



Annual Report

2014





Annual Report

2014 BUSINESS REPORT AND
FINANCIAL STATEMENTS OF THE
MAGYAR NEMZETI BANK



Published by the Magyar Nemzeti Bank

Publisher in charge: Eszter Hergár

Editor: Gábor Kalina

H-1054 Budapest, Szabadság tér 9.

www.mnb.hu

ISSN 1216-6197 (print)

ISSN 1585-4604 (on-line)

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Part A)

**2014 Business Report
of the Magyar Nemzeti Bank**

1 The Governor's foreword

In July 2014, the Monetary Council concluded its two-year easing cycle. As a result, after a cumulative 490 basis point reduction, the central bank policy rate declined to 2.1 per cent. After conclusion of the easing cycle, in the second half of 2014 the longer-term maintenance of the low interest rate level was warranted in the Council's judgement, in order to ensure the achievement of the Bank's medium-term inflation target and a corresponding degree of support for the real economy.

Up until 31 December 2014, credit institutions participating in the second phase of the Funding for Growth Scheme had concluded contracts with small and medium-sized enterprises for a total amount of HUF 584.2 billion. As a result, 19,000 enterprises received financing amounting to nearly HUF 1,300 billion in the first and second phases of the scheme altogether. In September 2014, the Monetary Council raised the credit line allocated under the second phase of the scheme by HUF 500 billion to HUF 1,000 billion, and in October 2014 it decided to extend the FGS until 31 December 2015.

At its meeting on 23 April 2014, the Monetary Council adopted the self-financing concept and, in this context, it made a decision to reform its monetary policy instruments: it converted its main policy instrument into deposits and introduced an interest rate swap facility. Following this, the overnight central bank deposit portfolio of the banking sector increased substantially, before reverting to its previous level starting from mid-October. Also, in conjunction with the self-financing concept, the forint government paper portfolio of the banking sector expanded significantly. At its meeting on 23 September 2014, the Monetary Council decided that the MNB would provide the Hungarian banking system with the foreign currency needed to phase out household foreign currency loans, including their settlement and conversion into Hungarian forints. Accordingly, the central bank created two new foreign currency sale instruments. The MNB's euro sale tenders were successful and had no impact on the forint exchange rate. Compared to the previous year,

demand increased for traditional (overnight, one and two-week and three-month) central bank EUR/HUF FX swap instruments providing euro liquidity in 2014. Considering the changed circumstances, the Monetary Council decided to terminate the currency swap tenders constituting Pillar III of the Funding for Growth Scheme as of 1 July 2014.

In 2014, additional steps were taken with a view to boosting and removing the obstacles to the lending activity of the financial intermediary system. The FGS eased the financing constraints of small and medium-sized enterprises even further. Under the second phase of the scheme, until the end of 2014 credit institutions concluded contracts with 14,000 enterprises for a total of around HUF 600 billion. It was a positive trend that the participation of smaller companies increased compared to the first phase of the programme: the share of micro-enterprises in the facility rose to 40 per cent, and every second loan within new investment loans was under HUF 10 million. As regards commercial real estate project loans, the asset management company (MARK Zrt.) set up by the MNB in November 2014 may facilitate the intensive cleaning of the portfolio. The conversion of household mortgage-backed foreign currency loans into forints eliminates a significant systemic risk, which may also contribute to the expansion of credit supply. The Supreme Court (Kúria) clarified the legal status of household foreign currency loans by passing a uniformity decision in June 2014. In September 2014, the legislator adopted the acts resolving the settlement of unilateral contract modifications and the unfair charging of the exchange rate margin. Legislation passed in November 2014 regulated the conversion of foreign currency mortgage loans and the method of interest charging ("fair banking system"). The MNB played an important role in this process. While the settlement prescribed due to the invalidity of the exchange rate margin and unfair interest rate and fee increases resulted in a drastic loss for credit institutions, thanks to their abundant capital buffers and parent bank capital injections, the sector remained stable and well capitalised throughout 2014. At the same time, the conversion of FX loans relieved

debtors and the banking sector from significant exchange rate risks.

In the course of 2014, the MNB revised the indicator regulating the long-term foreign exchange funding adequacy ratio of credit institutions, conceived and introduced the so-called debt cap regulations, formulated the MNB decrees related to the Settlement Act, and commenced work on developing the methodology for macroprudential instruments (such as the identification of systemically important banks, the countercyclical capital buffer and the systemic risk buffer).

The integration of the supervisory function expanded the set of central bank instruments and potential measures, while data and experiences gained from microprudential surveillance provided an extensive information base for monetary policy. Thanks to the increased potential of the supervisory area resulting from integration, using the full set of supervisory instruments the MNB took consistent action at several distressed credit institutions before the negative trends recognised in their operations could jeopardise the rest of the market participants. In the insurance market, the most significant event of the year was the MNB's publication of its recommendation related to the introduction of the tax incentive of pension insurance plans, which succeeded in steering the market in the right direction. In respect of funds, the MNB focused on the cost analysis of activities, while customer information and record keeping practices enjoyed priority in the segment of intermediaries.

The MNB launched a separate publication dedicated to its consumer protection and market surveillance activities, containing factual consumer protection data, details about the experiences gained and the risks identified.

In 2014, the MNB continued its efforts to set up the Hungarian resolution framework in accordance with the relevant European Union directive. After the Resolution Act entered into force in its entirety in September 2014, the MNB commenced its operations acting in its scope of authority for resolution, participating actively in strengthening the shock resistance of the financial sector. Moreover, in order to facilitate the enhancement of the resolution framework, it took part in the elaboration of legislation and commencement orders. The Resolution Fund was set up, and its Fee Policy and Fee Schedule were approved. The experts of the MNB are continuously

engaged in building relations with European Union partner institutions and international institutions.

On 18 December 2014, acting within its scope of authority, the Financial Stability Board placed MKB Bank Zrt. under resolution and appointed resolution administrators to the Bank. In parallel with this, in December 2014 the Reorganisational Processes Directorate was also set up, tasked with the management of the reorganisation of MKB Bank and the coordination of the work of the resolution administrators.

As in previous years, one of the priorities of the MNB was to guarantee the security of the payment system. The Bank published a communication on virtual payment instruments (such as Bitcoin), integrated the international guidelines on the security of online payments into its inspection programme, issued several statements and professional opinions in respect of payment transactions, and scrutinised 23 payment service providers in the framework of its payment inspections. It found violations in 127 cases, and imposed fines on the credit institutions concerned in the amount of HUF 38.8 million in total.

The development of domestic payment systems was shaped by two important events in 2014. The MNB acquired GIRO Zrt., which resulted in the reduction of service fees and the adoption of a strategic development plan. Moreover, the central bank held several rounds of professional consultations with CLS Bank to ensure the inclusion of the forint in the Continuous Linked Settlement mechanism operated by CLS. Within the scope of its oversight responsibilities, the MNB recast its risk-based oversight framework in line with the new guidelines issued by the BIS, and commenced the comprehensive assessment of the fundamental financial infrastructures in Hungary. Conducted in international cooperation, the re-licensing process of KELER CCP was successfully completed in the summer of 2014, and the MNB informed the professional public of its payment-related activities through a series of publications and presentations.

After an increase of EUR 795.8 million during the year, official foreign exchange reserves amounted to EUR 34.6 billion at the end of 2014. The increase in foreign exchange reserves during the year can be attributed to transfers from the European Commission and the bond issues of the Government Debt Management Agency. Their impact, however, was largely offset by debt repayments.

At the end of 2014, the total value of currency in circulation amounted to HUF 3,736 billion, representing a 17 per cent year-on-year increase. The increase in the stock of currency in circulation was observed across all denominations, but mainly involved the two largest denominations.

In 2014, the MNB performed cash transactions for its customers, credit institutions and the Hungarian Post Office with a value of HUF 3,243 billion.

The counterfeiting of forint banknotes in 2014 was consistent with the trends of previous years; the 1,935 counterfeit notes identified and withdrawn from circulation in 2014 represent a 21 per cent decline compared to the previous year. The 5,000-forint note accounted for more than 40 per cent of counterfeit forint notes.

In the period between 2014 and 2018, the MNB is set to redesign the banknote series presently in circulation. Of the six denominations comprising the Hungarian banknote series, the first banknote redesigned by the MNB was the HUF 10,000 note, which became legal tender on 2 September 2014, and was put into circulation on 1 December 2014.

Since June 2014, the MNB has applied the changes stemming from the comprehensive renewal of international methodological standards in its balance of payments statistics and financial accounts statistics. Data disclosures related to both the balance of payments and the financial accounts have been released with shorter deadlines and more details since this methodological changeover. In addition, in July 2014 a new monthly publication was launched on balance of payments statistics for the faster and even more regular provision of information. As regards data supplies for supervisory purposes, in 2014 the MNB adopted the data supply standard developed by the European Banking Authority in relation to prudential requirements for credit institutions and investment firms: the receipt and processing of reports prepared according to uniform EU-level formal and substantive requirements commenced from the middle of the year.

The MNB recorded a profit of HUF 27.4 billion in 2014, which was slightly higher than the profit realised in 2013. This favourable result can mainly be attributed to increased profits from exchange rate changes. Expenditures from other constituents of net income increased in conjunction with the MNB's corporate social responsibility programme.

Actual operating costs amounted to HUF 32,175 million in 2014, which was 7.2 per cent lower than the approved budget. Actual and budget data for 2014 already included the annual costs associated with the MNB's new supervisory functions.

Execution of the budget in 2014 was mainly determined by savings recorded in personnel costs, partly stemming from the lower-than-expected average staff number and from costs rescheduled for 2015, but it also reflected the postponement of the utilisation of appropriations for central bank research to 2015, and the lower-than-budgeted operating costs. In addition, training, communication and legal costs proved to be lower than planned.

The financially realised value of investments implemented in 2014 was HUF 20,379 million, including advance payments for investment purposes. Most of this was related to property purchases for training, administrative and other institutional purposes and the related renovations, which exceeded the costs recorded for last year. The implementation of information technology projects cost HUF 1.1 billion, while the majority of the scheduled banking security investment projects was carried forward to 2015.

In 2014, the MNB renewed its environmental strategy; over the medium term (2014–2016), the focus is on the environmentally conscious development of the MNB's buildings and on improving the environmental performance of the cash supply chain. In 2014, the MNB's environmental management system (KÖVHIR) was subject to a comprehensive review, and the central bank commenced its enhancement and expansion, building on the experiences of the first three-year cycle. A programme supporting the implementation of the environmental strategy was developed in consideration of the achievements in environmental performance. Its execution is still in progress. As part of the implementation of the programme, the Krisztina körút site was integrated into the KÖVHIR system, and the MNB successfully obtained the EMAS certificate – the international accreditation recognising environmental-friendly operation. In the autumn of 2014, a thorough environmental assessment commenced affecting the MNB's subsidiaries involved in cash production; a proposal on the roll-out of the KÖVHIR system will be prepared based on its findings.

Without prejudice to its primary objective and basic tasks, the central bank considers its mission to serve

the public good from its own sustainable earnings and, to the extent possible, provide support for professional objectives and certain goals serving broad social interests. The results of the MNB's three-year corporate social responsibility programme achieved in 2014 have clearly contributed to the realisation of the goals serving broad social interests. The central bank's corporate social responsibility activities cover a wide spectrum of initiatives in education, scientific activity, financial literacy, culture and charity donations, with particular emphasis on the acquisition of knowledge and the creation and preservation of value.

In 2014, the communications of the MNB were dominated by the presentation of activities serving broad social interests and large-scale central bank programmes supporting the economic policy of the government and Hungarian economic growth. Communications focused on the success of the Funding for Growth Scheme and the self-financing

programme, the easing cycle, the achievement of not placing any additional burden on Hungary's budget with central bank operations, the Pallas Athena Public Thinking Programme, the widening of international relations, the Corporate Social Responsibility Programme, the enrichment of national values, support for the settlement and conversion of household foreign currency loans, the work on developing the rules of the payment-to-income ratio and the supervisory measures to protect consumers.

With Latvia's accession to the euro area, as of 1 January 2014, the number of euro-area Member States increased to 18 from 17. The number of ESCB members did not change in 2014. In 2014 as well, the General Council, the ESCB committees and the working groups established by the committees were useful fora for joint professional work and the exchange of professional experience with the ECB and the central banks of the EU Member States.

2 A brief overview of the Magyar Nemzeti Bank

Company name: Magyar Nemzeti Bank

Registered office: 1054 Budapest, Szabadság tér 8–9

Form of operation: company limited by shares. The form of operation, i.e. the designation ‘company limited by shares’ or its abbreviation need not be included in the company name of the Magyar Nemzeti Bank.

Year of foundation: 1924

Owner (shareholder): the Hungarian State, represented by the minister in charge of public finances

Scope of activities: as defined by Act CXXXIX of 2013 on the Magyar Nemzeti Bank (hereinafter: MNB Act)

Subscribed capital: HUF 10 billion

2.1 OBJECTIVES AND BASIC TASKS OF THE MNB

The Magyar Nemzeti Bank (hereinafter: MNB, the central bank) is a legal entity operating as a special company limited by shares, which conducts its operations in accordance with the provisions of the MNB Act. Pursuant to the MNB Act entering into force on 1 October 2013, in addition to its former tasks, the MNB assumed responsibilities for macroprudential policy, supervision of the system of financial intermediation and resolution as of 1 October 2013. In the course of 2014, in relation to the MNB’s basic tasks the set of macroprudential tools was supplemented in accordance with the Directive of the European Parliament and of the Council on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, and the Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms. Moreover, in 2014 Parliament established the framework defining the MNB’s resolution authority powers in Act XXXVII of

2014 on the further development of the institutional system strengthening the safety and security of certain participants of the financial intermediary system.

In accordance with Article 127 of the Treaty on the Functioning of the European Union, the MNB Act – which establishes the MNB’s primary objectives and basic tasks as well as its institutional, operational, personnel and financial independence and operation – stipulates that the primary objective of the MNB is to achieve and maintain price stability. Without prejudice to its primary objective, the MNB supports the maintenance of the stability of the system of financial intermediation, the enhancement of its resilience and its sustainable contribution to economic growth, and the MNB supports the economic policy of the government using the instruments at its disposal.

The MNB Act also stipulates the independence of the central bank in accordance with Article 130 of the Treaty on the Functioning of the European Union. On the basis of central bank independence, the MNB and the members of its bodies shall be independent in carrying out their tasks and meeting their obligations conferred upon them by the MNB Act, and shall neither seek nor take instructions from the Government, the institutions, bodies and offices of the European Union, the governments of its Member States or any other organisations or political parties, except from the European Central Bank and as required based on its membership in the European System of Financial Supervisors. The Government or any other organisation shall adhere to this principle, and shall not attempt to influence the MNB or any member of its bodies in the course of performance of their tasks.

The basic tasks of the MNB are the following:

- it defines and implements monetary policy;
- it has the exclusive right to issue banknotes and coins, including commemorative banknotes and coins, which shall be legal tender of Hungary;

- it has the exclusive right to hold and manage official reserves in foreign exchange and gold, in order to preserve the external stability of the Hungarian economy;
 - it has the exclusive right to conduct foreign exchange operations in relation to the management of foreign exchange reserves and the implementation of the exchange rate policy;
 - it has the exclusive right to oversee the domestic payment and settlement systems as well as the securities settlement systems and, as part of this duty, oversees the operation of the system and the operation of the organisation performing central counterparty activities in order to ensure the sound and efficient operation of these systems and the smooth circulation of money. Within the scope of its powers set forth in the MNB Act, it participates in the development of payment and securities settlement systems;
 - it collects and publishes the statistical information required for carrying out its tasks and fulfilling its statistical reporting obligations toward the European Central Bank as defined in Article 5 of Protocol (No. 4) on the Statute of the European System of Central Banks and of the European Central Bank attached to the Treaty on the Functioning of the European Union;
 - it establishes the macroprudential policy aimed at enhancing the resilience of the system of financial intermediation and ensuring its sustainable contribution to economic growth. To that end and within the limits specified in the MNB Act, the MNB explores the business and economic risks threatening the system of financial intermediation as a whole, promotes the prevention of the development of systemic risks and the reduction or elimination of systemic risks which have evolved. Furthermore, in the event of disturbances to the credit market it contributes to the balanced functioning of the system of intermediation in financing the economy by stimulating lending or – in the event of excessive credit outflow – by restraining lending.
- ensures the smooth, transparent and efficient functioning of the system of financial intermediation;
 - facilitates the prudent operation of the persons and organisations forming part of the system of financial intermediation and supervises the prudent exercise of owners' rights;
 - discovers undesirable business and economic risks to individual financial organisations or individual sectors thereof, reducing or eliminating specific or sectoral risks which have evolved, and taking preventive measures to ensure the prudent operation of individual financial organisations;
 - protects the interests of those using the services provided by financial institutions and strengthens public confidence in the system of financial intermediation.
 - via the Financial Arbitration Board, it helps to settle – out of court – disputes arising from the establishment and performance of the legal relationship established between the consumer and the organisations of the system of financial intermediation in respect of the use of services.
- Any further tasks of the MNB shall be defined by acts and, in relation to the supervision of the system of financial intermediation, by legal regulations adopted pursuant to the authorisation of an act. Such tasks of the MNB shall comply with the basic tasks and responsibilities of the MNB as defined in the MNB Act.

2.2 THE BODIES AND MANAGEMENT OF THE MNB

The MNB operates as a legal entity in the form of single-member company of limited by shares. The general rules pertaining to companies limited by shares and the relevant provisions of Act V of 2013 on the Civil Code are applicable to the MNB, with due consideration of the derogations set forth in the MNB Act.

Tasks of the MNB above and beyond its basic tasks:

- it acts as a resolution authority;
- acting as a sole supervisor of the system of financial intermediation, it:

The Hungarian State as the shareholder is represented by the minister in charge of public finances. The MNB operates without a General Meeting.

The **shareholder** is entitled to pass decisions, by way of a shareholder's resolution, on the establishment of an

amendment to the Statutes as well as the appointment, dismissal and remuneration of the auditor.

As a guarantee of independence, contrary to the practice of other companies limited by shares, the remuneration of the MNB's Governor, Deputy Governors and other members of the Monetary Council as well as the members of the Supervisory Board are determined by the MNB Act rather than the shareholder.

Likewise, the bodies of the MNB are specified by the MNB Act as follows: the Monetary Council, the Executive Board, the Supervisory Board and the Financial Stability Board.

The MNB's supreme decision-making body is the **Monetary Council**.

The scope of competence of the Monetary Council includes:

- strategic decisions concerning monetary policy, the issue of legal tender, the holding and management of foreign exchange and gold reserves, as well as strategic decisions relating to foreign exchange transactions and statistical tasks in the context of foreign exchange reserve management and implementation of exchange rate policy including, in particular, decisions regarding the required reserve ratio, interest payable on reserves, decisions on the exchange rate regime and determining the central bank base rate;
- in relation to macroprudential tasks, oversight, the supervision of the system of financial intermediation and the MNB's role as a resolution authority, decision on the strategic framework within which the Financial Stability Board makes decisions;
- establishing the rules of procedure;
- decisions on any other matter that an act refers to the exclusive competence of the Monetary Council.

Members of the Monetary Council are: the Governor of the MNB as Chairman of the Monetary Council, the Deputy Governors of the MNB and members elected by Parliament for six years. The Monetary Council has at least five and at most nine members.

At the first meeting of each year, the Monetary Council elects a Deputy Chairman from among the Deputy

Governors of the MNB to substitute the Chairman – except in issuing decrees – if the latter is unable to attend. In 2014, the Monetary Council elected Deputy Governor Dr Ádám Balog as Deputy Chairman.

Members of the Monetary Council in 2014:

- Dr György Matolcsy, Governor, Chairman of the Monetary Council from 4 March 2013,
- Dr Ádám Balog, Deputy Governor from 6 March 2013,
- Dr Ferenc Gerhardt, Deputy Governor from 22 April 2013,
- Dr László Windisch, Deputy Governor from 2 October 2013,
- Andrea Bártfai-Mager, from 21 March 2011,
- Dr János Béla Cinkotai, from 22 March 2011,
- Dr György Kocziszky, from 5 April 2011,
- Gyula Pleschinger, from 5 March 2013,
- Dr Csaba Kandrács, from 30 September, 2013.

Established on 1 October 2013, the **Financial Stability Board** acts as the decision-making body of the MNB in relation to oversight, macroprudential tasks and resolution authority duties, as well as prudential supervision. Within this scope of competence, the Financial Stability Board:

- continuously monitors the stability of the system of financial intermediation as a whole and of the financial markets in order to maintain the stability of the system of financial intermediation as a whole;
- takes account of risk factors threatening the system of financial intermediation as a whole;
- analyses the risks related to certain types of institutions or products or to the spread of these which may represent a threat to the system of financial intermediation as a whole;
- monitors developments on international and European markets and risks which may represent a threat to the stability of the system of financial intermediation as a whole, and makes decisions

on the necessary measures within the strategic framework defined by the Monetary Council;

- discusses strategic, regulatory and risk-related issues affecting the system of financial intermediation as a whole and issues opinions if necessary;
- in situations threatening the stability of the system of financial intermediation, assesses systemic risks and decides on the measures required to mitigate or eliminate such risks;
- places on its agenda, as necessary, the recommendations, opinions and risk warnings of the European Systemic Risk Board relevant to the system of financial intermediation as a whole;
- discusses the recommendations and decisions issued by the European Supervisory Authorities as needed, including decisions addressed to national supervisory authorities calling for specific measures in the event of serious risks to the stability of the European financial system and expresses its opinion on the tasks arising from such decisions;
- publishes non-binding recommendations for the organisations of the system of financial intermediation describing the grounds of the MNB's application of law;
- annually defines the priority target areas of the MNB's control activities;
- and makes decisions in administrative proceedings relating to the exercise of supervision over the system of financial intermediation.

Pursuant to the MNB Act, the Financial Stability Board is composed of the Governor of the MNB as its chairman, the Deputy Governor responsible for monetary policy, financial stability, lending incentives and the supervision of financial organisations, the Deputy Governor responsible for the supervision of financial organisations and consumer protection and, as managers designated by the governor of the MNB, the Deputy Governor responsible for statistics, cash logistics and the financial infrastructure, and the Executive Directors responsible for financial stability, lending incentives and the supervision of financial institutions. In accordance with the MNB Act, responsibility for implementing the decisions of the Monetary Council and the Financial Stability Council,

as well as for managing the operation of the MNB rests with the **Executive Board**.

The scope of competence of the Executive Board includes:

- managing the implementation of the decisions of the Monetary Council and the Financial Stability Board;
- approving the accounting report of the MNB, issuing decisions on the payment of dividends;
- approving the draft report to be sent to the shareholder on the management and assets of the MNB;
- approving matters related to the organisation and internal management of the MNB;
- approving professional plans and programmes relating to the operation of the MNB and the performance of its tasks, including the development and operational budget;
- managing the MNB's internal audit organisation in respect of tasks falling outside the scope of competence of the Supervisory Board, and discussing the findings and plans of the internal audit;
- amending the collective agreement in respect of employment rights and obligations, the exercise and performance of these rights and obligations, and the associated procedures; and
- adopting decisions in respect of the central bank's powers to perform account management and other financial and auxiliary financial services, as well as certain auxiliary services supplementing investment service activities.

The members of the Executive Board, which is the executive body of the MNB, are the Governor, as the Chairman of the Board, and the Deputy Governors of the MNB.

Provisions relating to the functions and operational procedures of the Monetary Council, the Financial Stability Board and the Executive Board are set forth in the MNB Act, the MNB's Statutes, Organisational and Operational Rules as well as the rules of procedure formulated by these bodies.

In addition to the auditor appointed by the shareholder, the MNB is also audited by the State Audit Office and the Supervisory Board.

The supervisory competence of the **State Audit Office** in relation to the MNB is set forth in the Act on the State Audit Office. The State Audit Office supervises the financial management of the Magyar Nemzeti Bank and activities under the MNB Act that are not included in its basic tasks. In this regard, the State Audit Office examines if the MNB operates in accordance with the applicable law, its Statutes and the shareholder's resolutions.

The **auditor** of the MNB can be appointed for a maximum of 5 years. The shareholder decides on the appointment, dismissal and remuneration of the auditor by way of a shareholder's resolution. Prior to putting forward a proposal for the appointment or dismissal of the MNB's auditor, the Governor of the MNB consults with the President of the State Audit Office.

The **Supervisory Board** is the body responsible for the continuous supervision of the MNB on behalf of the owner. The supervisory competence of the Supervisory Board defined by the MNB Act does not cover the supervision of the Bank's performance of its basic tasks, its actions as a resolution authority and its supervisory activity in respect of the financial intermediary system, or the impact of such on the MNB's profit and loss. Accordingly, the Supervisory Board compiles the report specified in the Act on Accounting subject to the above limitations.

Members of the Supervisory Board as defined in the MNB Act are its Chairperson elected by Parliament, three additional members elected by Parliament, the representative of the minister responsible for the state budget and an expert appointed by the minister responsible for the state budget. The Chairman of the Supervisory Board, who is elected by the Parliament, is nominated by the governing parties, whereas the other members elected by the Parliament are nominated by the parliamentary groups.

The members' term of office coincides with the mandate of the Parliament.

Until the expiry of their mandates on 5 May 2014, the Supervisory Board of the MNB comprised the following members:

- Zsigmond Járai, Chairman,
- Dr Tamás Katona,
- László Madarász,
- Dr Péter Róna,
- Dr Gábor András Szényei,
- István Varga,
- Gábor Orbán (representative of the minister responsible for the state budget),
- Dr Attila Simon Tóth (expert appointed by the minister responsible for the state budget).

At the time of compiling the financial statements, Parliament did not elect the members of the Supervisory Board.

2.3 ORGANISATION OF THE MNB

The organisation of the MNB is based on the operating and operational governance model introduced on 1 July 2013 and, in respect of the integrated organisation, on 1 October 2013. Although the organisational structure changed several times in 2014, these changes did not fundamentally alter the organisational structure in place since 1 July 2013.

The organisational structure as of 31 December 2014 is shown in the **organisation chart**.

2.4 RELATIONS BETWEEN THE MNB AND THE EUROPEAN SYSTEM OF CENTRAL BANKS

Hungary's accession to the European Union also entailed the MNB's membership in the European System of Central Banks (ESCB). The ESCB comprises the European Central Bank (ECB), which was established in June 1998 with its seat in Frankfurt, and the national central banks of the EU Member States. Its governing bodies are the Executive Board and the Governing Council, the latter consisting of the members of the ECB's Executive Board and the governors of the central banks of the euro-area Member States. The third decision-making body of the ECB is the General Council, which is responsible for maintaining an institutional relationship between the Eurosystem and the central banks of non-euro-area Member States. The General Council holds its meetings quarterly and consists of the President and the Vice-President of the ECB and the respective governors of the central banks of all EU Member States. The key responsibilities of the General Council include consultancy concerning preparations for accession to

Members of the Executive Board and the Monetary Council of the Magyar Nemzeti Bank



Dr György Matolcsy
Governor,
Chairman of the Monetary Council



Dr Ádám Balog
Deputy Governor with general
responsibilities,
Deputy Chairman of the
Monetary Council



Dr Ferenc Gerhardt
Deputy Governor,
Member of the Monetary Council



Dr László Windisch
Deputy Governor,
Member of the Monetary Council

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the euro area, approval of the convergence reports of the ECB and monitoring the functioning of ERM II. Within the framework of the latter activity, it assesses the sustainability of the bilateral exchange rate of non-euro currencies participating in ERM II against the euro and provides a forum for the alignment of monetary and exchange rate policies and the management of intervention and financing mechanisms in ERM II. In addition, the General Council is involved in verifying whether the central banks of EU Member States and the ECB comply with the prohibition of monetary financing of the budget and privileged access of the public sector to financial institutions. The General Council also contributes to the ECB's advisory functions and to the collection of statistical information; it must be consulted in respect of any changes in the rules of accounting and financial data supply, as well as issues related to the adjustment of the keys for subscriptions to the ECB's capital. The mandate of the General Council will expire on the date when all of the Member States have adopted the euro.

With the launch of the Single Supervisory Mechanism (SSM) on 4 November 2014, the ECB assumed responsibility for the duties conferred on it in relation to the policies pertaining to the prudential supervision of credit institutions. In order to separate supervisory and monetary policy functions at the organisational level, supervisory tasks and the preparation of related draft decisions have been assigned to a newly established body, called the Supervisory Board, while decision-making is the responsibility of the Governing Council.

On 9 July 2013, the Council of the EU approved Latvia's entry to the euro area, resulting in an increase in the number of euro-area Member States from 17 to 18 as of 1 January 2014. The number of ESCB members did not change in 2014.

The ESCB members are also the owners of the ECB. The respective ownership shares of Member States are determined according to their shares in GDP and total population of the EU (on the basis of statistical data compiled by the European Commission). As of 1 July 2013, the paid-up capital of the ECB increased from EUR 10.76 billion to EUR 10.825 billion, and it did not change in 2014.

Currently, euro-area central banks subscribe to 70 per cent of the ECB's capital, while the remaining 30 per cent is divided among the central banks of non-euro-area Member States. These latter central banks pay a pre-defined minimum percentage of their respective subscriptions to the ECB's capital as a contribution to the operational costs of the ECB which are incurred in connection with their ESCB membership. With effect from 29 December 2010, this contribution was defined as 3.75 per cent of the respective subscriptions (previously it had been 7 per cent). As set forth in the Statute of the ESCB and of the ECB, the capital keys are adjusted every five years, or whenever a new Member State joins the EU or the euro area. In the second half of 2013, the capital keys were adjusted twice, due to the scheduled 5-year revision and Latvia's accession to the euro area. Consequently, on 1 January 2014, the share of the MNB in the ECB's paid-up capital increased from 1.3740 per cent to 1.3798 per cent (requiring the MNB to pay an additional capital contribution to the ECB in the amount of EUR 23,544).

The ESCB Committees play an important role in the work of the ECB's decision-making bodies. The basic role of these committees is to prepare decisions and facilitate coordination as per the horizontal division of various central bank duties, covering all areas of central banking operations from monetary policy through communication to statistical data reporting. Experts from the central banks of non-euro-area Member States attend those committee meetings whose agenda includes items affecting the ESCB as a whole and which fall within the competence of the General Council. (For a detailed description of the ESCB Committees and the activities of the various fora assisting them, see Chapter 3.13). With the participation of the central banks of non-euro-area Member States, the committees meet and discuss current issues relevant to their professional areas 4–5 times a year on average, according to a schedule determined for a year in advance.

The senior executives and relevant experts of the MNB continue to play an active role in the activities of these committees and their working groups. In 2014, the ESCB committees continued to provide very useful fora for the exchange of professional experience.

3 Review of the MNB's performance in 2014

3.1 MONETARY POLICY

In July 2014, the Monetary Council concluded its two-year easing cycle. With a cumulative reduction of 490 basis points, the central bank policy rate declined to 2.1 per cent as a result of a two-year easing cycle. Leading central banks maintained exceptionally loose monetary conditions, which were reflected in the risk assessment of domestic financial instruments, widening the scope for monetary policy manoeuvres.

In the judgement of the Monetary Council, output remained below potential throughout 2014 amid recovering economic activity, and unemployment exceeded the long-term level determined by structural factors. In 2014, consumer price dynamics fell to historically low levels. Indicators capturing the medium-term outlook for underlying inflation trends indicated moderate inflationary pressure. In the first half of 2014, inflation hovered around zero per cent before sinking further during the year and falling significantly below the 3 per cent inflation target. The reduction in the base rate in the course of 2014 was justified by the low inflation environment, subdued inflationary pressures even over the medium term and a degree of spare capacity in the economy, while perceptions of the risks associated with the economy were supportive throughout the period. The Monetary Council's monetary policy stance was balanced and conservative; in the first half of 2014, achieving the medium-term inflation target called for the maintenance of the cautious approach to monetary easing.

Global money market sentiment was volatile in the first half of the year, primarily due to increased uncertainty surrounding the Russia-Ukraine conflict and the future of the quantitative easing programmes launched by leading global central banks. In the second half of 2014, intensifying geopolitical conflicts, the termination of the Fed's asset purchase programme and the uncertainty about its interest rate increase, the monetary easing of the ECB, the Bank of Japan and the People's Bank of China, as well as the continued

fall in oil prices impacted the global financial markets. In the judgement of the Monetary Council, even in conjunction with the increased uncertainty of the global financial environment, there was still room for interest rate cuts; however, in line with the cautious monetary policy, the interest rate reduction was implemented in smaller steps than it had been previously. In July, the Monetary Council ended its two-year period of easing cycle and reduced the key policy rate to a historically low level. After termination of the interest rate cycle, in the second half of 2014 the Monetary Council judged that, based on available information, the central bank base rate had reached a level sufficient to ensure the achievement of the medium-term inflation target and provide an adequate degree of support to the real economy. Provided that the assumptions underlying the Bank's projections held, achieving the medium-term inflation target pointed in the direction of maintaining loose monetary conditions for an extended period.

