ESRB
European Systemic Risk Board
European System of Financial Supervision

EUROPEAN CENTRAL BANK
EUROSYSTEM

Notification template for national macroprudential measures not covered by of the Capital Requirements Regulation (CRR)/ Capital Requirements Directives (CRD) (other than borrower-based measures)

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This notification will be made public by the ESRB once the relevant authorities have adopted and published the notified macroprudential measure[1].

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1. Notifying national authority and scope of the notification		
1.1	Name of the notifying authority	Magyar Nemzeti Bank (MNB)
1.2	Country of the notifying authority	Hungary
1.3	Name of the macroprudential measure that is notified	Foreign Exchange Coverage Ratio (FECR)
2. Description of the measure		
2.1	Description of the measure	The requirement for the Foreign Exchange Coverage Ratio (hereinafter: FECR), which has been in force since 2016, limits the degree of mismatch between FX assets and FX liabilities in proportion to the balance sheet total (hereinafter BST), at 15 percent before the amendment.

[1] On request by the notifying authority, it may be agreed with the Head of the ESRB Secretariat that this notification, or a part thereof, should not be published for reasons of confidentiality or financial stability.

Date of template version: 26-11-2021

		With the amendment, the so far symmetrical regulatory limit (+/-15 percent) on the on-balance sheet open FX position became asymmetric, and the minimum value of the FECR was reduced to -30 percent in the case when banks' FX liabilities exceed the amount of FX assets (FX liability surplus). The 15 percent limit remains unchanged in the case when banks' FX assets exceed the amount of their FX liabilities (FX asset surplus). $$-\mathbf{30}\% < \frac{\textbf{FX assets} - \textbf{FX liabilities}}{\textbf{Balance Sheet Total}} < \mathbf{15}\%$$.
2.2	Legal basis and process of implementation of the measure	As macroprudential authority in Hungary, the MNB has the power to issue legally binding regulations to reduce systemic risks, as stipulated in Law CXXXIX of 2013 on the Magyar Nemzeti Bank (the MNB Act). Article 171 (1) k) kc) of the MNB Act authorises the Governor of the MNB to decree the measures required to prevent the build-up of systemic risks and to reduce systemic risks, and to increase the resilience of the financial intermediary system, within the strategic framework defined by the Monetary Council, based on the decision of the Financial Stability Board, including requirements for the reduction of systemic liquidity risks. Furthermore, Article 4 (7) of the MNB Act states that the MNB shall explore risks threatening the financial intermediary system as a whole, it shall help to prevent the build-up of systemic risks, and shall help to mitigate or eliminate the systemic risks that may already exist.
2.3	Coverage	The scope of the measures remains unchanged. The FECR requirement shall apply to credit institutions operating as companies limited by shares and the Hungarian branches of foreign credit institutions, as well as the credit institutions of groups including credit institutions under consolidated supervision. The scope of the measure does not cover building societies, the Magyar Fejlesztési Bank Zrt., the Magyar Export-Import

		Bank Zrt. and the Központi Elszámolóház és Értéktár (Budapest) Zrt.. Banks and banking groups subject to the proposed regulation need to comply on a sub-consolidated level.
2.4	Any other relevant information	
3. Timing for the measure		
3.1	Timing for the decision	05/11/2021
3.2	Timing for publication	07/12/2021
3.3	Disclosure	Communication on the official internet site of the MNB in Hungarian and English: Press release https://www.mnb.hu/en/pressroom/press-releases/press-releases-2021/mnb-supports-efficient-operation-of-fx-swap-market-by-amending-macroprudential-regulation Information on macroprudential measures addressing liquidity and financing risks: https://www.mnb.hu/en/financial-stability/macroprudential-policy/the-macroprudential-toolkit/instruments-addressing-liquidity-and-financing-risks Decree is available (only in Hungarian): https://njt.hu/jogszabaly/2015-25-20-2C
3.4	Timing for application	10/12/2021
3.5	End date (if applicable)	

4. Reason for the activation of the measure		
4.1	Description of the macroprudential risk to be addressed	The aim of the instrument is to lower the risks associated with excessive currency mismatches. The reduction of on-balance sheet currency mismatches also reduces institutions' reliance on off-balance sheet instruments (mainly swaps) which, in turn, lowers the risks stemming from these instruments as well (renewal, liquidity and margin call risks). Growing FX liabilities and their surplus over FX assets in the banking sector mainly due to FX liquidity abundance particularly embodied in the growing amount of client and corporate wholesale deposits observed since the outbreak of COVID pandemic led to decreasing, and then negative FECR levels. The change stems mostly from abundant global liquidity along with clients' FX rate expectations. As banks' have limited control over these funds, their on-balance sheet FX positions open naturally towards the liability side. This means that the current FECR limit is becoming binding to some institutions and hampers their normal liquidity management operations. The easing will not lead to a substantial increase in systemic risks, and therefore does not jeopardise the Decree's macroprudential objective. Excess FX liabilities carry much lower risks than excess FX assets. In the latter case, banks use mostly HUF funds to finance FX loans, relying on mostly short-term FX swaps to hedge their FX rate risks, which leads to serious renewal risk (for further elaboration, see ESRB Recommendation ESRB/2011/1). With FX liability surpluses, the central bank can provide HUF in the form of FX swaps to the extent of the collateral available, which lowers renewal risks significantly. (See also 5.1.)

