EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 24 February 2014

on the mismatch of maturity and foreign currency positions of credit institutions

(CON/2014/15)

Introduction and legal basis

On 16 January 2014, the European Central Bank (ECB) received a request from the Magyar Nemzeti Bank (MNB) for an opinion on a draft decree regulating the mismatch of maturity and foreign currency positions of credit institutions (hereinafter the 'draft decree').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and the sixth indent of Article 2(1) of Council Decision 98/415/EC[1], as the draft decree concerns rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Background information and the purpose of the draft decree

1.1 From 1 October 2013, the MNB became the entity not only responsible for macro-prudential policy, but also for the micro-prudential supervision of the entire financial market. As a result of changes in legislative competence pursuant to the new Law on the Magyar Nemzeti Bank[2], the Governor of the MNB is now exclusively authorised to adopt legislation on mitigating systemic risk, *inter alia*, to regulate the maturity mismatch and foreign currency position of credit institutions.

1.2 The volume of foreign currency-denominated mortgage lending to households expanded rapidly in Hungary until 2008. Banks financed the fast build-up of foreign currency assets mainly by: (a) raising foreign currency-denominated external funding; and (b) switching forint funding to foreign exchange (FX) funding via FX swaps. The average remaining maturity for foreign currency funding and FX swaps became considerably shorter than the average maturity for foreign currency-denominated loans. This led to significant maturity mismatches, and consequently increased Hungary's need for foreign currency reserves[3].

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1 Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

2 See Law CXXXIX of 2013 on the Magyar Nemzeti Bank.

3 See also Opinions CON/2011/87 and CON/2012/27. All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

1.3 To mitigate this risk, Government Decree 366/2011[4] introduced the Balance Sheet Coverage Ratio, the Asset Coverage Ratio, and the foreign funding adequacy ratio (FFAR).

1.4 The draft decree will review, update and replace the provisions of Government Decree 366/2011 which are applicable to the FFAR. This review brings about the following major proposed changes: (a) the calculation of the required amount of stable foreign currency funding should change from a gross-based approach to a net-based approach, meaning that certain parts of the assets are not expected to be funded by FX funding as regulated by the draft decree; (b) in accordance with the prospective NSFR, the deposits (liabilities) should be divided into stable and less stable categories, with a proposed weighting of 90% and 80%, respectively; (c) the weight of foreign currency-denominated stakes in assets is proposed to decrease to 0%; (d) the required level of the FFAR should be set at 75% from July 2014 (it is currently at 65%), and should gradually increase further to 100% by January 2017.

1.5 By introducing these measures, the MNB aims to:

(a) reduce the funding risk related to short-term foreign exchange debt of banks and maturity mismatch, and to prevent further deterioration;

(b) mitigate the vulnerability arising from severe changes in the short-term funding conditions by gradually closing the maturity gap between FX assets and FX liabilities;

(c) provide an opportunity to stakeholders until 2018 to prepare for the implementation of the NSFR.

2 General Observations

The draft decree regulates the same subject matter as the specific provisions of Government Decree 366/2011 that are applicable to the FFAR. Based on the rules applicable with regard to the hierarchy of legal acts in Hungary, the draft decree cannot repeal the provisions of Government Decree 366/2011 that are applicable to the FFAR. Since regulating this subject matter now falls within the competence of the Governor of the MNB, the ECB would like to draw the Hungarian legislator's attention to the need to avoid duplication of relevant legislation by repealing the respective provisions of Government Decree 366/2011 in line with the procedural rules applicable to Hungarian legislation.

3 Specific Observations

3.1 The FFAR is similar in concept to the NSFR that is currently being developed under the Basel Committee on Banking Supervision (BCBS), since it builds upon structural funding metrics that require banks to hold stable funding in relation to the composition of their assets. However, a number of differences between the NSFR and the FFAR remain. Specifically, in December 2013 the BCBS agreed in a consultative document to introduce a more granular calibration through the

4 See Government Decree 366/2011 determining the liquidity requirements and regulating the provisions applicable to foreign currency maturity mismatch. The ECB was not consulted on this Government Decree, and therefore it did not have the opportunity to issue an opinion as regards its provisions.

consideration of assets and liabilities with a maturity between six months and one year. The intention behind this revision was to reduce cliff effects resulting from liabilities falling below the one-year maturity horizon, and to assign funding factors that reflect the necessary funding requirements for assets and the stability of available funding for liabilities.

3.2 The current wording of the definition of 'stable deposit' in Article 2(32) of the draft decree would benefit from further clarification. In December 2013, the European Banking Authority (EBA) published a guideline[5] for the identification of retail deposits with different stability characteristics, which could be a point of reference for such clarification. Reflecting this guideline may also be useful for the differentiation of deposits under the FFAR. While differences between the NSFR and the FFAR are to be expected, given that the FFAR's aim is to limit risks from foreign currency mismatches, it may be appropriate to adjust the FFAR in line with applicable international standards.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 24 February 2014.

[signed]

The President of the ECB

Mario DRAGHI

5 See Guidelines EBA/GL/2013/1 on retail deposits subject to different outflows for purposes of liquidity reporting under Regulation (EU) No 575/2013, on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (Capital Requirements Regulation – CRR). On overview of the EBA's regulatory activity is available on the EBA's website at www.eba.europa.eu.