Template for notifying the intended use of a systemic risk buffer (SRB)

Please send this template to

- notifications@esrb.europa.eu when notifying the ESRB;
- macropru.notifications@ecb.europa.eu when notifying the ECB;
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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 Type of measure intended (also for reviews of existing measures)	Change the scope of an existing SRB
2. Description of the notified measure	
2.1 Institutions covered by the intended SRB	The measure is to be applicable to all credit institutions authorised in Hungary (thereinafter: credit institutions) that are within the scope of the EU/575/2013 Regulation (CRR). The SyRB is applicable to all credit institutions with problem project exposures and FX non-problem project exposures above the de minimis limit. Credit institutions shall apply the measure on a sub-consolidated basis. SyRB formed in CET1 capital will be required only in respect of domestic exposures (RWA), thus the SyRB requirement excludes exposures to other Member States or to third countries. Institutions required to maintain other-than-zero SyRB rates were first identified in the second quarter of 2017 based on data provided for 31 March 2017. The SyRB rates of banks were revised first in Q2 2018 based on data provided for 31 March 2018, and second in Q2 2019 based on data provided for 31 March 2019. Currently, by the currently effective SyRB application and calibration, there are no banks maintaining an SyRB for CRE problem exposures.
2.2 Buffer rate **(Article 133(11)(f) of the CRD)**	As the MNB sets SyRB rates for this dedicated systemic risk up to 2 percent, the measure is subject to the ‘notification only procedure’ under Article 133 (11) of the 2013/36/EU Directive (CRD). Institution-specific SyRB rates are set in the range of 0 to 2 percent. The size of the SyRB rate has, up until the current revision, depended on the contribution of institutions to the systemic risk stemming from problem commercial real estate (CRE) exposures. From 1 January 2020, the size of the SyRB rate will depend also on the contribution of institutions to the systemic risk stemming from FX non-problem project exposures.

Problem exposures are defined for the purposes of the SyRB as:

- the gross amount of domestic commercial real estate project loans if these:
  - are non-performing for more than 90 days,
  - are restructured, with the exception of loans restructured more than a year ago that have become performing loans since, and
  - other project loans that are deemed non-performing by the financial institution;
- the gross amount of domestic on-balance sheet held-for-sale commercial real estate.

Foreign currency exposures qualified as non-problem mean the gross value of the domestic commercial real-estate project loans in foreign currency and not classified under problem exposures.

The contribution to systemic risk is measured by the ratio of the weighted sum of targeted exposures to the sub-consolidated domestic Pillar I. capital requirement. The numerator of the calibration indicator is the weighted sum of exposures. The weights used for the calibration are: 100 percent for problem exposures and 5 percent for foreign currency non-problem exposures.

Weighted sum of problem exposures and foreign currency exposures qualified as non-problem as a proportion of the domestic Pillar I capital requirement if the non-weighted, aggregated gross value of problem exposures and foreign currency exposures qualified as non-problem exceeds HUF 20 billion	**Buffer rate**
0.00 – 29.99 %	*+0.0%*
30.00 – 59.99 %	*+1.0%*
60.00 – 89.99 %	*+1.5%*
above 90.00 %	*+2.0%*

A de minimis rule applies: institutions with non-weighted, aggregated gross value of the problem exposures and the foreign currency exposures qualified as non-problem problem below HUF 20 billion are exempted from the SyRB requirement.

2.3 Exposures covered by the SRB	Only to domestic exposures

3. Timing of the measure

3.1 Timing of the Decision	8 August 2019
3.2 Timing of the Publication	In the course of consultations with the Hungarian Bank Association, banks were notified on 12 June 2019 of the planned measure. The press release will be published one month followed the date of the ESRB notification.
3.3 Disclosure	All relevant information is communicated via a press release and the official website of the MNB. See: http://www.mnb.hu/en/financial-stability/macroprudential-policy/the-macroprudential-toolkit/instruments-to-limit-excessive-exposure-concentrations In the case of the introduction and the modification of the SyRB application, the MNB used to publish a press release with the justification of the current actions, with the text of the General Decision. In the case of the SyRB rate determinations and annual revisions, the MNB publishes a press release with the justification of the current actions,

