

Hungary

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REGULATORY FRAMEWORK

Key policies

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.

Primary and secondary legislation

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 (Resolution Act);
- Act CCXXXVII of 2013 on credit institutions and financial enterprises (Banking Act);
- Act CXXXIX of 2013 on the National Bank of Hungary (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 (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 respects, Act CXX of 2001 on Capital Markets, Act LIII of 2017 on the Prevention and Combating of Money Laundering and Terrorist Financing, Act CCXXXV of 2013 on Payment Providers and Act XVI of 2014 on Collective Investment Trusts and Their Managers, and on the Amendment of Financial Regulations, also have significant effects on the banking sector.

Regulatory authorities

3 | Which regulatory authorities are primarily responsible for overseeing banks?

The financial markets are exclusively supervised by Hungary's central bank, the Hungarian National Bank (MNB). 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 MNB. This means that the MNB 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 MNB, and the MNB took the place of the HFSA in ongoing procedures.

The reformed MNB 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 and 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.

Government deposit insurance

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.

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 replaced by the Banking Act in 2014, 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-time affiliation fee at the rate of half-a-percent 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 to the FDI. The amount of annual fee to be paid may not be higher than 0.3 per cent of the amount, up to the limit covered by the compensation scheme of the deposits insured by the FDI and kept with the member institution on 31 December of the previous year and of the 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 OBA as provided for by statutory provisions on the annual accounting and bookkeeping obligations of credit institutions.

In the case of deposits being frozen, the FDI undertakes to provide compensation to the depositors for the principal and interest on frozen deposits. The above undertaking may not be higher than the amount

of principal and interest 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.

Receiving ordinary credit

The second element, laid down in Act CXXXIX of 2013 regarding the MNB, is the opportunity to receive extraordinary credit, which may be provided by the MNB for credit institutions and to the FDI in the event of an emergency. For this purpose, 'emergency' means that the insolvency of the credit institution endangers the stability of the entire monetary system. The MNB has discretionary power to provide such extraordinary credit.

The Hungarian government aims to increase the direct and indirect state's stake in the Hungarian banking system, the exact percentage of its interest constantly varies, since the state occasionally acquires new shares and unloads some as well. Current state ownership in credit institutions lies at about 50 per cent, including the Hungarian Development Bank and the Hungarian Export-Import Bank, which are solely owned by the Hungarian state.

Transactions between affiliates

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 perspective, 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;
- a financial enterprise;
- an investment enterprise;
- owned by the parent company's holding in the institution; or
- if the credit institution's parent company is a financial holding company.

In such cases, the companies are subject to supervision on a consolidated basis, which 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 qualifying as subject to the supplementary supervision, such as 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 MNB upon the occurrence of events invoking such measures.

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

- activities auxiliary to financial services:
 - currency exchange activities;
 - operation of payment systems;
 - money processing activities;
 - financial brokering on the interbank market; and
 - credit consultancy services;
- insurance mediation services;
- securities lending or borrowing, acting as nominee for shareholders, providing investment services pursuant to Act CXXXVIII of 2007, auxiliary services, intermediary activities and commodity exchange services;
- transactions in gold;
- keeping registers of shareholders;
- trust service;
- 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 any other form of security with a view to reducing or avoiding losses from financial services;
- activities relating to management and enforcement claims as an agent;
- sale and purchase of information related to financial instruments;
- conveyance of subsidies from the European Union, and the state;
- activities in connection with the acquisition of right of road usage pursuant to Act LXVII of 2013 on the fees payable for usage of motorways, highways and main roads in proportion to the distance that was taken;
- services in connection with managing deposits; and
- distribution of electronic money.

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.

Regulatory challenges

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

Hungary is facing similar regulatory challenges faced by other EU countries. On December 2017, the Basel Committee on Banking Supervision (BCBS) published a package of proposed reforms for the industry's global regulatory framework (Basel IV). These packages comprise reforms of the standardised approach for credit risk, the internal ratings-based approach, the quantification of company voluntary arrangements' risk and operational risk approaches. One principal feature is the way banks calculate risk-weighted assets. The implementation of the Basel IV framework is a remarkable challenge for the European banking industry, because methodologies for the determination of capital requirements are to be revised. The BCBS proposes a nine-year implementation timetable, which allows considerable time for preparation. A five-year 'phase-in' period would commence on 1 January 2022, with full implementation anticipated from 1 January 2027. For banks, this means that the next steps for efficient implementation must be planned and managed at an early stage and integrated

into the organisation's strategy. Further regulatory challenges arise from the new EU payment system regulations (PSD 2) as well as from the new EU data protection regulation, Regulation (EU) No. 2016/679. The money transmission system is developing, since an instant payment system was planned to be launched on 1 July 2019, but is postponed until 2 March 2020. The instant payment system will be open for third-party payment providers to join.

