be obtained before executing a contract for the acquisition of majority ownership in a company with a qualifying holding in a credit institution.

The permissions must be obtained in each case prior to the conclusion of the contract. Accordingly, following the conclusion of the contract the Central Bank must be informed within 30 days about the execution of the above transactions.

In cases specified in the Competition Act the acquirer must also obtain the approval of the Competition Authority.

28 Are the regulatory authorities receptive to foreign acquirers? How is the regulatory process different for a foreign acquirer?

The process basically corresponds to the general process prescribed for any acquirers. There are two supplementary rules, however, provided for foreign acquirers as follows.

If there is a foreign-registered financial institution, insurance company or investment company among the founders wishing to acquire a qualifying holding – in addition to the general requirements – a statement from the competent supervisory authority of the country of origin stating that the enterprise conducts its activities in compliance with prudential regulations must also be attached to the application for authorisation.

If the applicant is a financial institution, investment firm, insurance company, reinsurance company or a UCITS management company authorised in another EEA member state or is the parent of either of the companies; or controls any of these companies, the Central Bank shall forward the application without delay to the competent supervisory authority of the place where the financial institution, investment firm, insurance company, reinsurance company or the UCITS management company is established.

29 What factors are considered by the relevant regulatory authorities in an acquisition of control of a bank?

While considering an application, the Central Bank must investigate whether the applicant's activity and its influence over the credit institution endangers the prudent guidance and control of the credit institution. The Central Bank will also investigate whether the applicant's transparency in business connections and ownership structure and the structure of its direct or indirect holding in other businesses allows the competent authority to exercise effective supervision over the financial institution. The Central Bank shall refuse to grant the authorisation if the applicants' or its members' or executive officers' activities, influence on the financial

institution is considered harmful to the financial institutions independent, sound and prudent management; business activities or relations, or direct or indirect members' share or holdings in other companies is structured in a manner to obstruct supervisory activities, or good business reputation is lacking.

The Banking Act gives only examples of the circumstances when the applicant's or its owner's activity or its influence on the credit institution endangers its prudent operation.

According to the Banking Act, prudent operation is endangered particularly if:

- the applicant's or its owner's financial and economic standing is inconsistent with the extent of the acquisition of ownership share as proposed;
- the legitimacy of the origin of the funds used for acquisition of the ownership interest or the authenticity of the information the person specified as owner of the funds is not sufficiently evidenced;
- the applicant or its owner fails to meet the conditions determined for the credit institution by the Central Bank in the extraordinary action plan;
- the Central Bank has suspended its right to exercise voting rights within the five years before the notification; or
- in case of individuals, he or she:
  - has a criminal record;
  - has seriously or regularly breached the banking regulations, and it has been stated in a final decision less five years ago, does not have a satisfactory reputation; or
  - has been as established as having personal responsibility for the liquidation or a situation close to insolvency of a credit institution.

30 Describe the required filings for an acquisition of control of a bank.

When applying for authorisation for the acquisition the following filings are necessary:

- the application for authorisation, which will include details of any companies that have qualifying holdings in the credit institution, the percentage of shares owned by the applicant in the enterprise that holds a qualifying holding in a financial institution and the planned percentage of shares to be acquired;
- the contract proposal made for the acquisition of ownership or for an agreement to secure substantial advantages attached to voting rights, including the facts required to determine the grounds for disqualification and a statement regarding any criminal proceedings in respect of the executive officers of the applicant;
- the details of the applicant, a statement about its current and future obligations, proof that the applicant has no debts with the tax authorities and the details of the person or entity that has a qualifying holding in the applicant entity;
- a statement, with related probative documents, that the amount that is used for the acquisition originates from the applicant's lawful income;
- a description of the drafts for the organisational and ownership structure; and
- certain special filings required if the credit institution belongs or, following the acquisition, will belong to a body subject to supervision on a consolidated basis or supplementary supervision.

Update and trends

The government recently communicated its plan to cut the tax rate regarding the bank sector to increase the lending activity of banks, thus attempting to stimulate the economy. However, these changes are not planned to enter into force until 2016.

The government also announced it purchased 15 per cent ownership in the Erste Bank Hungary, which owned a market share regarding retail credit approximately 15 per cent. Moreover, in 2014 the government also purchased the Hungarian subsidiaries of the GE Capital and the Bayerische Landesbank in accordance with its plan to increase the percentage of the bank sector owned by Hungarians.

In 2014 the Central Bank established an asset management agency – the Hungarian Reorganisation and Receivables Management Company – to handle non-performing commercial real-estate loans to help banks clean up their corporate loan portfolio and boost lending.

31 What is the typical time frame for regulatory approval for both a domestic and a foreign acquirer?

The applicant or the owner may exercise voting rights deriving from the qualifying holding or the rights deriving from the advantages secured by the agreement connected with acquisition of ownership or voting rights as of the 60th business day of the Central Bank's receipt of the application for authorisation, unless the Central Bank refuses to authorise the acquisition as of the 60th business day of the receipt of the application.

The Central Bank may, however, call the applicant for completion of documents. The duration for the completion is 20 business days – in the cases of companies seated in another EU member state it is 30 business days – and this period is not included in the aforementioned 60 business-day period.

NAGY & TRÓCSÁNYI

Zoltán Varga **varga.zoltan@nt.hu**
Balázs Baranyai **baranyai.balazs@nt.hu**

Ugocsa utca 4/B
Budapest 1126
Hungary

Tel: +36 1 487 8700
Fax: +36 1 487 8701
www.nt.hu

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