	with the name and applicable SyRB rate of the institution concerned.
3.4 Timing of Application	1 January 2020
3.5 Phasing in	The current notification is about the revision of the SyRB previously implemented and used. This will be the base for determining the SyRB rates applicable from 1 January 2020. As the measure and the new calibration are of a preventive nature, the MNB expects that no institution will have to maintain an SyRB from 1 January 2020. Thus, the period provided to financial institutions can be deemed adequate.
3.6 Review/deactivation of the measure	The institution-specific requirements setting individual buffer rates will be reviewed at least annually. Decisions will be based on the ratio of the weighted sum of targeted exposures to the sub-consolidated domestic Pillar I. capital requirement.
4. Reasons for the intended SRB	
4.1 Description of the long-term non-cyclical systemic risk in your Member State **(Article 133(11)a of the CRD)**	The persistently high ratio of the problem project exposures in the Hungarian banking sector was identified as a key macroprudential risk in 2014. Alongside the favourable CRE market processes, the SyRB contributed to the mitigation of the systemic risk concerning the problem CRE exposures. Domestic problem CRE exposures of the banking sector fell to HUF 59 billion, to 5.4 percent of all domestic exposures as of 31 March 2019. Currently there is no bank that has to maintain an SyRB, which leaves room for covering other risks with the buffer requirement. The recent intense rebound of the CRE market and the dynamically growing CRE project financing may lead to the excessively rapid, adversely structured and concentrated build-up of commercial real estate project-financing exposures in the Hungarian banking system. As project financing is mainly denominated in foreign currency, a significant systemic risk potential originates from this dimension. Although in most cases the companies that take out FX denominated project loans generate revenues determined in euros from letting properties, this does not always represent effective FX coverage. In many cases the companies renting CRE generate their revenues in Hungarian forints, especially in the retail sector. This means that foreign currency risk can arise in the case of some CRE project loans, which, in higher quantities and concentration, can have system-wide effects. The problem is amplified due to the overwhelming part of the stock being concentrated in the balance sheets of O-SIIs. The project-financing segment is characterised by high procyclicality owing to the peculiarities of the commercial real estate market, thus a shock can lead to considerable losses in the banking system through non-performing loans, and the solvency of banks can be damaged. The accumulation and the persistence of non-performing portfolios in turn may limit banking system's role in supporting economic growth. Even if the practice of banks is observed to be more prudent and supervised more closely microprudentially, the intensive growth of project lending and the consequent build-up of concentrated exposures point toward the potential heightening of related systemic risks. Overall, from a macroprudential point of view, it is important to introduced

	preventive measures in this risky segment to avoid the build-up of structural systemic risks similar to those that accumulated before and during the latest crisis. On the one hand, the systemic risk buffer increases the shock-absorbing capacity of the institutions that develop excessively large risky portfolios of project-financing loans and do not curtail their problem exposures; on the other hand, it may encourage institutions to follow less risky project-financing practices and to keep such portfolios at a low level or to remove problem stocks from their balance sheets in case related risks are realized in the long term.
4.2 Reasons why the dimension of the long-term non-cyclical systemic risk threatens the stability of the financial system in your Member State **(Article 133(11)(b) of the CRD)**	The excessively rapid, adversely structured and concentrated build-up of commercial real estate project-financing exposures in the Hungarian banking system poses a key macroprudential risk, as it can lead finally to high sectoral and individual stock and ratio of problem project exposures. This may threaten financial stability through a number of channels: • **Impact on profitability:** As the stock of distressed CRE project loans increases, so do impairment losses, which negatively affects the profitability of banks, and weakens the ability of institutions to accumulate capital, threatening the solvency of the banks. Furthermore, NPL stocks in excessively large volume are able to tie down significant resources, which can again lead to deteriorating profitability (if, e.g., employees are assigned to workout activities instead of loan origination). The need to continuously finance the unimpaired part of non-performing loans also may decrease profitability. The cost of financing can also increase due to high NPL rates, as investors payed close attention to NPL in their risk evaluation; high NPL rates therefore can increase the risk premium on bank liabilities. • **Impact on lending:** Mounting credit losses on project exposures and consequently high NPL rates can limit lending through lower capacity and tighter capital constraints, and also through negatively affecting the willingness for lending: high losses and NPL rates can make banks over-cautious, lowering their willingness to take on more risk in financing investment and growth in the corporate segment. As non-performing project loans tie down financing resources, the banking sector's lending capacity can weaken in case of effective liquidity limits, leading to decreased lending. • **Impact on collaterals:** A change in the value of collaterals or, in case of FX loans, in the exchange rate, can increase impairment losses. In an extreme scenario, in case of a deeper crisis, the value of collaterals can nosedive, leading to significant system-wide consequences in such moderately liquid markets like the one for commercial real estate. It is important to mention that the impact of problem CRE project exposures can be multiplicative in nature, i.e., the impact of the total system-wide risk is able to be greater than the sum of the impacts of the risks of individual institutions due to, e.g., possible system-wide fire sales and the earlier moderately liquid market for the repossessed CRE.
4.3 Indicators used for the activation of the measure	The following indicators were used for the activation of the SyRB and the monitoring of the targeted macroprudential risk: • Total domestic problem project exposures and foreign currency exposures qualified as non-problem over the domestic Pillar I. capital requirement (calibration indicator)