Inflation trends in 2014

In the assessment of the Monetary Council, the inflation trends that started in 2010 continued in

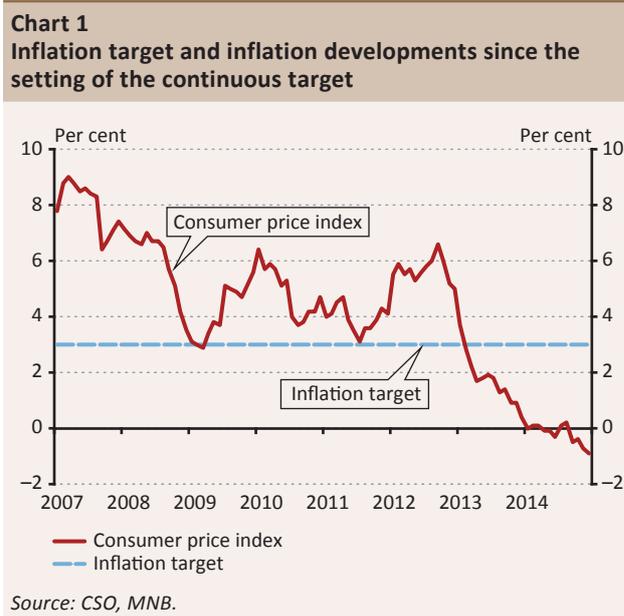


Table 1
Consumer price index and its components
 (percentage change, year-on-year)

	2012	2013	2014	2014			
				Q1	Q2	Q3	Q4
Core inflation	5.1	3.3	2.2	3.0	2.4	2.1	1.2
Unprocessed food	6.8	6.1	-3.7	-3.4	-6.6	-3.3	-1.7
Fuel and market energy	12.0	-1.0	-2.1	-3.6	-0.4	-0.6	-3.7
Regulated prices	4.7	-3.7	-6.6	-7.3	-7.2	-6.5	-5.4
Consumer price index	5.7	1.7	-0.2	0.0	-0.2	-0.1	-0.7
Consumer price index excluding indirect taxes	3.5	1.2	-0.2	0.0	-0.2	-0.1	-0.7

Note: In the case of price indices with unchanged tax content, the CSO adjusts the consumer price index for the technical effect of changes in indirect taxes. The time series of certain inflation groups may differ, even retroactively, from those published in earlier years due to the reclassification of some partial items at the beginning of 2012.
 Source: CSO.

2014 and were different from those of the previous periods. Despite the substantial monetary easing, consumer price inflation declined considerably due to factors outside of the scope of monetary policy and remained below the price stability objective of 3 per cent throughout the year, moving into the negative range several times. Average annual inflation was -0.2 per cent in 2014.

The inflation rate, which was significantly lower than the inflation target in 2014, was the combined result of several factors. The main contributors to the historically low inflation rate recorded throughout the year were low imported inflation, commodity price developments, changes in the price indices of unprocessed foods and industrial goods, the level of spare capacity in the economy, low wage dynamics and falling inflation expectations, and the gradual reduction of regulated energy prices. The further

decline in inflation towards the end of the year was primarily due to falling oil prices.

The central bank's indicators capturing underlying inflation trends pointed to historically low dynamics as well, as the combined result of subdued inflation in external markets, declining commodity prices and imported inflation, slack capacities in the economy, low wage dynamics, and the decline in inflation expectations. In an environment of recovering economic activity, output remained below its potential, and the domestic real economy environment and labour market factors continued to be disinflationary, albeit to a lesser degree. Low inflation and more anchored inflation expectations may have contributed to the fact that the tightening observed in the labour market only resulted in moderate acceleration in wage growth.

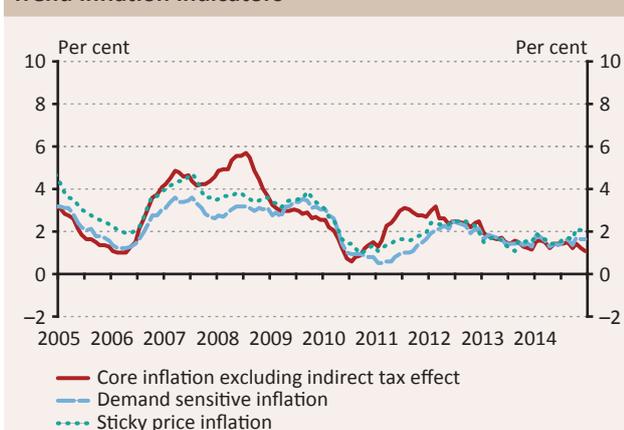
Over the long term, monetary policy can best contribute to economic growth and a predictable macroeconomic environment by achieving and maintaining price stability and by ensuring the stability of the financial system.

Changes in monetary policy instruments

Demand for loans available under the Funding for Growth Scheme remained strong

Under the second phase of the Funding for Growth Scheme (FGS) launched on 1 October 2013, against collateral, the MNB provided refinancing loans at 0 per cent interest to participating credit institutions, which then lend these funds to small and medium-sized enterprises (SMEs) with an interest margin capped at 2.5 per cent and a maturity of up to 10

Chart 2
Trend inflation indicators



Source: MNB.

years. The overall available amount of the programme was initially HUF 500 billion, which may be raised to up to HUF 2,000 billion by the Monetary Council, depending on the prevailing macroeconomic, financial and lending environment. A difference compared to the first phase is that at least 90 per cent of the overall amount available must be used for the disbursement of new loans, and the share used for loan redemption may not exceed 10 per cent.

From 1 January 2014, financial enterprises may also provide financing (via the refinancing provided by the MNB's partner credit institutions) and, in addition to loans, a new product – financial lease – can also be offered under the FGS. The upper limit of the credit amount was raised to HUF 10 billion from HUF 3 billion. In May, further fine-tuning took place: the maturity of working capital loans to be refinanced under the programme was raised to 3 years from 1 year. In addition, in order to facilitate the portfolio cleaning of credit institutions, new investment loans can be now used to purchase commercial real estate for leasing purposes when such real estate served or still serves as collateral for a loan (or the subject matter of a leasing transaction) which was terminated or deemed non-performing prior to 31 March 2014. Moreover, the deadline for the drawdown of investment loans and the related refinancing loans was extended by six months.

In consideration of the expected increase in demand, on 2 September 2014 the Monetary Council raised the credit line allocated under the second phase of the FGS by HUF 500 billion to HUF 1,000 billion, while leaving the end-of-year contracting deadline unchanged. Subsequently, on 27 October 2014, the Monetary Council decided to extend the second phase of the FGS by one year, as SMEs continue to show heightened demand for long-term forint loans available under the FGS with a fixed interest rate, while credit conditions are still excessively tight in the lending market. Extension of the programme was also necessitated by the need for better utilisation of European Union funds, as a significant part of European Union tenders is expected to be announced in 2015. The announcement of the tenders may generate considerable demand both for the pre-financing of EU grants and for the related investment loans.

By 31 December 2014, credit institutions participating in the second phase of the programme concluded contracts with small and medium-sized enterprises for

a total amount of HUF 584.2 billion, and the related refinancing loan portfolio held by credit institutions amounted to HUF 472.3 billion. Around 19,000 enterprises received financing amounting to nearly HUF 1,300 billion in the first and second phases of the scheme altogether.

Reform of monetary policy instruments in relation to the self-financing concept

At its meeting on 23 April 2014, the Monetary Council of the MNB adopted the self-financing concept and, in this context, made the decision to restructure its monetary policy instruments. The self-financing concept facilitates a shift to internal financing, which means that Hungarian participants, households and banks will contribute to the financing of the general government to a larger degree than before, while the contribution of foreign investors will decline. The ultimate goal of the programme is to reduce the external vulnerability of the country through a reduction in gross external debt, and to improve the stability of general government financing and the Hungarian financial system.

The renewal of the MNB's instruments is intended to increase banks' role in the financing of public debt:

- as of 1 August 2014, the **two-week MNB bills were converted into central bank deposits**, as a result of which funds deposited by banks at the MNB shifted, in part, into government securities;
- from 26 June, the regularly announced **interest rate swap (IRS) instrument** helps reduce interest rate risks and hence, supports the adjustment by banks;
- collateralised loans and security swap instruments were added to the range of **potential business instruments**, intended to provide credit institutions with liquidity assistance in the case of market turbulence.

The purpose of converting the main policy instrument into deposits is to channel the two-week portfolio of the banking system into HUF-denominated government securities, in line with the self-financing programme. The loss of liquidity resulting from the conversion of the two-week instrument stimulated the channelling of liquid assets. This is because the two-week deposit may not be withdrawn before maturity or used in the money market as collateral for loans, nor can it serve as collateral for central bank loans.

In 2014, the MNB conducted 13 interest rate swap tenders, concluding interest rate swap contracts with partner credit institutions in a total amount of HUF 405 billion at nominal value. The announced offered amount at the three and five-year interest rate swap tenders was HUF 210 billion and HUF 220 billion, respectively; bids submitted by participants amounted to HUF 219 billion and HUF 351 billion, and the amount allotted by the MNB was HUF 157 billion and HUF 248 billion, respectively.

Market interest rate swap spreads, i.e. the difference between government securities yields and the fixed rate of market interest rate swap contracts, have not changed significantly since the announcement of the self-financing programme. Three and five-year interest rate swap spreads narrowed to around zero for a short period after the announcement of the programme, before returning to their previous level of around 50 basis points at the beginning of July, and subsequently remained more or less at the same level until the end of the year.

At the end of December 2014, the value of the Hungarian banking sector's HUF-denominated government paper portfolio was HUF 829 billion higher compared to the end of December 2013. Holdings of forint-denominated government paper in banks' own possession without repo correction also increased in comparison to the basis interpreted in the context of the self-financing concept (average of end-of-month values in January, February and March 2014). This is in line with the fact that – relative to their holdings in the basis period – credit institutions participating in interest rate swap tenders undertake to increase the adjusted value of their holdings of securities eligible for interest rate swap transactions by at least as much as their IRS contracts concluded with the MNB. Accordingly, and also owing to the conversion of the main policy instrument into deposits, the banks that increased their government security holdings were primarily those that participated in the interest rate swap tenders of the MNB, as well as banks which are active in money markets and whose account turnover is significant compared to their balance sheet total, as such banks had to replenish their eligible collateral in response to the conversion of the MNB bills. By contrast, banks not participating in the central bank's self-financing programme reduced their portfolios of government securities. Thus, participation in the programme fundamentally defined the behaviour

of banks and, based on actual data, the MNB's programme succeeded in facilitating the purchase of government securities by banks and hence, the stabilisation of the Hungarian government securities market.

Forint liquidity management of the banking system

In 2014, items affecting the liabilities side forint liquidity of the central bank's balance sheet (main policy instrument,¹ required reserve holdings and overnight central bank deposits together) declined by a total of HUF 157 billion to HUF 5,860 billion. The decline in liquidity was primarily due to an increase in currency in circulation. The Funding for Growth Scheme raised liquidity by around HUF 350 billion, and the Single Treasury Account (STA) also contributed to the expansion of liquidity. After the announcement of the self-financing programme, the Government Debt Management Agency no longer issued foreign currency bonds, which, *ceteris paribus*, reduced both the central bank's balance sheet and the liquidity of the banking system. Once again in April and October 2014, credit institutions required to hold reserves were free to choose from reserve ratios of 2, 3, 4 and 5 per cent. Seven credit institutions opted for the option to change in May, and 28 in November. As a result, the average required reserve ratio increased to 2.87 per cent from 2.59 per cent in May, and remained at the same level in November.

After the conversion of the main policy instrument, the overnight central bank deposit portfolio of the banking sector increased substantially. The MNB held the first two-week deposit tender on 6 August 2014, and on 13 August the last two-week MNB bills matured. At the tender held on 21 August, the portfolio of the main policy instrument exhibited a sharp temporary decline of around HUF 500 billion to HUF 4,472 billion. That notwithstanding, the overnight central bank deposit portfolio fluctuated in a fairly high range, between HUF 300 billion and HUF 800 billion. In September, the portfolio of the two-week instrument rose to around HUF 5,000 billion once again, and the overnight deposit portfolio declined, although its level of HUF 200–400 billion was still higher than usual. While the portfolio of overnight deposits averaged HUF 112 billion before the conversion of the MNB bill, it rose to HUF 302 billion on average between 6 August and the end of September. From mid-October, however,

¹ In the case of the MNB bills, the total portfolio is considered, not only the holdings of banks.

overnight deposits fluctuated in the range below HUF 200 billion once again, only rising above this level at the end of certain months and at the end of the year, in line with seasonality. Accordingly, in the last quarter of the year, the average overnight deposit portfolio amounted to only HUF 137 billion. Before the conversion, the HUFONIA was 59 basis points lower than the central bank base rate on average, and subsequently this difference rose to 76 basis points, likely as a result of the increased overnight deposit portfolio.

Three-month benchmark yields – the yields most relevant for the transmission of monetary policy – moved in line with the reductions of the central bank base rate overall, but also reflected higher volatility and greater uncertainty in respect of interest rate expectations. At the end of January, the forint weakened significantly against the euro, generating a temporary spike in benchmark yields, which rose above the central bank base rate. Subsequently yields declined again, and at the end of the easing cycle they resided close to the key policy rate or below. In the second half of the year, yields on discount Treasury bills (DTB) fell significantly short of the central bank base rate. The low DTB yields can be attributed partly to the self-financing programme² and partly to reduced DTB issuance by the Government Debt Management Agency. According to the latest data from November, with the exception of consumer credit, interest rates moved in line with the reductions of the key policy rate in the case of deposits and loans with short-term maturities or with an interest rate fixation of up to 1 year.

Instruments providing foreign exchange liquidity

Foreign exchange spot tenders

At its meeting on 23 September 2014, the Monetary Council decided that the MNB would provide the Hungarian banking system with the foreign currency needed to phase out household foreign currency loans, including their settlement and conversion into Hungarian forint. The central bank's programme is intended to ensure that the phasing-out of household foreign currency loans is carried out quickly and in

a well-organised manner, safeguarding the stability of the financial system and without significantly affecting the exchange rate of the forint. Since both the settlement and the conversion of foreign currency mortgage loans into forints opens the foreign exchange position of the banking sector, banks must close the position by purchasing foreign currency. The MNB announced its programme in order to prevent the appearance of banks' demand for foreign currency in the FX market and thus avoid any negative effects on the exchange rate and financial stability. The required foreign currency is supplied from the international reserves of the central bank.

The MNB developed two new instruments in relation to the settlement with clients.³ A euro sale facility conditional upon the reduction of short-term external debt and an unconditional euro sale instrument combined with a long-term foreign exchange swap. The MNB allocated EUR 2 billion for the conditional instrument and EUR 1 billion for the unconditional instrument. The MNB has announced tenders since 13 October 2014, initially with a weekly frequency and, since 1 December, as required by banks. The instruments will be available at least until the end of March 2015. By the end of December, the MNB had sold a total of EUR 1,081 million at the tenders, of which the share of the conditional and the unconditional instrument was EUR 293 million and EUR 788 million, respectively.

Similarly, the MNB introduced an instrument conditional on the reduction of short-term external debt and an unconditional instrument in relation to the phasing out of household foreign currency loans as well. In case of the latter, the MNB extended the range of maturities available to banks compared to the settlement phase. The MNB held tenders on 10 and 11 November, and subsequently it announces the tenders as required by banks until the end of January 2015. The banking sector's hedging requirement in relation to the conversion is around EUR 8 billion, nearly all of which was provided by the MNB: by the end of the year, the MNB allocated a total of EUR 7,944 million to credit institutions (of which the share of the conditional and the unconditional instrument was EUR 1,655 million and EUR 6,289 million, respectively).

² After the conversion of the two-week MNB bill, the banking sector's demand for liquid forint instruments – such as DTB and overnight deposits – increased, which pushed down yields in the forint money market. This was partly due to banks' reduced range of eligible collateral after the elimination of their MNB bill portfolio, and partly due to the fact that, after the conversion, other participants with MNB bill holdings placed short-term forint deposits in the banking sector, which the banking sector attempted to invest in liquid assets.

³ For more information about the central bank's euro sale tenders, see:

http://english.mnb.hu/Monetaris_politika/mnben_jegybanki_eszkozta_r/mnben_eszkozta_r_tenderek/fx-spot-tenders

The MNB's euro sale tenders were successful in the sense that the settlement and conversion had no impact on the forint exchange rate. The condition pertaining to the reduction of short-term external debt expands the MNB's room for manoeuvre in foreign exchange reserves, while the long-term swaps involved in the unconditional instruments ensure that the reduction of the foreign exchange reserves is stretched over a longer period of time. Consequently, foreign exchange reserve adequacy will be continuously ensured in the coming years.

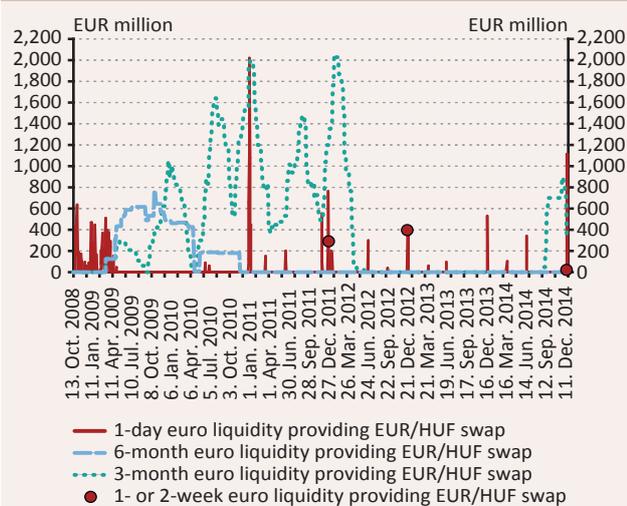
Central bank foreign currency swap transactions

Market yield spreads of short-term foreign currency swaps (FX swap) remained moderate in the first half of 2014, but widened slightly in the second half of the year. In the first six months, the average overnight spread calculated from Bloomberg quotes was 20 basis points, while the more stable three-month spread stood at 50 basis points on average. Consolidated spreads were in line with the favourable risk assessment of Hungary. At the same time, in response to the balance sheet adjustment of non-resident participants, excess demand for foreign currency characterised the FX swap market at the end of each quarter, triggering temporary spikes in the overnight spread, which reached 200 basis points on 31 March and 300 basis points on 30 June. At the end of August and at the beginning of September,

implied forint yields fell sharply not only in the short-term government securities market, but also in the HUF/FX swap market. This was accompanied by the widening of FX swap spreads. Thus, by the second half of the year the average overnight spread rose to 50 basis points, while the average three-month spread increased to 80 basis points. In addition, at the end of the year the short-term swap market saw a seasonality-induced spread widening again, with the overnight spread reaching 630 basis points on the last day of the year.

Compared to the previous year, demand increased for traditional (overnight, one and two-week and three-month) central bank EUR/HUF FX swap instruments providing euro liquidity in 2014. As usual, the banking system took recourse to the overnight facility mainly on the last day of each quarter: in the framework of overnight tenders the MNB allocated EUR 100 million on 31 March, EUR 342 million on 30 June, and EUR 1,117 million on 31 December. Moreover, starting from September, the banking system reverted to the use of the three-month instrument, which had been last used in March 2012. The central bank's outstanding three-month swap contracts peaked at EUR 900 million in December before dropping to EUR 350 million by the end of the year. In addition, with a view to assisting credit institutions in the management of FX liquidity, the MNB announced a one-off, two-week swap tender stretching over the end of the year, allocating EUR 20 million.

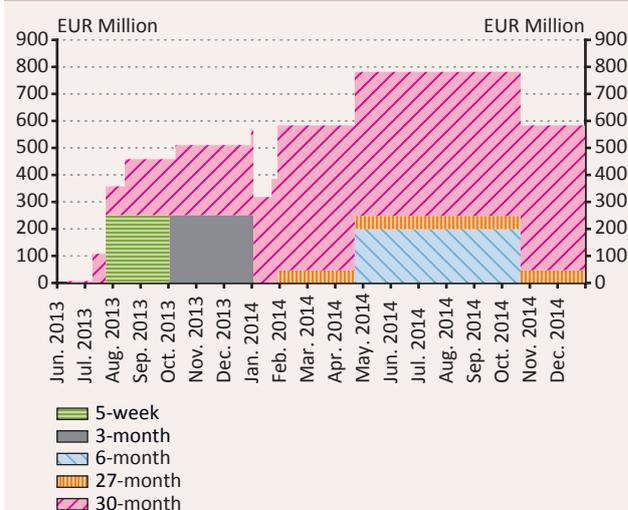
Chart 3
Recourse to the MNB's FX swap instruments – outstanding amounts



Note: excluding the swap facilities provided under Pillar III of the Funding for Growth Scheme.

Source: MNB.

Chart 4
Swap facilities provided under Pillar III of the Funding for Growth Scheme



Source: MNB.

The total swap portfolio allocated to credit institution counterparties at the central bank's FX swap and CIRS (currency interest rate swap) tenders introduced in 2013 under Pillar III of the FGS rose to EUR 781 million from EUR 568 million in the first half of the year. The original maturities of outstanding stock were 6, 27 and 30 months at the end of June. Thanks to the decline in Hungary's external vulnerability, favourable FX swap market conditions and elaboration of the self-financing concept, there was no longer a need to maintain the central bank currency swaps. In consideration of the changed circumstances, the Monetary Council decided to terminate the currency swap tenders constituting Pillar III of the Funding for Growth Scheme as of 1 July 2014. As of 31 December, the portfolio amounted to EUR 581 million.

3.2 STABILITY OF THE FINANCIAL INTERMEDIARY SYSTEM

Pursuant to the MNB Act, the primary objective of the MNB is to achieve and maintain price stability. Without prejudice to its primary objective, the MNB supports the maintenance of the stability of the financial intermediary system, the enhancement of its resilience and its sustainable contribution to economic growth; furthermore, the MNB supports the economic policy of the government using the instruments at its disposal. As a member of the European System of Financial Supervision, the MNB performs the tasks imposed on it arising out of the scope of the European Banking Authority, the European Insurance and Occupational Pensions Authority, the European Securities and Markets Authority and the European Systemic Risk Board, and supervises the Hungarian financial intermediary system. Within the scope of its powers laid down in a separate Act, the MNB also functions as a resolution authority from 16 September 2014.

In line with the practice of recent years, in 2014 the MNB published its *Financial Stability Reports* twice (22 May and 12 November), and issued its quarterly publication entitled *Trends in Lending* with the results of its surveys presenting the latest trends in lending.

Key developments in the financial intermediary system

The *Financial Stability Reports* provide a comprehensive assessment of risks to financial stability, presenting the main risks in detail. The key risks included in banks' balance sheets impede healthy

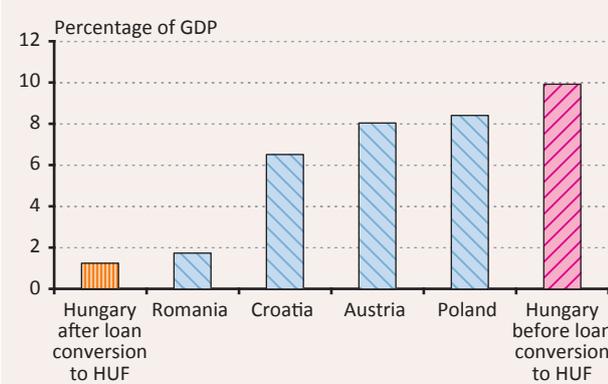
lending and hence, impair the adequate growth of the economy. The *Financial Stability Report* published on 22 May 2014 discusses the preferred directions of the banking sector's transformation in detail. The goal is to create a stable and profitable banking system that supports sustainable economic growth, and this can be best achieved through the transformation of the asset side of banks' balance sheets. The cleaning of the banking sector's loan portfolio and normalisation of institutional operation are prerequisites for a sustainable expansion of the credit market. In the corporate segment the high ratio of non-performing loans, and in the household sector the high share of foreign currency loans represented severe risks via the deteriorating quality of the portfolio.

The issue of household foreign currency loans is being addressed by the settlement prescribed in view of the invalidity of exchange rate margins and unfair interest rates and commission charges, and by the conversion to the "fair banking system". The settlement will significantly reduce the stock of outstanding foreign currency loans. The settlement of the exchange rate margin and unfair interest rate increases affects debtors differently, depending on individual credit conditions (maturity, level of interest rate increase, date of disbursement). On the whole, the measures may have a positive impact on portfolio quality. Owing to the reduction of monthly instalments, the probability of default is expected to decrease. Similarly, credit risks are further mitigated by the removal of the exchange rate risk after the conversion of the loans into forints, and this points to an improvement in portfolio quality over the medium term. Transition to the "fair banking system" and the conversion of FX loans to HUF contribute to banks' balance sheet clean-up, the reduction of risks and the strengthening of competition. This may speed up the consolidation of the banking sector, which may be further boosted by leveraging cost-side synergies.

The MNB played an important role in the settlement of foreign currency loans. The MNB contributed to the settlement by issuing four MNB decrees, in accordance with the provisions of Act XL of 2014 which, in part, conferred the regulation of the technical details upon the MNB. First and foremost, the MNB determined the precise method of the recalculation of loans and the calculation of consumer claims, both for duly performing and delinquent debtors. Institutions subject to winding-up or liquidation – in relation to which no adequate data are available for the calculation of consumer claims – were covered by

a separate MNB decree; moreover, banks' obligation to provide information was also regulated in a separate MNB decree. The MNB participates in the conversion of FX loans to HUF by making available a portion of the central bank's FX reserves, allowing for the closure of the opening foreign exchange position of the banking sector without market tensions. The MNB participates in the transition to the fair banking system by the assessment of the indicators of changes to interest rates and of changes to interest rate margins and by ensuring that the indicators are controllable.

Chart 5
Outstanding Swiss franc loans to households in selected regional countries

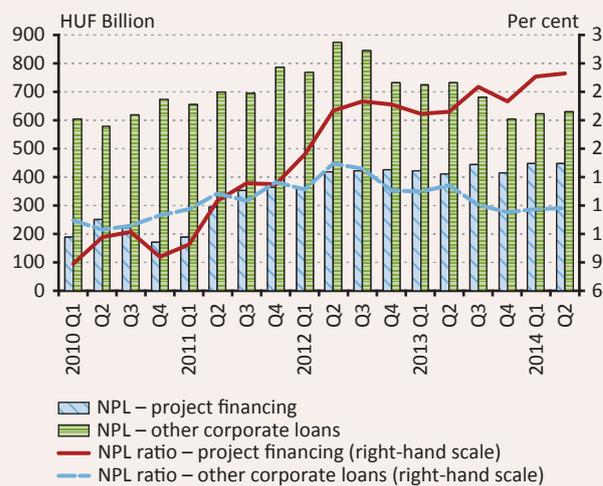


Source: MNB.

In the interests of accelerating the process of portfolio cleaning, the MNB took the steps described in the *Financial Stability Report* issued on 12 November 2014, with a view to mitigating the risks in the balance sheets of the banking sector, in order to ensure that the sector is capable of providing adequate support to economic growth. The asset management company set up by the MNB may facilitate the intensive cleaning of the commercial real estate portfolio. Efficient portfolio cleaning is rendered practically impossible by the lack of a factoring market, market surplus and depressed demand. As a result, the large portfolio of bad loans stuck permanently in banks' balance sheets ties down substantial resources and capital. In addition, in view of the risks associated with their balance sheets, banks have adopted a cautious attitude with regards to lending. The asset management company set up in November 2014 at the initiative of the central bank may represent an efficient remedy for the problems arising from the poor quality of the corporate portfolio. The advantage of the asset manager is that it can free up substantial resources – including capital

and liquidity – in the banking system by taking over a relatively small number of claims and properties, while the ratio of non-performing corporate loans is reduced perceptibly.

Chart 6
Non-performing project and other corporate loans in the banking sector



Source: MNB.

The banking sector accumulated excessive losses in 2014, but thanks to owners' capital injections, the position of the sector remained stable. Capital adequacy was satisfactory at the sectoral level at the end of 2014 as well, but capital buffers are concentrated. The results of the solvency stress test indicate that even in the case of an unfavourable macroeconomic scenario the capital shortfall would be manageable. The liquidity position of the banking sector remains strong: the settlement prescribed due to the invalidity of the exchange rate margin and the unfair unilateral interest rate increases, and the conversion of FX mortgage loans may deplete the current level of back-up liquidity by no more than 20 per cent even in the worst-case scenario, and thus an adequate buffer would still be ensured.

Outstanding household debt shrank further during 2014, but a turnaround was achieved in corporate lending, in which the FGS played a decisive role. In the second phase of the FGS, participating credit institutions concluded contracts with nearly 14,000 companies in the amount⁴ of HUF 584.2 billion by the end of December. New loans accounted for 97 per cent of the disbursements, comprising new investment

⁴ Of this, the overall contract amount of credit institutions was HUF 558 billion in 2014.

loans (61 per cent), new working capital loans (27 per cent) and loans provided for the pre-financing of EU grants (12 per cent). The high share of new investment loans reflects a favourable trend from the perspective of lending developments and the expected impact on economic growth. The low share of loan redemptions – in particular, FX loan redemptions – suggests that the majority of corporations took recourse to the option of FX loan redemption in the first phase already.

In the second phase of the scheme, the average loan size decreased compared to the first phase, indicating that credit institutions have become more inclined to finance micro-enterprises as well. Within the contracts concluded under Pillar I, the average size of new investment loans, new working capital loans and EU loans was HUF 23 million, HUF 57 million and HUF 36 million, respectively. While the amount of every third new investment loan was below HUF 10 million in the first phase of the scheme, the same is true for every second loan in the second phase. The decline in loan size is consistent with the smaller average size of the enterprises accessing the loans: while in the first phase one fourth of the disbursements went to micro-enterprises, this ratio rose to one third in the second phase. The inclusion of financial lease as a form of financing in the FGS helped smaller and riskier enterprises access financing under the scheme. In the second phase, credit institutions provided financial leases to around 4,900 enterprises, in the amount of HUF 61.3 billion. The regional concentration of loans continued to decline: while more than one third of loans went to the region of Central Hungary in the first phase, this ratio decreased to one fourth in the second phase.

In March 2014, the MNB issued a discussion material on the future of the Hungarian banking sector, entitled “Which direction is the Hungarian banking sector heading? – Discussion material on the prospects of the Hungarian banking sector and the MNB’s vision regarding the banking system”. With the reduction or elimination of risks in banks’ balance sheets, a healthy, stable and profitable banking sector may come into being, composed of fewer but more competitive and cost-efficient banks, capable of supporting sustainable economic growth. Changes point to the evolution of a consensual vision. In addition, the criteria of the fair banking system – which determine pricing, the option of simple loan redemption and the criteria of raising interest rates and interest rate spreads objectively – foster the evolution of a banking system better fit to serve the interests of the Hungarian economy.

The MNB conducted a Market Intelligence Survey in 2014 as well, in the context of which MNB staff members visited more than 10 financial institutions to discuss with representatives of the institutions the status of the specific institution and the Hungarian banking sector, including factors determining the future of the sector. In respect of the risks they perceived, representatives of banks tended to cite measures aimed at resolving the problems of foreign currency debtors and the deterioration in clients’ willingness to pay. The results of the survey were presented in the May issue of the *Financial Stability Report*.

Macroprudential regulatory activity of the MNB

In 2014, the MNB finalised and introduced several macroprudential tools and commenced the formulation of the methodology of numerous tools. In 2014, it revised the indicator regulating the long-term foreign exchange liquidity of financial institutions (FFAR), developed the so-called debt cap regulations (payment-to-income ratio [PTI] and loan-to-value ratio [LTV]); moreover, the experts of the MNB participated actively in the development of MNB decrees related to the Settlement Act. MNB staff commenced work on the methodology related to the identification of systemically important banks, the countercyclical capital buffer and the systemic risk buffer.

