

3.16 HUNGARY

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I. FRAMEWORK

Act No. XXX of 1997 on Mortgage Banks and Mortgage Bonds (Mortgage Bank Act) contains the specific rules applicable to mortgage banks and mortgage bonds. Act No. CCXXXVII of 2013 on Credit Institutions and Financial Enterprises is applicable generally to the establishment, operation, supervision and liquidation of mortgage banks, unless otherwise provided by the Mortgage Bank Act.

II. STRUCTURE OF THE ISSUER

Mortgage banks are specialised credit institutions in Hungary whose business activity is restricted, in principle, to mortgage lending, mortgage refinancing and auxiliary financial services: mortgage banks grant financial loans secured by mortgages on real estate property located on the territory of the Republic of Hungary and other European Economic Area (EEA) countries. Funds will be raised by way of issuing mortgage bonds ("*jelzáloglevél*"). Cover assets will be held on the balance sheet of the mortgage bank. All the mortgage bonds of a single mortgage bank are covered by the same (one single) cover pool which is only open to changes with the prior permission of the coverage supervisor, acting in the interest of mortgage bond holders.

III. COVER ASSETS

The Mortgage Bank Act provides that mortgage banks shall always possess cover surpassing the principal of outstanding mortgage bonds and the interest thereon both on a nominal basis and based on present value calculation. Decree No. 40/2005. (XII.9.) of the Minister of Finance contains the detailed provisions on the present value calculation of cover assets and the methodology of stress tests to be published on a regular basis. Furthermore, mortgage banks shall prepare a manual of keeping the register of cover assets ("*fedezetnyilvántartás*"), which also needs the approval of the Magyar Nemzeti Bank (MNB) in its capacity as financial supervisory authority and the coverage supervisor.

Loans secured by a residential real estate can be taken in cover up to 70% of the mortgage lending value of the property. In case of loans secured by commercial real estate the limit is 60%.

Mortgage bonds are covered by loans secured by mortgages ("*jelzálogjog*"), independent mortgage liens ("*önálló zálogjog*"), or by mortgages and joint and several surety assumed by the Hungarian State ("*állami készfizető kezességvállalás*"). Supplementary coverage may exclusively consist of liquid assets listed in the Mortgage Bank Act and may not exceed 20% of the total coverage. Pursuant to the Mortgage Bank Act, cover assets must be entered into the register of cover. The availability and quality of cover assets is permanently monitored by the coverage supervisor, reports on availability and quality of cover assets are disclosed on a daily basis.

According to Section 14 (5) of the Mortgage Bank Act, in the case when mortgage bonds and their coverage are not denominated in the same currency, the mortgage bank is obligated to hedge the currency exchange risk by entering into derivative transactions. Section 3 (10) of the Mortgage Bank Act provides that mortgage banks are entitled to conclude such transactions exclusively for hedging purposes, i.e. risk management and liquidity. The Mortgage Bank Act entitles mortgage banks to include derivatives concluded with the aforementioned objectives in the ordinary coverage as well.

IV. VALUATION AND LTV CRITERIA

The rules of calculation of the mortgage lending value ("*hitelbiztosítéki érték*") are included in the Decree of the Minister of Finance No. 25/1997 on the Calculation Methods of the Mortgage Lending Value of Real Estate not Qualifying as Agricultural Land and the Decree of the Minister of Agriculture No. 54/1997 on the Calculation

Methods of the Mortgage Lending Value of Real Estate Qualifying as Agricultural Land. Both decrees prescribe the use of comparative methods, and prescribe the application of the principle of carefulness in the valuation process. Furthermore, they also determine the validity of the valuation report.

Mortgage banks may also provide appraisal services to determine the market value and the mortgage lending value of real properties.

Mortgage lending value calculation provisions refer to the sustainable aspects of the property. The mortgage bank's internal regulation for determining mortgage lending value is based on methodological principles defined in the above decrees. Such internal regulations are also subject to the former approval of the MNB.