New regulatory challenges arise from technological changes and development, for example, online banking, conducting contracts online and digital financial services. A group of these challenges are connected to fraud management, like the digital identification of customers. In order to be prepared for the challenges ahead, MNB created and publicised its first FinTech Strategy titled Financial Innovation and Stability in October 2019. The strategy raises awareness that high level digitalisation supports the maintenance of the stability of the financial system and also its sustainable contribution to the economic growth and it can cause serious risks in stability and consumer protection if unregulated and unsupervised financial services become too popular.

Consumer protection

7 | Are banks subject to consumer protection rules?

The CXXXIX Act of 2013 on the MNB 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 MNB are efficient supervision, efficient enforcement of sanctions and the protection of defenceless groups in society.

The MNB, upon request, or of its own motion, monitors compliance with consumer protection provisions of Hungarian law and opens the proceeding. Proceedings for the protection of consumers' interests may not be opened more than five years after the infringement. The administrative time limit for these proceedings is six months. During this period, the MNB has the power to carry out trial transactions and to conduct direct inquiries or general inquiries. If the MNB 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 MNB 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 MNB are practices such as unilateral increment of fees and misinforming consumers.

Future changes

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 conjunction 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. It shall be a continuous function of the legal and regulatory policies to increase the ability of the banks to be shock resistant, generate and ensure sustainable and fair competition between banks and as well as increase consumer protection.

Digitalisation and new technologies will likely indicate changes in legal and regulatory policies in the next few years in order to provide a supportive, consumer friendly and stable environment to digital financial services (see question 6). Another anticipated change in the following years is connected to the sustainable financial services, since sustainability is a high priority for Hungary and for the European Union as well.

SUPERVISION

Extent of oversight

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 MNB. The banks and Hungarian branch offices of credit institutions established in other EU member states have to provide the MNB 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 MNB is entitled to compel the banks to supply data on certain issues. In the event that they find themselves in danger of breaching the rules on prudence, banks are obliged to notify the MNB.

During the supervisory review, the MNB 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 MNB, which are 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 MNB may conduct comprehensive inspections and direct inquiries 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 nine months. In the event of general inquiries the deadline is 12 months.

The MNB 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 MNB 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.

Enforcement

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

Laws are enforced during an authorisation procedure by the rejection of authorisation and the withdrawal of authorisation. On the other hand, the MNB may choose between measures determined in the Banking Act according to the seriousness of the violation.

Concerning the regulatory instruments, other supervisory tools also exist. These supervisory tools, such as recommendations, supervisory guidance, samples for by-laws, can help inform and guide the banking sector in connection with the supervisory interpretation of the legislation and the expectations of the authority.

In the event of a bank violating the laws concerning it, the MNB will consider taking measures, such as, for example:

- calling upon the bank and the legal person other than a financial institution engaged in providing financial services or financial auxiliary services, or both, to take the necessary steps to comply with the regulations of this Act and the regulations relating to prudential requirements;
- requiring the 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 MNB 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 MNB 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 MNB 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 MNB in its resolution or late compliance with those 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 500 million forints that cannot be paid off by the bank itself.

An inquiry by the MNB 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 violates the provisions of Hungarian law, the MNB first calls upon the branch or bank to rectify the situation. If it refuses to comply, the MNB 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 MNB may take the issue to the European Banking Authority.

If the MNB considers that the continued 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 MNB 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 long-term primary supervisory issues facing the MNB concerning the banking sector are assuring (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, competitive and sustainable growth;
- identifying poor market practices in the mortgage-lending market and risks threatening the liquidity of certain financial institutions;
- handling already known risks, including conduct risks;
- providing substantiation for reorganisation plans;
- proactively and consistently protecting consumers' rights and interests;
- providing a forum for resolving disputes;
- educating consumers;
- helping EU-level supervision;
- internal and external control to detect fraud;
- the quality of data of data services; and
- the detection of the risk of money laundering and terrorist financing.