In accordance with the MNB Act in effect as of 1 October 2013, as a macroprudential authority, the MNB is entitled to formulate legislation aimed at the mitigation of systemic liquidity risks. Formerly prescribed in a government decree, liquidity indicators are currently regulated by two separate MNB decrees. Provisions pertaining to the short-term liquidity coverage ratio of credit institutions have been included in the new decree of the MNB in an unchanged form, while the MNB decree regulating the foreign exchange funding adequacy ratio (FFAR) – the requirement pertaining to the longer-term foreign currency liquidity of credit institutions – represents a revised regulation both in respect of substance and scope. Upon the revision of FFAR in the first half of 2014, the MNB modified the calculation method of the indicator on the one hand, and prescribed the gradual increase of the ratio’s level on the other hand. Moreover, in order to avoid potential market distortion effects, the scope of the regulation was extended to cover the Hungarian branch offices of foreign credit institutions as well. In relation to the new, EU level liquidity requirements,

in the first quarter the experts of the central bank participated in preparations for determining the data supply criteria of the liquidity coverage ratio (LCR) launched in June 2014.

For the prevention of excessive household indebtedness and the proliferation of foreign currency lending, the MNB formulated a new macroprudential regulation, MNB Decree No. 32/2014 (IX. 10.) on the regulation of the payment-to-income ratio and the loan-to-value ratio. Effective from 1 January 2015, the so-called debt cap regulation consists of two basic pillars. The payment-to-income ratio (PTI) reduces customers' indebtedness by limiting the payment burden that can be undertaken by customers when they take out a new loan to a pre-specified proportion of their regular, legitimate income. In the case of collateralised loans (e.g. mortgage loans), the loan-to-value ratio (LTV) limits the size of available loans in proportion to the collateral (home value). While the restrictions introduced do not imply excessive tightening in the case of forint loans, if the MNB perceives robust household lending dynamics, it will restrict excessive credit outflows by tightening the debt cap rules.

Act XL of 2014 defines the principles and the framework of settlement with consumers, and mandates the Governor of the MNB to regulate the detailed rules of settlement relying on the special expertise of the central bank. Accordingly, after having consulted with the representatives of market participants in November and December 2014, as a result of intensive professional work, the experts of the MNB developed the rules of settlement in the framework of three MNB decrees. The MNB decrees include the basic methodology of settlement, methodologies for the management of special cases (discounts, delinquency, exchange rate cap, etc.), the deadline of financial settlement, and the methodology required for settlements involving financial institutions subject to winding up or liquidation.

In 2014, the formulation of the methodology related to the identification of systemically important institutions commenced. Following the publication of the countercyclical capital buffer recommendation of the European Systemic Risk Board (ESRB), the experts of the MNB began to work on the further development of the methodology.

The persistently high ratio of non-performing corporate project loans has been identified as

a significant systemic risk. A possible solution to resolve this problem might be the introduction of a systemic risk buffer (SRB), and the MNB examined the possibilities in this regard during 2014. On the one hand, owing to the increased capital requirement, the SRB may improve the shock-absorbing capacity of institutions not performing balance sheet cleaning; on the other hand, it may be an efficient incentive for balance sheet clean-up through the increased cost of capital.

In 2014, the experts of the MNB continued to monitor the international regulatory processes relevant to the financial system. Among other things, they participated actively in the task force of the European Banking Authority (EBA) dedicated to developing the European regulation of the Net Stable Funding Ratio (NSFR) and in the task forces of the ESRB addressing national and cross-border macroprudential policy measures.

3.3 SUPERVISION AND CONSUMER PROTECTION

Approval of the MNB's supervisory strategy

In July 2014, within the strategic framework defined by the Monetary Council, the Financial Stability Board approved the supervisory strategy of the MNB. The supervisory vision presented in the strategy for the period of 2014–2019 calls for a stable, competition-driven and credible financial sector under the strong supervision and guidance of the MNB. The primary objective of supervisory activity is to maintain and support the stability of the financial system and to restore and strengthen the confidence of financial participants in the system and in one another with the assistance of the integrated supervisory instruments. Based on the vision, the mission and the information available, the MNB defined market objectives for the financial system as a whole and for the individual sectors, and identified sectoral focal points for each individual sector subject to its supervision. The supervisory strategy provided a framework for the definition of key supervisory and audit target areas and annual tasks.

The Summary constituting the annex to the supervisory strategy was published on the MNB's website.⁵

⁵ http://felugyelet.mnb.hu/data/cms2423424/14_07_31_Felugyeleti_strategia_abra.pdf

Microprudential supervision

Supervision of credit institutions

In line with the new strategy, the supervision of credit institutions last year focused on tasks intended to reinforce stability and confidence.

With a view to ensuring the stability of the financial system at the institutional level, consolidating the market and strengthening the transparency of the banking system and as a result of the integration processes of the cooperative banking sector, the MNB initiated exceptional measures in the case of several institutions in 2014. As a result of the measures, the operating licenses of six cooperative credit institutions (Körmend és Vidéke Takarékszövetkezet, Orgovány és Vidéke Takarékszövetkezet, Alba Takarékszövetkezet, Tisza Takarékszövetkezet, Széchenyi István Hitelszövetkezet, Magyar Vidék Hitelszövetkezet) and one commercial bank (Széchenyi Kereskedelmi Bank Zrt.) were revoked. The measures were intended to protect depositors and to prevent the escalation of problems threatening other market participants.

The acceleration of portfolio cleaning at credit institutions is one of the key priorities of the MNB's supervisory activity. With that in mind, the MNB participated actively and successfully in the comprehensive Asset Quality Review (AQR) launched by the European Central Bank (ECB) with a view to performing a comprehensive assessment of the asset quality of the most important credit institutions of the European Union based on a uniform methodology. As a result of the comprehensive assessment, the requirements defined for large banks in the uniform EU regulation (CRDIV and CRR) as of 1 January 2014 can be enforced transparently, on the basis of a uniform methodology across Europe.

In accordance with the supervisory priority of mitigating accumulated credit risks, the central task of on-site and off-site microprudential supervision was to

control the management of non-performing loans at all credit institutions. Moreover, the examination of loans disbursed under the Funding for Growth Scheme played an important role in the comprehensive audits in 2014. In addition, in the case of the largest banks and groups, the MNB also assessed compliance with the new liquidity requirements and reviewed the recovery plans. It also commenced designing the reviews aimed at evaluating the sustainable business model.

The business model approach being developed in consideration of the European Banking Authority's (EBA) recommendation and international examples will also improve the efficiency of banking supervision. Based on the detailed financial model, potential risks may be explored faster and deviations from regulatory expectations may be predicted earlier. Furthermore, the MNB can gain a more precise insight into the operations of individual institutions, their expected profitability and the sustainability of their strategies. All of this may help to provide a thorough, forward-looking understanding of the processes in the Hungarian financial system, the timely detection of risks and hence, the safeguarding of financial stability.

In the MNB's assessment, the mandatory integration system – which coordinates and uniformly regulates the operations of cooperative credit institutions – contributed significantly to the mitigation of the individual risks of the institutions. For the more efficient supervision of cooperative credit institutions, establishing a regulated cooperation with the central organisations of the new integration was a key priority in the area of supervision.

Besides these priorities, in accordance with its basic statutory obligations, the MNB also carried out the mandatory comprehensive inspection of credit institutions. In 2014, it concluded a total of 44 inspections in the sector of credit institutions, 25 of which were commenced in 2013. Of the inspections commenced in 2014, 11 inspections were still in progress at the end of the year.

Table 2
Number of inspections at credit institutions

Type of entity	Type of investigation	Concluded in 2014		Starting in 2014	In progress in 31 December 2014
		from 2013	from 2014		
Credit institution	comprehensive	25	19	30	11
	direct inquiries	2	3	4	1
	thematic	0	0	2	2

Supervision of insurance companies, funds, financial institutions, and intermediaries

As part of its risk-based supervision, the MNB implemented the sectoral and institutional supervision plans, while simultaneously enforcing prudential and consumer protection aspects. Focusing on the pre-defined priority inspection target areas, the scheduled comprehensive and targeted inspections of insurance companies, funds, and intermediaries were completed in full.

The comprehensive inspections concentrated on the examination of the compliance of enterprise management systems with the new statutory provisions pertaining to insurance companies, insurance products and risks affecting actual capital position (cost allocation, insurance technical reserves, accrued acquisition costs). During the consumer protection-oriented inspection of insurance products – in particular, motor third-party liability insurance, unit-linked life insurance plans and pension insurance – the MNB detected violations in several cases due to deficiencies in the general contract terms and conditions and in customer information. Apart from this, the prudential risks identified by the inspections typically concerned the setting-up of insurance technical reserves and a number of other areas of insurers' operations. During the year, the MNB laid down the foundations of surveillance based on the assessment of insurers' business models.

From the perspective of the insurance market, the most important development of the year was the introduction of the tax incentive of retirement plans. In response to this and in order to steer the

development of the pension insurance market in the right direction, the MNB issued a recommendation specifying its expectations. Insurance companies heeded the recommendation by phasing out pension insurance products which were more expensive than the recommended value; consequently, total cost indicators (TCI) declined to the recommended level or below for all products remaining in the market. During the on-site inspection and off-site supervision of voluntary mutual insurance funds, priority aspects included the cost analysis of fund activities (also with regard to disintegrating group relationships), the client identification procedures of fund members, and the proper execution of member account settlements. As regards voluntary pension funds, the examination of indirect investment costs versus direct costs continued to be a priority.

As part of the supervision of intermediaries, the on-site inspections of independent insurance brokers launched in 2013 continued. During the inspections performed in 2014, the MNB focused in particular on customer information, needs assessment, persons acting as brokers, the compliance of the registration system of mediated transactions, and complaint management. The inspections detected some incorrect market practices (unlawful use of brokers to mediate the contracts of non-resident insurers), which affected several brokers not included in the inspections.

In 2014, a total of 44 inspections were concluded in the sector of insurance companies, funds, and intermediaries and in respect of financial undertakings, of which 20 inspections were commenced in 2013. At the end of the year, 20 inspections were still in progress.

Table 3
Number of inspections at insurance companies, funds, and intermediaries

Type of entity	Type of investigation	Concluded in 2014		Starting in 2014	In progress in 31 December 2014
		from 2013	from 2014		
Insurance	direct inquiries	–	1	1	–
Insurance	comprehensive	9	7	14	6
Pension fund	comprehensive	4	5	14	9
Health fund	comprehensive	5	3	4	1
Mutual aid fund	comprehensive	1	–	–	–
Independent insurance intermediaries	direct inquiries	1	6	10	4
Financial enterprises	direct inquiries	–	1	1	–
Warehouse	direct inquiries	–	1	1	–

Supervision of capital market institutions

At the end of 2014, the MNB supervised 120 capital market institutions. In the ongoing supervision and inspections at institutions providing investment services, the special inspection target of the MNB in 2014 included the protection of client claims, execution of tasks deriving from Act XVI of 2014 on Collective Investment Trusts and their Managers and Amending Certain Finance Related Acts based on the relevant directive (AIFMD), effective as of 15 March 2014, and the supervisory duties prescribed in Regulation (EU) No. 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR).

Based on the priorities, the MNB attached key importance to duties linked to the enforcement of KELER CCP Ltd.'s compliance with the criteria laid down in EMIR. In 2014, KELER CCP's Supervisory College was established, with the European Securities Markets Authority (ESMA), the Magyar Nemzeti Bank, the Central Bank of Ireland, the National Bank of Belgium and the Financial Conduct Authority of the United Kingdom as its members. After the Polish clearing house, on 4 July 2014 KELER CCP Ltd. became the second clearing house in the region to obtain the license prescribed by EMIR.

During the year, the MNB performed 21 scheduled comprehensive inspections, one thematic inspection as per the working plan, and three targeted inspections at the supervised institutions. The most noteworthy of the comprehensive inspections was the inspection at the Budapest Stock Exchange (BSE). A comprehensive thematic analysis entitled "Hungarian venture fund managers and fund operations" was also published during the year, providing a detailed analysis of the status of JEREMIE funds in the sector.

The inspections found that most institutions conducted their activities prudently, in compliance with regulations and abiding the law; in some cases, however, the findings of the inspections necessitated supervisory measures.

The thematic inspection of online trading platforms – conducted in relation to the key priority of client claims protection – affected 22 investment firms. In this context, the MNB ordered extraordinary data provision, and carried out an on-site targeted inspection at four investment firms.

Table 4
Number of inspections at capital market institutions

Type of entity	Type of investigation	Number of investigation
Investment firm	comprehensive	2
Investment fund manager	comprehensive	6
Venture capital fund manager	comprehensive	6
Commodity exchange dealer	comprehensive	2
Credit institution (investment service)	comprehensive	4
Budapesti Értéktőzsde Zrt.	comprehensive	1
Credit institution (investment service)	direct inquiries	1
Investment firm	direct inquiries	2
Investment firm (22 investment firms)	thematic	1*
Total number of investigations		25

**The thematic investigation included four on-site direct inquiries at investment firms.*

International work

The MNB participates in the work of international organisations on an ongoing basis. Since some of the supervised institutions are members of foreign financial groups, continuous liaison with partner supervisors assists the MNB in the identification and adequate management of all risks that may arise. In 2014, the supervisory area of the MNB carried out the microprudential international tasks related to supervisory colleges, in conjunction with the EBA and the ECB.

As regards the insurance sector, the MNB participated actively in preparations for the launch of the Solvency II regulation in 2016. For the sake of maximum preparedness, the MNB coordinated the preparation of qualitative and quantitative impact studies in Hungary, and took part in the stress test of the European Insurance and Occupational Pensions Authority (EIOPA), as well as in the low yield environment study. This facilitated a deeper understanding of the sector's risks and preparedness.

In 2014, the MNB strengthened its international role significantly by organising the Budapest session of an EIOPA working group, and also reinforced its position in the Supervisory Board – the supreme decision-making body of EIOPA – by obtaining permanent

assignments. Active participation in various international surveys (e.g. in supervisory colleges and cross-border activities) is also aimed at enhancing and strengthening the cooperation with EIOPA.

With respect to the capital market sector, the MNB is an active member of certain working groups of ESMA, participating in the preparation and review of the consultation documents of EU law.

Market surveillance

As the falling yield environment increased the risk of unauthorised financial services, in order to restore confidence in money and capital market participants and products, the MNB initiated numerous market surveillance procedures in 2014 on suspicion of unlicensed or unregistered activities, illegal market manipulation, insider trading or the violation of acquisition rules. The supervisory fines imposed as a result of the procedures amounted to nearly HUF 2 billion.

The MNB identified unregistered intermediary (agency) services and unlicensed financial and investment services as key market risks. In the context of actions taken against persons pursuing unauthorised activities with a large clientele and relying on its market surveillance tools, the MNB imposed an exceptionally large supervisory fine of HUF 1.251 billion in the so-called "Fortress case".

In 2014, the MNB attached key significance to the inspection of financial activities related to high-leverage, online financial products (online forex). It is an increasingly frequent phenomenon that unlicensed non-resident institutions offer forex transactions directly online or through Hungarian intermediaries. As the MNB considers this trend a significant risk, it launched several market surveillance procedures in 2014 already, and defined this issue as a priority inspection target for 2015 as well.

The MNB took particular care to improve the transparency of the activity of stock exchange issuers. With that in mind, it evaluated and conducted targeted reviews of disclosures on a continuous basis. The MNB imposed supervisory fines on one particular organisation in four cases, amounting to HUF 11.5 million in total, and in one case, it suspended the trading of the same company's stock on the stock exchange. Compliance with the disclosure obligation of the issuers of publicly offered securities was

examined in the framework of targeted inspections. In these inspections, the MNB verified the application of international financial reporting standards (IFRS), in particular, among listed issuers. Taking action against the violations of the disclosure obligation, the MNB applied measures against the affected issuers.

In performing its capital market monitoring activity, the MNB inspects money and capital market transactions on an ongoing basis using complex statistical models, which served as a starting point for several market surveillance procedures launched on the grounds of suspected market manipulation and insider trading in 2014. As a result, the MNB concluded a market surveillance procedure with a resolution and a supervisory fine in respect of a hard-to-prove case of insider trading, which was also followed by criminal proceedings.

In consideration of the data supply changes entailed by the migration of BSE trading to the XETRA system, the MNB paid particular attention to examine and improve the quality of transaction data supplied by investment service providers in order to facilitate the speedy execution of data suppliers' migration-related tasks and to contribute to maintaining the filtering precision of its models. As a result of the data quality improvement project, migration to the new system was concluded smoothly. The MNB plays an important investor protection role in the licensing of capital market issuers. In this context, the MNB passed 819 resolutions and 42 rulings in 2014. In the licensing procedures of IPOs and admissions for listing, the MNB's primary goal was to act as a "gatekeeper" and, in addition to the verification of formal requirements, it also strived to ensure informed investor decisions through the inspection of the applications' contents. All of this contributed to ensuring the protection of investors, improving confidence in securities, and facilitating the proper functioning and development of securities markets. Based on the above, the MNB will refuse the admission of a security to the stock exchange if, in its judgement, listing the security on the stock exchange would be detrimental to investors' interests in view of the issuer's position. The MNB took particular care to respond without delay to any significant circumstances arising in relation to market entry by performing evaluations based on consumer protection considerations and by providing adequate information to the public.

In respect of investment funds, the MNB successfully executed the tasks prescribed by the new regulations

coming into effect in 2014 and consistently enforced the additional requirements entailed by the new regulations in the licensing procedures of investment funds.

Table 5
Number of market surveillance investigations

Subject of investigation	Number of investigations
Unauthorised activity	10
Market manipulation, insider dealing	4
Compliance with company takeover rules	1
Sum of fines imposed (million HUF)	1,944.9

Legal enforcement

In the context of its legal enforcement activity, in 2014 the MNB passed a total of 64 resolutions concluding its inspections in the money and capital markets, and passed 183 resolutions in procedures launched based on claims or within the scope of its continuous supervisory capacity. In the framework of control procedures, it concluded – with the application of measures corresponding to the severity of the violations found – comprehensive inspections at 33 cooperative banks, 4 banks, 3 banking groups along with their financial undertakings, 2 investment service providers and 9 investment fund managers, and completed the ex post and targeted inspection of 2 banking groups.

As part of its money market legal enforcement activity, the MNB imposed crisis management measures in the case of one credit institution and one cooperative bank. In these cases, the MNB applied the exceptional measures prescribed in sectoral legislation, appointed supervisory commissioners, and revoked the licences of the credit institution and the cooperative bank concerned. The MNB revoked four operating licenses due to exclusion from the Integration Organisation of Cooperative Credit Institutions, and revoked one license due to exit from the organisation. In addition, the business licenses of 6 financial service providers and 24 intermediaries were revoked either because they had no liability insurance or because winding up procedures were in progress against them.

As part of capital market legal enforcement, the MNB suspended the license of one investment firm, and imposed a fine of HUF 14 million on the executive officer of an investment firm, due to a severe

violation of the statutory provisions pertaining to the responsibility of executive officers.

The MNB imposed fines from HUF 100,000 to HUF 35 million on 24 occasions in relation to money and capital market legal enforcement activities.

In most cases, penalties were imposed particularly in relation to the infringement of regulations concerning the prevention of money laundering and terrorist financing, the capital requirement, data supply and the Central Credit Information System. Moreover, the MNB imposed fines for the violation of legal provisions on the separation of the institution's own liquid assets from its clients' assets, the principle of equal treatment in portfolio management, the prohibition of the execution of orders in the absence of the client's instruction, and non-compliance with the measures prescribed in previous resolutions.

Authorisation activity

The authorisation activity of the MNB enables different types of financial organisations to enter the market, and by authorising specific changes (e.g. range of activities, owners, executive officers) it fosters the prudent operation of already active institutions. The MNB enforces its "gatekeeper" role in its authorisation procedures as well. A focal point of this endeavour is the confirmation of the good reputation of executive officers, in the context of which the MNB performs a complex evaluation considering all official or publicly available information.

For the first time in 2014, a branch office of a third country credit institution (Bank of China Limited Hungarian Branch) was established and approved for market entry.

The ownership structure of several credit institutions changed. The Hungarian state was granted authorisation in September 2014 to acquire a direct, qualifying holding in MKB Bank Zrt. and its subsidiaries. In the course of 2014, the following institutions obtained direct qualifying holdings: QUAESTOR Értékpapír-kereskedelmi és Befektetési Zrt. in Credigen Bank Zrt. (100%); BankKonzult Pénzügyi és Gazdasági Tanácsadó Kft. in evoBank Zrt. (98.33%); Magyar Posta in FHB Kereskedelmi Bank Zrt. (49%); Magyar Takarékok Befektetési és Vagyongazdálkodási Zrt. in Magyar Takarékszövetkezeti Bank Zrt. and its subsidiaries (over 50%).

The adoption of the new EU capital requirement regulations (CRR) gave rise to new authorisation subjects. A high number of authorisation and other procedures (e.g. reduction of regulatory capital, Common Equity Tier 1 qualification, exemptions from the calculation of the leverage ratio) were conducted pursuant to the regulation.

In the case of financial enterprises, fewer foundation permits (a total of nine) were issued in 2014 than in the previous year. By contrast, the number of authorisation procedures aimed at the extension of the activities of existing companies increased (a total of ten cases concluded with authorisation).

As part of the sectoral regulation of the capital market, the new legislation regulating the fund manager sector – Act XVI of 2014 on Collective Investment Trusts and their Managers and Amending Certain Finance Related Acts (hereinafter: Collective Investments Act) – entered into force on 15 March 2014. Compliance procedures conducted pursuant to the provisions of the Collective Investments Act were commenced and, in some cases, concluded. Act XV of 2014 on Trusts and the Regulation of Trust Activities effective from 15 March 2014 ensures implementation of Act V of 2013 on the Civil Code and also expanded the authorisation powers of the MNB. In this context, operating licenses were issued to two fiduciary asset management companies. Two new investment firms entered the market. The number of market exits declined compared to 2013. The MNB revoked the licenses of three investment fund managers upon request, and revoked the operating licenses of one commodity exchange service provider and one investment firm, at the request of the affected institutions.

The MNB's consumer protection administrative activity

With the integration of supervisory duties into the central bank, the MNB re-evaluated its consumer protection role as well, recognising that prudently operating institutions alone are not sufficient to maintain a stable and trusted financial system. Restoring confidence in the financial intermediary system – the central value of the MNB's supervisory strategy – and reinforcing fair market operations require increased consumer protection supervision. With that in mind, one of the key priorities of supervisory activities in 2014 was the renewal of administrative financial consumer protection activities. In this context, the MNB's goal was to improve the

efficiency of inspections and to develop a preventive approach to consumer protection activities.

To this end, besides remedying individual infringements, the MNB shifted its focus to the comprehensive, systemic management of consumer protection issues. Besides individual petitions submitted by consumers, during the inspections the MNB relied on information and signals from other sources and, based on consumers' requests, performed individual inspections in accordance with the relevant statutory regulations.

In scheduling the inspections and defining the topics to be examined, the MNB took account of market trends and behaviours (e.g. fee and cost increases). Accordingly, it performed its inspections in consideration of the legislative changes affecting the market and their institutional implementation, as well as the timing of the business activity of the supervised institutions (for instance, it commenced a thematic inspection of the annual percentage rate of charge before Christmas).

In its *ex officio* consumer protection inspections, the MNB made a significant effort to obtain direct experience about financial institutions' activities relevant to consumer protection and their market behaviour, in the course of on-site inspections and trial transactions. As a new practice, suspected sector level infringements were inspected at all participants of the sector, and for confirmed infringements, the sanctions imposed by the MNB were based on stricter principles without exception. Inspections conducted in the second half of the year confirmed the benefits of strict, consistent action, as the positive effects were perceivable even in the short term: offending procedures and behaviours were corrected, and the deficiencies identified were rectified.

One of the key thematic inspections of the year affected unilaterally raised fees and charges, with the MNB imposing consumer protection fines amounting to a total of HUF 1.86 billion in this regard.

As part of its consumer protection activity, by issuing professional recommendations, in 2014 the MNB participated actively in the legislative processes affecting the settlement and conversion of foreign currency loans into forints. In addition, wherever the consumer protection inspections detected regulatory deficiencies in the area behind the phenomena detrimental to consumers, the MNB proposed the

amendment of the relevant legislation, and stood up consistently for its initiatives during legislative consultations. As a result, new consumer protection provisions have been included in numerous sectoral regulations or existing rules have been modified. The MNB has been also vested with powers to formulate decrees in several topics (Act CLXII of 2009 on Consumer Credit, Act LX of 2003 on Insurance Institutions and the Insurance Business, settlement acts – Act XL of 2014 and Act LXXVII of 2014).

Financial Consumer Protection Centre

With powerful legal enforcement, the MNB intends to strengthen preventive consumer protection attitudes over the long term. Efficient consumer protection communication and educational-training activity aimed at improving consumer awareness are important tools in this regard, and a Financial Consumer Protection Centre (FCPC) has been set up, as a separate organisation, to carry out the related tasks.

The creation of a professional customer service, the development and enhancement of financial literacy and consumers' financial awareness are among the priority objectives of the FCPC. To that end, the FCPC strives to establish continuous cooperation and liaisons with civil organisations as well. An important task of the FCPC is the proactive analysis of available information, which facilitates problem-focused, efficient inspection activity.

In 2014, the FCPC developed a customer-friendly, integrated customer relationship and claims handling system, which assists those turning to the MNB with financial problems in an easy-to-understand, yet highly professional manner.

In order to foster clear customer information, financial awareness, and financial literacy, the MNB launched a series of papers entitled "*Financial Navigator*". The full selection of the papers published so far can be accessed online, and more than 1,600,000 printed copies are available at the MNB's customer service, at the Government Windows located at county seats, in the Financial Consulting Office Network, and in more than 6,000 branches of nearly 200 financial institutions. In the fourth quarter, key significance was attached to the preparation and publication of electronic information materials dedicated to the topics of settlement and the conversion of foreign currency loans.

At the beginning of the year, the MNB concluded a cooperation agreement with the Ministry of Public Administration and Justice. In the framework of the agreement, consumers can now submit their consumer protection requests and claims addressed to the FCPC and to the Financial Arbitration Board at Government Windows at all county seats and, in Pest county, in the city of Vác as well. As Government Windows are designed to help consumers in filling out their forms, their requests and claims arrive at the MNB fully completed.

In order to set up a national financial consumer protection information network, the MNB created the Civil Network programme. In organising the programme, the MNB held a financial consumer protection civil forum on five occasions during the year, and launched the Civil Network Newsletter to inform organisations on news and updates concerning financial consumer protection.

In July and October, the MNB announced a project-based tender for the support of civil organisations involved in financial consumer protection. A total of 57 applications were received for the two tenders. In total, 27 organisations submitted bids for the tender aimed at the improvement of financial awareness. Of the 27 organisations, 20 bidders received grants of HUF 77.5 million in total.

The explicit goal of the second tender was to promote the provision of broad-based consumer information concerning the settlement act. Upon the assessment of the submitted bids, 17 organisations of the 30 applicants were granted access to assistance of HUF 80 million in total.

3.4 RESOLUTION

To fulfil its newly assumed resolution duties, the MNB set up the Resolution Department in the last quarter of 2013, which, following organisational restructuring, has been functioning as an independent directorate since December 2014. In parallel, the Reorganisational Processes Directorate was also set up in December 2014, under the direct control of the Deputy Governor for Monetary Policy, Financial Stability and Lending Incentives, tasked with the execution of reorganisation and the coordination of the work of resolution administrators.

In 2014, the development of the Hungarian resolution framework in transposition of the directive of the

European Parliament and of the Council on the framework for the recovery and resolution of credit institutions and investments firms (Bank Recovery and Resolution Directive – BRRD) was a priority task of the MNB. Accordingly, the area supported the preparatory work of the Ministry for National Economy (MNE) in charge of the proposed legislation on further development of the system of institutions strengthening the stability of individual players of the financial intermediary system. The Act XXXVII of 2014 (Resolution Act) entered into force in its entirety on 16 September 2014, establishing the framework for the resolution activities of the MNB and concluding the period of preparations. Pursuant to the provisions of the Resolution Act, the legislation work proceeded by drawing up further laws and implementing regulations, the first of which was announced in December 2014 after public consultation with Hungarian stakeholders and after consulting the European Central Bank. The MNB decree defines the criteria for the determination of the quantifiability of breaching the requirements to be examined in respect of insolvency or expected insolvency as a condition for resolution.

Acting in its scope of authority for resolution, the MNB announced public calls for the registration of resolution administrators and independent valuers. After having examined and assessed the applications received, the registration of resolution administrators was completed, while the registration of independent valuers is still in progress.

The Resolution Fund was set up in July 2014 as a new element of the financial stability safety net, to ensure the professional supervision of the resolution activity and the financing of resolution, i.e. covering the costs of the crisis management tools applied during resolution. Based on the MNB's proposal, in September 2014 the Board of Directors, the governing body of the Resolution Fund adopted the Fee Policy and the regulation on fee collection of the Resolution Fund, and on this basis determined the fees payable by fund members for 2014. At its meeting in December 2014, the Board of Directors decided on the continued usage of the fee payment obligations defined in the Fee Schedule for 2014 until the approval of the Fee Policy and Fee Schedule for 2015, which is expected to take place after finalisation of the relevant EU legislation, by the deadlines defined therein.

Also in the course of 2014, several proposals, notices and reports were prepared for the Financial Stability Board in relation to the Resolution Act concerning

the resolution aspects of the Banking Union, the resolution strategy of the MNB, the setting-up of the international relationships of the MNB's resolution function and the professional development of the MNB-owned Financial Stability and Liquidation Nonprofit Ltd.

The experts of the MNB are continuously working on the enlargement of their relationship network with domestic and foreign organisations, pursuant to legal obligations, working with partner authorities on the establishment of a resolution college, monitoring the international regulatory processes affecting the financial system, and participating actively in the resolution working groups of various European organisations and institutions including, in particular that of the European Banking Authority (EBA). In addition, one of the representatives of the MNB delivered a presentation on the Hungarian implementation of the BRRD at the conference of the Bank of Spain involving 19 countries.

Acting in its scope of authority for resolution, the MNB placed MKB Bank Zrt. under resolution on 18 December 2014. Reorganisation of MKB Bank was initiated immediately by the appointed resolution administrators, jointly with the management of MKB Bank; this process is expected to be concluded in 2015.

During the process of restructuring, the basic aim for MKB Bank is to accelerate the separation of bad portfolio elements which have played a significant role in generating losses in recent years. Simultaneously with portfolio cleaning, restructuring of the Bank Group and cost-cutting measures are also being carried out. In cooperation with the management of MKB Bank, the MNB will ensure a smooth reorganisation programme with every instrument at its disposal, which means that this programme will be carried out in such a way as not to affect the continuity of banking services.

3.5 PAYMENT AND SECURITIES SETTLEMENT SYSTEMS

Security of domestic payments

Payment inspections

In 2014, the MNB performed scheduled inspections at 19 credit institutions to verify compliance with the provisions of Act LXXXV of 2009 on the Pursuit of the Business of Payment Services (hereinafter: Act

on Payment Services) and MNB Decree No. 18/2009 (VIII. 6.) on executing payments (hereinafter MNB Decree), and performed unscheduled inspections at three credit institutions and one payment service provider. Unscheduled inspections were conducted upon external request in two cases – due to high-value fraud and unauthorised account management – and in two cases they were initiated by the MNB based on internal information available to the MNB concerning a liquidity shortage observed during the intraday clearing of the Interbank Clearing System, and the interchange fee charged by a financial service provider on card payments. Of the inspections conducted in 2014, one inspection was concluded without taking any measures. The MNB instructed 12 credit institutions to take measures, of which 3 credit institutions were subjected to fines due to the severity of the infringements, in the amount of HUF 38.8 million in total. The inspection reports describing the deficiencies found during the inspections established the violation of legal regulations in 127 cases.

The inspections revealed that credit institutions violated the provisions of the Act on Payment Services in respect of the provision of prior and subsequent information, the formal and substantive requirements of the framework contract, the amendment of the framework contract, the opening of the payment account, the correction of payment transactions, liability and loss allocation rules and queuing rules. Moreover, violations of the MNB Decree were detected in respect of certain rules pertaining to the receipt of payment orders, the refusal of payment orders to the other payment service provider or to the client, the queuing or the partial execution of payment orders, the official transfer orders and remittance summons, the execution of payment transactions, the execution of payment transactions to a payment account between payment service providers, the value date, the availability of funds transferred to the payee, and direct debits. The most frequent infringements involved the violation of the Act on Payment Services in respect of the supply of prior and subsequent information, and of the MNB Decree in respect of making the amount of the payment transaction available to the payee.

By reinforcing the compliance of credit institutions and other payment service providers with regulations, payment inspections contribute to the reliable and compliant operation of the financial intermediary system, the predictability of payment processes for

customers, and hence, the efficient delivery of services to customers.

Statements on payments

In 2014, the MNB issued 65 professional opinions on payment services based on administrative and customer inquiries. In 26 cases, it provided an opinion focusing on payment issues in relation to European Union legislation or draft legislation put forward for administrative consultation, in one case it proceeded as an expert on payments on court assignment, and in 38 cases it issued statements or professional opinions upon household, institutional, administrative or other requests.

