**Annex 11:**

**Information on unstable funds that are prioritised in the context of the supervisory review process and on the related liquidity requirements.**

Annex 11 forms part of the guidelines entitled “Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment Process (ILAAP), and their Supervisory Review Process and Business Model Analysis (BMA) (hereinafter: Guidelines on the ICAAP, ILAAP and BMA review), which provides an overview of the portfolios deemed risky in terms of liquidity[[1]](#footnote-2), in respect of which the MNB expects add-on capital buffers upon the institutions’ internal risk assessment and audits them with special care. The MNB reviews the unstable portfolios published here on an annual basis.

The Guidelines cover the portfolios with risk profiles that cause for supervisory concern in the Hungarian market based on analysis and supervisory information. In order to manage such risks, it is justified and expected that the institutions concerned are required to hold additional liquidity. As a principal rule, the MNB prescribes the add-on requirement for the LCR as the difference between the expected level specified for the unstable portfolios and the existing Pillar 1 requirement as surplus outflows, which can be reduced by the amounts excluded due to the inflow limit. Following the ILAAP dialogue, the institution may be authorised to cover the outflow by other amounts not taken into consideration (e.g. credit facilities). The MNB uses the following formula to determine the LCR indicator adjusted for the additional requirement:

LCR II = HQLA/[OUT-min(IN;OUT\*0,75)+max(ILAAP-max{IN-OUT\*0,75;0};0)]

ILAAP: additional requirements defined as outflows

Any departure from the above methodology will be indicated separately for each portfolio. If no methodology has been defined for the respective portfolio, the institution must assess the add-on requirements based on its own risk assessment. For each individual portfolio the MNB expects institutions to describe how they handle their unstable portfolios under Pillar 1 and Pillar 2.

The MNB expects the institution to assess the risks of the portfolios included in the guidelines on its own as well, and – if necessary – recognise under Pillar 2 larger liquidity buffer than that specified in the guidelines.

The requirement level depends on the standards of the institution's risk management framework and on the quality and reliability of ILAAP calculations. If the institution under review can duly justify the adequacy of the model or practice applied, the MNB may diverge from these rules in respect of unstable portfolios. According to Section 1 of this Annex, the expectation of 100 percent outflow, to be applied to large deposits, is not subject to deliberation. When determining the add-on requirements, the MNB also takes into consideration the systemic liquidity risks.

By applying the principles of level playing field, the MNB applies the expectations in an identical manner for all market players concerned. This also means that the MNB expects money and capital market players not subject to consolidated supervision in Hungary (including branch offices operating in Hungary) to exhibit a market behaviour that complies with the conditions described below, and the MNB will enforce compliance with such conditions by other supervisory tools and under international cooperation schemes.

The MNB verifies the add-on liquidity recognised for unstable portfolios during the annual ILAAP review, relying on the data request form entitled “Data request for the review of unstable liabilities”, available on the website. The template has to be filled in according to the reference date set by supervisory review process, complying with the level of the supervisory review (individual/consolidated). In the case of consolidated ILAAP supervisory review of portfolios of foreign subsidiaries — if it is justified by local particularities — derogation from the rules of Annex 4 (sic orig.) is allowed. The exposures that are deemed risky in several respects must be stated in each affected portfolio and – in accordance with the requirements applicable to the respective portfolio – the add-on liquidity must be recognised for each risk separately, but the value of 100 percent recognised for the Pillar 1 and Pillar 2 outflow for a single transaction represents a ceiling. The terms used in these Guidelines (e.g. retail deposit) must be applied as specified in Commission Delegated Regulation (EU) 2015/61 (Delegated Act).

***Risks that may arise at institutions subject to the CRD/CRR, treated with high priority by the MNB:***

# Holders of large deposits

Traditional commercial bank liquidity management is based on the assumption that the large volume of independent sight or short-term deposits constitute a stable balance at portfolio level, and thus the institution can use it for the funding of long-term investments. The statutory requirements assume that the granularity is fulfilled when they consider the retail or corporate deposits. Accordingly, the concentration of deposit holders represents additional risk compared to the statutory requirements. Due to the stronger bargaining position, it is justified in professional terms to reckon with early withdrawal options. **The MNB expects that the institutions should calculate upon defining the LCR with 100 percent outflow for the portfolio of large deposit holders exceeding the limit, consolidated with Pillar 1.**

The surplus outflow must be reported in the ‘C\_76.00.A380 1.5.1.\_\_Pillar 2 requirement as specified in Article 105 of CRD’ cell – without taking into account any reduction by the amount that would contravene the inflow limit. Not to be reported in table ‘C\_76.00.W’.

The concentration of large deposit holders appears particularly at the smaller institutions, and thus the principle of proportionality is not applicable here.

Methodological guide

Large deposit holders: client groups must be consolidated[[2]](#footnote-3), the institutions belonging to the same group of control as the reporting agent should be ignored (parent, subsidiary, sister, fund managed by own fund manager); all types of clients other than banks.