V. ASSET – LIABILITY MANAGEMENT

As indicated above, the Mortgage Bank Act provides that mortgage banks shall always possess cover surpassing the principal of outstanding mortgage bonds and the interest thereon. Mortgage banks shall comply with the above requirements as follows:

- > The aggregate amount of the outstanding principal claims considered as coverage, reduced by the amount of any value adjustments, shall exceed 100% of the amount of the nominal value of the outstanding mortgage bonds; and
- > The aggregate amount of interest accrued on the outstanding principal claims considered as coverage, reduced by the amount of any value adjustments, shall exceed 100% of the amount of interest accrued on the nominal value of the outstanding mortgage bonds (Section 14 (2) of the Mortgage Bank Act).

Under Section 14 (4) of the Mortgage Bank Act the amount of coverage for mortgage bonds shall always be calculated and published at their present value as well.

Cash flow mismatch between cover assets and cover bonds is furthermore reduced by special prepayment restrictions on the borrowers' side.

VI. TRANSPARENCY

Mortgage banks shall publish the amount of the nominal value and the accrued interest of the outstanding mortgage bonds as well as the value of the coverage assets in a national daily newspaper and in the Exchange Journal as of the last day of each quarter, before the last day of the next month. Such figures need to be certified by the coverage supervisor and disclosed to the MNB as well.

VII. COVER POOL MONITOR AND BANKING SUPERVISION

The coverage supervisor (cover pool monitor) shall be appointed by the mortgage bank and approved by MNB. According to Section 16 of the Mortgage Bank Act, a company auditor or an auditor may be appointed; however, the coverage supervisor may not be identical with the auditor of the mortgage bank.

As a matter of fact, Hungarian mortgage banks have had one of the "big four" audit companies as coverage supervisor from the beginning of their operations. The coverage supervisor is responsible for monitoring and certifying, on a permanent basis:

- > the existence of eligible security; and
- > the registration of the eligible security in the coverage register. In accordance with Section 11 (2) (n) of the Mortgage Bank Act, a certificate from the coverage supervisor shall be attached to each mortgage bond regarding the existence of the coverage.

According to section 16 (7) of the Mortgage Bank Act, a coverage supervisor may be appointed for a fixed period of time, not exceeding five years, however, he may be re-appointed following the termination of the period of his appointment. Although the contract of appointment concluded between the mortgage bank and the coverage

supervisor is governed by civil law, it may not be lawfully terminated without the approval of the MNB. Within the scope of his coverage supervision activities, the coverage supervisor may not be instructed by the mortgage bank.

The MNB is responsible for verifying the compliance of the credit institutions, including the mortgage banks, with the Credit Institutions Act and other acts e.g. the Mortgage Banks Act, and applicable banking regulations. The MNB is entitled to impose various sanctions on credit institutions, including warnings of non-compliance, withdrawing licences and imposing fines on credit institutions and their management. Section 22 and 23 of the Mortgage Bank Act provides that the Hungarian Financial Supervisory Authority shall exercise special supervision over mortgage banks in addition to the provisions of the Credit Institutions Act and the provisions of the Capital Markets Act. Within the framework of such special supervision, MNB shall draw up an analysis schedule and conduct on site audits of mortgage banks according to the analysis schedule it compiles.

VIII. SEGREGATION OF COVER ASSETS AND BANKRUPTCY REMOTENESS OF COVERED BONDS

Pursuant to the Mortgage Bank Act a cover pool administrator will be delegated to the insolvent mortgage bank to safeguard the interests of bondholders and derivative partners. The cover pool administrator cannot be identical with the insolvency administrator of the mortgage bank. The cover pool administrator should provide for the timely satisfaction of principal and interest claims of bondholders and derivative partners in case of a possible insolvency situation. The cover pool administrator will only safeguard the interests of bondholders and derivative partners and will also have an access to the part of assets not qualifying as coverage and those not recorded in the cover register. The transfer of the portfolio or parts of it to another mortgage bank may grant for liquidity, however, the transfer of the portfolio or parts of it requires the prior written consent of the MNB.

