



THE CENTRAL BANK OF HUNGARY

European Systemic Risk Board
Francesco Mazzaferro
Head of Secretariat

Sonnemannstrasse 22
60314 Frankfurt am Main
Germany

Ref.No.: 49750-2/2015
Budapest, March 27, 2015

Subject: notification of ESRB regarding a new macroprudential measure regulating the forint maturity mismatch of credit institutions incorporated in Hungary

Dear Mr. Mazzaferro,

Hereby I would like to notify the ESRB that Magyar Nemzeti Bank (hereinafter: MNB) intends to introduce a new macroprudential regulation with the aim of regulating the forint maturity mismatch of the credit institutions.

The act on the conversion of retail mortgages denominated in foreign currency into HUF took effect on 1 February, 2015. The conversion effectively deals with exchange rate risks, but it also causes a serious systemic HUF maturity mismatch, since most of the residential mortgage loans that are to be converted have remaining maturities of more than 10 years. The maturity mismatch risk generated by residential FX mortgage loans and other FX loans was handled by the MNB decree on the Foreign Exchange Funding Adequacy Ratio (hereinafter: FFAR). However, FFAR cannot mitigate maturity mismatch brought by the conversion of FX loans to HUF any more. Thus there is a need to introduce a new, targeted macroprudential regulatory measure to resolve the excessive maturity mismatch between HUF mortgage loans and their funding sources.

The Basel Committee on Banking Supervision (BSBS) developed the Net Stable Funding Ratio to reduce funding risk over a longer time horizon by requiring banks to fund their activities with sufficiently stable sources of funding in order to mitigate the risk of future funding stress. Therefore MNB started to identify the most appropriate regulatory solution by examining whether frontloading the Basel NSFR would serve our goal. We have concluded that since the systemic risk stems from the excessive maturity mismatch between the residential mortgage loans with maturities of more than 10-20 years and retail deposits with a considerably shorter actual maturity we would need a more targeted measure as these mortgage loans represent a significant proportion in the balance sheet of the banking system. Since unlike Slovakia or Denmark the Hungarian regulation doesn't prescribe any matching requirement between mortgage loans underwritten and the proportion of mortgage bonds that have to be issued, the excessive maturity mismatch that is compounded with the concentrated funding needs resulting from the simultaneous execution of the conversion in all banks in a relatively short time period warrants a prompt macroprudential intervention.

Our approach is to require that banks fund their long term mortgage loans with mortgage-backed funding (mortgage bonds, MBS, etc.) at least partially. Mortgage-backed funding can be described as long term source of funding that offer funding to banks at a relatively low price, given that they offer dual recourse

to investors (to both the issuer and the cover pool) and they are not bail-in-able, which means that they also have positive credit ratings, serving as a safe investment for investors. Furthermore, due to the conversion, there is a huge amount of residential HUF mortgage loans available for the issuance of such instruments. Based on the issues concerned above, the draft decree introduces the Mortgage Funding Adequacy Ratio (hereinafter: MFAR).

Specificities in detail

The new macro-prudential regulation of MNB intends to introduce a minimum required level of HUF denominated mortgage-backed liabilities relative to the amount of residential mortgage loans to orient banks towards more balanced funding. According to the draft decree this minimum proportion is 15%.

In the numerator of the MFAR the following liabilities can be taken into account so that the measure would be neutral towards the different forms of mortgage-backed funding:

- mortgage bonds issued by a mortgage loan company under supervision on a consolidated basis,
- residential MBS (hereinafter: RMBS) issued by institutions under supervision on a consolidated basis,
- refinancing mortgage loans,
- repurchasing obligation stemming from the sale of an independent lien.¹

In the denominator of the MFAR the net value of the residential mortgage loans with at least one year of residual maturity shall be taken into account.