Digitalisation and new technologies are increasing within the financial sector. With respect to this new shift, the MNB wishes to uphold a financial system that affords competitive and secure financial instruments to the consumers. The four strategic goals for the future are:

- supporting the headway of competitive financial services;
- increasing the efficiency and stability of the financial system;
- invigorating the Hungarian FinTech ecosystem; and
- strengthening the general financial culture and supporting the education of digital literacy.

In the FinTech Strategy, the MNB identifies several challenges ahead of the general use of innovative financial services, for example, a considerable number of natural persons still prefer to use cash instead of bank cards and who also avoid online banking.

RESOLUTION

Government takeovers

12 | 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 Hungarian parliament has adopted the Resolution Act, according to which the MNB shall, in the case of a systemic crisis, notify the minister in charge of monetary regulation and the capital and insurance market if the objective of resolution actions applied by the MNB has not been accomplished.

Based on the notification in his or her decision, the minister in charge of the monetary regulation, 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. During the course of state recapitalisation 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 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 through a public auction. No bank with liquidity problems has ever been fully acquired permanently by the Hungarian state.

According to the Banking Act, the MNB 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 or she 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.

Bank failure

13 | 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 MNB may pass a resolution in which it appoints a supervisory commissioner. In certain cases, the MNB 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 MNB.

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.

According to the Banking Act, each credit institution, which is not covered by supervision on a consolidated basis, or that is specifically required upon the review of the group recovery plan, is required to have in place a recovery plan proportionate to the nature, scale and complexity of the risks inherent in the business model and the credit institution's financial services and financial auxiliary services. The credit institution shall submit the recovery plan to the Authority after it is approved by its management body in its managerial function.

The minimum content of the recovery plan is prescribed by the Banking Act, containing among others:

- a summary of the key components of the plan, any significant changes relative to the previous plan and the overall recovery capacity of the credit institution;
- a communication and information plan for addressing adverse reactions in the market;
- definition of the credit institution's critical functions;
- arrangements designed to ensure a service level of the credit institution's critical functions having regard to liquidity and solvency;

- an estimated timeframe for each and every major action set out in the plan;
- description of circumstances which may constitute hindrances for the implementation of the plan, including the impact they may have on counterparties, contractual partners and, if the credit institution is subject to supervision on a consolidated basis, on other entities of the group; and
- procedures for determining the value, and the marketability of the credit institution's core business lines, processes and assets, including the measures required for their marketing and an estimated time frame for the implementation thereof.

The recovery plan shall include a framework of indicators that identifies the points at which the credit institution may take appropriate actions referred to in the plan. The indicators may be of a qualitative or quantitative nature relating to the credit institution's financial position, with the proviso that the credit institution is to ensure that such indicators shall be capable of being monitored easily.

14 | 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 interests 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 question 17 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 MNB continuously monitors the operation of credit institutions, it should notice when a credit institution does not operate prudently. In those cases, the MNB tries to enforce the prudent operation and, as stated 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.

Planning exercises

15 | Describe any resolution planning or similar exercises that banks are required to conduct.

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. According to the Banking Act, credit institutions are required to distinguish between pledged and unencumbered assets that are available at all times, in particular during emergency situations. They also 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;
- 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 EU member states and in third countries.

CAPITAL REQUIREMENTS

Capital adequacy

16 | 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, in order 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 (EU) No. 575/2013, 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 and 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 MNB 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 (EU) No. 575/2013 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.

17 | How are the capital adequacy guidelines enforced?

Banks have certain notification and data disclosure requirements as regards the MNB, in particular, that the banks comply with the capital requirements. The board of directors of a credit institution must immediately notify the MNB in writing:

- if the danger of illiquidity is imminent;
- in occurrences of danger with respect to the activities of the credit institution (eg, 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 MNB within two business days in writing if the subscribed capital is increased or reduced, or their certain financial activities have been suspended, limited or terminated. Credit institutions operating as a branch office have additional reporting obligations.

Through the supervisory review, the MNB 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.

Undercapitalisation

18 | What happens in the event that a bank becomes undercapitalised?

If the amount of a bank's equity capital falls below the minimum amount of subscribed capital prescribed by the Banking Act, the MNB 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 MNB may compel the financial institution's executive board 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 mandatory subscribed capital.

Insolvency

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

The MNB 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;
- set the maximum of the interest applicable by the credit institution;
- compel the board of directors to convene the general meeting;
- delegate a supervisory commissioner;
- revoke its consent to the appointment of liable executive officers; and
- 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 MNB can turn to the court of registry.