	• Stock of total and domestic non-performing project loans and its ratio over total and domestic project loans • Stock of total and domestic restructured project loans and its ratio over total and domestic project loans • Stock of total and domestic problem project exposures and its ratio over total and domestic project exposures • Stock of domestic foreign currency exposures qualified as non-problem and its ratio over domestic problem and non-problem project exposures • Concentration of problem project exposures in the banking sector In case of all indicators, sectoral and bank level data is followed.
4.4 Effectiveness and proportionality of the measure **(Article 133(11)(c) of the CRD)**	The systemic risk buffer: a) increases the shock-absorbing capacity of the institutions that develop excessively large risky portfolios of project-financing loans and do not curtail their problem exposures, b) may encourage institutions to follow less risky project-financing practices and to remove problem stocks from their balance sheets or to keep such portfolios at a low level. Problem CRE exposures and exposures with a high probability of becoming problem exposures may pose a structural systemic risk that is concentrated and might become high for a relatively long time despite sequential Pillar 2 measures and may pose a burden on the balance sheets of several major banks in Hungary in case of economic shocks. The SyRB requirement is supposed to target this risk as it could be levied on the combination of exposures that are deemed to be now or at the future horizon the most problematic. This measure proved to be effective in recent years. It has increased the affected credit institutions' shock absorbing capacity to the level that internalized systemic level risks and it alternatively incentivised banks to clean their balance sheets. As the new calibration is of a preventive nature, the accommodation to the new conditions will not hamper healthy lending practices, thus the cost of the regulation is likely to be low. The chosen definitions, the level of application and the targeted data reporting requirements minimise the room for the circumvention. The measure is considered proportionate, as it is directly linked to the contribution of the institutions to the systemic risk identified. It is derived from the ratio of the weighted sum of problem exposures and foreign currency exposures qualified as non-problem to the domestic Pillar I capital requirement. The capital surcharge is levied on domestic RWA and was capped at 2 percent. The *de minimis* limit of HUF 20 billion ensures that only systemically relevant exposures are taken into account.
4.5 Justification of inadequacy of existing measures in the CRD or in the CRR, excluding Articles 458 and 459 of the CRR, to address the identified risks **(Article 133(11)(e) of the CRD)**	The SyRB requirement will be only applied to credit institutions that significantly contribute to the systemic risk. The SyRB requirement is aimed at strengthening the loss absorbing capacity to the level where systemic risks are also internalized, or to prevent the build-up of risky exposures in an undesired speed, structure (FX denomination) and concentration. These systemic risks that come on top of institution-specific risks are complementary to those risks that have already been covered by Pillar 1 and additional Pillar 2 capital requirements. These measures, however,