During the calibration of MFAR it had to be taken into account that the regulation's aim was to orient financial institutions in the direction of reducing HUF maturity mismatch and the inclusion of long-term liabilities, so that they could obtain real, long-term external funding. Thus, the considerable liabilities have to meet each of the following conditions:

- denominated in HUF;
- covered by retail mortgage or lien founded on residential property;
- at least one year of residual maturity at the time of the
 - issuance of mortgage bonds/RMBS or
 - purchase of independent lien or
 - borrowing of the refinancing mortgage loan;
- are not owned by an institution under the same consolidated supervision as the issuer

In the initial phase - taking into account the current demand conditions - it is important to reinvigorate the issuance of mortgage bonds, therefore the draft decree makes certain concessions:

- In the numerator those non HUF denominated securities that were issued prior to 31 March 2015 (deadline for the FX retail mortgage conversion in the banks' balance sheets) can also be taken into account, as negotiations between stakeholders and the MNB led to this mutually acceptable deadline to facilitate compliance.
- As an exception to the consolidation principles, mortgage bonds can be taken into account even if they are owned by an institution under the same consolidated supervision, if they issued prior to 31 March 2015 and are accepted by the MNB or the European Central Bank (hereinafter: ECB) as collateral in ordinary monetary operations. The inclusion of such securities is possible only on 20% of the inclusion value applied by the MNB or the ECB.

¹ Act XXX of 1997 on Mortgage Loan Companies and on Mortgage Bonds: Section 8 (4): Mortgage loan companies may purchase independent liens on real estate properties located in the territory of Hungary:

a) if filed by the seller credit institution in security of a mortgage loan in due compliance with all other criteria specified in Subsection (2); and

b) if the lien is repurchased in installments or under deferred payment terms by the seller credit institution at the time of sale on condition that the mortgage will be transferred to the repurchasing credit institution only when the purchase price is paid up in full.

Legislative process

MNB initiated a consultation procedure with the ECB on March 25, 2015. Beforehand MNB invited a high level consultation in respect of the draft decree with the stakeholders, thereby providing an opportunity for financial institutions to offer comments and proposals. The course of public consultation has successfully ended; comments and proposals are incorporated in the draft decree. Hence, following the conclusion of the consultation procedure with the ECB, the legal wording of the decree will be approved by the Financial Stability Board of the MNB, and the decree will be published in the Official Gazette.

The proposed date of the adoption of the MNB decree on the regulation of banks' HUF maturity mismatch is 30 June 2015.

Considering the already issued amount of mortgage bonds and the present legal background already enabling meeting the conditions of MFAR, the proposed regulation sets a minimum of 15% compliance level from 1 July 2016, which will be reviewed a year later if necessary. At the same time it may be necessary to review the considerable elements in the numerator of MFAR to prescribe increased limit of maturity to push institutions to even longer-term funding.

Sincerely Yours:

MAGYAR NEMZETI BANK


Nagy Márton
Executive Director
Financial Stability and Lending Incentives



Attachment: Draft Decree of the Governor of Magyar Nemzeti Bank on the regulation of the forint maturity mismatch of credit institutions (unofficial English translation)

Decree

.../2015 (....) of the Governor of the Magyar Nemzeti Bank
on the regulation of the forint maturity mismatch of credit institutions

Acting on the basis of the authorisation in Article 171 (1) k) kc) of Law CXXXIX of 2013 on the Magyar Nemzeti Bank (hereinafter: the MNB Act) and within the scope of my duties specified in Article 4 (7) of the MNB Act, I hereby decree the following:

Section 1 (1) Except for the entities listed in Subsection (2), the provisions of this Decree shall apply to credit institutions operating as companies limited by shares and the Hungarian branch offices of third country credit institutions (hereinafter: credit institutions), as well as the institutions of groups including credit institutions under consolidated supervision (hereinafter: credit institution group) pursuant to Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises and Act CXXXV of 2013 on the integration of cooperative credit institutions and amendments to economy-related legal regulations.

(2) The scope of this Decree does not cover:

- a) Magyar Fejlesztési Bank Zrt.,
- b) Magyar Export-Import Bank Zrt.,
- c) Központi Elszámolóház és Értéktár (Budapest) Zrt. and
- d) building societies not subject to consolidated supervision.