As a general rule, Section 20/A (4) of the Mortgage Bank Act declares that the cover pool administrator is obliged to maintain the liquidity of the pool on a constant basis, allowing transfer of the pool or parts of it to another mortgage bank and to enter into derivative transactions. Within two years after the commencement of the liquidation procedure, both the cover pool administrator and the bondholders may request the court to complete the cover from the general insolvency estate. The cover pool administrator shall be entitled to receive remuneration for his work and refund of appropriate expenses. Although holders of the mortgage bonds, derivative partners or the coverage supervisor may inform MNB or the only competent Metropolitan Court Budapest on issuer default, after proving all relevant circumstances, it is only the MNB who is entitled to initiate an insolvency proceeding against the mortgage bank.

Hungarian legal provisions also provide for a wide-range of measurements, including extraordinary measurements, to be taken by the MNB prior to any insolvency situation.

For example, the MNB is entitled to delegate a supervisory commissioner to the mortgage bank. This extraordinary measurement may be taken by the MNB prior to the commencement of any insolvency procedure – in accordance with Section 157 (1) of the Credit Institution Act. In this case both the rights of the owners of the mortgage bank and the rights of the management of the mortgage bank will be restricted in order to guarantee the satisfaction of the claims of the mortgage bank's creditors, e. g. bondholders' and derivative partners' claims.

Pursuant to the Section 21 (1) in the course of execution proceedings against a mortgage bank, Act no LIII of 1994 on Execution by Court shall be applied with the deviations set forth in subsections (2)-(3).

Moreover: pursuant to the Section 58 (1) c) of the Act XXXVII of 2014 on the further development of the system of institutions strengthening the security of the individual players of the financial intermediary system: the scope of the bail-in does not extend to mortgage covered bonds.

IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION

The legislation when taken together with the practices, processes and procedures across the industry should fall within the criteria of Article 129 of the Capital Requirements Regulation (CRR). Hungarian mortgage bonds comply with the requirements of Article 52(4) UCITS as well as with those of Article 129(1) CRR.¹

Hungarian covered bonds issued in euro zone countries qualify as European Central Bank (ECB) eligible.

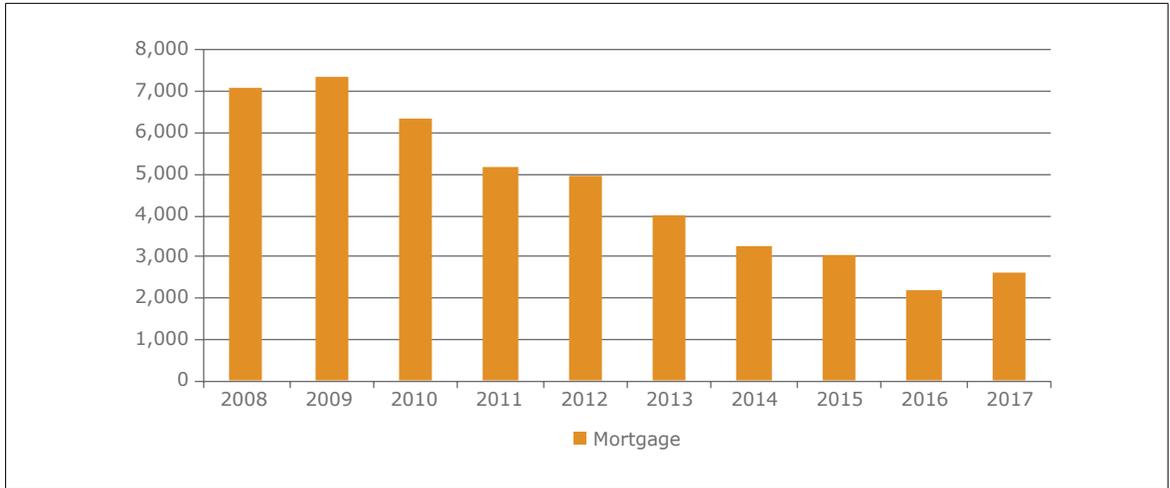
X. ADDITIONAL INFORMATION

The 20/2015. (VI.29.) MNB Decree introduced the Mortgage funding adequacy ratio (MFAR) from 1st of April 2017. MFAR = HUF liabilities backed by household mortgage loans / net stock of residential HUF mortgage loans with a residual maturity longer than 1 year. The minimum required level of the ratio: 15%. This ratio will be increased to 20% from 1st of October 2018.