If the bank becomes insolvent, the board of directors must immediately notify the MNB 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 MNB at the Metropolitan Court.

The MNB initiates liquidation proceedings against the bank or the branch office of a third-country financial institution in the event that the MNB 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 MNB 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. Only the non-profit business association specifically established for liquidating organisations covered by Act CXXXIX of 2013 on the National Bank of Hungary shall be appointed as the liquidator or receiver of a financial institution.

The MNB may, from the submission of the request for liquidation, order the prohibition of all payments until the starting date of the procedure (the date of the order's promulgation in the Official Gazette). The MNB's permission is also required for the settlement's approval during the settlement process if the further operation of the bank constitutes a condition of the settlement. If no settlement has been reached or the court refuses to confirm the settlement, the court issues an order concerning, 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 these cases, the MNB 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 liquidation order's effect applies to all EU member states.

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

Recent and future changes

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

The Banking Act has been amended 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 every EU member state and the European Economic Area. 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, although 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. The future implementation of the Basel IV framework is a remarkable challenge for the European banking industry, because methodologies for the determination of capital requirements are to be revised.

OWNERSHIP RESTRICTIONS AND IMPLICATIONS

Controlling interest

21 | 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 that makes it possible to exercise a significant influence over the management of that undertaking.

In respect 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 MNB.

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.

Foreign ownership

22 | Are there any restrictions on foreign ownership of banks?

There are no restrictions, except for the risks of national security of nationals, legal persons or other entities outside of the European Economic Area, European Union and Swiss Confederation (see question 27).

Implications and responsibilities

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

Once the permission described in question 21 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 shall also be fulfilled during the course of the credit institution's operation.

24 | 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 21).

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 simply 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 MNB 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 MNB 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 MNB 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 MNB must take measures, or exceptional measures, against the credit institutions or the owners.

In the foregoing circumstances the MNB 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 MNB may limit or prohibit the credit institution concluding transactions between the owners and the credit institution. The MNB may also simultaneously call upon the owner of the financial institution that has a qualifying shareholding to take any necessary measures.

25 | 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, essentially the same measures and exceptional measures described in question 24 may be taken by the MNB, such as compelling the financial institution's board of directors to convene a general meeting and calling on the owners of the financial institution with a share of 5 per cent or more 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 owners' receivables 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 resolve the reason the measures were imposed or the credit institution's liquidation is ordered by the court.

If the financial institution fails to comply with the supervisory measures, the MNB may convene a general meeting of the financial institution at the court of registry.

If the measures taken by the MNB were insufficient to prevent the insolvency, the MNB must initiate the liquidation of the credit institution pursuant to liquidation rules governed by the Act on Bankruptcy and Liquidation Proceedings (see also question 19).

CHANGES IN CONTROL

Required approvals

26 | 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 21.

According to the Banking Act, the MNB'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 MNB's permission.

Finally, the MNB'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 MNB 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.

Foreign acquirers

27 | 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 Undertakings for Collective Investment in Transferable Securities management company authorised in another EEA member state, or is the parent of either of the companies, or controls any of these companies, the MNB shall forward the application without delay to the competent supervisory authority of the place where the applicant is established.
- Pursuant to Act LVII of 2018 on the control of foreign investments that violate Hungary's security interests, which has been in force from 1 January 2019, nationals, legal persons or other entities outside the European Union, European Economic Area or Swiss Confederation have to announce their financial services and operations of payment systems provided in Hungary. As regards those legal persons registered in Hungary, the European Union, European Economic Area or Swiss Confederation, which own more than 25 per cent – in the case of a public limited company, more than 10 per cent – of the ownership rights, or have dominant influence in a company incorporated in Hungary, providing services specified in the Act (eg, financial services or ancillary financial services), if the member, who has – according to the Hungarian Civil Code – majority control in the legal person is a citizen of a country or a legal person registered in a country other than the European Economic Area, European Union or Swiss Confederation, then there must also be an announcement of its financial services and operations of payment systems provided in Hungary.
- The foreign investor is allowed to acquire the specified ownership rights or dominant influence after the announcement of this to the minister appointed in a government decree and after the acknowledgement of the acquisition of ownership rights. The minister monitors whether the acquisition of ownership rights, the acquisition of the right to operate or carry out the newly started activity by the foreign investor violates the security interests of Hungary. In 60 days – which can be extended by a maximum of 60 days in

justified cases – from the arrival of the announcement, the minister confirms the acknowledgement of the announcement in writing or bans the acquisition of ownership rights, the acquisition of the right to operate or carry out the newly started activity if it would violate the security interests of Hungary. The foreign investor has the right to challenge the decision of the minister in cases specified in the Act in an administrative lawsuit.