Deposit: According to the definition of 10GA, the funds obtained in repo transactions, loans taken and security deposits may be excluded[[3]](#footnote-4); no additional funds may be excluded citing other deposit or other reasons.

Limit: 1 percent of the outstanding deposits; Table M01, Book value of deposits except banks 673-(675+676+689+694).

Excess outflow: must be applied to the part of deposits that exceed the limit; the surplus should increase the outflow already recognised in LCR to 100 percent. For deposits of various outflows, the surplus must be determined relative to the average outflow weight of deposits over the limit, assuming that the deposits with the highest outflow weight will be above the limit[[4]](#footnote-5).

The surplus must be specified without currency breakdown, but the general requirement related to the currency composition of the liquidity buffer is valid

The add-on requirements also apply to NSFR, with the alteration that the part of the deposits that exceed the limit may not provide stable funding. Due to the different weights of LCR and NSFR, the two add-on requirements are not identical. The quantification of the NSFR add-on requirement has no impact on the regular data reporting. The measurement and implementation thereof by the bank is expected from the NSFR’s entry into force. The MNB will verify compliance by estimation based on 10GA and during the reviews.

# Notice deposits

The MNB is of the opinion that in a potentially low interest environment the loss of the accrued interest on the fixed deposits which may be withdrawn early is not an adequate incentive to wait until the maturity of the deposit, and thus residual liquidity risk appears compared to the LCR regulation (Article 25 (4)b) of Delegated Act).

The MNB prescribes no automatic add-on requirement for this portfolio. On the other hand, the institutions are expected to assess, in legal terms, the possibility of early withdrawal of retail term deposits, analyse the actual early withdrawals in statistical terms, and if necessary to quantify the excess outflow and recognise the respective cover.

Affected indicators: LCR, stress tests

# Cancelled deposits

The MNB is of the view that in the Hungarian market a major part of the cancelled deposits are disposed over only after the expiry of the notice period, and thus these deposits represent higher risk than reflected in the LCR regulation (Article 25 (4)b) second paragraph of Delegated Act (an outflow rate of 100 percent is applied only when the payment is made to another credit institution). The aforementioned regulation contains no provision on the higher outflow rate of cancelled non-retail deposits.

The MNB prescribes no automatic add-on requirement for this portfolio. On the other hand, the institutions are expected to examine the average balance of their deposits being in the notice period and the stability of these deposits also in statistical terms. If the effect is material, they must quantify the excess outflow and recognise the respective cover.

Affected indicators: LCR

# Deposits redeemable at 31-60 days’ notice

The MNB identified the deposits redeemable at 31 days’ notice as a risk. This kind of redemption clause improves the LCR, but it involves major operational risk. On the one hand, the LCR must be satisfied permanently, not only on the reference date of the month-end official reporting. This raises the risk that if the deposit is cancelled, the institution’s liquidity position deteriorates within a few days. If the institution verifies its LCR compliance rarely or with delay (i.e. only a few days before the deadline for the submission of the LCR report) it further increases the risk of breaching the regulation.

The MNB prescribes no automatic add-on requirement for this portfolio. On the other hand, the institutions are expected to assess the balance of their deposits redeemable at 31-60 days’ notice, and to review their internal processes as to when the area in charge of liquidity management notices the cancellation of these deposits, and whether this ensures permanent compliance with the LCR requirements. The institution is expected to quantify the degree of the add-on buffer as necessary.

# Failure to record credit facilities

The MNB identified the delayed recording of credit facilities as a risk. At several institutions the loan contract is recorded only upon disbursement rather than when the contract is signed. Such delay represents a shortcoming both for the credit risk and liquidity position.

The MNB prescribes no automatic add-on requirement for this portfolio, but it expects the institutions to estimate the average balance of the non-captured credit facilities, and determine in respect of that the excess outflow and recognise the cover for them in accordance with Article 23 of Delegated Act and the related MNB Q&A[[5]](#footnote-6).

# Individually priced deposits

Some of the large corporations have their own liquidity management practice, the behaviour of which tends to resemble that of a financial enterprise. Individually priced deposits expiring within 30 days are regarded as particularly high risk. These deposits must be monitored and it must be assessed whether the statutory outflow of 40 percent reflects the risk of deposit withdrawal. It is an additional risk factor when the enterprise has presumably requested an interest rate quote from several banks and chose the respective bank based on that when placing the deposit, or when there is no other relation or there is only negligible other relation with the enterprise (e.g. account turnover). It is expected from the institution to define respective portfolio as accurately as possible. During the reviews, the MNB asks for detailing the objectively definable individually priced deposits maturing within 30 days.

# Fiduciary deposits

When a third party places a deposit with the institution as an asset manager (under an agency contract), the characteristics of it may differ from the behaviour of the “original depositor” and rather resemble a financial client.

Institutions are expected to identify these – and due to the absence of a precise definition, similar – deposit portfolios and assess their stability.

It should be noted that based on Article 27(6) of the Delegated Act, deposit brokers are excluded from the operational relationship.

# Customer funds managed under investment services arrangement

The MNB examines the practice used by the bank for managing received funds under an investment services arrangement (deposit account or customer account) and their separation from own assets on the assets side.