Section 2 For the purposes of this Decree:

1. mortgage bond: the instrument defined in Section 11 of Act XXX of 1997 on Mortgage Banks and Mortgage Bonds (hereinafter: Mortgage Act);

1. net book value: the concept defined in the MNB Decree on the obligations of money and credit market institutions to report data to the central bank's information system primarily to enable the Magyar Nemzeti Bank to carry out its supervisory duties;

3. refinancing mortgage loan: the extension of a loan pursuant to Section 5(1) of the Mortgage Act;

4. repurchase price: the concept defined in Section 8(5) of the Mortgage Act.

Section 3 (1) The mortgage funding adequacy ratio is the indicator calculated according to Annex 1.

(2) The mortgage funding adequacy ratio of the credit institution shall at all times stand at a level of 0.15, with the exception of the case defined in Subsection (3).

(3) The mortgage funding adequacy ratio requirement shall be regarded as fulfilled if the denominator is zero.

(4) In case of credit institution groups, the level defined in Subsection (2) shall be met jointly, in a consolidated manner by all group members established in Hungary.

(5) Mortgage funding adequacy ratios shall be calculated on the basis of the quarterly data reporting of credit institutions to the Magyar Nemzeti Bank (hereinafter: MNB).

Section 4 The preliminary consultation of this draft Decree pursuant to the sixth indent of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions has been carried out.

Section 5 (1) This Decree shall enter into force on 1 July 2016.

Method for calculating the mortgage funding adequacy ratio

1. The mortgage funding adequacy ratio is determined as the quotient of the forint liabilities on the collateral pledged for residential mortgage loans over the stock of residential forint mortgage loans with residual maturity in excess of one year.

2. The following assets may be taken into account in the numerator of the mortgage funding adequacy ratio:

e) the stock of mortgage bonds issued by the mortgage lending member of the credit institution group,

f) the stock of securities issued by the credit institution group member on collateral pledged for residential mortgage loans pursuant to Article 129 of Regulation (EU) No. 575/2013/EU of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012;

g) the refinancing mortgage loans received,

h) the repurchase price due following the sale of an independent lien.

3. The liabilities defined in Point 2 — with the exceptions defined in Point 4 — may be taken into account in the numerator of the mortgage funding adequacy ratio if

e) they are denominated in Hungarian forint,

f) they originate from the collateral or the sale of a residential mortgage loan or a lien based on residential property,

g) they had a maturity of at least one year at the time of issuance of the mortgage bond or the mortgage-backed security, at the time of the sale of the independent lien within the meaning of Section 8(4) of the Mortgage Act or at the time of taking out the refinancing mortgage loan, and

h) they are not recorded on the balance sheet of the same credit institution group member.

4.

a) Fulfilment of Point 3, item a) does not need to be examined in case of securities issued in a foreign currency prior to 31 March 2015,

b) Point 3, item d) does not need to be applied in the event of the set-off of mortgage bonds issued prior to 31 March 2015 and recorded on the balance sheet of an institution under consolidated supervision with the mortgage bank and classified as collateral approved by the MNB or the European Central Bank. Mortgage bonds meeting the criteria defined herein may be included at up to 20 per cent of the valid adjusted market value applied by the MNB or the European Central Bank.

5. The liabilities included in the numerator of the mortgage funding adequacy ratio shall be included at their balance sheet value. In case of institutions applying Hungarian accounting standards, when determining this value, the value of the accruals associated with the issued liability shall also be taken into account when drafting the report.

6. Refinancing mortgage loans extended by the mortgage bank to institutions outside its own credit institution group and the repurchase price due by institutions outside its own credit institution shall be deducted from the numerator of the mortgage funding adequacy ratio.

15. The denominator of the mortgage funding adequacy ratio is the net book value of the stock of residential forint mortgage loans with residual maturity in excess of one year.

7. The net book value of the stock of residential forint mortgage loans with residual maturity in excess of one year of the building society member of the credit institution group may be deducted from the denominator of the mortgage funding adequacy ratio. The deductible stock of mortgage credit shall be decreased by the balance sheet value of loans extended by own credit institution group members to the building society.