28 | Under what circumstances can a foreign bank establish an office and engage in business? For example, can it establish a branch or must it form or acquire a locally chartered bank?

According to the Banking Act, a foreign company may provide financial services or engage in financial auxiliary service activities solely by way of its Hungarian branch. Credit institutions established in any EEA member state need not obtain the authorisation issued by the MNB for activities pertaining to cross-border services, and for activities that are carried out by their Hungarian branches and authorised by the competent supervisory authority of their home state.

Act CXXXII of 1997 on Hungarian Branch Offices and Commercial Representative Offices of Foreign-Registered Companies governs the general conditions and rules for the establishment, operation and termination of branch offices and direct commercial representative offices of foreign-registered companies in Hungary. A branch shall have legal capacity, it may obtain rights and undertake commitments under its corporate name on the foreign parent company's behalf, such as acquire property, conclude contracts, and may sue and be sued. A branch office is regarded as established upon having been entered in the company registration records and may commence entrepreneurial activities following such registration. According to the Act, a foreign company shall, in respect of the establishment and operation of its branch office, receive the same treatment as a domestic economic organisation. The foreign company shall continuously provide the assets required for the operation of the branch and the settlement of its liabilities. The foreign-registered company and the branch shall be subject to unlimited joint and several liability for the debts of the branch incurred during its activity. Proceedings in that respect may be initiated against the foreign-registered company and its branch before a Hungarian court.

Unless otherwise prescribed by specific other legislation, the provisions of Act CXXXII of 1997 shall be applied to:

- the establishment of Hungarian branch offices by foreign credit institutions;
- the operation, state supervision, auditing and dissolution of such branch offices; and
- insolvency proceedings.

The financial branch office of a foreign company registered in any EEA member state established in Hungary may commence operations in accordance with the provisions of specific other legislation upon submission of an application for registration.

According to the Banking Act as regards the establishment of a financial institution incorporated as a branch, the financial institution shall enclose further documents with the application for authorisation of establishment than non-foreign institutions, such as:

- the foreign financial institution's charter document;
- the foreign financial institution's certificate of incorporation or a certificate issued within three months to date in proof of the foreign financial institution being registered in the companies (trade) register;
- a copy of the authorisation issued by the competent supervisory authority of the state where the foreign financial institution is established;

- a certificate issued within 30 days to date proving that the foreign financial institution participating in the foundation has no outstanding debts owed to the tax or customs authorities or the health insurance administration agency or pension insurance administration agency of competence in Hungary or in the state where the said foreign financial institution is established;
- a certificate from the competent supervisory authority of the state where established stating that the financial institution's head office from which its operations are directed is in that state;
- in the case of a credit institution or a financial enterprise, the audited and approved balance sheet and the profit and loss account of the founder, respectively, for the previous three fiscal years or for the previous fiscal year;
- a statement concerning the off-balance sheet liabilities of the foreign financial institution;
- a detailed description of the founder's ownership structure and of the circumstances under which the founder is considered to belong to the group of persons being affiliated with, furthermore the leading company's consolidated annual account for the previous year if the leading company is required to prepare a consolidated annual account;
- a statement executed in a private document representing conclusive evidence from the persons indicated in the application in which to grant consent to having the authenticity of the documents attached to the application for authorisation checked by the Authority by way of the agencies it has contacted;
- an indication of the financial services, financial auxiliary services performed by the applicant as authorised by the competent supervisory authority of the place where established, and the locations where such activities are performed;
- description of the scope of authority of the senior executive of the branch, and a description of the applicant's bodies the approval of which is expressly required for passing certain decisions; and
- a statement of the competent supervisory authority of the place where established in evidence of having no grounds for exclusion regarding the senior executive – of citizenship other than Hungarian – filling and occupying such office.