	are not able to capture the geographical and sectoral concentration of these projects and are not sufficient to internalize the possible systemic risk dimension of the targeted exposures. The SREP risk weights are set at high levels concerning CRE project exposures, but the SREP capital add-on is not able to completely address the systemic risk of the exposures in question, or to ensure appropriate preventive effects mentioned above. The total SREP add-on is capped at 250% in Hungary, which means that there is a limit on the amount of the capital add-on that can be prescribed for problem project exposures within the framework of the SREP. Therefore, the SREP capital add-on is not able to cover the full spectrum of the risks in question, and it is also limited in its capacity to ensure the necessary level of shock absorbing capacity or the necessary incentives for any prospective resolution or prevention of the problem, e.g. via asset cleaning, or preventing the build-up of the relevant exposures. Article 124 and 164 measures of the Capital Requirements Regulation (CRR) are primarily devoted to preventing the emergence of credit/asset bubbles, and they do not differentiate among newly issued and outstanding, problem and non-problem, FX and non-FX exposures thus they are not capable of tackling systemic risks originated from exposures in question. Moreover, in the case of project loan exposures, the value of the property materially depends upon the credit quality of the borrower, the exposures are deemed unsecured for the purposes of determining their risk weight. This means that there is no room within these articles to handle the targeted systemic risk.
5. Cross-border and cross-sector impact of the measure	
5.1 Assessment of cross-border effects and the likely impact on the internal market **(Article 133(11)(d) of the CRD and Recommendation ESRB/2015/2)**	The MNB expects no significant spillover effects, either in inward or in outward direction. • As only Hungarian exposures are taken into account, the MNB would expect insignificant impact of the measure on the functioning of the internal market via the financing of non-resident CRE projects of Hungarian banks in foreign countries. • As the amount and the share of similar lending in Hungary by branches of foreign banks, or by foreign banks directly across the border is limited, the inward impact potential is also limited. The preventive nature of the measure helps smooth accommodation to comply with the measure, or to avoid capital buffers. This way, even if the potential of such effects exists, no significant negative spillover effects are expected.
5.2 Assessment of leakages and regulatory arbitrage within the notifying Member State	No leakages and regulatory arbitrage are expected within Hungary. • Banks below the determined de minimis limit will have to maintain the buffer when exceeding the amounts of exposures considered as systemically material. Thus, the potential of exempted banks to lend is limited. • Due to their different lending structures, some banks will have more room for project financing in FX without maintaining an SyRB than others. Banks may also accommodate to the measure by shifting towards lending denominated in domestic currency, or by cleaning out problem exposures, leading to a decrease in systemic risks.

	• As the involvement of non-bank financial institutions in project financing is limited, this potential channel is not considered as important. The preventive nature of the measure helps a smooth accommodation to comply with the measure, or to avoid capital buffers. This way, even if the potential of such leakages and regulatory arbitrage exists, no significant materialised effects are expected.
5.3 Reciprocation by other Member States **(Article 134(4) of the CRD and Recommendation ESRB/2015/2)**	No reciprocation is requested. By the evaluation of the MNB, due to the preventive nature of the measure and the low share of cross-border financing, limited cross border impact is expected (See 5.1). This way the request for voluntary reciprocity is unwarranted, also with a view to the high implementation costs of the SyRB with similar data basis and content to the Hungarian application.
6. Combination of the SRB with other buffers	
6.1 Combination with G-SII and/or O-SII buffers (Article 133(4) and (5) of the CRD)	G-SII buffer is not applicable for Hungarian banks. As the SyRB is applied only to Hungarian exposures, SyRB is applicable cumulatively with the O-SII buffer.
6.2 Other relevant information	-
7. Miscellaneous	
7.1 Contact person(s) at notifying authority	**Mr. Gergely Fábián,** Executive Director Executive Directorate for Financial System Analysis and Lending Incentives Phone: +36 (1) 428 2600/1874 E-mail: fabiang@mnb.hu **Mr. Ádám Banai**, Director Directorate for Financial System Analysis Phone: +36 (1) 428 2600/1864 E-mail: banaia@mnb.hu
7.2 Any other relevant information	