4.2	Indicators used for activation of the measure	The FSB of the MNB has considered numerous factors while deciding on the current set of measures. • On Balance Sheet FX mismatch between assets and liabilities – in absolute (nominal) value and relatively to the Balance Sheet Total (BST); at sectoral and at individual level • Gross and net FX swap market positions in absolute terms and relatively to BST • FX swap stock – market share of banks • Short and long-term external debt of banks – in absolute terms and relatively to total liabilities • Structure of FX assets and FX liabilities (composition by type, counterparty, maturity)
4.3	Effects of the measure	The modification of the FECR may improve some banks' accommodation capacities with no harm to the main objectives of stable funding. The greater room for manoeuvre of banks supports the efficiency of the FX swap market, which could also help increase the efficiency of monetary transmission and reduce end-of-quarter FX swap market turbulences. The amendment significantly increases the scope for restructuring the denomination structure of banks' balance sheets; however, no significant change in the structure of the balance sheet is expected at the sector level because large banks are less constrained by the regulation and therefore less likely to change their balance sheet structure because of the amendment. Significant adjustments are only expected on the part of some smaller banks mainly operating in form of Hungarian branches of foreign banks.
5. Sufficiency, consistency and non-overlap of the policy response		
5.1	Sufficiency of the policy response	The amendment gives more scope to the FX swap market activity of banks; however, the measure remains sufficient in mitigating risks from currency mismatches in the MNB's view. The easing will significantly increase the room for manoeuvre in changing the denomination structure of bank balance sheets without leading to a substantial

		increase in systemic risks. Excess FX liabilities carry significantly lower risks compared to an FX asset surplus, which was one of the main characteristics of the unsustainable financing structure that led to the 2008 financial crisis. Exchange rate risk arising from intra-balance sheet FX differences is managed by banks with derivative instruments. Prior to the 2008 crisis, this meant mainly short-term swaps for receiving foreign currency due to FX asset surpluses, which carried significant renewal risks. However, in the case of the currently observable surplus of foreign currency funds, swap transactions for receiving HUF are required, which means that the risk of the FX swap market drying up is much lower, as the MNB can be available to provide Hungarian forint liquidity to the extent of acceptable collateral. In addition, the Foreign exchange Funding Adequacy Ratio (FFAR) regulation continues to ensure that FX funds are sufficiently long-term and stable. The MNB monitors the relevant processes and risks and is ready to amend the regulations accordingly, if necessary.
5.2	Consistency of application of the policy response	This measure is an amendment of the FECR measure which was introduced to achieve an intermediate objective (Mitigate and prevent excessive maturity mismatch and market illiquidity) specified in the ESRB recommendation ESRB/2013/1. This is a national measure outside the scope of EU legislation; for systemic liquidity risks, the MNB is entitled, as a national authority, to issue decrees aimed at the mitigation of risks. The requirement encourages the maintenance of prudent liquidity and funding positions and is designed to mitigate excessive currency mismatches.
5.3	Non-overlap of the policy response	The measure is a loosening one. Thus, it intends to extend the room for banks to operate within less constraining conditions with no real threat to the financial stability aspect targeted by the FECR. The FECR supplements the FFAR regulation that ensures that FX funds are sufficiently long-term and stable to cover FX assets and the corresponding

		financing needs. These measures are complementary to each other, but both are necessary to successfully mitigate risks from currency mismatches and FX funding practices: • while the FECR poses a general limit on currency mismatches between assets and liabilities, • the FFAR, beyond the latter, ensures that non-liquid FX assets are financed by stable FX funds, also mitigating risks from maturity mismatches.
6. Cross-border and cross-sector impact of the measure		
6.1	Assessment of cross-border effects and the likely impact on the Internal Market (Article 133(11)(d) CRD and Recommendation ESRB/2015/2[2])	The regulation is not expected to have a significant impact on the cross-border activities of banks, or on the internal market. However, the MNB will monitor the impact of the new measure continuously.
6.2	Assessment of leakages and regulatory arbitrage within the notifying Member State	The MNB expects no material leakages and regulatory arbitrage within Hungary because of the simple structure of the measure and its targeted effect on risks. However, the MNB will monitor the impact of the new measure continuously.
6.3	Request for reciprocation	The MNB does not request the ESRB to issue a recommendation to other Member States to reciprocate the measure as it is not expected to have material cross-border effects. Additionally, the measure can only be applied at the institution level and cannot be introduced to only the Hungarian exposures of foreign institutions which makes the reciprocation irrelevant.

[2] Recommendation of the European Systemic Risk Board of 15 December 2015 on the assessment of cross-border effects of and voluntary reciprocity for macroprudential policy measures (ESRB/2015/3) (OJ C 97, 12.3.2016, p. 9).

6.4	Justification for the request for reciprocation	
7. Miscellaneous		
7.1	Contact person(s)/mailbox at notifying authority.	**Mr. Gergely Fábián**, Executive Director Executive Directorate for Financial System Analysis and Statistics Phone: +36 (1) 428 2600/1874 E-mail: fabiang@mnb.hu **Mr. Tamás Nagy**, Director Directorate for Financial System Analysis Phone: +36 (1) 428 2600/2639 E-mail: nagyt@mnb.hu
7.2	Any other relevant information.	
7.3	Date of the notification	29/03/2022