Central bank communication on virtual instruments usable for payment

In a communication issued on 19 February 2014, similar to the supervisory authorities of several other countries, the MNB called the attention of consumers and end-users to the risks arising from the use of virtual instruments usable for payment. In its communication, the central bank emphasised that virtual instruments promoted as an alternative to legal tenders – including Bitcoin – differ from legal tenders and all currently known and approved payment methods for several reasons. Virtual instruments usable for payment can be typically generated by anyone, practically anywhere, without a single issuer responsible. For this reason, they are not supervised by any authority. Therefore, such virtual instruments are not covered by adequate liability, warranty and loss allocation rules, even though these instruments, like any other currency, can be lost or stolen, and their value may change rapidly due to their use for speculative purposes.

The guidelines of the SecuRe Pay Forum and the European Banking Authority on the security of internet payments

In the judgement of the European Banking Authority (EBA), the European Union needs a more secure framework for internet payments and accordingly, it issued guidelines pertaining to the management of such payments on 19 December 2014. The guidelines define security requirements for the payment service providers of the European Union, and the EBA expects payment service providers to comply with the requirements by 1 August 2015. Since the EBA called

for the competent authorities of Member States to integrate these requirements into their supervisory practice, the MNB decided to inspect payment service providers' compliance with these guidelines in the coming period. The guidelines published by the EBA are based on the recommendations of the European Forum on the Security of Retail Payments (SecuRe Pay), a voluntary cooperative initiative set up by the ECB and comprising relevant authorities from the European Economic Area (EEA).

Payment and settlement systems

Oversight of Hungarian payment and settlement systems

At its meeting on 24 March, the Financial Stability Board of the MNB approved the report on the 2013 operations of payment, securities settlement and clearing systems, which stated that the MNB's Real-Time Gross Settlement System (VIBER), the Interbank Clearing System operated by GIRO Zrt. (ICS) and the securities settlement and clearing system of KELER Ltd. operated reliably, without major incidents and with abundant liquidity throughout 2013. In addition, at its meeting on 25 November 2014, the Financial Stability Board approved the risk-based oversight framework – recast in accordance with the new oversight principles of the Bank for International Settlements (BIS) – on the basis of which the comprehensive assessment of the overseen infrastructures commenced at the end of 2014. The MNB expects oversight assessments to conclude in 2015.

Inclusion of the forint in the Continuous Linked Settlement mechanism (CLS)

At its meeting on 9 January 2014, the Financial Stability Board of the MNB decided to issue a Letter of Intent to CLS Bank on performing the necessary preparations, and expressed its intention to work together with CLS Bank to ensure that the forint becomes available in the Continuous Linked Settlement mechanism operated by the company. Seeking a solution for the difficulties faced by the financial system during the 2008 financial crisis, the possibility of including the forint in the CLS system has arisen numerous times, as the continuous linked settlement model applied by the system eliminates the foreign exchange settlement risks entailed by FX transactions. Having weighed the opinions offered by banks and the domestic foreign exchange settlement exposures, the MNB finally decided to sign the Letter of Intent so that

the accession process may proceed to the next, due diligence phase.

The banking community provided support and cooperation during the due diligence phase in 2014, which involved the familiarisation of CLS with the local legislation on payment systems and the analysis of FX payments by CLS. Parallel to this, work commenced on designing and putting in place future operative processes, and after identification of the detailed tasks required for accession, the due diligence process concluded successfully, and implementation of the system began, according to the decision of the Financial Stability Board on 28 October 2014. Before the scheduled launch of the service in November 2015, the MNB, CLS and the affected banks will work together to develop the procedures and IT solutions required for the secure operation of the system. Along the same lines, the business operations, regulations and legal environment of VIBER will be slightly modified, as the central bank's framework needs to be aligned to the internationally applied procedures of CLS before the CLS solution can be used.

Acquisition of GIRO Zrt.

Until April 2014, GIRO Zrt. was owned by the central bank and 21 commercial banks: five large shareholders owned 76.52 per cent of the shares, while the MNB held 8.09 per cent of the stock. In the first half of 2014, the MNB purchased GIRO Zrt., the company running the Interbank Clearing System. With that, the MNB became the operator of the third fundamental financial infrastructure beside VIBER and KELER. After several rounds of consultations with large and small shareholders, the central bank acquired 100 per cent of the stock of GIRO Zrt.; thus it became an indirect owner of BISZ Zrt., the subsidiary owned exclusively by the company. The acquisition took place at an overall sale price of HUF 9.5 billion, which the MNB determined based on a business assessment provided by an internationally recognised, independent financial consulting firm. The acquisition was driven by three objectives set by the central bank: to facilitate the lowering of charges payable by clients, to enhance the efficiency of payment system developments, and to keep fundamental financial infrastructures in national ownership. In order to meet these goals, with the participation of the MNB, a new development strategy was devised in 2014 and, in line with the decision of the company's Board of Directors at the end of the year, the fee charged for clearing services was reduced by 20 per cent from 1 January 2015.

Re-licensing of KELER CCP Ltd.

In order to comply with the provisions of Regulation (EU) No. 648/2012 regulating the operations of central counterparties (EMIR), in 2013 KELER CCP Ltd. submitted an application for re-licensing to the Hungarian supervisory authority as its competent authority. As the basic condition for the re-licensing procedure was designation in accordance with Act XXIII of 2003 on Settlement Finality in Payment and Securities Settlement Systems, based on the application submitted by KELER CCP Ltd., within the framework of two designation procedures, the MNB designated KELER CCP as a system operator subject to the Act on Settlement Finality in respect of its spot and derivative capital market transaction settlement systems, and its systems as systems subject to the same Act. As noted in Point 3.3 on surveillance activity and consumer protection, after several rounds of consultation during the re-licensing procedure, on 17 June 2014 the international supervisory college of KELER CCP passed a joint decision to the effect that KELER CCP meets the requirements of the regulation. In continuation of its work, the college held a meeting in December 2014, at which college members reviewed the most important operational changes affecting KELER CCP. This practice of the college is in compliance with the provision of EMIR prescribing annual reviews.

Miscellaneous information

Publications and conference presentations related to payments and payment systems

On 5 June 2014, the MNB published the *Payment Systems Report*. The Report provides a detailed description of the trends of Hungarian payment methods and instruments, changes in the efficiency of payments, and developments related to the operation and oversight of Hungarian payment and settlement systems. Three payment-related central bank studies were published during the year in the MNB Bulletin, which are available on the central bank's website. The studies analysed the changes in payment service fees and the structure of payments in 2013, the effects of the introduction of intraday clearing on turnover in Hungarian payment systems, and the possible effects on payments of the August 2014 conversion of the two-week MNB bills into deposits. Beside these publications, payment experts of the central bank analysed the current issues of Hungarian payments in presentations at various conferences in 2014.

3.6 MANAGEMENT OF FOREIGN EXCHANGE RESERVES

Objectives of holding reserves

Similarly to other central banks, one of the basic tasks of the Magyar Nemzeti Bank, as stipulated in the MNB Act, is the management of the country's foreign exchange reserves. The foreign exchange reserves held by the MNB serve various purposes, the most important of which include:

- to ensure the level of reserves expected by market participants ('international collateral');
- to support monetary policy (ensuring intervention capacity and the banking system's foreign exchange liquidity);
- to ensure foreign currency transaction requirements (support government debt management, satisfy the government's foreign currency payment obligations, etc.).

Market participants continue to closely monitor developments in foreign exchange reserves. The MNB itself regularly reviews the desired level of reserves and, as required and so far as possible, takes measures to ensure the appropriate level.

One of the guarantees of a predictable, stable exchange rate regime is an adequate level of reserves, which, if necessary, allows for central bank intervention in the interest of protecting the exchange rate. As regards monetary instruments, there was a sufficient level of FX reserves behind the FX swap facilities introduced in recent years in support of the foreign exchange liquidity of the banking system.

In terms of transaction goals, ensuring the foreign currency liquidity required for the management of government debt continued to be the most important objective last year. In this regard, continuous provision of the foreign currency needs of budgetary organisations should also be considered. Transfers from the European Union also go through the MNB. They have been significant sources for the accumulation of reserves in recent years, and will retain this role in years to come. In the course of 2014, these transaction goals were once again accomplished smoothly.

The MNB still does not intend to maintain reserves solely for the purpose of accumulating wealth. At the

same time, however, it strives to meet total return criteria when managing foreign exchange reserves in the required amount at all times, i.e. as a responsible asset manager, it intends to preserve their value and, as far as possible, achieve an extra return.

Amount of reserves

With an increase of EUR 795.8 million during the year, the official foreign exchange reserves amounted to EUR 34.6 billion at the end of 2014.

The level of reserves was mainly influenced by maturing bonds and other debt management items of the Government Debt Management Agency. Bonds maturing on 29 January and on 28 July implied an EUR 1 billion decline each, while those maturing on 6 May and 7 November depleted the reserves by GBP 500 million and EUR 2 billion, respectively. The issuance of five and ten-year USD-denominated bonds on 25 March offset the decline arising from maturing bonds by a total of USD 3 billion. Other debt management items and orders from budgetary institutions further reduced the reserves by around EUR 1.06 billion. Similar to earlier years, the most significant item increasing the reserves were incoming funds from the European Union, which amounted to EUR 5.5 billion in 2014. The own return on foreign exchange reserves was nearly EUR 230 million. At the end of the year, liquidity providing EUR/HUF swap tenders amounted to EUR 952 million.

Chart 7
Changes in foreign exchange reserves



Performance and financial risks of foreign exchange reserves

Inevitably, the MNB faces financial risks in conducting its basic statutory tasks and managing the country's

foreign exchange reserves. These risks do not result from a conscious choice, in fact, they are much more of an intrinsic property for the MNB. As a general principle, the magnitude of risks taken should be consistent with the objectives of the core activity, the degree of the risks assumed should be known, and risk assumption should be purposeful and in harmony with the institution's risk-taking capacity. In managing foreign exchange reserves, the MNB must meet the three targets of liquidity, security and return, which means that the central bank strives to reach the highest possible level of return while continuously keeping to the predefined low risk level.

Similar to other central bank tasks, the Monetary Council is the supreme decision-making body in respect of the management of foreign exchange reserves. Accordingly, it sets targets and requirements in relation to foreign exchange reserves, such as the reserve level and liquidity, makes decisions on numéraire, risk-taking strategy and the main strategic numeric parameters of reserve investments. The powers of making operational decisions are exercised and the foreign exchange reserve management strategy is implemented by the Executive Board within the framework specified by the Monetary Council. The Executive Board approves the limit system: the maximum deviations of risks of reserve portfolios permitted vis-à-vis the benchmarks, the partner limits and the scope of investment instruments permitted in reserve management.

The two main pillars of reserve management are the benchmark system and the limit system. The independent measurement of performance is a key element of the risk-taking policy. In order to measure the success of portfolio management, the performance of each reserve portfolio is compared to that of a reference portfolio (the benchmark portfolio). Benchmark portfolios show what yield would have been produced by a passively managed portfolio that represents a wide market segment if investment parameters had been the same. The performance of the foreign exchange management activity is reported in the context of these reference portfolios. The benchmarks – reflecting the return/risk preference of the MNB and measuring the performance of the portfolios – is maintained by the risk management institutional unit, a unit independent of the business area.

The most important risk categories associated with the management of foreign exchange reserves are

market risk, liquidity risk, credit risk, and counterparty risk. The MNB applies limits to mitigate the financial risks related to the management of foreign exchange reserves. In line with the conservative reserve policy typical of central banks, in its reserve management the MNB applies a strict limit system, which takes account of market and other indicators as well, in addition to the required high-level credit ratings.

In managing foreign exchange reserves, the MNB applies various risk minimising techniques to ensure that the risks assumed by the MNB are within the limits of the MNB's risk tolerance. In respect of derivatives, the MNB concluded ISDA (International Swaps and Derivatives Association) and related CSA (Credit Support Annex) agreements with its partners, in order to keep the level of potential exposures to partners through margining low. Likewise, the margining requirement assists in ensuring the adequate risk management of repurchase agreements regulated by GMRA (Global Master Repurchase Agreement). As regards foreign exchange market transactions, in line with the best international practice, the MNB settles its transactions in the CLS system, minimising settlement risks. In the context of reserve management, the MNB also considers the foreign currency liquidity requirement of newly introduced monetary policy instruments.

The MNB manages EUR, USD, JPY and GBP portfolios. The MNB undertakes exchange rate exposure only in euro, covering the risk of the foreign currency/euro cross rate with derivative instruments. Holding other assets denominated in currencies other than euro however hedged to euro is justified by the need to achieve a higher level of diversification and, in the case of the dollar, to provide increased liquidity. Similar to the previous year, the MNB managed five portfolios actively denominated in EUR and USD. In USD, it holds a money market and an investment portfolio, and in EUR it holds a so-called credit risk free portfolio and an investment portfolio in addition to the money market portfolio. The MNB manages the GBP and JPY portfolios as index-tracking portfolios, strictly tracking the benchmark. Furthermore, from end-2012, the MNB added US agency mortgage-backed securities (agency MBS instruments) to its investment strategy in the form of a mandate given to an external asset manager and a custodian. The strategic target duration of the reserve portfolios was around one year.

The credit risk free euro portfolio, which constitutes the majority of the foreign exchange reserves, consists exclusively of high-rated government papers, high-rated government guaranteed securities and issuances of international (supranational) institutions. 100 per cent of the benchmark portfolio consisted of AAA to AA-rated euro-area government securities. In addition to the above, the euro investment portfolio can only include high-rated corporate and bank issuances as well as covered bonds; in this portfolio, government securities typically serve the purpose of adjusting the maturity structure.

The benchmark of both the euro and the dollar-denominated investment portfolios contains high-rated government securities, corporate and bank bonds as well as money and capital market assets with a maximum remaining maturity of 7.5 years. The structure of the benchmark portfolios and their composition in terms of the assets' credit rating and remaining maturity reflect a conservative risk appetite, which is typical of central banks in general.

In an environment of falling yields due to the global crisis that unfolded from 2008, central banks broadly achieved profits on their foreign exchange reserves based on the generally rising prices of the bonds managed in central bank portfolios. The MNB also benefited from this process through its revalued position stemming from the high credit quality government and other bonds handled in its portfolios in the context of a falling yield environment. In light of the yield environment approaching zero, the opportunities for further revaluation gains narrowed, which explains its weaker performance compared to previous years. The diverging monetary policy measures of the ECB and the Fed had a profound impact on developments in 2014. While in the USA investors' expectations and yield curves were driven by the end of quantitative easing, Europe had just begun focusing on easing its monetary stance. With the end of the asset purchase programme in the USA, investors began to price in the effects of potential interest rate increases. By contrast, the euro area was characterised by quantitative easing, which was reflected in negative deposit rates and the commencement of asset purchase programmes. In line with the diverging monetary policies, the euro yield curve declined across all maturities, while in the case of the USD it rose over the medium term and declined over the long term.

Despite the low yield environment, in 2014 the MNB achieved positive results in respect of foreign exchange reserves, both in absolute terms and relative to the comparable benchmarks. The liquidity required for the achievement of monetary policy objectives was available throughout the year, with no credit risk incidents adversely affecting the reputation of the MNB. In 2014, the annualised yield achieved on foreign exchange reserves – weighted with market value and adjusted for costs of financing – was 0.8 per cent, surpassing last year's performance by around 60 basis points and outperforming the benchmark by 6 basis points.

As regards the future performance of foreign exchange reserves, there is still a risk that the performance of reserve portfolios will turn negative once the extremely low yields on high-rated instruments shift in response to an increase in yields, which may undermine reserve performance owing to the revaluation losses stemming from the depreciation of outstanding bonds.

The value-at-risk of the items in the MNB's foreign exchange balance corresponding to the changes in the interest rate amounted to EUR 38 million at the end of 2014 (95 per cent confidence level VaR over a one-month time horizon). The EUR 38 million Value at Risk represents approx. 1 thousandths of the reserve portfolio value.

3.7 CASH LOGISTICS ACTIVITIES

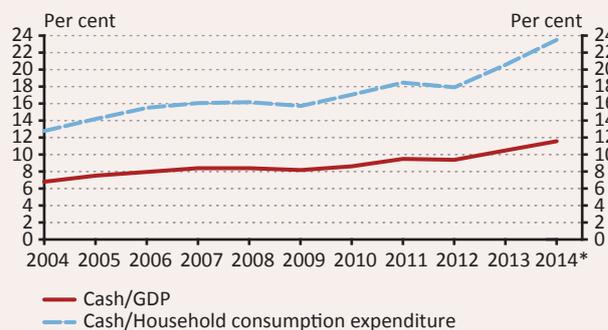
Currency in circulation

On 31 December 2014, the value of currency in circulation amounted to HUF 3,736 billion, representing a 17 per cent (HUF 547billion) year-on-year increase.

As a result of a dynamic increase in currency in circulation registered in HUF, this indicator exceeded 11.6 per cent of GDP at the end of the year. The increase in currency in circulation presumably stems from the decline in deposit rates in the past year – parallel with a falling inflationary environment – as a result of which the interest loss on currency holdings fell to a historical low.

Compared to end-2013, the volume in circulation in 2014 was up 24 per cent for the HUF 20,000 denomination, 8 per cent for the HUF 10,000 denomination, 2 per cent for the HUF 5,000

Chart 8
Cash/GDP and cash/household consumption expenditure



*The 2014 GDP data and the data of household consumption expenditures are MNB estimates.

denomination, 6 per cent for the HUF 2,000 and HUF 1,000 denominations each and 8 per cent for the HUF 500 denominations.

The two highest denominations continued to dominate in the volume of cash, accounting for over 61 per cent of the total number of banknotes in circulation at the end of 2014. The reason for this is that besides their payment function they also have a wealth accumulation function, and they probably play a key role in the operation of the illegal economy as well.

The volume of coins in circulation was 7 per cent higher than in the previous year on average, with the volume of HUF 200, 20 and 5 coins increasing the most.

Chart 9
Breakdown of banknotes in circulation by number as of end-2014

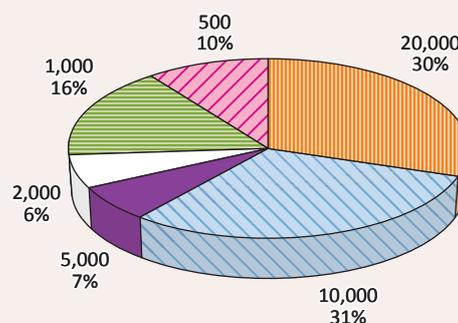


Table 6
Quantity and value of banknotes and coins⁶ in circulation on 31 December 2014

Banknotes	Volume	Value	Ratio (%)	
	Million pieces	Billion HUF	Volume	Value
20,000 forint	112.9	2,258.1	30.2	61.5
10,000 forint	116.5	1,165.3	31.1	31.7
5,000 forint	25.0	125.2	6.7	3.4
2,000 forint	22.9	45.8	6.1	1.3
1,000 forint	59.8	59.8	16.0	1.6
500 forint	37.1	18.5	9.9	0.5
Total	374.2	3,672.7	100.0	100.0
Coins	Volume	Value	Ratio (%)	
	Million pieces	Billion HUF	Volume	Value
200 forint	112.3	22.5	7.8	40.7
100 forint	155.4	15.5	10.8	28.0
50 forint	135.1	6.8	9.4	12.3
20 forint	256.6	5.1	17.9	9.3
10 forint	300.8	3.0	20.9	5.4
5 forint	478.1	2.4	33.2	4.3
Total	1,438.3	55.3	100.0	100.0

Chart 10
Developments by year in the number of counterfeit forint banknotes removed from circulation

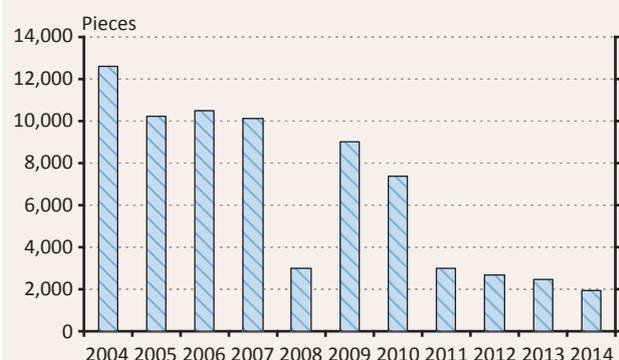
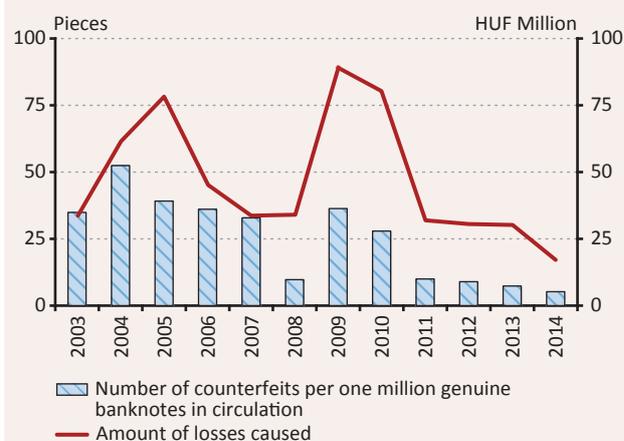


Chart 11
Changes in the number of counterfeits per one million genuine banknotes and the amount of losses caused



Cash distribution

In 2014, the MNB handled cash turnover in an amount of HUF 3,243 billion and provided 264 million banknotes to its account-holding clients, i.e. credit institutions and the Hungarian Post Office. At the same time, 224 million banknotes were delivered to the Bank.

Last year, the MNB qualified some 38 million banknotes as unfit for circulation and replaced them with new, high quality banknotes.

Prevention and reduction of counterfeiting

The counterfeiting of forint banknotes was consistent with the trends of previous years; the 1,935 counterfeit notes identified and removed from circulation in 2014 represents a 21 per cent decline compared to the previous year.

Accordingly, the number of counterfeit banknotes in circulation per 1 million genuine banknotes fell to 5

⁶ The table does not contain commemorative coins and commemorative banknotes issued by the Bank; at par value these coins are legal tender.

last year, which is a favourable figure in international comparison.

In order to maintain this favourable situation, the broad-based dissemination of information regarding banknotes plays a crucial role. In this context, in 2014 the MNB's experts held direct training for more than 4,000 retail cashiers to prepare them for identifying counterfeit banknotes successfully. In contrast with the trend of previous years – when most counterfeit banknotes were higher denominations (HUF 10,000 and HUF 20,000 notes) – the most frequently counterfeited denomination in 2014 was the HUF 5,000 note, which accounted for 40 per cent of all counterfeit banknotes.

Table 7
Counterfeit HUF banknotes discovered in 2014 by denomination
(per cent)

Denominations	500	1000	2000	5000	10,000	20,000
Breakdown	4	0	4	43	32	17

No major changes occurred in counterfeiting methods, which are still characterised by the use of office reproduction equipment (colour photocopy machines and printers). The counterfeit banknotes, which may seem deceiving at first glance, can be easily identified by using simple measures (touch, holding the banknote up to the light or moving it), or with UV-A or UV-C lamps in the cash office.

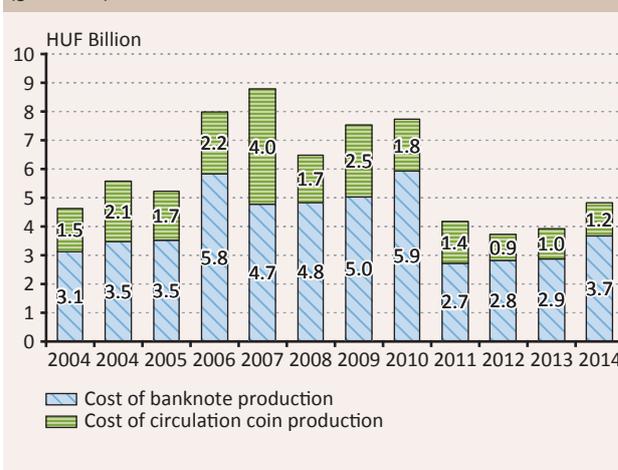
The occurrence of counterfeit currencies remained marginal. Central bank experts examined 1,208 counterfeit currency specimens in 2014, including 982 counterfeit euro banknotes.

Banknote and coin production

In order to meet the increasingly large cash demand and replace unfit and therefore destroyed banknotes and coins, the MNB has banknotes and coins produced.

In 2014, the cost of cash production was a gross amount of HUF 4.9 billion, almost 24 per cent higher than in the previous year. The increase in expenditure can be attributed to the heightened production needs associated with the banknote issuance programme.

Chart 12
Production of banknotes and coins in circulation
(gross cost)



The MNB's cash controlling activity

In 2014, the MNB inspected 13 cash handling organisations – including 12 credit institutions – and 3 cash processing providers to verify compliance with the provisions of the MNB Act on money issuance, the Banknote Decree⁷ and the Decree on data supply linked to the basic tasks of the MNB.⁸ 15 administrative control procedures commenced in 2014, and the MNB concluded 6 procedures among those launched in 2013. In four cases, the MNB called on the inspected organisations in a letter of warning to eliminate the deficiencies found. The MNB did not find any violations of legal provisions in nine cases, and terminated the procedures without the application of further measures. It closed 8 procedures in January 2015. Moreover, the MNB inspected the action plans drawn up – and sent to the MNB – by the designated institutions and the Post Office in accordance with the Banknote Decree for the management of extraordinary circumstances arising in cash distribution. Special attention was given to the control of procedures ensuring the uninterrupted operation of branch ATMs in extraordinary circumstances. In two cases, a warning has been issued regarding violations found during the ongoing administrative control procedures aimed at verifying the data derived from data supplies related to suspected counterfeit banknotes as per the Banknote Decree. Upon the conclusion of the administrative control procedures completed in 2014, the MNB established the violation of certain

⁷ MNB Decree No. 11/2011 (IX. 6.) on the processing and distribution of banknotes and on technical tasks relating to the protection of banknotes against counterfeiting.

⁸ MNB Decree No. 23/2013 (XI. 6.) on the reporting obligations for the central bank information system to be fulfilled primarily in the relation to carry out the basic tasks of the Magyar Nemzeti Bank.

rules pertaining to the re-circulation of banknotes, the notification of the MNB upon the installation of banknote handling machines of the type listed in the MNB register, the content of the cash processing provider's internal regulation, and the handling of suspected counterfeit banknotes (Articles 5(2), 14, 23, Point 2.1.1 of Annex 2, and Annex 4).

Redesign of forint banknotes

In the period between 2014 and 2018, the MNB is set to redesign the banknote series presently in circulation and issue re-designed and enhanced banknotes which, besides being aligned to the cash distribution requirements set by cash processing equipment and ATMS, provide adequate protection from counterfeiting by way of state-of-the-art security features. Of the six denominations making up the Hungarian banknote series, the first banknote redesigned by the MNB was the HUF 10,000 note, which became legal tender on 2 September 2014. The redesigned HUF 10,000 banknotes were gradually put into circulation from December 2014, once participants of the cash-cycle were adequately prepared. By 31 December 2014, more than 19 million new banknotes were held by payment participants, and the notes are expected to be made broadly available during 2015. The existing HUF 10,000 banknotes will remain in circulation; the MNB will make a decision about their withdrawal at a later point, based on comprehensive professional considerations.

Renewal of MNB decrees on the processing and distribution of banknotes and coins

The MNB decrees containing new and modified rules pertaining to cash processing and distribution were issued on 25 September 2014. They define rules in respect of the distribution, processing and re-circulation of cash, the management of operating risks endangering cash distribution, and the handling of suspected counterfeits. Except for the rules pertaining to the exchanging of forint banknotes, which have been effective since 24 November 2014, the modifications of both MNB decrees entered into force on 1 October 2014.

Tightening of the MNB decree regulating the reproductions of coins

In order to protect commemorative coins and common coins in circulation and to combat practices deceptive to consumers, the MNB revised the MNB decree on the reproductions of coins, tightening the provisions

on the production of reproductions and restricting certain activities. MNB Decree No. 36/2014 (IX. 25.) defines a broader range of prohibitive provisions in respect of the production of coin reproductions, and reduces the range of reproductions that are not subject to MNB authorisation.

Issue of commemorative coins

Under the MNB Act, the MNB is entitled to issue banknotes and coins, including commemorative banknotes and coins which are legal tender of Hungary.

Starting from 2014, each precious metal commemorative coin is also issued in a less expensive, cupronickel version to benefit collectors who wish to buy the same artistic theme at a more affordable price. By issuing lower-priced versions, the MNB and Magyar Pénzverő Zrt. (Hungarian Mint) also wish to encourage younger generations to collect commemorative coins. Accordingly, gold and silver commemorative coins are also issued in a non-ferrous metal version, with a face value of HUF 2,000. The MNB also encourages the transfer of values by its decision to distribute silver – for a period of 3 months after issuance – and non-ferrous metal commemorative coins at face value.

The central bank issued 13 coins in the context of its commemorative coin programme in 2014.

The most valuable piece of the commemorative coins issued in 2014 is the "Gold Florin of Mary", a gold commemorative coin issued by the MNB on 20 March with a face value of HUF 50,000 in normal and in piedfort weight (which is four times the weight of the normal weight coin). Coins struck from non-ferrous metal with a face value of HUF 2,000 have also been produced. The coins have been issued as the third element of the "Hungarian Medieval Gold Florins" series ("Gold Florin of Charles I", "Gold Florin of Louis I").

The MNB issued four additional commemorative coins in April 2014: the Miklós Ybl commemorative coin struck in silver with a face value of HUF 10,000 and its non-ferrous metal version with a face value of HUF 2,000; and a bicentennial commemorative coin in honour of Béni Egressy, also in a silver and non-ferrous metal version, with a face value of HUF 10,000 and HUF 2,000, respectively.

On 24 May 2014, the MNB issued a silver and a non-ferrous metal collector coin to commemorate the 90th anniversary of its foundation, with a face value

of HUF 10,000 and HUF 2,000, respectively. In June 2014, the MNB issued silver and non-ferrous metal collector coins with a face value of HUF 10,000 and HUF 2,000, respectively, to mark the 100th anniversary of the death of landscape painter Béla Spányi.

In July 2014, the MNB commemorated the 150th anniversary of the death of András Fáy, author and politician, with the issue of silver and non-ferrous metal collector coins with a face value of HUF 5,000 and HUF 2,000, respectively.

In August 2014, the MNB issued a non-ferrous metal collector coin to mark the 25th anniversary of the foundation of the Hungarian Maltese Charity Service. The face value of the coin is HUF 2,000.

In the autumn of 2014, six additional commemorative coins were issued: the Somogyvár-Kupavár National Memorial Site non-ferrous metal collector coin with a face value of HUF 2,000 and the Róbert Bárány collector coin in a silver and a non-ferrous metal version with a face value of HUF 5,000 and HUF 2,000, respectively, as part of the Hungarian Nobel Prize Winners series. On 6 November 2014, the MNB issued a non-ferrous metal collector coin with a face value of HUF 2,000 to mark the 200th anniversary of the birth of Ábrahám Ganz. After the coins dedicated to Ignác Alpár (2005), Adam Clark (2011) and Miklós Ybl (2014), the Ödön Lechner collector coin commemorating the 100th anniversary of the artist's death was issued in November 2014 as part of the series dedicated to the greatest Hungarian architects. The respective face values of the silver and non-ferrous metal coins are HUF 10,000 and HUF 2,000.

The 350th anniversary of the death of Miklós Zrínyi was in November 2014. Born on 3 May 1620, the Hungarian-Croatian aristocrat was the most excellent military commander and outstanding politician of the period, as well as the author of treatises on the art of war and a prominent poet. In honour of Miklós Zrínyi, the MNB issued a silver and a non-ferrous metal

collector coin with a face value of HUF 5,000 and HUF 2,000, respectively.

Finally, in December 2014 a silver and a non-ferrous metal collector coin was issued to commemorate the 100th anniversary of the birth of Kossuth Prize winner film director and cameraman István Homoki-Nagy, with a face value of HUF 10,000 and HUF 2,000, respectively.

3.8 STATISTICAL SERVICE

The Magyar Nemzeti Bank gathers and publishes statistical information to carry out its duties under the MNB Act and to perform its data supply obligation toward the ECB.

The MNB prepares and publishes on its website – for the most part, according to the published release calendar – monetary, balance of payments and related stock, financial account and securities statistics, statistics on payments and the payment system, as well as time series on prices, exchange rate statistics, financial stability, and the macroprudential and financial intermediary system. The MNB also publishes methodological documents related to the individual statistical areas.