The MNB announced a covered mortgage bond purchasing programme on 21 November 2017. MNB begun purchasing covered bonds on the secondary market mid-January 2018, while primary market purchases under the programme started mid February 2018. The official aim of covered bond purchasing programme is to decrease medium- and long-term funding costs and indirectly the interest rates level of retail mortgage loans. The conditions are the following: i) HUF- denominated, publicly issued, listed, fixed-rate mortgage bond ii) at least 90% of the ordinary coverage is related to retail mortgage loans, iii) minimum 3 years original maturity; iv) at least one market maker.

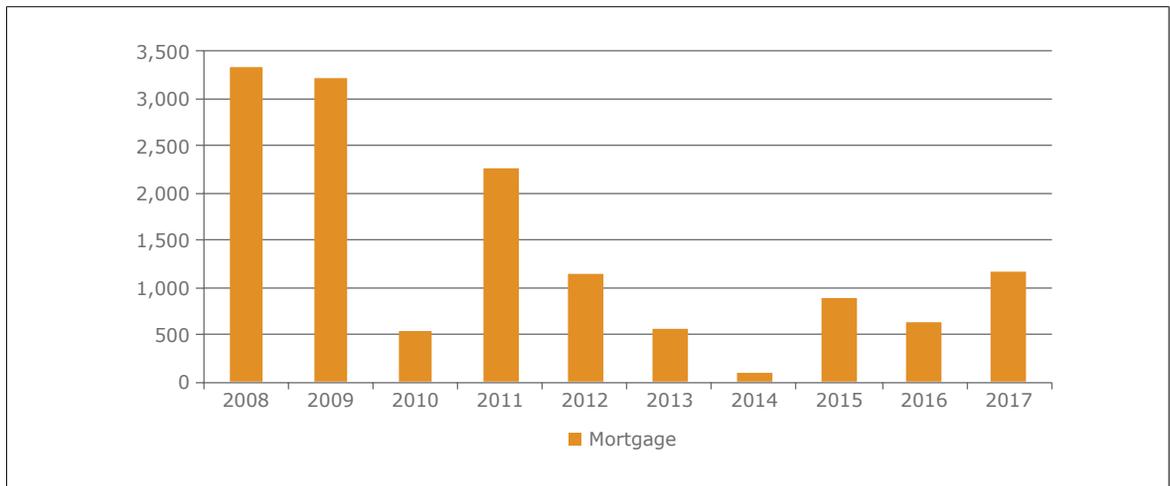
¹ Please click on the following link for further information on the UCITS Directive and the Capital Requirements Regulation (CRR): <https://hypo.org/ecbc/covered-bonds/>.

> FIGURE 1: COVERED BONDS OUTSTANDING, 2008-2017, EUR M



Source: EMF-ECBC

> FIGURE 2: COVERED BONDS ISSUANCE, 2008-2017, EUR M



Source: EMF-ECBC

Issuers: OTP Jelzálogbank Zrt. (OTP Mortgage Bank Ltd.), Takaréék Jelzálogbank Nyrt (Takarék Mortgage Bank Co. Plc.) previously FHB Jelzálogbank Nyrt (FHB Mortgage Bank Co. Plc.), UniCredit Jelzálogbank Zrt. (UniCredit Mortgage Bank Ltd), Erste Jelzálogbank Zrt. (Erste Mortgage Bank Ltd.), and K&H Jelzálogbank Zrt. (K&H Mortgage Bank Ltd.), Established, but not active: MKB Jelzálogbank Zrt. (MKB Mortgage Bank Ltd.).

ECBC Covered Bond Comparative Database: http://ecbc.eu/framework/27/Hungarian_Covered_Bonds.