Factors considered by authorities

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

While considering an application, the MNB 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 MNB 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 MNB shall refuse to grant the authorisation if the applicants' or its members' or executive officers' activities and influence on the financial institution is considered harmful to the financial institution's independent, sound and prudent management, business activities or relations, 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, or there are reasonable grounds to suspect that, in connection with the acquisition of qualifying holding, money laundering or terrorist financing within the meaning of the relevant legislation is being or has been committed or attempted, or that the planned acquisition of qualifying holding could increase the risk thereof. In relation to control of foreign investments that violate Hungary's security interests, see question 27. The Banking Act only gives 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 MNB in the extraordinary action plan;
- the MNB has suspended its right to exercise voting rights within the five years before the notification; or in the case of individuals, he or she:
 - has a criminal record;
 - has seriously or regularly breached the banking regulations, and this has been stated in a final decision less than five years ago;
 - has been established as having personal responsibility for the liquidation or a situation close to insolvency of a credit institution; or
 - does not have a good business reputation.

Filing requirements

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

When applying for acquisition authorisation, the following filings are necessary according to the Banking Act:

- in the case of credit institutions that are subject to supervision on a consolidated basis or supplementary supervision, a description of the apparatus for the conveyance of information related to supervision on a consolidated basis or supplementary supervision and a statement from the persons with close links to the credit institution guaranteeing to provide the authority with the data, facts and information necessary for supervising the credit institution on a consolidated basis or for supplementary supervision, and a statement from each natural person with close links to the credit institution containing his or her consent to have the personal data he or she has disclosed to the credit institution processed and disclosed for the purposes of supervision on a consolidated basis or supplementary supervision;
- the applicant's specific identification data as described in the Act;
- evidence concerning the legitimacy of the financial means for acquiring a qualifying holding;
- similarly, authorisation will be refused if documents issued within 30 days in proof of having no outstanding debts owed to the tax authority (if the taxpayer is listed in the taxpayers' register as being free of tax debts it shall be recognised as equivalent), customs authority, health insurance administration agency or pension insurance administration agency of competence under the applicant's national law;
- a statement declaring that other holdings and business activities of the applicant are not harmful to the prudent management of the financial institution;
- for natural persons, an official certificate from the body operating the penal register for the purpose of verification of having no prior criminal record, or a similar document that is deemed equivalent under the applicant's national law;
- if other than a natural person, the applicant's consolidated instrument of constitution in effect on the date of application, a certificate issued within the last 30 days proving that the applicant was

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established (registered) in compliance with the relevant national regulations and is not adjudicated in bankruptcy, liquidation or dissolution proceedings, and its senior executives are not subject to any disqualifying factors;

- if other than a natural person, a detailed description of the applicant's ownership structure supported by documentary evidence and information about beneficial owners, and if the applicant is subject to supervision on a consolidated basis a detailed description of these circumstances, furthermore, the consolidated annual account for the previous year of the credit institution or investment firm subject to supervision on a consolidated basis, if they are required to prepare a consolidated annual account;
- a statement declaring any and all contingent liabilities and commitments;
- a statement of the applicant executed in a private document representing conclusive evidence that gives consent to attaching authentic documents to the application; and
- if there is a foreign financial institution proposing to acquire a qualifying holding a statement or certificate from the competent supervisory authority of the country of establishment stating that the enterprise conducts its activities in compliance with prudential regulations.

Timeframe for approval

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 MNB's receipt of the application for authorisation, unless the MNB refuses to authorise the acquisition as of the 60th business day of the receipt of the application.

The MNB 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.

UPDATE AND TRENDS**Key developments of the past year**

32 | Are there any emerging trends or hot topics in banking regulation in your jurisdiction?

The main issues and challenges are connected to new technologies and digitalisation. The use of cash instead of bank cards and other modern financial instruments is still widespread in Hungary. However, new technology is emerging heralding significant changes in the near future. As FinTech solutions gain popularity, the MNB published its first FinTech Strategy in October 2019, which establishes the current environment and also introduces goals and recommendations for the future. Based on the relevant EU regulation, strong customer authentication should have been applied from 14 September 2019; however, the MNB decided to provide an extra 12 months for the Hungarian financial sector to meet with the statutory requirements in case of online payments. Payment service providers shall submit a migration plan to the MNB, which will continuously monitor its fulfilment. During the 12-month period, customers shall be able to use their cards for online payments without increased risk since the liability rules of Act LXXXV of 2009 on the Pursuit of the Business of Payment Services are applicable to the payment service providers. Another important aim is to support sustainable financial services in Hungary, since investors often lack information regarding what shall be considered as a sustainable financial product.