MNB decrees on statistical data collection

Five MNB decrees were issued in 2014 regarding data supply for 2015: the MNB decree defining data supply required primarily for the MNB's basic tasks,⁹ and four additional MNB decrees prescribing data supply primarily for the performance of its supervisory functions.¹⁰ In 2014, a number of effective MNB decrees¹¹ relevant to data supply were amended on two occasions due to changes in the domestic and international legal environment: the modifications affected the data supply tables related to the foreign financing adequacy ratio (FFAR);¹² a new data supply on payment transactions¹³ has been prescribed for the presentation of the pricing of payment services; and the MNB decrees¹⁴ defining the reporting

⁹ MNB Decree No. 48/2014 (XI. 27.).

¹⁰ MNB Decree No. 49/2014 (XI. 27.); MNB Decree No. 50/2014 (XI. 28.); MNB Decree No. 51/2014 (XII. 9.); and MNB Decree No. 52/2014 (XII. 9.).

¹¹ MNB Decree No. 23/2013 (XI. 6.); MNB Decree No. 37/2013 (XII. 29.); MNB Decree No. 38/2013 (XII. 29.); MNB Decree No. 40/2013 (XII. 29.); MNB Decree No. 42/2013 (XI. 29.); and MNB Decree No. 43/2013 (XII. 29.).

¹² MNB Decree No. 14/2014 (V. 19.) amended MNB Decree No. 43/2014 (XII. 29.) (a new FDMM table was introduced, and the previously prescribed DMM, KDMM and KONSZDMM tables were also modified).

¹³ MNB Decree No. 30/2014 (VII. 30.) amended MNB Decree No. 23/2013 (XI. 6.), adding provisions pertaining to the new data supply entitled "Revenues from payment services" (ID code: P55).

¹⁴ MNB Decree No. 42/2013 (XII. 29.) and MNB Decree No. 43/2013 (XII. 29.) were modified due to provisions required for the implementation of Article 17(1) of Commission Implementing Regulation (EU) No. 680/2014 of 16 April 2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No. 575/2013 of the European Parliament and of the Council.

requirements of capital market, money and credit market organisations have been modified to support the implementation of the provisions of Commission Implementing Regulation (EU) No. 680/2014.

Methodology and publication changes in MNB statistics

The international methodological standards of the compilation of balance of payments and national accounts statistics (Balance of Payments and International Investment Position Manual Sixth Edition: BPM6, System of National Accounts: SNA 2008, European System of Accounts: ESA 2010) have been changed in recent years. Application of the new standards in European Union Member States and institutions became mandatory in the relevant statistical data supply in 2014. In the first half of 2014, the MNB concluded the preparation process launched in 2009 for the application of the new international methodological requirements in the area of balance of payments statistics and financial accounts statistics. In this context, consultations with international institutions and the CSO on methodology were concluded; new methodological and information technology developments were completed; and the first statistics with new contents and structure were released. The revised balance of payments statistics and financial accounts were published on the MNB's website on 24 June and 30 June 2014, respectively. As of these dates, the central banks also provides statistical data to international institutions as per the new methodological standards.

In preparation for the new data disclosures, in order to provide advance information to users and present the changes, in March 2014 the MNB dedicated a new page to the methodological changeover under the Statistics menu item on its homepage, and provided information to external and internal users of statistics on several occasions. The MNB called users' attention to the fact that, in parallel to the methodological changeover, it would also perform comprehensive data revisions on the balance of payments and financial accounts time series.

At the time of the first data disclosure, the new methodology had been retrospectively applied to the time series of balance of payments statistics until 2013, but the September 2014 publication already included the long time series updated with the new methodology retrospectively to 1990. As regards the financial accounts, the first data disclosure in June

2014 included time series revised from 1989, and the entire time series had been updated to reflect the effect of the methodological changeover. In September 2014, a number of new, technical modifications took place, in line with current changes to the balance of payments and the non-financial national accounts.

On the whole, data disclosures related to both the balance of payments and the financial accounts have been released within shorter time limits and with more details since the methodological changeover. In addition, in July 2014 a new monthly publication was launched on balance of payments statistics for the faster and more regular provision of information, and the revised Methodological Manual on balance of payments statistics was published on the MNB's website at the end of the year.

As regards monetary statistics, the effects of the methodological changeover related to the renewal of national accounts and financial statistics were first reflected – along with other substantive changes – in the central bank's publications and international data supplies in 2015. In this context, preparations continued in 2014 for data supplies to be provided in accordance with the ECB's new decrees on monetary balance sheet statistics and interest rate statistics. In order to reduce the burden on reporting entities, most data requirements are generated through estimates, but a smaller part of them are integrated into the MNB decree on data supply, effective from 2015.

Starting with the publication for January 2014, the range of data presented in the time series of monetary balance sheet and interest rate statistics has been enlarged, and the methodological treatment of loan impairments in monetary statistics publications has changed.

With the quarterly collection of payment data, payment data can be now published more frequently, allowing for the monitoring of payment processes with the shortest lag possible.

Supervisory statistics

In the area of data supply for supervisory purposes, preparations for the receipt and processing of reports prepared according to uniform EU level formal and substantive requirements posed the greatest challenge in 2014. In its supervisory capacity, the MNB received the first reports from reporting entities prepared pursuant to Commission Implementing Regulation (EU)

No. 680/2014 on 30 June. Application of the standard developed by the European Banking Authority entailed significant substantive and technical changes both for reporting entities and the MNB. In the next couple of years, in line with legislative changes, the content of uniform data disclosures will be enlarged gradually, and they will replace, to a large degree, the supervisory data disclosures prepared in accordance with the MNB's decrees. The data disclosures of three banking groups will be sent to the European Banking Authority – after the required verifications – in the format required by the XBRL standard. The MNB faces a changeover of similar magnitude regarding the data disclosures of insurance companies as well: the introduction of reports with content and form standardised at the European Union level is related to the implementation of the Solvency II regulation in 2016. As part of the preparations for this changeover, EIOPA has issued a recommendation and, in order to ensure compliance, the MNB requests insurance companies to submit a limited part of the new data collections pertaining to 2014 already.

International data reporting and cooperation

The MNB complied with all of the reporting obligations pertaining to EU Member States in 2014. Accordingly, it provided regular data supplies to the statistical office of the European Union (Eurostat), the European Central Bank, and the Bank of International Settlements (BIS). In accordance with its status as a central bank, and in line with the expectations arising from international cooperation as well as its membership obligations, the MNB provides data and information on a regular basis to the International Monetary Fund (IMF), the World Bank and the Organisation for Economic Co-operation and Development (OECD). The MNB played an active role in international statistical working groups in 2014 as well.

Data quality and regulatory inspection

Similar to previous years, in 2014 the Statistics Directorate of the MNB verified compliance with the data supply requirements laid down in the MNB decrees on data supply – i.e. timely performance and data quality – primarily in the framework of

ongoing inspections. Based on the findings of ongoing inspections and in order to control the quality of data disclosures serving the purposes of its basic tasks, the MNB commenced administrative control procedures as necessary, in the context of which, focusing on selected topics, it conducted on-site inspections or requested documents for off-site inspections.

During the year, the Statistics Directorate commenced administrative control procedures against 21 organisations – 2 banks and 19 investment fund managers – in order to verify the quality of statistical data disclosures. Given the magnitude and nature of the errors and deficiencies found, in the case of two banks the administrative control procedure was concluded with a resolution stipulating measures. On 31 December 2014, the administrative control procedures launched against the investment fund managers were still in progress. Three administrative control procedures initiated against banks in 2013 were concluded in 2014, with a letter of warning in two cases, and with a resolution stipulating measures in one case.

In 2014, measures were applied in 267 cases (a notice in 2 cases and letters of warning in the rest of the cases), due to violations detected during the ongoing inspections. In six cases, the violations involved non-compliance with the completion instructions, and in the rest of the cases, a failure to meet the reporting deadline. Based on the findings of the inspections, the MNB ordered the reporting entities to eliminate the errors found and to comply with legal regulations in the future. The measures affected certain statistical data disclosures relevant to balance of payments, monetary, securities and payment statistics, and to the financial intermediary system.¹⁵

No fines were imposed in 2014.

3.9 THE MNB'S CORPORATE SOCIAL RESPONSIBILITY ACTIVITY

The Fundamental Law and the Act on the Magyar Nemzeti Bank guarantee the central bank's organisational, operational and financial independence. At the same time, the independence, significance, and social recognition of the MNB, and the public assets under its management entail social

¹⁵ Data supplies for balance of payments statistics (ID code: R02, R04, R05, R06, R07, R11, R12, R15, R19, R29); monetary statistics (ID code: H01); securities statistics (ID code: E62); payments statistics (ID code: P05, P26); and data supplies pertaining to the financial intermediary system (table code: 14HD, 14ND, 8APA, 8APT).

responsibility. In May 2014, the MNB's Statute was published which, among other things, laid down the principles of the MNB's corporate social responsibility. Published in June, the Corporate Social Responsibility Strategy determined the central bank's key objectives and presented the details of the programme for their implementation. The focal point of the programme is a professional activity, which is aligned to the MNB's basic tasks, serves broader social interests, reflects credibility and professionalism, creates value, strengthens social cohesion, facilitates scientific thinking and develops financial literacy. The MNB's formulation of its corporate social responsibility strategy and the activities pursued in 2014 were consistent with the practices of international institutions.

The CSR programme of the MNB attaches key significance to the enhancement of financial consumer protection. Since the integration of the functions of financial supervision into the central bank, the MNB has taken more resolute action in this regard, in order to ensure the enforcement of consumer rights. It has also intensified its efforts in the area of market surveillance. Besides the enforcement of statutory regulations, the central bank's consumer protection activity also pressures financial service providers into "fair" conduct.

Pursuant to the MNB Act, revenues from the fines imposed during the MNB's supervisory activity may only be spent on purposes related to the CSR programme. Apart from the revenues from fines, without prejudice to the achievement of its primary objectives and the performance of its basic tasks, the MNB made available additional resources to finance the implementation of its corporate social responsibility strategy. In the implementation of its Pallas Athena Public Thinking Programme, the MNB considers its mission and strategic task to improve financial literacy and financial awareness and to enhance the underlying economic and social intelligence, as well as the related institutional system and infrastructure. To that end, through its expert staff, strategic cooperating partners and foundations established for implementing the objectives aligned to its tasks, it seeks to play a leading role in the renewal of economic and financial training, and endeavours to establish relations with top-ranking universities, research workshops, institutions, and experts.

The establishment of the Pallas Athena Foundations as a means of providing an organisational structure

for its Public Thinking Programme, is a priority goal of the CSR Strategy of the Magyar Nemzeti Bank. The foundations were put into operation at the end of the first half of 2014. The priority goal of the foundations established by the MNB is to raise the quality of Hungarian education in economics both in Hungary and in the region of the Carpathian Basin, and to improve the general population's economic literacy by way of educational programmes and the nurturing of exceptional talents, and by supporting Hungarian researchers to create internationally recognised intellectual works. Besides the already ongoing training of financial and banking experts, various programmes have been put into focus, in particular, those related to the promotion of financial conferences and professional colleges, scholarships, curriculum development and the publication of professional papers. The well-designed, gradual extension of these programmes will put Hungary on the map of modern economic thinking in the coming decades.

Established in 2008, the activities of the Money Compass Foundation is aimed at the enhancement of the financial awareness of the broad public. Over the past six years, the Foundation has gained significant recognition and reputation. Building on this, but also with a view to shaping financial attitudes on a broader scale, the long-term agenda of the Foundation was significantly renewed and enlarged in 2014, with its founders providing professional and financial support for its implementation.

In addition, within the constraints of available resources, the MNB participates, directly or through its foundations, in value creation, the preservation of national values, intellectual and cultural heritage (e.g. strategic partnerships with the Opera House-Erkel Theatre, the Palace of Arts and the Liszt Academy), and supports the training of professionals and scientific activities (e.g. Hungarian Economic Association, Role Model Foundation). Through charitable donations, it has contributed to improving the quality of life and equal opportunities of disadvantaged groups and to alleviating the difficulties arising from extraordinary life situations (e.g. Three Princes Movement, Csodalámpa Wish Fulfilling Foundation, National Association of Large Families, International Children's Safety Service, Foundation for the healing of children with tumours). Within the framework of its corporate social responsibility programme and aligned to its designated strategic objectives, the central bank is open to enlarging the group of its cooperating partners.

Consistent with the practice of other European central banks, through its Depository Programme the MNB strives to locate and preserve national art and other distinguished art treasures, cultural assets, artistic and inherited values in order to accumulate a collection that can be expected to gain widespread cultural, artistic and social recognition.

In addition to its general institutional responsibility for the natural and built environment aimed at sustainability, the Magyar Nemzeti Bank strives to develop exemplary and leading practices in the area of environmental protection. Along these lines, the MNB's renewed Environmental Policy for 2014–2016 was approved in the first half of 2014.

3.10 FACTORS SHAPING THE COMMUNICATIONS OF THE MNB

In 2014, the communications of the MNB were dominated by the presentation of activities serving broad social interests and large-scale central bank programmes supporting the economic policy of the government and Hungarian economic growth. Among other things, communications focused on the success of the Funding for Growth Scheme and the self-financing programme, the easing cycle, the achievement of not placing additional burden on Hungary's budget with central bank operations, the Pallas Athena Public Thinking Programme, the widening of international relations, the Corporate Social Responsibility Programme, the enrichment of national values, support for the settlement and conversion of household foreign currency loans, the work on developing the rules of the payment-to-income ratio, and supervisory measures protecting consumers.

The statements and information of the MNB were characterised by independent and responsible central bank behaviour. By formulating and publishing the Statue and Corporate Social Responsibility Strategy of the MNB, decision-makers made it clear that in the spirit of forward-looking thinking facilitating the growth of Hungary, they expanded the duties of the central bank focusing on price stability. Central bank communications brought into focus the Pallas Athena Foundations, through which the MNB accumulates public wealth, participates actively in the enhancement of financial awareness and raises the quality of economic and financial education.

After the monetary policy turnaround, relying on novel methods, the MNB endeavoured to stabilise

the economy and ensure a sustainable growth path. Non-conventional tools and innovative solutions were frowned upon by some economists and political participants. Regardless of this, the MNB took firm action against attacks and political pressure that weakened confidence and attempted to curtail the central bank's independence.

Implementation of the intensive campaign aimed at promoting the Funding for Growth Scheme was a significant communication task throughout 2014. Notifications and information regarding the FGS – a programme intended to assist small and medium-sized enterprises – reached stakeholders through the participation of the media, direct advertisements, communications, interviews and lectures. There was regular news on the results, the effects and the extension of the FGS, the raising of the credit line allocated under the FGS, the modified product information material, the changes in terms and conditions and the expansion of financing options.

The MNB launched a major, successful communication campaign to facilitate the smooth introduction of the new and enhanced HUF 10,000 banknote.

The MNB disseminated its main messages primarily through press releases and professional articles. During the year, the central bank published 205 press releases and 67 professional articles in the media or on its homepage. In addition, it held 32 press conferences and background briefings.

It posted information on its homepage about the decisions of the Monetary Council, core inflation indicators, the consolidation of the financial market, supervisory measures aimed at protecting consumers, infringements, statistical data, and the issuance of commemorative coins.

In keeping with the expectations of the 21st century, the MNB widened its online communication channels by joining the most popular social network, Facebook, supplementing the MNB's online content with information primarily targeting the youth. The number of users is on the rise.

3.11 THE MNB'S INCOME IN 2014

In 2014, the Magyar Nemzeti Bank earned a profit of HUF 27.4 billion. In 2014, the balance sheet and the profit were affected by the following main developments:

- the level and composition of foreign exchange reserves defined by monetary policy, and foreign exchange purchases and sales affecting the level of reserves: operations performed by the Government Debt Management Agency in relation to debt management, net foreign exchange inflows from EU transfers, foreign exchange conversions performed by the Hungarian Treasury for purposes other than debt financing, the conversion of household FX loans into forints;
- developments in instruments absorbing forint liquidity, which are correlated with changes in foreign exchange reserves and the MNB's net foreign currency receivables;
- changes in forint interest rates and international foreign exchange interest rates;
- changes in the forint exchange rate;
- the MNB's Corporate Social Responsibility programme; and
- changes in accounting rules.

Net interest and interest-related losses amounted to HUF 86.3 billion. The deterioration of the interest result can be attributed to changes in accounting rules as a result of their harmonisation with international accounting practice (for details, see Part B), Chapter 4.1). The changeover generated a one-off loss in net interest income for 2014; at the same time, however,

the application of the new accounting rules from 2015 will alleviate unwarranted fluctuations in the central bank's result. In line with the new methodology, the premium on high-coupon securities purchased over face value will be recognised evenly until the maturity of the security, reducing interest revenues. As a result, no losses will be recognised upon the maturity of the security to reduce the income from financial operations. Without the one-off impact of the methodological changeover, net interest income would have been positive in 2014, thanks to the narrowing gap between FX and forint yields.

Net forint interest and interest-related losses amounted to HUF 158.5 billion, HUF 72.9 billion less than in 2013. The average central bank base rate weighted by calendar days was 200 basis points lower in 2014 than in the previous year. The average stock of forint liabilities with interest pegged to the base rate (forint deposits of the central government, minimum reserves and liquidity absorbing instruments) increased compared to 2013. The improvements in net interest income resulted from the declining base rate.

Foreign currency interest and interest-related profits amounted to HUF 72.2 billion, representing a decline compared to the previous year. The lower level of profits reflects the change in accounting methodology and a decline in interest revenues from foreign exchange reserves. Expressed in euro, the level of reserves was higher than in 2013 for the most part of the year, but the decline in EUR yields reduced the interest revenues realised.

Table 8
Abbreviated income statement and individual balance sheet items of the MNB
(HUF billions)

No.	Description (P/L line)	2013	2014	Change
1	Net interest and interest related income (I+II)-(X+XI)	-49.4	-86.3	-36.9
2	Net forint interest and interest related income (I-X)	-231.4	-158.5	72.9
3	Net foreign exchange interest and interest related income (II-XI)	182.0	72.2	-109.8
4	Realised gains/losses arising from financial operations (IV-XIV)	-112.6	-119.6	-7.0
5	Income arising from exchange rate changes (III-XII)	200.3	511.0	310.7
6	Other constituents of net income* (V+VI+VII+VIII)-(XIII+XV+XVI+XVII+XVIII)	-12.0	-277.7	-265.7
7	Profit/loss for the year (1+4+5+6)	26.3	27.4	1.1
8	Revaluation reserves in the balance sheet			
	Due to unrealised foreign exchange gain/loss	509.6	518.0	8.4
9	Due to changes in the market value of the foreign currency securities	-91.1	54.5	145.6

* Revenues on supervisory activities, net profit/loss of banking operations, costs of issuing banknotes and coins, net creation and release of provisions, income/expenses from commission and from other items.

The realised total loss arising from financial operations amounted to HUF 119.6 billion. This category of P&L mainly states gains and losses realised from changes in the market prices of securities included in the FX reserves. Fixed-income, high-coupon securities represent a substantial portion of foreign exchange reserves, continuously earning above-market interest income. These securities are purchased above par value, incurring a loss upon maturity or sale according to the accounting rules in effect before December 2014. This is the reason behind the loss realised on financial operations. The new accounting practice will eliminate this problem, through the amortisation of the difference between the par value and the market price of the security (premium). Consequently, income from financial transactions is expected to improve significantly from 2015.

The two main factors determining income arising from exchange rate changes are the difference between the official and the cost rate, and the volume of foreign exchange sales. In 2014, the forint exchange rate was typically weaker than in 2013, with significant divergence between the official and the cost rate in certain periods. The volume of foreign exchange sales was higher than in the previous year, which can be mainly attributed to the Debt Management Agency's debt management operations and the conversion of household FX loans. In the course of the year, the exchange rate gains earned by the MNB amounted to HUF 511 billion, which was the MNB's most significant profit item in 2014 again.

Other constituents of net income include operating income, costs and expenses, costs of issuing banknotes and coins, creation and release of provisions, income

from supervisory activity and income/expenses from fees and commissions and other income/expenses. Net expenditures deriving from these items amounted to HUF 277.7 billion in 2014. The increase compared to 2013 primarily reflects the transfer of assets by the founder to foundations in the framework of the Pallas Athena Public Thinking Programme.

The MNB's equity amounted to HUF 645.9 billion at the end of the year. Equity was basically shaped by the level of revaluation reserves, in particular, the reserves due to exchange rate changes. The changes in the accounting rules had no effect on shareholders' equity, as the revaluation reserves of FX securities increased in line with the deterioration in net interest income.

Revaluation reserves due to exchange rate changes rose by HUF 8.4 billion compared to the end of 2013, as the difference between the official and the cost rate at the end of 2014 was larger than in the previous year. Revaluation reserves due to exchange rate changes stood at HUF 518 billion on 31 December 2014.

On 31 December 2014, the MNB's balance sheet showed unrealised gains of HUF 54.5 billion on foreign currency securities marked to market. The positive changes in the revaluation reserves relative to the previous year can be attributed to two factors: the change in accounting rules and the increase in the market price of securities owing to the decline in FX yields.

3.12 FINANCIAL PERFORMANCE OF THE MNB

The internal operations of the MNB are essentially aimed at providing the resources required for an efficient discharge of the duties stipulated by the MNB Act.

Operating expenditures

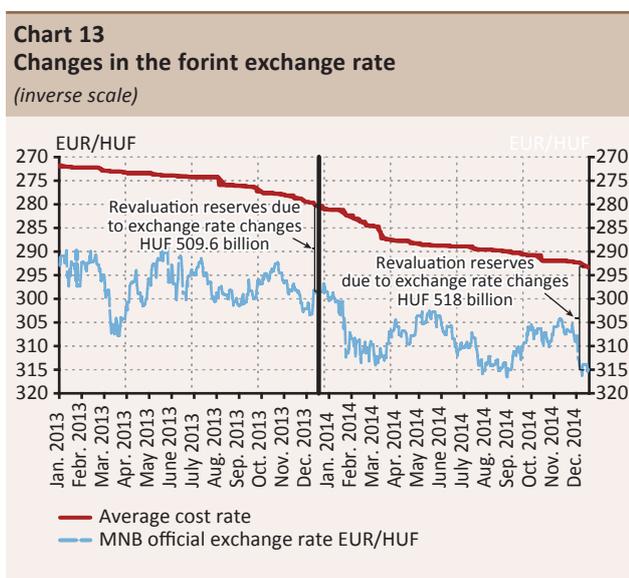


Table 9
Operating costs of the MNB in 2014

Description	Budget for 2014*	Actual data for 2014	Index (2014 actual / 2014 budgeted)
	HUF millions		%
1. Staff expenditures	17,266	16,329	94.6
2. General operating costs	17,399	15,846	91.1
Total	34,665	32,175	92.8

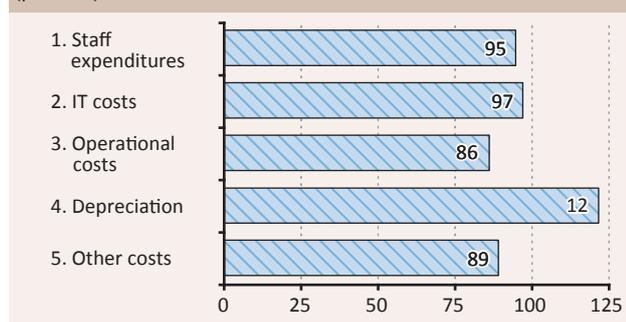
* Operating budget plan modified in accordance with Resolution No. 160/2014 of the Board of Directors.

Actual operating costs amounted to HUF 32,175 million in 2014, 7.2 per cent lower than the approved budget. Since the MNB's scope of competence did not include supervisory activity in 2013 Q1–Q3, 2014 costs may not be compared to the figures recorded for the previous year.

After the approval of the 2014 operating budget plan, in the second half of July the MNB's Board of Directors approved a proposal for the modification of the operating budget plan, in order to update it with the changes that had taken place in the first half of the year, including the execution of Board resolutions passed during the first six months.

The execution of the budget in 2014 was mainly determined by savings in personnel costs (e.g. in the case of wage costs, optional benefits in kind and other personnel benefits), but also reflected the postponement of the utilisation of appropriations for central bank research to 2015 and the lower-than-budgeted operating costs (in particular, armed guarding services). In addition, training, communication and legal costs proved to be lower than envisaged. At the same time, the value of depreciation charges exceeded the appropriation, primarily due to the amortisation costs of real property purchased during the year.

Chart 14
Changes in operating costs in 2014 compared to the budget, broken down by cost category
(per cent)



Personnel costs

In the planning of personnel costs for 2014, the effects of the changes in 2013 were taken into account, the most important of which was the modification of the remuneration system and the integration of the HFSA into the MNB. In January 2014, the MNB completed the phasing out of the bonus system commenced in 2013 and integrated the payroll-based remuneration

of employees taken over from the HFSA into the new, wage band-based structure. As a result, by 2014 Q2 the standardisation of the benefit system, the transformation of the welfare and support system, the widening of entitlement and the expansion of the range of optional elements were completed.

Personnel costs amounted to HUF 16,329 million in 2014, reaching 94.6 per cent of the approved budget. The main reasons for the HUF 937 million difference were the following:

“Other employee benefits” were HUF 482 million lower than the approved budget, mainly as a result of three factors. The comprehensive screening programme scheduled for 2014 as a healthcare benefit was carried over to 2015. The payments of employer pension fund contributions were lower than budgeted, owing to unfilled vacancies compared to the plan, and the fact that the entitlement of new entrants began after a six-month probationary period (see the next chapter on the personnel management of the MNB). The utilisation of the elements of optional benefits in kind generated a lower commission and tax burden than anticipated.

“Payroll costs incurred on staff” and “Taxes on personnel-related payments” fell short of the approved budget by HUF 228 million in total, partly as a consequence of the deviation from the staffing plan, and partly due to the second-round effects of the items noted above (e.g. healthcare benefits carried forward).

“Other staff costs” were HUF 227 million lower than the approved budget, as after the mandate of the Supervisory Board had expired, the payment of the related compensation was no longer necessary; moreover, assignment fees and the amount of payments due for the notice period were also lower than envisaged.

General operating costs

General operating costs (HUF 15,846 million) represent 91.1 per cent of the approved budget in 2014.

IT costs fell short of the budget by HUF 50 million, i.e. by 3.0 per cent. This is mainly due to the extension of the procurement procedure related to IT security consulting, with the final deadline also modified. The related costs, therefore, will be incurred only in 2015. In addition, the MNB took recourse to IT expert

consultations in a smaller amount than the limit available under the man-day based contracts, which reduced the associated costs.

Operational costs were lower than the budget (by HUF 431 million, i.e. 14.0 per cent). Most of the savings derive from the expenses of armed guarding, as the MNB took recourse to the facility protection and guarding services of the Police Reserve Force to a lesser degree than expected. In addition, the costs associated with new training and the scheduled property renovation of the holiday centre – which were incurred until the start of operations – were recognised as investment. Some of the property maintenance work scheduled for the building on Szabadság tér (e.g. the restoration of the facade, the renovation of the conference centre) will only be implemented in 2015.

The *depreciation charges* of tangible and intangible assets (HUF 2,100 million) were higher than the budget by 21.6 per cent (HUF 373 million) in 2014. This is partly because actual costs include the depreciation of the properties purchased during the year (in the case of real property, the amortisation costs of leased areas are re-routed to expenditures; see “book transfers”). On the other hand, in the budgeting period for 2014 (at the end of 2013), the planned depreciation charges of the assets taken over from the HFSA – based on the information available – fell significantly short of the actual value.

Other costs were also lower (by almost HUF 1,200 million) than budgeted in 2014. This is mainly due to the postponement of the utilisation of the amount allocated for central bank research to 2015. Training costs were also lower than expected, as some of the contracts required for the implementation of the training plan approved in April are yet to be concluded, and performance was carried over to 2015. The communication costs of the Funding for Growth Scheme are only slightly smaller than the budget, but given the substantial amount appropriated for this purpose compared to the rest of the costs, the savings are still rather considerable. In the context of the property purchases, some of the amounts incurred as legal expenses upon payment were capitalised in the case of certain properties as an investment expense, which also increased the deviation of legal expenses from the plan.

The *transfer of costs* is intended to ensure that the total amount of operating expenses reflects only the

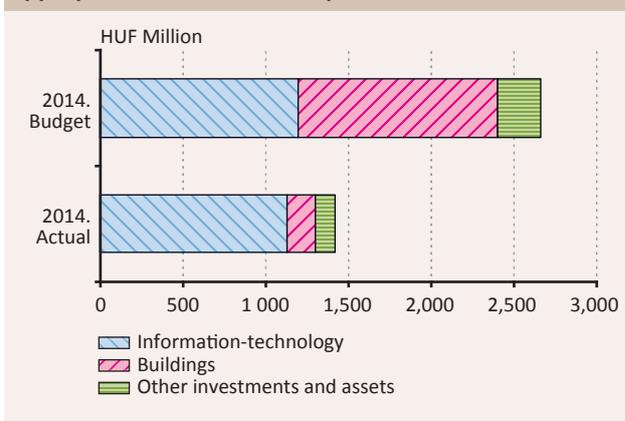
actual expenses incurred by the MNB. On the one hand, in the case of services and properties provided by the MNB, the costs associated with the leased areas are transferred to expenditures, which then will be recovered from rental fees and revenues from other services. On the other hand, the transfers include the performance settlement of information technology developments implemented from own resources, i.e. the costs associated with capitalised concessions, patents, licences, trade marks and similar rights are transferred.

Capital expenditure

In order to achieve the central bank's objectives and maintain the quantity and quality of tangible assets, the MNB needs to implement development projects and purchases. In relation to normal operations, the approved capital expenditure budget for 2014 amounted to HUF 2,663 million. An appropriation was also approved for the implementation of the CSR programme for ensuring the location of internal training, and for the renovation, rebuilding or reconstruction of existing real estates and real property to be purchased by the MNB.

In 2014, HUF 20,379 million was spent in relation to investment projects, including advance payments made for investment purposes, the majority of which is comprised by real estate purchased for training, office and other institutional purposes (HUF 18,960 million).

Chart 15
Trends in the MNB's capital expenditure, excluding the appropriation for real estate purchases and renovations



Purchases made for operating purposes comprise a large portion of information technology investment. The expansion of the capacity of the central data storage system became necessary because of

changes in the technology. In the framework of the procurement of user workstations, the Bank purchased desktops and laptops to replace obsolete devices. Investment for the replacement of the virtualisation infrastructure and VIBER servers is linked to the enhancement of the IT infrastructure, which replaced the equipment pool accumulated from the previously purchased servers. The version upgrade of the Kondor+ sales system was completed in 2014. A network level link was implemented between the new building of the MNB.

An important investment of the IT security area collects entries and information generated in IT devices, systems and applications, supports the investigation of security incidents and the detection of attempted breaches. As regards services provided over the internet, guaranteeing the highest level of security is a key priority. The protection of WEB portals against application-level attacks is ensured by the substantial filtering of traffic on applications.

The quality of the information system supporting central bank statistics is of crucial importance, and an essential condition for this activity is the availability of high-quality IT support. Among its IT developments, the MNB continued its Integrated Statistical System programme. The developments implemented in this context were necessitated mainly by the changes in methodology. The technological enhancement of the payment and securities clearing system is also in progress. Supervisory reports to the European Banking Authority must be sent in a new format, which required new developments. In relation to cash logistics activities, developments necessitated by the upgrade of EBIZ, the transaction system supporting banknote processing, and WebeC, the client relations module of the Integrated Emission System, are in progress.

The most important investment projects related to properties include the replacement of the industrial batteries serving the storage capacity of the uninterrupted power supply systems in the buildings of the MNB and the installation of the entry and property security systems.

It is the duty and objective of the MNB to enhance the resilience of the system of financial intermediation and ensure its sustainable contribution to economic growth. The acquisition of the founder and publishing rights of the publication issued by the Hungarian Banking Association facilitates the implementation of

these objectives with the assistance of a professional and scientific financial publication.

Personnel management at the MNB

The MNB regards personnel management as a strategic issue, facilitating efficient and effective operations. With that in mind, it strives to recruit and retain highly qualified, knowledgeable, dedicated and loyal employees, worthy of representing the MNB in an international environment. Relying on such a pool of employees, the MNB is capable of driving the changes aligned to renewing economic and social interests and values.

In managing these changes, the MNB seeks solutions that are mutually beneficial for employees and the employer, and it maintains and enhances the conditions for high-quality work.

The MNB's management, including the human resources area, values employees' satisfaction and their positive attitude to employment, and supports the employees' professional fulfilment.