# LCR consolidation group

When calculating the group LCR the institution should make efforts to take into consideration all enterprises subject to consolidated supervision. The MNB accepts if this is performed not comprehensively, based on the principle of proportionality (e.g. with estimations, omissions). However, institutions are expected to assess the potential effect of the estimations regularly.

# step-in risk

It represents a liquidity risk that the bank provides liquidity assistance to certain entities not belonging to the prudential consolidation, but belonging to the banking group in the broad sense. With a view to avoiding reputational risks impacting the entire group, loans may be provided without any legal obligation or the bank may waive the exercise of its options to terminate contracts unilaterally. Such significant clientele includes investment funds managed by own asset manager, particularly when the name of the fund contains the bank’s name. The bank should assess the liquidity risks inherent in a run on the funds. When assessing the liquidity of the fund’s assets a 30-day LCR horizon should be taken into consideration. Since the price risk of liquid assets is borne by the investor, it is not necessary to apply the LCR haircuts. When estimating the outflow, investors should be regarded as depositors without deposit insurance. Closed-end funds and mutual fund shares with redemption period of T+31 days or longer may be considered as risk mitigating factors, but it should be borne in mind that the bank may also provide liquidity assistance by purchasing the mutual fund shares from the customer or by subscribing new ones. The surplus of one fund must not be used for covering the deficit of the other.

# Maturity mismatch

The MNB expands the set of indicators used for the assessment and monitoring of liquidity and funding risks with the maturity mismatch. The risk is attached to the entire balance sheet rather than to individual portfolios.

For the calculations we use the data from the C\_66 maturity match table. The data quality and the models used for the reallocation will be inspected during the ILAAP reviews.

Institution are expected to perform measurement (and manage them by limits) based on their own methodology[[6]](#footnote-7). However, it is necessary to verify the data quality of C\_66, and explain the key differences between the institution’s own and the MNB’s methodology.

Description of the indicator used by the MNB:

* The initial balancing capacities are reduced by the reallocated outflows, increased by reallocated inflows, amended by the change in balancing capacity and reduced by the reallocated credit line drawdowns. We take the minimum values on the horizons of 1-30 days; 1-12 months and 1-5 years. Accordingly, the maturity mismatch indicates 3 values in accordance with the 3 assessed horizons.
* C\_66.01b1080;1 - C\_66.01.a0380;O - (C\_66.01.c1270;[O+1] - C\_66.01.a0260;O) + C\_66.01.a0700;O + (C\_66.01.c1280;[O+1] - C\_66.01.a0590;O) + C\_66.01.a1070;O + C\_66.01.c1290;O , where ’O’ denotes the residual maturity columns, the cells of which are to be added from 1 to T, thereby obtaining the cumulated maturity mismatch calculated until T. The indicator is calculated for each maturity (from (T=1 to 21), and then we take the minimum value for the terms of 1-30 days (T=1-10); 1-12 months (T=11-18) and 1-5 years (T=19-20). (O is the index used for the cumulation, while T is the horizon over which cumulation is performed.)
* $min\_{T\left\{\begin{array}{c}1,…,10\\11,…,18\\19,20\end{array}\right.}⁡[C\\_66.01b1080;1 +\sum\_{O=1,…,T}^{}\{- C\\_66.01.a0380;O - (C\\_66.01.c1270;[O+1] - C\\_66.01.a0260;O) + C\\_66.01.a0700;O + (C\\_66.01.c1280;[O+1] - C\\_66.01.a0590;O) + C\\_66.01.a1070;O + C\\_66.01.c1290;O\}]$
1. The additional liquidity risk can be identified primarily for liabilities, but may also relate to assets or off-balance sheet items. [↑](#footnote-ref-2)
2. In the case of large deposit holders and clients being close to the limit, the client group must be identified in more detail (based on Opten, shared managing director private individuals, etc.) [↑](#footnote-ref-3)
3. It is not necessary to take into consideration the issued bonds, and they are not included in 10GA either. [↑](#footnote-ref-4)
4. If a company classified as a large deposit holder has 40 operational deposits, 30 of which are covered by deposit insurance, and also has 100 other HUF deposits, and the limit is 35, surplus outflow must be calculated for the part exceeding the limit, i.e. for 40+100–35=105 deposits. The parts of deposits with the highest outflow factor should be considered to be above the limit, i.e. 100 other deposits and 5 out of the operational deposits not covered by deposit insurance. The average outflow rate of these under Pillar 1 is (5x25%+100x40%)/(5+100)=39.3%, and thus the nominal value of the surplus is 105x(1–39.3%)=63.75. [↑](#footnote-ref-5)
5. <https://www.mnb.hu/letoltes/6-2017-egyeb-termekekhez-es-szolgaltatasokhoz-kapcsolodo-kiaramlasok.pdf> [↑](#footnote-ref-6)
6. Including but not limited to, e.g.: aggregated and currency breakdown, maturity (short-term/long term), contractual/reallocated/stress outflow, volume limit/time limit (time-to-wall). [↑](#footnote-ref-7)