In 2014, it was crucial to ensure the availability of a workforce in adequate quality and quantity for the implementation of the MNB's strategic objectives. This was supported by the developments and self-training programmes implemented in the framework of the MNB's training system.

In the context of its corporate social responsibility programme, in 2014 the MNB operated an internship system and supported professional knowledge transfer. The internship programme is designed to help students of higher education to gain experience and new graduates to find jobs, and to ensure a steady supply of qualified professionals.

For that purpose, the MNB recruited undergraduates and new graduates, expanded its internship programme and, in the framework of close cooperation with higher education institutions, launched a dual training programme. During their internship, undergraduates work and gain professional experience at the MNB, and they are also entitled to scholarships.

In 2014, as in previous years, the MNB applied its own grading system; the applied remuneration system was based on the total income approach, with basic salary and benefits in kind comprising its components. With

a simple and transparent incentive system, the MNB offered a fair, equitable and competitive income to its employees, adhered to the principle of equal pay for equal work, and recognised high-quality work and outstanding performance in wages.

As a responsible employer mindful of the well-being of its employees, the MNB provided broad-based support in the framework of benefits in kind, offering welfare benefits, aid and assistance to its employees and operating a benefit system based on their choices.

Changes in staff number

Changes in the staff number of the MNB were determined by the labour supply required for the tasks to be completed and by measures related to the transformation of the organisation.

During the year, the employment of 230 employees was terminated as a result of natural migration, the expiry of fixed-term contracts, quality replacements and the termination of employment during the probationary period. In order to secure an adequate workforce aligned to the challenges, and the MNB's changed tasks and operating structures, the central bank recruited 359 new entrants to fill vacant or new positions. Employees joining or returning from the so-called "inactive payroll" – which is not included in the statistical headcount – increased the staff by 55 persons.

The average staff number of the MNB was 1,192 persons in 2014, 97 per cent of the scheduled average staff number calculated from the labour requirement of the professional areas.

In the framework of the internship programme 49 persons were employed, with 9 additional students supported and admitted to internship in the context of dual training.

As regards the composition of staff by age, an almost one-year decline can be observed: the average age of employees dropped to 41 years in 2014 compared to 41.8 in 2013.

Procurement

Similar to the other central banks in the European Union, the MNB conducts public procurement procedures in respect of acquisitions where the value reaches the value limits of international public

procurements. The MNB is subject to the public procurement authority based on Commission Decision 2008/963 amending the Annexes to Directives 2004/17/EC and 2004/18/EC of the European Parliament and of the Council on public procurement procedures, as regards their lists of contracting entities and contracting authorities.

The procurement processes of the MNB are regulated by the MNB's internal regulations, in accordance with the effective Act on Public Procurement.

There are three types of procurement procedures at the MNB:

- other procurement below net HUF 2 million;
- other procurement reaching net HUF 2 million but not reaching the public procurement value limit (other procurement between net HUF 2 and 8 million); and
- public procurement.

Procurement procedures below net HUF 2 million are conducted by the cost bearer organisational units within their own sphere of responsibility, while procurements and public procurements reaching the value of net HUF 2 million are arranged by the Central Procurement Department of the Central Procurement and Operation Directorate with support from the organisational units.

In 2014, 195 procurement requests were received. Of the public procurement procedures launched, 72 procedures were carried forward to 2015.

The number of procedures concluded (contracted) in 2014 was 122 (with 26 carried forward from 2013)

- public procurement: 63
- other procurement in excess of net HUF 2 million: 59.

The total value of the completed procedures with a value in excess of net HUF 2 million implied an expense of HUF 10,330 million for the central bank. A large portion – nearly 60 per cent – of the expenses comprises procurements related to the communication of the MNB's Funding for Growth Scheme, while the remaining 40 per cent represents actual operating costs associated with the infrastructure enlargement required for the increased duties of the MNB.

Environmentally conscious operation

In 2014, the environmental activity of the MNB was determined by the themes set out in its revised environmental strategy. Along with the environmentally conscious development of buildings, measures were aimed at the further enhancement of the environmental performance of the cash supply chain.

In 2014, the MNB implemented the harmonisation and standardisation of waste management activities at its properties; the recycling of paper waste is now ensured in all buildings of the MNB located in Budapest.

The Krisztina körút site – which houses the largest number of employees – was also included in the environmental management system in 2014. The processes designed to improve environmental performance are now in place at the site.

In 2014, the MNB set the goal for its headquarters to achieve, within three years, the ‘Very good’ qualification in the international environmental protection grading system, which is one notch higher than the current assessment. This exemplary initiative is unique in Hungarian practice. The pro-rata implementation of the changes required to achieve the higher grading has been completed. A comprehensive audit has been conducted by an external expert.

As in previous years, the environmental performance of the MNB’s buildings in 2014 was defined, to the largest degree, by energy consumption. The total energy consumption of the properties included in the environmental management system (the headquarters on Szabadság tér, the Logistics Centre and the Krisztina körút site) was down 7.5 per cent compared to the 2013 base. (According to the environmental objective of the MNB, at the end of 2016 total energy consumption will be 10 per cent lower than the 2013 base). The lower energy consumption achieved in 2014 reflects the combined result of several factors. The upgrading of the lighting system at the headquarters (replacement of escape route position lighting by LED lights) and the reduction of the vehicle fleet had a positive impact. In addition, the increasingly mild, albeit more volatile, weather conditions also contributed to the reduction of energy consumption. Heating-related energy consumption

was down by 10.9 per cent compared to 2013. The improved efficiency of total energy consumption is demonstrated by the fact that the decline in energy consumption was coupled with increased activity (higher number of jobs) or, in some cases, higher-intensity work processes (replacement of banknotes).

The operation of the environmental management system (KÖVHIR) enabled the MNB to continuously monitor environmental factors with a substantial environmental footprint and to intervene, as required, to ensure the consistent improvement of environmental performance. In 2014, the Krisztina körút site was integrated into the KÖVHIR system, and successfully obtained the EMAS certificate – the international accreditation recognising environmental-friendly operation.

In 2014, a decision was made to evaluate the cash production activity and to consider options for its enhancement. The environmental assessment of the affected subsidiaries (Diósgyőri Papírgyár Zrt., Pénzjegynyomda Zrt., Magyar Pénzverő Zrt.) is in progress. The inspection is also intended to determine whether the environmental management system of the MNB should be extended to its subsidiaries, or whether such an extension would be worthwhile.

Managing operational risks

The successful implementation of the MNB’s strategic objectives and the protection of its good reputation and wealth are crucially important values. An efficient operational risk management system plays an important role in the protection of these objectives and values. With that in mind, the identification, assessment and continuous in-house monitoring of operational risks and the implementation of the appropriate response measures constitute an integral part of the MNB’s corporate governance. In the first half of 2014, the management of the MNB approved a new operational risk management strategy. An important part of the strategy is business continuity management, designed to ensure the uninterrupted performance of basic tasks, in particular, the maintenance of the smooth operation of the Hungarian payment system, including the protection of households’ continuous cash supply even in extraordinary circumstances. For this purpose, the MNB performed three business continuity tests in 2014, with the assistance of external participants.

3.13 INTRODUCTION OF THE ESCB COMMITTEES

Since Hungary's accession to the European Union, the MNB's management and experts have been participating in the work of ESCB committees and their working groups. These committees and working groups provide an opportunity for national central banks to work together and formulate joint positions. This cooperation also enables the representatives of national central banks to obtain information on the ECB's activities on a regular basis. As of 31 December 2014, fifteen ESCB committees and three other committees assisting the work of the ESCB were in operation. In order to prepare the tasks related to the Single Supervisory Mechanism (SSM) launched in November 2014, it was included in the mandate of all the ESCB committees in 2013 that the given committee would support the work of the decision-making bodies of the ECB in respect of the topics falling into its own field of competence. Beside the two existing configurations (euro-area composition and ESCB composition) starting from 2014, some committees hold meetings in SSM composition as well, with the attendance of representatives of the supervisory authorities operating as organisations independent of the central banks of the Member States participating in the SSM.

The following provides a brief summary of the fields of activity (mandates) of each ESCB committee:

Accounting and Monetary Income Committee (AMICO): This Committee develops and regularly reviews accounting policy principles which define the framework of financial statements in accordance with the Statute of the ESCB and the methodology of the preparation of regular financial reports, facilitating their coordination at an international level. It monitors the calculation of monetary income based on the risk management process developed by the security framework system of accounting.

Banknote Committee (BANCO): This Committee determines the euro banknote needs of euro-area countries, coordinates the production of banknotes and works out the stockpiling and banknote processing policies of euro banknotes. Its tasks include sharing experience in the production of euro banknotes, the examination and development of security features to prevent euro banknotes from being counterfeited, and the assessment of security risks related to the production of the euro. It contributes to the

harmonisation of practices applied in the euro area, the development of the system which monitors counterfeiting, and the verification of statistics regarding euro banknotes and coins.

Committee on Controlling (COMCO): COMCO has been an ESCB committee since July 2007 (only euro-area NCBs participate in the work of this committee). It contributes to the application and enhancement of the Common Eurosystem Cost Methodology, and prepares analyses on the cost data and cost structure of certain functions and products of the Eurosystem/ESCB. In the area of management information systems, it serves as an important forum for cooperation and information exchange on issues concerning the ESCB as a whole. Between July 2007 and April 2012, COMCO operated under the name 'Committee on Cost Methodology', and on 18 April 2012, its name was modified to 'Committee on Controlling' (hence the name of the committee highlights the significance of the financial controlling function the committee fulfils in the preparation and implementation of euro-area projects.)

Eurosystem/ESCB Communications Committee (ECCO): This Committee contributes to the development of the external communication policy of the Eurosystem, the ESCB, and the ECB, with the aim of making the objectives defined by the Eurosystem/ESCB more transparent and understandable and informing the public of the tasks and activities of the Eurosystem and the ESCB.

Financial Stability Committee (FSC): The FSC has been operational since 2011, when the Banking Supervision Committee (BSC) ceased operation. Its task is to provide professional support to the decision-making bodies of the European Central Bank in their functions relating to financial stability and macroprudential policy issues.

Internal Auditors Committee (IAC): By reviewing relevant common projects, systems and activities, and providing for cooperation in certain auditing issues which are of 'common interest' for the ECB and national central banks, this Committee assists the ESCB in achieving its targets.

International Relations Committee (IRC): The IRC assists in carrying out those tasks of the ESCB that are related to international cooperation and contributes to formulating the position of the Eurosystem regarding the various areas of relations with non-EU countries.

Information Technology Committee (ITC): This Committee contributes to the development of the information technology policy and strategy of the Eurosystem and the ESCB, develops the related guidelines with special regard to security concerns, and provides technical advice to other committees. Furthermore, it initiates and implements Eurosystem and ESCB-level developments and independent projects.

Legal Committee (LEGCO): LEGCO provides legal assistance for the work of the ESCB; in particular, it contributes to the maintenance of the regulatory framework of the Eurosystem and the ESCB and to the review of the transposition of legal regulations into national law, and monitors and reports on how national authorities and EU institutions comply with their consultation obligations relating to draft legislation in areas falling within the ECB's competence.

Market Operations Committee (MOC): The MOC assists the ESCB in the implementation of the single monetary policy and the execution of foreign exchange transactions, including those related to the operation of ERM II and to the management of the ECB's foreign reserves, as well as in the appropriate adaptation of monetary policy tools applied by the central banks of Member States where the euro is yet to be introduced.

Monetary Policy Committee (MPC): This Committee assists the ESCB in the implementation of the single monetary and exchange rate policy of the Community. In addition, it provides assistance in the execution of the ESCB's tasks related to the coordination of the monetary and exchange rate policies of the NCBs of non-euro area Member States and the ECB.

Organisational Development Committee (ODC): The ECB approved the formation of this Committee in July 2013. The ODC has only euro-area members, and its task is to assist the work of ECB decision-makers with proposals regarding the planning and organisational issues related to the operation of the Eurosystem and the SSM. In addition, the ODC also coordinates the work of the Eurosystem Procurement Coordination Office (EPCO) and runs the operational risk management and business continuity system of the Eurosystem/ESCB.

Payment and Settlement Systems Committee (PSSC): This Committee assists the ESCB in the smooth operation of the payment system and the cross-border use of collaterals. Furthermore, it supports the ESCB in general and 'oversight' issues relating to payment

systems, as well as issues concerning central banks in respect of securities clearing and settlement systems.

Risk Management Committee (RMC): The ECB approved the formation of this Committee in September 2010. The RMC has only euro-area members, and its task is to assist the work of ECB decision-makers in managing and controlling risks arising from the market operations of the Eurosystem by means of analyses and proposals.

Statistics Committee (STC): The STC assists the ESCB in collecting statistical information required for the execution of its tasks. It contributes, *inter alia*, to the elaboration and cost-effective application of necessary modifications in statistical data collection.

Other committees assisting the work of the ESCB:

Budget Committee (BUCOM): This body assists the Governing Council of the ECB on issues concerning the budget of the ECB; it is composed of euro-area NCBs.

Human Resources Conference (HRC): The objective of this committee, which was established in 2005, is to serve as a forum for the central banks of the Eurosystem/ESCB in the exchange of information, opinions and experiences on issues concerning the management of human resources.

Eurosystem IT Steering Committee (EISC): This Committee was established in 2007 for the purpose of managing the ongoing IT developments in the Eurosystem – with special regard to tasks related to the information technology management of the Eurosystem – and assisting the Governing Council of the ECB in its decision-making process regarding joint information technology projects and operations with the Eurosystem/ESCB, thus contributing to the effectiveness and efficiency of IT management. It is composed of euro-area NCBs. Operation of the Committee was suspended (and the EISC declared a "dormant committee") in November 2014, and its tasks were allocated to the Committee on Controlling, the Information Technology Committee and the Organisational Development Committee.

3.14 THE MNB'S RESEARCH ACTIVITIES IN 2014

Academic research activities are typically performed by the Research Department, while applied research is mainly carried out by the Analysis departments.

Academic research is ultimately published in international and domestic peer-reviewed journals. Applied research, as well as academic research in its early stages is presented in dedicated publications of the MNB: the *MNB Working Papers* series (issued in English only), the *MNB Occasional Papers* series and the *Financial and Economic Review* (formerly: *MNB Bulletin*). In addition to the publications, participation in international conferences, the annual work meeting organised jointly by the MNB and the Centre for Economic Policy Research (CEPR, London) in Budapest as well as participation in the research networks and working groups coordinated by ECB all form part of the MNB's research activity.

Publications

In 2014, three articles were published in leading international journals (one article in the *Journal of Business and Economic Statistics*, one in the *Statistics and Probability Letters*, and one in the *Emerging Markets Review*). In addition, one article was published in a leading Hungarian journal, *Statisztikai Szemle*, and three Hungarian publications were printed in the *Polgári Szemle*. The researchers of the MNB also published their academic findings in the *ECB Working Papers* series and in the Discussion Papers of the Centre for Economic Policy Research (CEPR, London) (*CEPR Discussion Papers*).

In addition, three articles were published in the *MNB Working Papers* series, eight studies in the *MNB Occasional Papers* and a total of seventeen articles were published in the *MNB Bulletin* and in the *Financial and Economic Review* last year.

Conferences and lectures

Once again in 2014, the MNB organised the joint Macroeconomic Policy Workshop with CEPR. This prestigious scientific conference was dedicated to the topic of *The Changing Role of Central Banks Post-Crisis*, with keynote lecturers Luc Laeven (Tilburg University, now Head of Research at ECB), Sir Charles Bean (London School of Economics) and Richard Portes (London Business School, founder of CEPR). In addition, eleven other academic lectures were delivered, one of which was presented by an MNB staff member.

MNB researchers delivered lectures at several international conferences, central banks and universities. The joint conference of the European

Economic Association and the Econometric Society (EEA-ESEM) is worth special mention, as two MNB Occasional Papers were presented there. In addition, the researchers held academic lectures at the Deutsche Bundesbank, at Türkiye Cumhuriyet Merkez Bankası (the Turkish central bank), at the Narodowy Bank Polski, and at the BI Norwegian Business School in Oslo. In keeping with its traditions, the MNB delegated numerous lecturers to the conference of the Hungarian Society for Economics (MKE) held in December.

Several staff members participated in the research network and working groups coordinated by the ECB. MNB staff contributed to the work of the Macroeconomic Research Network and the Household Financial and Consumption Survey. The MNB attends the regular meetings of the Working Group on Econometric Modelling, the Wage Dynamics Network and the Competitiveness Network, and an MNB lecture was delivered at the Nielsen Price Analysis Project Workshop.

3.15 PUBLICATIONS AND CONFERENCES ORGANISED BY THE MNB IN 2014

Publications

Inflation Report

The Inflation Report is published quarterly in order to enable the public to understand and follow the Bank's policies. The Report provides a regular presentation of past and expected future trends in inflation, evaluates the macroeconomic processes that are key to inflation, and provides a summary of the forecasts and considerations on the basis of which the Monetary Council takes its decisions.

Financial Stability Report

Published twice annually, this Report outlines the standpoint of the Bank regarding developments in the financial system and describes the effect of these changes on the stability of the financial system. The analysis focus of the Report is the forward-looking assessment of long-term trends and risks.

Report on Payment Systems

Once a year, the Report provides a comprehensive review of the trends in payments and the functioning

of the overseen payment and securities settlement systems in Hungary, the risks arising, and any measures taken by the MNB which are necessary to maintain the smooth provision of payment services and facilitate the reliable and efficient operation of the supporting payment and settlement systems.

Report on the Balance of Payments

The Report is published four times a year in order to inform market participants of balance of payments developments and to provide a deeper insight into the workings of the economy. Developments in the external balance are key to financial stability, as processes relating to the balance of payments allow for conclusions to be drawn concerning the sustainability of economic growth and relevant risks. The MNB carries out comprehensive analyses of trends relating to Hungary's external balance, examining a number of indicators to assess macroeconomic imbalances.

Growth Report

To be published on an annual basis in future, the Growth Report is intended to present, by using standard and alternative indicators, Hungary's longer-term growth path (occasionally encompassing an entire business cycle) and its driving forces. The Report provides an annual overview of the most important trends shaping economic growth over the short, medium and longer term.

Financial Consumer Protection and Market Supervision Report

Starting from 2014, the MNB publishes its Financial Consumer Protection and Market Supervision Report once a year in October, both in printed form and online. The objective of the publication is to present the MNB's activities in the fields of financial consumer protection and market supervision stemming from the MNB's administrative function, and the risks identified in these areas. The review period covers the second half of the year preceding the year of publication and the first half of the current year.

Interim Report: Quarterly report on the MNB's activities

The Interim Report is published twice a year, in April and November, between the annual and semi-annual reporting periods. It gives account of the basic activities of the operating units of the Bank stipulated

in the MNB Act, in respect of the first and the third quarters: monetary policy, overview of the financial system, FX reserves, cash transactions, cash logistics activities, and statistical changes.

Semi-annual Report: Semi-annual report on the MNB's activities

This Report is published once a year in September and is the Bank's business report for the first half of the year.

Annual Report

Published once annually, this publication presents the Bank's business report on the previous year and its audited annual financial statements.

MNB Occasional Papers

This series presents economic analyses related to the MNB's monetary policy decision-making process. It aims at increasing the transparency of monetary policy. Accordingly, in addition to studies describing the technical details of forecasting, the publication also covers economic issues surrounding the preparatory work for decision-making. The Occasional Paper (OP) series of the MNB primarily presents practical (applied) research related to the central bank's professional areas, summarises theories and international findings in relation to specific topics, and provides analyses facilitating the understanding of central bank decision-making.

MNB Working Papers

The MNB Working Papers series presents the results of theoretical research conducted in the MNB. Studies published in this series are meant primarily for academic, central bank and other researchers, with the goal of encouraging readers to offer comments that the authors may use in their future research. Since the autumn of 2005, this series has been available only in English.

MNB Bulletin

The short articles contained in the MNB Bulletin are intended to inform the general public in a comprehensible format about current economic trends and the findings of research projects in which the Bank is involved. After its second issue in 2014, the publication was discontinued and replaced by the MNB's Financial and Economic Review.

Financial and Economic Review

With a history of over a decade, the Financial and Economic Review is a recently rejuvenated social and scientific journal offering an increasing range of content and a gradually developing set of rubrics, with contemporary typography. It is published in a separate volume in Hungarian and in English. Since the end of 2014, the journal has been edited and published by the MNB.

Trends in Lending

The first Trends in Lending, which was issued in May 2013, replaced the publication *Senior loan officer survey on bank lending practices*. The objective of the publication is to present a detailed picture of the latest trends in lending and to facilitate the appropriate interpretation of these developments. To this end, it elaborates on the developments in credit aggregates, demand for loans perceived by banks, and credit conditions.

Public Finance Review

An expert team from the MNB conducts regular analyses of fiscal processes in order for the Bank to be able to conduct its tasks relating to the definition and implementation of monetary policy at the highest professional standard. A new publication titled 'Public Finance Review' enables the wider public to familiarise itself with the main results of expert analyses.

Other publications

Statute

Following the adoption of the Fundamental Law and the MNB Act, and commemorating the 90th anniversary of its foundation, the MNB wishes to redefine its mission, vision and fundamental values, as well as its key strategic and institutional goals by publishing the Statute of the Magyar Nemzeti Bank. Thus, the two main pillars of the activities of the Magyar Nemzeti Bank are INDEPENDENCE and RESPONSIBILITY, which shall serve as fundamental values in all of its decisions.

Corporate Social Responsibility Strategy (CSR)

Entitled "Knowledge and Value", the Corporate Social Responsibility Strategy of the MNB was published in 2014.

Without prejudice to its primary objective and basic tasks, the central bank, as a national institution, considers its mission to serve the public good from its own sustainable earnings and, to the extent possible, provide support for professional objectives and certain goals serving broad social interests that reflect credibility, create value, promote scientific thinking and talent management, enhance financial literacy and strengthen the cohesion between communities and within society as a whole. To that end, the Magyar Nemzeti Bank's corporate social responsibility programmes cover a wide spectrum of initiatives in education, research and science, financial literacy, culture and charity donations, with particular emphasis on the acquisition of knowledge and the creation and preservation of value.

Funding for Growth Scheme – The first 18 months

The MNB launched its Funding for Growth Scheme (FGS) in June 2013. The collection of studies published at the end of 2014 summarises the results of this period. Encompassing a period of one and a half years, the volume provides a comprehensive view of the effects of the scheme and the objectives achieved.

The Environmental Strategy of the MNB

The environmental activity of the central bank has been reviewed along the lines of its corporate social responsibility strategy. The MNB is committed to the implementation of environmentally conscious operations; it formulates its environmental strategy in line with the challenges of our times and accordingly, it will keep advancing with its environment-oriented management system and inform the public in this regard.

All publications of the MNB are available on its official website (<http://www.mnb.hu>).

Events organised by the MNB

As for events, the MNB pursues a strategy of openness with its associate and partner institutions, which strengthens professional partnership. The events organised by the MNB include international conferences, internal events and so-called cultural events as well.

International events

The majority of the international, professional conferences that last for several days involve 50-60

persons, which predominantly include professional conferences, lunches and cultural programmes. The majority of international conferences are held in the building of the MNB.

Lámfalussy Lectures Conference

The first Lamfalussy Lectures Conference took place in January 2014. This annual event is designed to invite distinguished lecturers to Hungary to share with and present to the audience and fellow professionals their views on the current issues of global economic policy, specifically on monetary policy and the financial system.

Presentations at the 2014 conference were dedicated to the economic, monetary and financial integration in Europe and its future. The presentations focused on four topics:

- Reasons behind the euro crisis
- Monetary policy challenges
- Euro accession strategies
- Banking Union.

The conference was held at an external location in Budapest, with the participation of around 400 attendees.

Economists Meeting organised jointly with the Official Monetary and Financial Institutions Forum (OMFIF)

In December 2014, the Magyar Nemzeti Bank hosted the Economists Meeting, a prestigious event of the London-based institution Official Monetary and Financial Institutions Forum (OMFIF). The meeting was held with the attendance of around 30 guests. One third of the guests represented the host institution, one third attended on behalf of local economic and financial organisations, and one third comprised visitors from foreign institutions. The title of the Economists Meeting was “Transformation of the economy and the financial system in Hungary and the CESEE region”. Related to the meeting but as a separate event, David Marsh, Executive Director of OMFIF, delivered a professional lecture on Hungary and the Economic and Monetary Union.

Meeting of the ESRB AWG Working Group

The one-day working group meeting of the ESRB’s (European Systemic Risk Board) scheduled for Budapest in June was hosted by the Magyar Nemzeti Bank. The quarterly meetings of the Working Group are intended to discuss risks surrounding financial stability and assist the work of the ESRB Secretariat and Advisory Committee by analyses and by the development of an analytical framework. The event is attended by department heads and senior analysts from central banks, supervisory authorities, the ECB, EIOPA and ESMA.

Meeting of the EIOPA IGSC Working Group

The July 2014 meeting of the EIOPA IGSC (Insurance Groups Supervision Committee) Working Group was held in the building of the Magyar Nemzeti Bank. Attendees included representatives from 17 Member States, EIOPA and the Commission of the European Union.

MNB Club events

The MNB believes that the maintenance, transfer and creation of values are important. In addition to ensuring price stability, the MNB as a financial value centre also supports national stability by stimulating growth in the economy, investing in knowledge, promoting art and culture and fostering social responsibility. The MNB Club is a special meeting place for people who are truly multifaceted. The invitees are all creators, who are able to create something that is globally unique, whether it is a new idea, endurance in work, technological innovation or the reinterpretation of our national traditions. They are creators who are connected by strength, bravery, desire to accomplish, perseverance, faith in success and the love of their country.

BESS at MNB lectures¹⁶

13 January 2014, Lóránt Kaszab (Cardiff University) Rule-of-Thumb Consumers and Labour Tax Cut Policy at the Zero Lower Bound

27 January 2014, Tamás Briglevics (Boston College) Consumer Bankruptcy Protection as Insurance against Business Cycles

28 January 2014, Victoria Nuguer (EPFL) Financial Intermediation in a Global Environment

¹⁶ BESS – Budapest Economic Seminar Series

- 29 January 2014, Denis Gorea** (Goethe University Frankfurt) Tax Avoidance: Aggregate and Distributional Consequences
- Classical and Bayesian VARs
 - Classical and Bayesian panel models
- 30 January 2014, Nikoleta Anesti** (University of Warwick) A FAVAR Approach to Credit Shocks in the Euro Area
- Classical Factor models and FAVARs
 - Classical and Bayesian state space models
- 10 February 2014, Eyno Rots** (Boston University) Learning and the Market for Housing
- Models with time varying parameters and stochastic volatility
- 12 February 2014, Anamaria Piloiu** (Goethe University Frankfurt) Economic Policy Uncertainty and Inflation Expectations
- Claudio Michelacci** (CEMFI) **Closed economy macroeconomics** (7–11 April 2014)
- The neo-classical growth model, endogenous growth models
 - Real business cycle models
- 26 March 2014, Luisa Lambertini** (Ecole Polytechnique Federale de Lausanne, EPFL) Macroeconomic Implications of Bank Capital Requirements
- Models with nominal price rigidities, New Keynesian models
 - Labour market models with search frictions
- 23 April 2014, Marcin Paweł Kolasa** (National Bank of Poland) Monetary and Macroprudential Policy with Foreign Currency Loans
- 7 May 2014, Artashes Karapetyan** (Sveriges Riksbank) Information Sharing and Information Acquisition in Credit Markets
- Evi Pappa** (European University Institute) **Open Economy Macroeconomics** (9–11 April 2014)
- Business-cycle facts in poor, emerging, and rich countries
 - The small-open-economy real-business-cycle model, terms of trade shocks
 - Interest rates, productivity shocks, and financial frictions
 - Sovereign debt
- 11 June 2014., Sandra Eickmeier** (Bundesbank) Analyzing Business and Financial Cycles using Multi-Level Factor Models
- 25 September 2014, Előd Takáts** (BIS) Can Demography Affect Inflation and Monetary Policy?
- 19 November 2014, Norbert Metiu** (Bundesbank) Financial Market Volatility and the Propagation of Monetary Policy Shocks
- 28 November 2014, Ted Loch-Temzelides** (Rice University) Robust Dynamic Optimal Taxation and Environmental Externalities
- Courses of the Bank's Education Centre: the Budapest School for Central Bank Studies*
- Spring courses 2014**
- Fabio Canova** (European University Institute) **Advanced time series methods** (31 March – 4 April 2014)
- Basics of Bayesian methods
 - DSGE and time series models, model evaluation
 - Forecasting
- Summer courses 2014**
- Marco Del Negro** (Federal Reserve Bank of New York) **Forecasting with Bayesian DSGE and time series models** (28 July – 1 August 2014)

– Topics: non-gaussianity, time variations, prior elicitation

Vincenzo Quadrini (University of South Carolina)
Macro-Financial Linkages (4–8 August 2014)

– Traditional models of macro-financial linkages (BGG, Kiyotaki and Moore)

– New models of macro-financial linkages

– Solving non-linear models with macro-financial linkages

– Macro-financial linkages in open economies

– Financial markets and labour market linkages

4 Additional information on the supervisory activity of the MNB in 2014

As a supervisory authority, the MNB exercises continuous supervision over the entities and persons subject to the laws of the financial sector. Within this framework, it continuously monitors the activities and processes of financial and capital market institutions, funds, insurance companies (financial organisations) and institutions comprising the financial infrastructure (regulated market, clearing house and central depository), both on-site and off-site, using the tools of prudential supervision, as well as market surveillance and consumer protection tools, taking measures as needed. The purpose of continuous supervision is to ensure the timely recognition and appropriate management of risks.

The tools of continuous supervision within the framework of off-site inspections include the processing and monitoring of the data and information available, continuous liaison with the institution, consultations, other communications regarding requests and reports in progress, and the execution of on-site inspections. The information obtained during continuous supervision is integrated into risk assessment. Risk assessment and institution assessment provide feedback for continuous supervision, defining the method and intensity of the supervisory management of the institution, the scheduling of inspections, and the focal points of specific inspections.

During the comprehensive on-site inspection of financial institutions, based on annually reviewed sector-specific methodologies, the MNB always checks the compliance of activities aimed at the prevention and combating of money laundering and terrorist financing. The MNB conducts targeted inspections in the cases that require immediate measures, or initiates a thematic inspection in cases affecting an entire sector or several institutions.

4.1 INSTITUTION OVERSIGHT

The number of overseen institutions as at 31 December 2014 is shown in table 10.

Table 10	
Number of overseen institutions	
Financial market	100
Investment fund manager	70
Commodity exchange dealer	3
Investment firm	24
Specialised asset management company	1
Agent	0
Agent of an investment fund manager with cross-border activity	0
Intermediary (according to Act XVI of 2014)	0
Central depository	0
Central counterparty	1
Stock exchange	1
Funds	108
Private pension fund	8
Voluntary fund	99
Voluntary health fund	32
Voluntary pension fund	54
Voluntary aid fund	13
Occupational retirement provision	1
Money market	1,085
Non financial institution	674
Electronic money issuer	1
Independent intermediary	667
Special services intermediary	1
Cash-in-transit companies	0
Payment service provider	5
Financial market agent	0
Money changer	0
Credit token issuer	0
Financial institution	411
Credit institution	152
Bank	33
Specialized credit institutions	9
Cooperative credit institutions	110
Financial enterprise equivalent to credit institutions	3
Financial enterprises	256
Financial holding company	0
Financial enterprises	256
Insurance market	709
Insurance company	237
Mutual association	23
Insurance limited company	212
Insurance cooperative	0
Branch	2
Independent insurance intermediary	454
Broker	393
Branch	0
Multiple agent	61
Special advisers, advocacy	18

4.2 STATISTICS OF INSPECTIONS COMPLETED

Inspections in 2014 were carried out on the basis of a thoroughly planned system, according to a detailed daily schedule.

In preparing the inspection plans, the MNB considers the following criteria:

- the cycle plan of supervisory inspections defined in the MNB Act;
- the risk rating of the institutions and the resource requirement and inspection duration determined accordingly;
- the supervisory scoring system designed to establish the order of institutions to be inspected, also in consideration of other individual characteristics of the institutions concerned; and
- the available resources.

Based on the experiences of previous years, the MNB maintained its practice of consulting with the selected auditors of the institutions, which assisted in preparations for the inspections.

The number of prudential on-site inspections and their distribution according to sector and inspection type is summarised in table 11.

4.3 AUTHORISATION AND LEGAL ENFORCEMENT ACTIVITY

The authorisation and legal enforcement activity of the MNB encompasses the entire spectrum of legal activities linked to the surveillance of the financial intermediary system, including the execution of all authorisation procedures related to the overseen institutions, and the performance of the legal enforcement tasks of the prudential inspection activity. The MNB is also responsible for ensuring the legal compliance of administrative decisions passed in the context of the supervisory activity. In this context, the MNB strives to exercise the powers conferred upon it as a supervisory authority in a stable and predictable manner, facilitating the enforcement of public interests. In its legal enforcement activity, the primary objective of the MNB is to take advantage of every element of the administrative instruments available to it. The statistics on the authorisation and prudential legal enforcement activity of the MNB are illustrated by the tables 12, 13, 14, 15, broken down by sector.

Table 11
Inspection statistics

Number of prudential on site investigations	2013		2014		2015 – plan	
	Comprehensive	Other	Comprehensive	Other	Comprehensive	Other
Banks and specialised credit institutions	13	18	13	20	10	21
Cooperative credit institutions	38	6	20	1	8	1
Financial enterprises	0	0	0	1	0	7
Insurance	21	4	13	7	8	7
Funds	29	1	18	0	17	1
Capital market participants	18	1	17	7	12	2
Payment institution	0	0	0	1	2	1
Financial intermediaries	0	0	0	8	0	0
Total	119	30	81	45	57	40

* Including inspections and validations in the context of the complex SREP (Supervisory Review and Evaluation Process).

Table 12	
Measures taken in the money market sector	
<i>(Pieces)</i>	
Prudential measures	
Resolutions closing supervisory control proceedings	58
Other prudential measures, resolutions	499
Rulings	51
involved: resolutions which impose fine	22
Total sum of fines (million Forint)	114.9
Authorisation resolutions/rulings	
Authorisation for the foundation of credit institutions	1
Refusal of credit institution's foundation	0
Authorisation of the operation of credit institutions	1
Refusal of credit institution's operation	0
Withdrawal of Authorisation for the foundation of credit institutions	0
Authorisation for operations of payment institutions	0
Authorisation of the issuance of electronic money of e-money institutions	1
Authorisation for the foundation and the operation of financial enterprises	9
Refusal of the foundation and operation of financial enterprises	0
Authorisation for operations of financial enterprises equivalent to credit institutions under prudential requirements	0
Withdrawal of Authorisation for operations of financial enterprises	4
Resolutions concerning the amendment of the scope of activities	12
Authorisation of the election of senior executives	265
involved: credit institutions' senior executives	119
Refusal of the election of senior executives	0
Approval of the amendment of agency contract	214
Authorisation of multiple special services intermediaries	0
Authorisation of multiple agents	28
Authorisation of brokers	1
Authorisation of the employment of intermediaries	45
Authorisation of the amendment of the bylaws	132
Authorisation of the acquisition of qualifying holdings	45
Refusal of the acquisition of qualifying holdings	0
Authorisation of merger and division	4
Authorisation of the transformation of a credit institution set up as a cooperative society into a bank	0
Authorisation for permanent operation	0
Authorisation of the acquisition of qualifying holdings in a nonresident enterprise	2
Resolutions in connection with trading book	0
Decision on the invalidation of Authorisation for employment of intermediaries	5
Withdrawal of the Authorisation for operations of intermediaries	22
Authorisation concerning the calculation of the capital requirements of operational risk	22
Authorisation of other regulations	15
Resolutions concerning consolidated supervision	11
Authorisation of the repayment of subordinated loan capital before due date	5
Resolutions issued under CRR	153
Authorisation of the transfer of client accounts	3
Resolutions concerning bank representative office	1
Rulings	82
Other resolutions	87

Table 13**Measures taken in the capital market sector***(Pieces)*

Prudential measures	
Resolutions closing supervisory control proceedings	17
Other prudential measures, resolutions	189
Involved: resolutions which impose fine	3
Rulings	24
Total sum of fines (million Forint)	40
Authorisation resolutions/rulings	
Authorisation for operations	11
Withdrawal of authorisation for operations	3
Authorisation of other regulations	19
Authorisation of senior executives	53
Authorisation of the acquisition of qualifying holdings	5
Rulings	31
Other resolutions	41

Table 14**Measures taken in the insurance sector***(Pieces)*

Prudential measures	
Resolutions closing supervisory control proceedings	20
Other prudential measures, resolutions	199
Involved: resolutions which impose fine	55
Rulings	23
Total sum of fines (million Forint)	171.8
Authorisation resolutions/rulings	
Authorisation of executive officers	141
Authorisation of professional executives	16
Authorisation of the acquisition of qualifying holdings	3
Withdrawal of authorisation for operations at request	22
Decisions on supervision on a consolidated basis	0
Other resolutions	9
Authorisation of the foundation of insurance companies	0
Authorisation of changes in insurance activity	1
Authorisation of activities closely related to insurance activities	9
Authorisation of the activities of independent insurance intermediaries (insurance brokers, multiple-insurance agents)	18
Authorisation of principal agents	1
Rulings	14

Table 15	
Measures taken in the funds sector	
<i>(Pieces)</i>	
Prudential measures	
Resolutions closing supervisory control proceedings	18
Other prudential measures, resolutions	10
Involved: resolutions which impose fine	0
Rulings	5
Sum of fine	0
Authorisation resolutions/rulings	
Resolutions closing activities	1
Approval of optional investment portfolio system	11
Approval of contract concluded with real estate appraiser	1
Authorisation for operations	1
Authorisation of the merger of pension funds	1
Authorisation of the division of pension fund branches	1
Resolutions (total)	1,487
Rulings (total)	124

4.4 MARKET SURVEILLANCE

The types and number of measures prescribed in the framework of the MNB's market surveillance activity in 2014 are presented in tables 16, 17.

Table 16	
Market surveillance and supervision related measures	
<i>(Pieces)</i>	
Market surveillance and supervision related measures	
Resolutions related to unauthorised activity	10
Involved: resolutions which impose fine	8
Resolutions related to market abuse	4
Involved: resolutions which impose fine	4
Resolutions related to compliance with company takeover rules	1
Involved: resolutions which impose fine	1
Resolutions closing supervisory control proceedings related to issuers	13
Involved: resolutions which impose fine	3
Resolutions related to issuers supervision	8
Involved: resolutions which impose fine	5
Involved: trading suspension on stock exchange	1
Injunctions closing a procedure	4
Involved: international request for assistance	2
Ex-ante approval of trading suspension on stock exchange	2
Injunctions imposing fine	7
Injunctions related to seizure	13
Injunctions related to provisional protective measures	3
Injunctions related to protective measures	6
Injunctions related to provisional measures	1
Injunctions related to engagement of interpreter	2
Injunctions related to witness summoned	215
Other injunctions (suspension of a procedure)	2
Imposed fine (million forints)	1,944.9
Imposed procedural fine (million forints)	2.35

Table 17**Authorisations related to securities issuance***(Pieces)*

Security issuance related approval measures	
Approvals concerning the publishing of a prospectus for the public offer of investment notes issued by investment funds	68
Approvals concerning the supplement of the prospectus made for the investment notes issued by investment funds	0
Registry of an investment fund	72
Approvals concerning the modification thereof the fund rules (management policy) of an investment fund	326
Deleting investment fund from registry	62
Approvals concerning the restructuring of an investment fund	20
Approvals concerning the merger of investment funds	12
Approvals concerning the mandate agreement concluded with a real estate appraiser	5
Approvals concerning the mandate agreement concluded with the depositary and the modification thereof	7
Approvals concerning the publishing of a prospectus for the public offer of securities	13
Approvals concerning the publishing of a prospectus for the public offer of securities and/or the listing of the securities to a regulated market	6
Approvals concerning the supplement of prospectuses or base prospectuses	36
Release of issuer from transparency (reporting) requirements	5
Approvals concerning takeover bids	0
Suspension of trade of securities on the stock exchange	0
Rulings on the suspension of the administrative procedure	6
Approval of security/defense plans for printed certificates of securities	163
Approvals concerning the fund rules (management policy) of risk capital funds	1
Registry of risk capital funds	7
Approvals concerning the modification thereof the fund rules (management policy) of a risk capital fund	6
Resolutions on refusal	1
Rulings on the termination of the administrative procedure	27
Rectifying resolutions/rulings	2
Rulings on the lengthening of timeframes set by CBH for the issuer's window to come back (with comments and/or a new draft)	0
Rulings on ,expert's appointment	0
Rulings on asking for modification and/or supplements	0
Rulings concerning ,writs on summons	1
Other resolutions/rulings	15
All resolutions/rulings	861
out of which resolutions imposing a fine	0
Sum of fines imposed (HUF)	0

4.5 CONSUMER PROTECTION

One of the main priorities of the MNB's supervisory tasks was to renew the administrative activity related to financial consumer protection. In this regard, the MNB's goals were to improve the efficiency of

inspections, to develop a preventive approach to consumer protection during consumer protection activities, to ensure its continuous presence, and to take firm and consistent action during the elimination and sanctioning of violations which were detected.

Table 18
The MNB's consumer protection administrative activity

Data		Consumer Protection			
		Insurance	Savings and loan associations	Financial market	Capital markets
Investigations conducted (number of pieces)	by request	147	0	197	18
	ex officio (direct inquiries, thematic investigation)	9	0	183	1
	prudential co-investigation	9	2	1	0
Injunctions	substantive	418	0	1,050	22
	not substantive	228	0	1,220	50
Decisions	without breach of law	70	0	159	10
	with breach of law	99	0	291	9
Number of breaches of law		199	0	661	20
Imposed fine (million forints)		53	0	2,063.3	2.1
Trial transaction (number of pieces)		32	0	14	0

Table 19
Consumer protection measures in the money market sector
(Pieces)

Consumer protection measures	
Due to unfair business-to-consumer commercial practices	33
Due to breach of complaints handling rules	100
Due to breach of obligation concerning periodic information	12
Breach of bank secrets	6
Breach of provisions concerning the rules of protection of clients of central credit information system	8
Breach of law concerning payment regulations	242
Breach of the provisions of the act on consumer credit	14
Breach of law concerning the unilateral modification of contracts	214
Other	32
Imposition of procedural fine in injunctions	1
Sum of decisions, injunctions	1,500
of which: decisions imposing fines	202
Sum of fines (million forints)	2,063.3

Table 20	
Consumer protection measures in the capital market sector	
<i>(Pieces)</i>	
Consumer protection measures	
Due to unfair business-to consumer commercial practices	0
Other	20
Sum of decisions, injunctions	41
of which: decisions imposing fines	4
Sum of fines (million forints)	2.1

Table 21	
Consumer protection measures in the insurance sector	
<i>(Pieces)</i>	
Consumer protection measures	
Due to unfair business-to consumer commercial practices	30
Due to breach of complaints handling rules	89
Due to omission of provision of the compensation motion/standpoint	6
Omission/delay in provision of the notice of premium payment and the delay in information concerning the termination (of contract) by reason of failure in payment of the premium	14
Omission of the provision of the yearly information related to life insurance contracts	10
Omission of the provision of the information on the conclusion of the life insurance contract	9
Breach of insurance secrets	6
Other	35
Imposition of procedural fine in injunctions	6
Sum of decisions, injunctions	587
of which: decisions imposing fines	76
Sum of fines (million forints)	53

In 2014, the MNB did not take consumer protection measures in the sector of funds.

4.6 ACTIVITY OF THE FINANCIAL CONSUMER PROTECTION CENTRE

Activities of the Financial Consumer Protection Centre with customers

The FCPC received 37,628 customer inquiries, including 30,582 customer service inquiries and 7,046 customer requests (petitions).

Customers may contact the FCPC through three different channels: in 2014, 21,205 requests were lodged by telephone, 4,010 in person and 12,413 in writing.

More than one half of customer service inquiries concerned financial market services. Numerous inquiries were related to vehicle financing, in particular, in relation to the issue of authorisation to sign contracts during agency activities. There was

continuous interest in relation to bank accounts, collections and claims management. Starting from August 2014, numerous questions and information requests were received in relation to the settlement and conversion of FX loans.

Table 22	
Distribution of customer inquiries and requests received by receipt channel	
Channel of petition	Share (%)
Letter	19
e-mail	14
Personal	11
Phone	56
Total	100

Inquiries related to the insurance sector accounted for less than one fifth of all complaints. As usual, most inquiries concerned motor vehicle liability insurance, but several questions and complaints referred to property insurance related claims and life assurance plans, especially unit-linked products.

There was a continuous interest in issues related to the registration, operating licenses and administrative inspections of insurance brokers.

Table 23
Distribution of customer inquiries and requests according to sectors

Petitions by customers per sector	Share (%)
Insurance	16
Other	22
Individual cases	4
Money market	54
Funds*	1
Financial market	2
Total	100

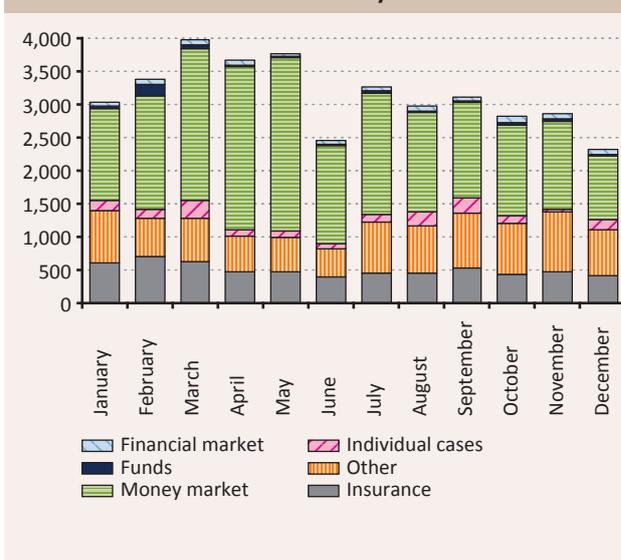
* Voluntary pension funds, health funds, mutual aid funds.

The number of inquiries in relation to the capital market sector and the sector of funds remained marginal. The most common capital market sector requests pertained to investment service providers and investment funds, while the majority of fund sector requests concerned pension funds.

Within the “miscellaneous” category, customers expressed keen interest in the contact information, operation and procedural rules of the Financial Arbitration Board, and questions were received continuously in relation to foreclosures.

The FCPC passed on 45 per cent of the customer claims processed to the relevant administrative areas for inspection. 10 and 4 per cent of the cases were passed on to the Financial Arbitration Board or partner authorities, respectively. Customer requests made in person, by telephone or in writing which did not meet the criteria for administrative procedure were given assistance by the Financial Consumer Protection Centre, which used every available communication

Chart 16
Number of customer inquiries and requests received by the FCPC in a sectoral and monthly breakdown



channel to help consumers meet the requirements to successfully launch the procedure.

Enhancement of financial awareness

In order to foster clear customer information, financial awareness and financial literacy, the MNB launched a series of papers entitled “Financial Navigator”. Based on the preliminary plans, the series will consist of 40 parts, and the first 10 papers of the series were published by the end of December 2014. Besides providing information, the papers are also intended to call consumers’ attention to potential risks.

The entire selection of the papers produced so far is available online, and the MNB published more than 1.5 million copies in print. The Financial Navigator publications are also available at the customer service of the MNB and in the branch network of financial institutions.

Table 24
Number of customer inquiries and requests broken down by sector and quarter

Sector	Q1	Q2	Q3	Q4	Total
Insurance	1,918	1,336	1,428	1,295	5,977
Other	2,021	1,473	2,319	2,375	8,188
Individual cases	565	277	539	311	1,692
Money market	5,403	6,569	4,777	3,661	20,410
Funds*	268	70	88	117	543
Financial market	216	159	191	252	818
Total	10,391	9,884	9,342	8,011	37,628

* Voluntary pension funds, health funds, mutual aid funds.

Table 25
Cases commenced in 2014

By type of cases	Pieces	Per cent	By sector	Pieces	Per cent
Judicial review of administrative decisions (litigious)	63	56.25	Financial Arbitration Board and others	7	6.25
Non-litigious	40	35.71	Insurance	18	16.07
Non-litigious (ruling imposing a fine)	1	0.89	Money market	80	71.43
Financial Arbitration Board	8	7.14	Financial market	7	6.25
Altogether	112	100.00		112	100.00

In the fourth quarter, key significance was attached to the preparation and publication of electronic information materials dedicated to the topics of the settlement and conversion of FX loans. The MNB's homepage dedicated to supporting consumer decisions contains numerous articles, notices and information material that are intended to facilitate the enhancement of financial literacy, the provision of clear information to customers, and easy understanding of legislation.

As part of the customer-friendly rejuvenation of the product selection page operated by the MNB, the central bank modified the product reporting application of the ERA system.

Cooperation with civil organisations

In order to set up a national financial consumer protection information network, the Civil Network programme was created by the MNB. During the year, the MNB organised financial consumer protection civil forums on five occasions, with representatives from 29 civil organisations. In addition, the MNB developed a separate website dedicated to civil organisations and launched the Civil Network Newsletter to provide news and updates in the topic of financial consumer protection.

In July and October 2014, the MNB announced project-based tenders for the support of civil organisations involved in financial consumer protection. A total of 57 applications were received for the two tenders.

The first tender was aimed at the improvement of financial awareness, and 27 organisations submitted bids. After the assessment of the bids, 20 organisations were granted a total of HUF 77.5 million.

The explicit goal of the second tender was to promote the provision of broad-based consumer information concerning the settlement act.¹⁷ Upon the assessment of the submitted bids, 17 organisations of the 30 applicants were granted access to assistance of HUF 80 million in total. The Customer Information Points to be established as a result will be open to consumers between 1 March and 31 December 2015 in various regions of the country.

4.7 ADMINISTRATIVE REPRESENTATION AT PROCEEDINGS IN 2014

Administrative representation at proceedings implies central bank representation in the assertion of claims of public interest, as well as litigation and non-litigious proceedings related to the MNB's administrative decisions passed in the context of its supervisory and consumer protection activities. It also represents the Financial Arbitration Board in litigation launched for the abrogation of the FAB's resolutions or recommendations, and files the records pertaining to such procedures.

Besides handling the continuous series of new legal proceedings, in 2014 the MNB took over litigation cases and other legal proceedings affecting the Financial Arbitration Board, which had been previously represented by an external law office.

Table 26
Court decisions received

Cases won	105
Cases lost	17
Cases dismissed	18
Lower instance court ordered to reopen the case	3
Altogether	143

¹⁷ Act XXXVIII of 2014 on the settlement of certain issues concerning the uniformity decision of the Curia related to consumer loan agreements provided by financial institutions.

5 Explanation of abbreviations and terms specific to central banking

ABBREVIATIONS

AQR: Asset quality review

BIS: Bank for International Settlements

BREEAM: Building Research Establishment Environmental Assessment Methodology

BRRD: Bank Recovery and Resolution Directive

BSE: Budapest Értéktőzsde Zrt. (Budapest Stock Exchange Co. Ltd.)

CEBS: Committee of European Banking Supervisors

CRD IV: Capital Requirement Directive – Directive 2013/36/EU of the European Parliament and of the Council (26 June 2013) on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC

CRR: Capital Requirement Regulation – Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms applicable in EU Member States

CSO: Central Statistical Office

EBA: European Banking Authority

ECB: European Central Bank

EIOPA: European Insurance and Occupational Pensions Authority

ESCB: European System of Central Banks

ESRB: European Systemic Risk Board

EMU: Economic and Monetary Union

FCPC: Financial Consumer Protection Centre

FGS: Funding for Growth Scheme

FSB: Financial Stability Board

GIRO: Giro Clearing House Ltd.

HFSA: Hungarian Financial Supervisory Authority

ICS: Interbank Clearing System

IMF: International Monetary Fund

ISDA: International Swaps and Derivatives Association

JEREMIE: Joint European Resources for Micro to Medium Enterprises

KELER: Central Clearing House and Depository Ltd.

LCR: Liquidity Coverage Ratio

MNB: Magyar Nemzeti Bank

MNE: Ministry for National Economy

NSFR: Net Stable Funding Ratio

OECD: Organisation for Economic Cooperation and Development

PIP ('FCP'): Financial Compass Programme

POP ('FTP'): Financial Training Programme

SRM: Single Resolution Mechanism

SSM: Single Supervisory Mechanism

VIBER: Real-time gross settlement system, a payment system operated by the MNB

Glossary

Cash turnover: The sum of exchanges and payments to and from the MNB.

CLS (Continuous Linked Settlement): A settlement model that enables the elimination of FX settlement risks. It is based on a multi-currency payment versus payment (PvP) mechanism. The CLS is operated by the CLS Bank.

Clearing: Control and transmission of payment transactions, calculation of interbank balances in accordance with specified rules; in the case of securities transactions: matching and confirmation of positions, calculation of accounts receivable/payable and managing the arising financial risk.

Currency interest rate swap, CIRS: Usually a medium or long-term transaction involving the exchange of different currencies, a series of interest payments on the principal and repayment of principals when the transaction is settled.

Duration: Average remaining maturity of bonds; an indicator measuring the level of risk associated with the bond portfolio.

ERM II, Exchange Rate Mechanism II: An exchange rate mechanism for establishing the conditions for an exchange rate policy cooperation between euro-area countries and EU Member States not participating in the third stage of EMU. The ERM II is a multilateral system of fixed but adjustable exchange rates, where the mid-rate is surrounded by a normal, $\pm 15\%$ fluctuation band. All decisions in relation to the mid-rate and, as the case may be, a narrower fluctuation band, are made on the basis of a joint agreement between the Member State concerned, the euro-area countries, the ECB, and the other Member States participating in the mechanism.

Foreign exchange funding adequacy ratio (FFAR): The ratio of the sum of stable foreign exchange funds and net foreign exchange swap stock with a maturity over a year and the weighted foreign currency denominated assets to be financed.

Foreign exchange swap: Usually a short-term transaction involving the exchange of different currencies and, when the transaction is settled, exchange of the currencies again at the price determined in the contract by the cross rate and the interest rate of the currencies.

FX swap: See Foreign exchange swap.

IMF reserve quota: The freely drawable, i.e. not yet drawn, portion of the IMF quota paid to the International Monetary Fund in SDR (Special Drawing Rights).

Interest rate futures: A stock exchange transaction where the basis of future settlement is a certain amount of standardised (expressed-in-contract) deposits with the interest rate specified at the time of the deal.

Interest rate swap, IRS: The exchange of fixed rate and variable rate interest on principal at pre-determined intervals, adjusted to certain market rates and conditions.

MNB Act: Act CXXXIX of 2013 on the Magyar Nemzeti Bank.

Monetary financial institutions: The central bank, financial institutions and money market funds together constitute this institutional category within financial corporations.

Money market funds: Money market funds are investment funds, the investment units of which are similar to bank deposits from the aspect of liquidity. Money market funds invest 85 per cent of their assets in money market instruments or transferable debt securities with a remaining maturity of maximum one year or instruments with a return similar to that of the interest rate of money market instruments.

Money market instruments: Low-risk, liquid securities traded in large amounts on markets where they can be exchanged for cash immediately at a low cost.

Omnibus II directive: See Solvency II directive.

O/N: Overnight deposit/loan.

Option: For the owner of the foreign exchange option this means a right, but not an obligation, to buy or sell a certain amount of currency against another currency at a pre-determined rate, at or before a pre-determined date. If the possessor of the option exercises this right, it will become an obligation for the seller (writer) of the option.

Payment System Forum: An independent, self-organising, open professional organisation with

consultative character committed to the matters of the domestic payment system and operating at the MNB's initiative, with the support of the Hungarian Banking Association and the involvement of market participants that play a decisive role in payment transactions as well as the Hungarian State Treasury, GIRO Zrt. and KELER Zrt. The supreme body of the Forum is the Payment System Council, which consists of the representatives of the members and operates under the co-chairmanship of the MNB and the Hungarian Banking Association.

Payment System Council: The decision-making body of the Payment System Forum.

Revaluation reserve: The revaluation reserve of the forint exchange rate and the revaluation reserve of foreign exchange securities are reserves that are part of the equity of the MNB. If they have a negative balance, the central government is liable to reimburse the negative portion, and credit the amount to the respective revaluation reserve account by 31 March of the year following the current year. The amount of the reimbursement is recorded in the balance sheet of the current year as a receivable from the central government.

Revaluation reserve due to forint exchange rate changes: Non-realised exchange rate gains and losses on the forint exchange rate changes of foreign currency assets and liabilities are indicated in the forint exchange rate revaluation reserve, which constitutes a part of equity.

Revaluation reserve of foreign exchange securities: The valuation difference between the market value and cost rate of foreign exchange assets based on securities (except for repurchased foreign exchange bonds) is indicated in the revaluation reserve of foreign exchange securities, which constitutes a part of equity.

Repurchase and reverse repurchase transaction: An agreement on the transfer of the ownership right of a security with a repurchase obligation at a pre-determined price at a future date specified or to be specified at the time when the contract is concluded. During the term of the contract, the buyer may either obtain the security which is the subject of the transaction and freely dispose over it (delivery repo

transaction) or may not obtain it and may not freely dispose over it, in which case the security is deposited as a bail to the benefit of the buyer during the term of the contract (hold-in-custody repo).

ROA: Return on assets.

ROE: Return on equity.

SEPA: Single Euro Payments Area, an area within which economic operators can effect and receive payments in euro anywhere, using one single payment account, in the same manner as in their own respective countries. Geographically, the Area covers the 28 EU Member States, Iceland, Liechtenstein, Norway, Switzerland and Monaco.

Settlement: Final settlement of interbank liabilities and receivables on an account managed by a common bank, typically the MNB.

Solvency II directive (138/2009/EC): Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance. A new, risk-based regulatory framework for insurers which is based on three pillars, namely, quantitative requirements, qualitative requirements and public disclosure. It is a European standard based on which the supervisory authorities can create standard rules for capital in order to decrease/avoid the risk of insolvency. Applicable from 1 January 2016. The Omnibus II directive (Directive 2012/23/EU of the European Parliament and of the Council) includes the amending provisions of the Solvency II directive – which has been approved but it is yet to become valid and applicable – and the Prospectus directive (Directive 2003/71/EC of the European Parliament and of the Council).

TARGET2-Securities (T2S): The single technical platform of the Eurosystem through which central depositories and national central banks can provide basic, cross-border and neutral securities settlement services in central bank funds across all Europe.

VaR: Value at risk – a method for measuring risks. VaR quantifies the maximum amount of loss to be expected at a given confidence level for a specific time horizon.

Part B)

**Audited financial statements
of the Magyar Nemzeti Bank**

1 Independent auditor's report



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Cg. 01-09-267553

This is a translation of the Hungarian Report

Independent Auditors' Report

To the Shareholder of Magyar Nemzeti Bank

Report on financial statements

1.) We have audited the accompanying 2014 annual financial statements of Magyar Nemzeti Bank ("the Company"), which comprise the balance sheet as at 31 December 2014 - showing a balance sheet total of HUF 12,640,588 million and a profit for the year of HUF 27,360 million -, the related profit and loss account for the year then ended and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

2.) Management is responsible for the preparation and presentation of financial statements that give a true and fair view in accordance with the Hungarian Accounting Law, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

3.) Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Hungarian National Auditing Standards and with applicable laws and regulations in Hungary. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

4.) An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.



5.) We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

6.) In our opinion the annual financial statements give a true and fair view of the equity and financial position of Magyar Nemzeti Bank as at 31 December 2014 and of the results of its operations for the year then ended in accordance with the Hungarian Accounting Law.

Other reporting requirement- Report on the business report

7.) We have reviewed the business report of Magyar Nemzeti Bank for 2014. Management is responsible for the preparation of the business report in accordance with the Hungarian Accounting Law. Our responsibility is to assess whether the business report is consistent with the financial statements for the same financial year. Our work regarding the business report has been restricted to assessing whether the business report is consistent with the financial statements and did not include reviewing other information originated from non-audited financial records. In our opinion, the business report of Magyar Nemzeti Bank for 2014 corresponds to the disclosures in the 2014 financial statements of Magyar Nemzeti Bank.

Budapest, 27 May 2015

(The original Hungarian language version has been signed.)

Szabó Gergely
Ernst & Young Kft.
Registration No.: 001165

Szabó Gergely
Registered auditor
Chamber membership No.: 005676

2 Balance sheet of the Magyar Nemzeti Bank

HUF millions

Reference number to notes on the Accounts	ASSETS	31.12.2013	31.12.2014	Change
1	2	3	4	4-3
	I. RECEIVABLES DENOMINATED IN FORINT	959,895	1,180,874	220,979
4.3.	1. Receivables from the central government	138,380	139,495	1,115
4.7.	2. Receivables from credit institutions	820,888	1,040,063	219,175
	3. Other receivables	627	1,316	689
	II. RECEIVABLES DENOMINATED IN FOREIGN CURRENCY	10,308,536	11,263,490	954,954
4.9.	1. Gold and foreign currency reserves	9,933,839	10,814,487	880,648
4.4.	2. Receivables from the central government	18,378	0	-18,378
4.8.	3. Receivables from credit institutions	13	10,500	10,487
4.10.	4. Other receivables	356,306	438,503	82,197
	III. BANKING ASSETS	33,431	84,220	50,789
4.12.	of which: invested assets	33,267	83,740	50,473
4.14.	IV. PREPAID EXPENSES/ACCRUED INCOME	136,112	112,004	-24,108
	V. TOTAL ASSETS (I+II+III+IV)	11,437,974	12,640,588	1,202,614
Reference number to notes on the Accounts	LIABILITIES AND EQUITY	31.12.2013	31.12.2014	Change
1	2	3	4	4-3
	VI. LIABILITIES DENOMINATED IN FORINT	9,470,835	10,290,278	819,443
4.5.	1. Central government deposits	242,019	524,838	282,819
4.7.	2. Deposits by credit institutions	864,490	5,997,814	5,133,324
	of which: two-week MNB deposit	0	5,083,350	5,083,350
	3. Banknotes and coins in circulation	3,188,994	3,735,554	546,560
4.11.	4. Other deposits and liabilities	5,175,332	32,072	-5,143,260
	of which: two-week MNB bill	5,169,021	0	-5,169,021
	VII. LIABILITIES DENOMINATED IN FOREIGN CURRENCY	1,455,590	1,650,694	195,104
4.5.	1. Central government deposits	509,886	550,771	40,885
4.8.	2. Deposits by credit institutions	571	59,096	58,525
4.11.	3. Other deposits and liabilities	945,133	1,040,827	95,694
4.13.	VIII. PROVISIONS	4,075	4,267	192
	IX. OTHER BANKING LIABILITIES	15,624	18,017	2,393
4.14.	X. ACCRUED EXPENSES/DEFERRED INCOME	27,290	31,454	4,164
4.15.	XI. EQUITY	464,560	645,878	181,318
	1. Share capital	10,000	10,000	0
	2. Retained earnings	9,762	36,057	26,295
	3. Valuation reserves	0	0	0
4.16.	4. Revaluation reserves due to exchange rate changes	509,603	517,984	8,381
4.16.	5. Revaluation reserves of foreign currency securities	-91,100	54,477	145,577
	6. Profit/Loss for the year	26,295	27,360	1,065
	XII. TOTAL EQUITY AND LIABILITIES (VI+VII+VIII+IX+X+XI)	11,437,974	12,640,588	1,202,614

27 May 2015, Budapest

Dr György Matolcsy
Governor of the Magyar Nemzeti Bank

3 Income statement of the Magyar Nemzeti Bank

HUF millions

Reference number to notes on the Accounts	INCOME	2013	2014	Difference
1	2	3	4	4-3
4.18.	I. INTEREST AND INTEREST RELATED INCOME DENOMINATED IN FORINT	19,227	9,447	-9,780
	1. Interest on receivables from the central government	7,872	4,566	-3,306
	2. Interest on receivables from credit institutions	10,738	4,030	-6,708
	3. Interest on other receivables	0	17	17
	4. Interest related income	617	834	217
4.18.	II. INTEREST AND INTEREST RELATED INCOME DENOMINATED IN FOREIGN CURRENCY	239,164	251,952	12,788
	1. Interest on foreign currency reserves	191,986	169,586	-22,400
	2. Interest on receivables from the central government	0	0	0
	3. Interest on receivables from credit institutions	0	0	0
	4. Interest on other receivables	1,877	67	-1,810
	5. Interest related income	45,301	82,299	36,998
4.19.	III. INCOME ARISING FROM EXCHANGE RATE CHANGES	233,602	520,671	287,069
4.18.	IV. REALISED GAINS ARISING FROM FINANCIAL OPERATIONS	26,221	3,435	-22,786
4.21.	V. OTHER INCOME	10,636	15,526	4,890
	1. Fees and commissions	1,423	936	-487
4.22.	2. Income other than fees and commissions	6,343	1,588	-4,755
4.24.	3. Income from supervisory activities	2,870	13,002	10,132
4.13.	VI. PROVISIONS RELEASED	1,777	1,272	-505
4.13.	VII. IMPAIRMENT RELEASED	3	120	117
4.25.	VIII. OPERATING INCOME	332	560	228
	IX. TOTAL INCOME (I+II+III+IV+V+VI+VII+VIII)	530,962	802,983	272,021
Reference number to notes on the Accounts	EXPENSES	2013	2014	Difference
1	2	3	4	4-3
4.18.	X. INTEREST AND INTEREST RELATED EXPENSES DENOMINATED IN FORINT	250,677	167,973	-82,704
	1. Interest on central government deposits	24,896	29,028	4,132
	2. Interest on deposits by credit institutions	23,488	55,306	31,818
	of which: interest on two-week MNB deposit	0	41,353	41,353
	3. Interest on other deposits	202,076	83,639	-118,437
	of which: interest on two-week MNB bill	201,881	83,513	-118,368
	4. Interest related expenses	217	0	-217
4.18.	XI. INTEREST AND INTEREST RELATED EXPENSES DENOMINATED IN FOREIGN CURRENCY	57,145	179,705	122,560
	1. Interest on central government deposits	211	113	-98
	2. Interest on deposits of credit institutions	0	0	0
	3. Interest on other liabilities	8,919	1,677	-7,242
	4. Interest related expenses	48,015	177,915	129,900
4.19.	XII. EXPENSES RESULTING FROM EXCHANGE RATE CHANGES	33,263	9,682	-23,581
4.20.	XIII. COST OF ISSUING BANKNOTES AND COINS	4,157	5,188	1,031
4.18.	XIV. REALISED LOSSES ARISING FROM FINANCIAL OPERATIONS	138,819	123,012	-15,807
4.21.	XV. OTHER EXPENSES	3,300	252,401	249,101
	1. Fees and commissions	755	837	82
4.22.	2. Expenses other than fees and commissions	2,545	251,564	249,019
4.13.	XVI. PROVISIONS CHARGED	1,562	1,463	-99
4.13.	XVII. IMPAIRMENT	985	3,460	2,475
4.25.	XVIII. OPERATING COSTS AND EXPENSES	14,759	32,739	17,980
	XIX. TOTAL EXPENSES (X+XI+XII+XIII+XIV+XV+XVI+XVII+XVIII)	504,667	775,623	270,956
	XX. PROFIT/LOSS BEFORE DIVIDENDS (IX-XIX)	26,295	27,360	1,065
	XXI. Dividends from retained earnings	0	0	0
	XXII. Dividends	0	0	0
	XXIII. PROFIT/LOSS FOR THE YEAR (XX+XXI-XXII)	26,295	27,360	1,065

27 May 2015, Budapest

Dr György Matolcsy
Governor of the Magyar Nemzeti Bank

4 Notes to the financial statements

4.1 THE MNB'S ACCOUNTING POLICY

The Magyar Nemzeti Bank (MNB), the central bank of Hungary, is owned by the Hungarian State. Ownership rights are exercised by the minister in charge of public finances (the shareholder).

The accounting policy of the Magyar Nemzeti Bank is based on the Act on Accounting (Act C of 2000), Act CXXXIX of 2013 on the Magyar Nemzeti Bank (hereinafter: the MNB Act) and Government Decree 221/2000 (XII. 19) on the special reporting and accounting requirements applicable to the Magyar Nemzeti Bank (hereinafter: MNB Decree). Since the effective date of the Act promulgating the international treaty on the accession of Hungary to the EU, i.e. 1 May 2004, the Magyar Nemzeti Bank has been a member of the European System of Central Banks (ESCB).

The following sections present a brief description of the accounting system of the MNB, and the valuation and profit recognition rules, whenever these differ from the general rules.

4.1.1 Changes in the regulatory environment

In 2014, one significant change occurred in the accounting rules and the accounting policy. Pursuant to the amendment of MNB Decree, the securities' premium and discount is subject to amortisation starting from the 2014 reporting period. Amortisation is accounted using the straight-line method over the remaining maturity.

Due to the change in the accounting policy, accounting of the securities' premium and discount has become uniform.

- Forint securities (government bonds and mortgage bonds) were previously recorded at purchase price in the MNB's books and the market value difference at acquisition (premium/discount) was accrued/deferred in the interest related income in proportion to the time elapsed. As a result of amortisation, the premium and discount continues to be recorded in profit and loss in proportion to time elapsed, but in the balance sheet it affects the account of the market value difference at acquisition, instead of as an accrual or prepayment.
- In the case of foreign currency discount securities, the implementation of amortisation has a similar effect as above. The interest related yield from the difference between the par value and the purchase price of the discount securities related to the current year must still be proportionally recorded as interest income, but in the balance sheet it debits the account of the discount, instead of the account of accrued income.
- The implementation of amortisation caused the most significant changes for foreign currency interest-bearing securities. Foreign currency securities-based receivables continue to be recorded at market value in the MNB's books. However, starting from 2014 due to amortisation of the account of the premium and discount, the market value difference recorded in the revaluation reserves of foreign currency securities is not the difference between the market value and the purchase value, but the difference between the market value and the amortised book value. Simultaneously, amortisation is booked as interest related income or loss continuously, removing the existing distortion resulting from the accounting of the coupon interest income and of the interest related income from premium and discount over a different period.
- The non-foreign reserves securities repurchased by the MNB with the aim of debt redemption are also affected by the change in the regulation, as from the end-2014 these bonds are recorded at amortised

purchase value in the balance sheet. However, the amendment left the current accounting unchanged, because the securities were purchased at par value, and consequently there was no balance on the account of the market value difference at acquisition.

Based on the above, the implementation of amortisation caused a one-off loss in the result, since in the case of foreign currency interest-bearing securities the total amount of amortisation calculated in proportion to the time until the date of the change (31 December 2014) by the straight-line method was recognised as interest related income or loss. However, the MNB's equity was not affected by this change in the accounting policy, as the account of the revaluation reserves of foreign currency securities improved by the same amount as the recognised loss, in connection with the realisation of part of the former unrealised gains/losses related to the amortised premium. In the case of forint securities and foreign currency discount securities, this accounting policy change had no effect on the profit and loss; in the balance sheet, the accounts of the premium/discount and the accounts of the accruals/prepayments were changed by the transfers of accrued/prepaid amounts recorded in proportion to time elapsed until the date of the change between the two accounts.

Effects of the changeover to amortisation on the balance sheet and profit and loss

HUF millions

Reference number to notes on the Accounts	Description	31.12.2014. in accordance with the old regulations	31.12.2014. in accordance with the new regulations	Change
ASSETS				
4.3.	Government bonds at book value	137,794	139,495	1,701
4.7.	Covered mortgage bonds at book value	28,254	29,249	995
4.9.	Foreign currency coupon bearing securities at book value	7,022,490	7,022,490	0
	<i>of which: par value+premium/discount</i>	<i>7,068,929</i>	<i>6,968,977</i>	<i>-99,952</i>
	<i>market price difference</i>	<i>-46,439</i>	<i>53,513</i>	<i>99,952</i>
4.9.	Foreign currency discount securities at book value	2,546,677	2,548,078	1,401
	<i>of which: par value+discount</i>	<i>2,545,714</i>	<i>2,547,115</i>	<i>1,401</i>
	<i>market price difference</i>	<i>963</i>	<i>963</i>	<i>0</i>
4.14.	Prepaid expenses/Accrued income	116,101	112,004	-4,097
Assets affected by the amendment of the MNB Decree		9,851,316	9,851,316	0
LIABILITIES AND EQUITY				
4.16.	Revaluation reserves of foreign currency securities	-45,475	54,477	99,952
4.15.	Profit for the year	127,312	27,360	-99,952
Liabilities and equity affected by the amendment of the MNB Decree		81,837	81,837	0

4.1.2 The MNB's accounting framework

One of the key accounting principles of the MNB is that transactions are booked for the period in which they occur, unless the financial year is already closed. This is especially important in terms of the accurate measurement of exchange rate gains and losses, with special regard to foreign exchange sales and purchases. Spot foreign currency transactions which involve foreign exchange conversions are recorded in the books at the date of the transactions. Assets and liabilities arising from such transactions affect the MNB's foreign currency position from the date of entering into the transaction. The same procedure is applied to recording the revaluation difference in the balance sheet relating to derivative transactions for hedging purposes.

On a daily basis, the MNB records:

- exchange rate differences arising from revaluation of its foreign assets and liabilities and derivative transactions for hedging purposes recorded off-balance sheet;
- amortisation of the securities' premiums and discounts after the changeover at 31 December 2014; and

– accrued/deferred interest arising from on and off-balance sheet assets and liabilities from hedging transactions.

Pursuant to the MNB Decree, for the purpose of reporting data to the owner, the MNB is required to close accounts relating to its assets and liabilities and to net income on a quarterly basis, and to prepare trial balances following the procedure specified under its accounting policy.

For internal use, the MNB compiles a balance sheet and income statement every month, which are supported by the following:

- market valuation of foreign currency securities, with the exception of foreign currency bonds repurchased by the MNB with the aim of debt redemption;
- breakdown and recording of realised and unrealised portions of foreign exchange gains and losses deriving from daily revaluation; and
- charging of depreciation and amortisation.

Upon the quarterly closing of accounts, the MNB measures its off-balance sheet contingent and future liabilities arising from derivative transactions for other purposes and securities lending operations based on international agreements (in this case, the liabilities are equal to the purchase value of the collateral received) and other off-balance sheet liabilities. The MNB also grades quarterly the claims and securities in the balance sheet and at the end of the year in addition to the foregoing it measures the invested assets. As a result of this measurement, the MNB recognises impairment losses as necessary and forms provisions for liabilities and expected losses.

The balance sheet date is 15 January of the year following the reporting year with the exception, if it is not a working day, the last working day before.

By law, the MNB is also required to report to Parliament. The MNB submits one single report to both Parliament and the Ministry for National Economy, which as it is in charge of public finances, exercises the rights of ownership as laid down in the MNB Act. This takes the form of an Annual Report, which contains a business report describing the MNB's structure, operations and state of affairs in the reporting year and the MNB's annual financial statements defined by the Act on Accounting, as adopted by the Board of Directors and approved by audit certificate. The Annual Report is published in unabridged form on the Internet. The website is accessible at: <http://english.mnb.hu>.

The Governor of the MNB also reports to the Parliament's committee responsible for economic affairs on the half-year activity of the MNB. This report is the Half-year Report which contains a business report describing the MNB's structure, operations and state of affairs in the reporting period and the MNB's half-year financial statements defined by the Act on Accounting. The Half-year Report is also published on the Internet.

Pursuant to Government Decree No 221/2000 (XII. 19), the MNB is not obliged to draw up consolidated financial statements and the MNB does not prepare consolidated financial statements.

The financial statements of the MNB must be audited by the statutory auditor in compliance with the Act on Accounting. The registered auditor of the MNB is Gergely Szabó (Ernst & Young Könyvvizsgáló Kft.), Chamber membership number: 005676.

The person authorised to sign the Annual Report is Dr György Matolcsy, Governor of the Magyar Nemzeti Bank.

The person responsible for accounting services is Gábor Kalina, registration number: 176115.

4.1.3 Major principles of valuation

Receivables from the central government

Securities stated under receivables from the central government are recorded in the balance sheet at amortised purchase price and include no interest. The difference between the purchase price excluding interest and the face value is shown in the MNB's income statement as a valuation gain or loss in proportion to the time elapsed.

Receivables from the central government also include any receivables associated with the reimbursement of revaluation reserves at year-end.

Impairment losses may not be recorded in connection with receivables from the central government.

Receivables from credit institutions

Mortgage bonds stated under receivables from credit institutions are recorded in the balance sheet at amortised purchase price net of interest. The market value difference at acquisition is shown in the MNB's interest related income as a valuation gain or loss in proportion to the time elapsed.

Impairment losses on mortgage bonds must be accounted in proportion to the risk of losses.

Interest-free refinancing loans and the base rate fixed security-backed loans provided to credit institutions within the framework of the Funding for Growth Scheme (FGS) must be recorded in the balance sheet at the disbursed amount.

Other receivables

Receivables from supervisory activities are recorded in the balance sheet with their impairment. The MNB books the supervisory fee prescriptions in line with the incoming data reported by the institutions and the penalty prescriptions are recorded in line with the finalised resolutions. The supervisory fees, levied and used penalties, as well as the received fees from public proceedings must be recorded as 'Income from supervisory activities'.

The balance of 'Other receivables' also contains the employee loans at the amount of the disbursements. The related interest income is shown as 'Interest on other receivables'.

'Other receivables' must be qualified and must be impaired if necessary.

Valuation of foreign currency assets and liabilities and the recording of exchange rate gains

In its books, the MNB records all foreign currency assets and liabilities at the official exchange rate prevailing on the date of acquisition. If a foreign currency asset or liability is created as a result of foreign exchange conversion, the exchange rate gain or loss arising from the difference between the actual rate and the official rate is recorded by the MNB as conversion income for that particular date and is recognised under gains/losses from exchange rate changes in the income statement.

The MNB carries out daily revaluation of foreign currency assets and liabilities as well as off-balance sheet assets and liabilities arising from derivative transactions for hedging purposes, taking account of variations in the official exchange rate. As a result of this revaluation, balance sheet items denominated in foreign currency are stated in an amount converted at the official exchange rate prevailing on 31 December. Banking assets and banking liabilities in foreign currencies (with the exception of foreign investments) and derivative transactions for purposes other than hedging do not form part of revaluation.

Income received in foreign currency is stated at the official exchange rate prevailing on that particular date.

Daily accounting for accrued income is preceded by reversing the accrued income on the previous day. As a result, foreign currency accruals are recorded in the balance sheet at the official exchange rate without revaluation.

In respect of the foreign exchange gains and losses arising in the course of daily revaluation, realised exchange rate gains can be stated as a profit item, while unrealised income is reported under 'Equity', in the item 'Revaluation reserve due to exchange rate changes'.

Realised income arises as a result of selling and buying foreign currency. The latter occurs when the assets in a given currency are exceeded by corresponding liabilities. Realised income arises as the difference between the value of the traded foreign currency at the official exchange rate and the average cost rate.

Foreign currency securities

Foreign currency securities are stated at market price. The difference between the market value (mid prices applied by the portfolio management facilitating tool) prevailing on the date of valuation and the amortised purchase value is recorded in the revaluation reserve of foreign currency securities as part of equity. Exchange rate gains or losses realised on selling and maturing are stated under 'Realised gains/losses arising from financial operations'.

The Magyar Nemzeti Bank measures its securities on the basis of market prices prevailing on the last working day in December. However if adequately liquid prices are not ensured on this day, the valuation of securities is based on the market prices available on the previous working day.

The foreign currency securities managed by the external trustee and custodian on the grounds of a given mandate are also stated at a market price, applying the prices received from the custodian.

Securities issued by the MNB abroad and subsequently repurchased must be recognised in gross, i.e. in the item 'Other foreign currency receivables'. Foreign currency bonds repurchased by the MNB with the aim of debt redemption are measured at amortised historical cost. Interest on repurchased bonds is recorded under both income and expenses.

Security repurchase transactions are recorded as credit/deposit transactions, while the related receivables or liabilities are stated as off-balance sheet items.

Securities lent through securities lending operations based on international agreements need not be removed from foreign exchange reserves; they are recorded as off-balance sheet items. Non-cash collateral and investments from cash collateral must be recorded as contingent liabilities under off-balance sheet items and if their market value is negative, a provision of equal amount must be created for the investments on a quarterly basis.

Accounting rules relating to the IMF quota

Part of the IMF quota subscribed in foreign currency and denominated in SDR as a callable loan is stated under foreign exchange reserve.

The part of the quota paid in forint, subscribed in SDR, is presented under 'Other foreign currency receivables' in the balance sheet. The related IMF forint deposit is presented on the liabilities side of the balance sheet. It is the MNB's duty to ensure at least annually that the amount of the IMF's forint deposit is equal to the amount of the quota paid in forint. As this deposit account is a HUF account only formally, it is presented under 'Other foreign currency payables' in the balance sheet.

The SDR allocation aims to increase the foreign exchange reserves of the IMF's members and creates an unmatured liability vis-à-vis the IMF on the liability side of the balance sheet. This transaction has an effect on profit or loss (interest must be paid on the SDR amount received), if it is utilised.

Accounting rules relating to derivatives

On the basis of transaction purpose, the MNB distinguishes between two groups of derivative transactions: hedging transactions and derivative transactions for purposes other than hedging.

Hedging transactions are defined as transactions which reduce the risk arising from changes in the exchange rate or market value of a specific asset or liability or open position, are directly related to such, are announced as hedging transactions at the start of the deal and neutralise or significantly mitigate the risk that is intended to be hedged. Furthermore, derivative transactions with the government or non-resident counterparts on behalf of the government are also regarded as hedging transactions.

Derivative transactions must be stated under off-balance sheet assets and liabilities. The aggregate revaluation difference of foreign currency assets and liabilities arising from hedging transactions must be stated in the balance sheet (depending on their balance, either in the item 'Other foreign currency receivables or liabilities', or 'Foreign currency receivables from or liabilities to the central government or credit institutions'), including the interest accrued in proportion to the time elapsed (as accrued income or accrued expenses).

When derivative transactions for purposes other than hedging are closed, the income from such transactions must be stated in the lines of income and expenses arising from exchange rate changes when foreign exchange transactions are involved, and in the lines of interest related income and interest related expenses in the case of transactions linked to interest rate changes. While such transactions are not revalued, consistent with the principle of prudence, in reasonable cases — based on the information available at the balance sheet date — a provision is set aside on a quarterly basis, equal to the negative market value of the transaction.

Banking assets and liabilities

Banking assets and liabilities are stated on the respective sides of the balance sheet. These are the following:

- assets and liabilities not directly related to central bank functions and bank operations (such as settlements relating to taxes, contributions, payments to employees, creditors, unsold precious metals held for non-central bank purposes); as well as
- liabilities arising from banknotes no longer accepted as legal tender but not yet exchanged;
- investments; and
- assets required for operating the organisation (such as intangibles, tangibles, and inventories).

The MNB's balance sheet does not state cash among liquid assets. The central bank is the exclusive issuer of banknotes and coins. Notes and coins held at the Cashier and the Depository are not in circulation and therefore are deducted from banknotes and coins on the liabilities side of the balance sheet.

Depreciation rates applied by the Magyar Nemzeti Bank:

Per cent

Description	31.12.2014
Concessions, licences and similar rights	17
Trademarks patents and similar assets	10–50
Capitalised value of reorganisation	20
Owned and managed buildings	2–3
Vehicles*	20
Telecommunication devices, office equipment, machines	9–50
Office equipment	14.5–33
Computer hardware	9–33
Emission machinery	5–33
Instruments	9–33
Bank security devices	2–33
Other equipment and devices	3–33

**Residual value 20 per cent of the vehicles.*

The above listed ranges of depreciation rates are reference values based on estimated useful economic life. The Bank must deviate from the reference values depending on the actual time of use. Depreciation is charged on a straight-line basis in every case.

4.2 EFFECTS OF MACROECONOMIC TRENDS ON THE 2014 BALANCE SHEET AND INCOME STATEMENT OF THE MAGYAR NEMZETI BANK

In 2014, the MNB recorded a profit of HUF 27.4 billion. In respect of macroeconomic events, changes in the forint exchange rate had a significant impact on the Bank's profit. Similarly to 2013, the official forint exchange rate against the euro fluctuated in a relatively narrower, but weaker band in the course of 2014. The MNB quotation exchange rate was EUR/HUF 314.89, which meant depreciation of 6.1 per cent relative to the end of 2013. The average exchange rate was EUR/HUF 308.62 in 2014, which was HUF 11.62 higher than in 2013. The official exchange rate was weaker than the average cost for the entire year. The difference between the two rates was EUR/HUF 15.76 at 31 December 2013 and after fluctuating during 2014 rose to EUR/HUF 21.47 at year-end. The total net revaluation effect was a gain of HUF 519.4 billion in 2014. The MNB realised a gain of HUF 511 billion on foreign currency sales in the course of 2014. The volume of foreign currency sales was mainly influenced by transactions with the Government Debt Management Agency (ÁKK) in connection with the maturity of the Hungarian government securities and the foreign currency payment obligations of the Hungarian State Treasury (MÁK).

The balance of revaluation reserves due to exchange rate changes, as an unrealised foreign exchange gain, increased by HUF 8.4 billion to HUF 518 billion by the end of 2014. The net foreign currency position of the MNB rose by EUR 0.2 billion' its amount was EUR 32.5 billion (HUF 10,230.3 billion) at year-end.

The balance sheet total according to Hungarian Accounting Standards (HAS) was HUF 12,640.6 billion on 31 December 2014, increasing by more than 10 per cent relative to end-2013. This was caused by the increase of foreign reserves on the assets side, owing to mainly the government-issued foreign currency bonds, EU-transfers and the weakening of the forint exchange rate. The amount of refinancing loans provided by the MNB under the FGS also increased during the year. On the liabilities side, the rise in banknotes and coins and central government deposits were significant items. The balance of revaluations reserves of foreign currency securities improved due to the introduction of amortisation from end-2014.

In 2014, the bank recorded a net interest and interest related loss of HUF 86.3 billion, which was HUF 36.9 billion higher than the loss from the previous year. The deterioration of the net interest result can be attributed to changes in accounting rules applying to securities. The HUF 72.9 billion decrease in the HUF interest loss was mainly generated by the lower average central bank base rate in 2014. The average central bank base rate was 2.38 per cent in 2014, which was 199 basis points lower than the annual average in 2013. In addition to the aforementioned changes in the accounting rules, net foreign currency interest income was determined by the increase in the Bank's net foreign currency receivables and by foreign exchange yields.

The total realised loss from financial operations amounted to HUF 119.6 billion in 2014. This category of P&L is mainly determined by changes in the market prices of securities included in the foreign exchange reserves. Gains or losses derived from market movements are realised on the sale or maturity of securities. Losses mainly occurred upon the maturity of bonds with high coupons which were bought over nominal value.

For more details on impacts on net income, see Section 3.11 of the Business Report.

4.3 FORINT RECEIVABLES FROM THE CENTRAL GOVERNMENT

HUF millions

B/S line	Remaining maturity	Balance		Change
		31.12.2013	31.12.2014	
	Government bonds maturing within 1 year	585	0	-585
	Government bonds maturing within 1 to 5 years	8,508	14,177	5,669
	Government bonds maturing over 5 years	129,287	125,318	-3,969
I.1.	Total receivables from the central government	138,380	139,495	1,115

The amount of government bonds recorded at historical cost was HUF 139.5 billion at the end of 2014, an increase of HUF 1.1 billion compared to end-2013. This change was the result of two conflicting factors. The last debt consolidation government bond matured in May of 2014 and consequently the amount of government bonds decreased by HUF 0.6 billion. The amount of receivables in turn increased by a one-off amount of HUF 1.7 billion due to the changeover to amortisation accounting in connection with securities, effective as of 31 December 2014. There were no new purchases during the year.

The aggregate balance of revaluation reserves due to exchange rate changes and of revaluation reserves of foreign currency securities was positive on 31 December 2014, and therefore receivables from the central government did not arise in connection with reimbursement.

4.4 FOREIGN CURRENCY RECEIVABLES FROM THE CENTRAL GOVERNMENT

HUF millions

B/S line	Description	Balance		Change
		31.12.2013	31.12.2014	
	Swap and forward transactions with the central government	0	0	0
	Currency swaps with the central government	18,378	0	-18,378
II.2.	Foreign currency receivables from the central government	18,378	0	-18,378

There was no amount in the line for foreign currency receivables from the central government on 31 December 2014. The net debit balance of currency swaps with the central government was HUF 18.4 billion at end-2013, but it changed into a net credit balance by the end of 2014, and thus these items were stated as 'Foreign currency liabilities of the central government', in line with its sign (see Section 4.5.).

Foreign currency receivables from the central government in a breakdown by remaining maturity

HUF millions

B/S line	Remaining maturity	Balance		Change
		31.12.2013	31.12.2014	
	– within 1 year	345	0	–345
	– within 1 to 5 years	7,816	0	–7,816
	– over 5 years	10,217	0	–10,217
II.2.	Foreign currency receivables from the central government	18,378	0	–18,378

4.5 FORINT AND FOREIGN CURRENCY LIABILITIES OF THE CENTRAL GOVERNMENT**Forint deposits of the central government**

HUF millions

B/S line	Description	Balance		Change
		31.12.2013	31.12.2014	
	Single Treasury Account (KESZ)	241,678	524,417	282,739
	Deposit by Government Debt Management Agency (ÁKK Zrt)	279	361	82
	Other	62	60	–2
VI.1.	Forint deposits of the central government	242,019	524,838	282,819

The total amount of forint deposits of the central government increased by HUF 282.8 billion relative to the previous year-end. The foreign currency received from the USD bond issue of the Government Debt Management Agency in March was converted by the issuer at the MNB, which caused a significant increase in the amount on the Single Treasury Account. Afterwards, due to the successful and steadily higher-than-planned forint government bond issues, the level of deposits was high. In the final quarter of 2014, the repayment of a euro loan borrowed from the European Commission earlier and government bond maturity caused a decrease in the amount of deposits. The annual average balance was HUF 1,247.4 billion, twice as much as in the previous year.

Foreign currency liabilities of the central government

HUF millions

B/S line	Description	Balance		Change
		31.12.2013	31.12.2014	
	Foreign currency deposits of the central government	509,886	463,423	–46,463
	Swap and forward transactions with the central government	0	74	74
	Currency swaps with the central government*	0	87,274	87,274
VII.1.	Foreign currency liabilities of the central government	509,886	550,771	40,885

* In 2013, the debit balance of HUF 18,378 million (net receivable amount) appeared as II.2. Foreign currency receivables from the central government, in line with its opposite sign.

The balance of the foreign currency deposits of the central government including currency swaps was HUF 550.8 billion on 31 December 2014, up HUF 40.9 billion compared to end-2013. The shift in the sign of the currency swap balance also contributed to changes in the amount of liabilities. Based on a government decision, the Government Debt Management Agency holds deposits only for liquidity management purposes at the MNB and basically converts its foreign currency income into forints.

The end-2014 balance of the hedging transactions contained foreign exchange swaps, forward transactions and currency swaps concluded with the Government Debt Management Agency in order to set the foreign

currency and interest rate structure of the foreign exchange debt amounted to HUF 87.4 billion. In line with its opposite sign, the net balance from end-2013 appeared as receivable (see Section 4.4).

Foreign currency liabilities of the central government in a breakdown by remaining maturity

HUF millions

B/S line	Remaining maturity	Balance		Change
		31.12.2013	31.12.2014	
	– within 1 year	509,886	474,289	–35,597
	– within 1 to 5 years	0	18,918	18,918
	– over 5 years	0	57,564	57,564
VII.1.	Foreign currency liabilities of the central government	509,886	550,771	40,885

Currency structure of the derivative transactions with the central government

HUF millions

No.	Description	Balance		Change
		31.12.2013	31.12.2014	
1.	– HUF	0	258,927	258,927
2.	– EUR	785,459	819,681	34,222
3.	Receivables from derivative transactions (1+2)	785,459	1,078,608	293,149
4.	– HUF	0	143	143
5.	– EUR	0	258,858	258,858
6.	– USD	767,081	906,955	139,874
7.	Payables from derivative transactions (4+5+6)	767,081	1,165,956	398,875
8.	Net payables from derivative transactions (7-3)	-18,378	87,348	105,726

4.6 NET POSITIONS VIS-À-VIS THE CENTRAL GOVERNMENT

HUF millions

B/S line	Description	Balance		Change
		31.12.2013	31.12.2014	
I.1.–VI.1.	Net forint position	–103,639	–385,343	–281,704
II.2.–VII.1.	Net foreign currency position	–491,508	–550,771	–59,263
	Total	–595,147	–936,114	–340,967

4.7 FORINT RECEIVABLES FROM AND LIABILITIES TO CREDIT INSTITUTIONS

Forint receivables from credit institutions

HUF millions

B/S line	Description	Balance		Change
		31.12.2013	31.12.2014	
	Security-backed loans	112,021	10	–112,011
	Covered mortgage bonds	41,496	29,249	–12,247
	FGS refinancing loans	667,342	1,007,964	340,622
	Other receivables	29	2,840	2,811
I.2.	Total receivables from credit institutions	820,888	1,040,063	219,175

The amount of receivables from credit institutions was HUF 1,040.1 billion on 31 December 2014. The total increase of HUF 219.2 billion in the balance relative to 2013 appeared due to the joint effect of a number of factors.

The majority of the total balance related to FGS refinancing loans. The MNB launched its three-pillar Funding for Growth Scheme on 1 June 2013. To stimulate lending to small and medium-sized enterprises (under Pillar I) and the redemption of existing foreign currency loans (under Pillar II), a credit line with a total value of HUF 750 billion was allocated in the first phase of the FGS. In view of the success of the first phase, in September 2013 the Monetary Council decided to continue the Scheme. Under the second phase of the Funding for Growth Scheme (FGS) commenced on 1 October 2013, with small and medium-sized enterprises (SMEs) able to apply for loans until the end of 2015. The closing date is 30 June 2016 in connection with investment loans under Pillar I, and 5 December 2018 with refinancing loans attached to factoring. The overall amount available to credit institutions is HUF 500 billion, which may be raised to up to HUF 2,000 billion by the Monetary Council. Credit institutions had funds available up to 100 per cent of their forint and foreign exchange outstanding loans to SMEs – also including loans disbursed under the first phase of FGS – as at 30 September 2013. In contrast to the first phase, this was not based on an initial allocation but, rather according to the loan contracts concluded with SMEs, on a 'first come, first serve' basis. The amount of refinancing loans granted under Pillar I and Pillar II totalled HUF 1,008 billion on 31 December 2014, from which the amount of disbursed loan was HUF 535.7 billion in the first phase and HUF 472.3 billion in the second phase. Repayment of the loans has started.

The change in the balance of security-backed loans was mainly caused by the reduction in two-year loans which matured. This active monetary tool was introduced by the central bank in April 2012, in order to strengthen the banks' lending capacity and to promote corporate lending. The amount of overnight loans was lower at the end of 2014, with a smaller extent of decrease.

Receivables in connection with mortgage bonds decreased by HUF 12.2 billion and amounted to HUF 29.3 billion at 31 December 2014. This value contains the amortised cost price difference, in addition to the nominal value. The nominal value of mortgage bonds was HUF 42.6 billion at the end of 2013, and three bonds from this stock matured in 2014, amounting to HUF 12.6 billion in total. The stock of mortgage bonds increased by HUF 1 billion, due to the modification of the accounting policy as per 4.1.1.

The end-2014 balance of other receivables showed an increase of HUF 2.8 billion compared to the previous year, which was caused by receivables from Széchenyi Bank, which is under liquidation. This amount was recorded with their impairment. Thus, the receivables from Széchenyi Bank in a gross value amounted to HUF 4.3 billion. Taking account of the expected returns of HUF 2.8 billion, an impairment loss of HUF 1.5 billion was created.

Forint receivables from credit institutions by remaining maturity

HUF millions

No.	Remaining maturity	Balance		Change
		31.12.2013	31.12.2014	
1.	– matured	0	2,842	2,842
2.	– within 1 year	150,097	95,913	–54,184
3.	– within 1 to 5 years	281,246	471,203	189,957
4.	– over 5 years	389,545	470,105	80,560
5.	Total receivables from credit institutions (1+2+3+4)	820,888	1,040,063	219,175

Forint liabilities of credit institutions*HUF millions*

B/S line	Description	Balance		Change
		31.12.2013	31.12.2014	
	Current accounts	259,875	477,646	217,771
	Two-week MNB deposits	0	5,083,350	5,083,350
	Other deposits	604,615	436,818	-167,797
VI.2.	Deposits of credit institutions	864,490	5,997,814	5,133,324

The line 'Deposits of credit institutions' includes the liquidity-absorbing instruments and minimum reserves of domestic credit institutions, both of which are pegged to the base rate; the aggregate balance of such was HUF 5,997.8 billion at the end of 2014. The maturity dates of all deposits were within one year. The increase of HUF 5,133.3 billion compared to the previous year-end was largely determined by the effect of the conversion of the main policy instrument for the purpose of renewing the monetary policy instruments. The two-week MNB bills stated under other forint liabilities were converted into two-week MNB deposits as of 1 August 2014, the stock of which amounted to HUF 5,083.4 billion at the end of the period. The balance of overnight central bank deposits was HUF 167.8 billion lower at the end of 2014 relative to end-2013.

4.8 NET POSITIONS VIS-À-VIS CREDIT INSTITUTIONS*HUF millions*

B/S line	Description	Balance		Change
		31.12.2013	31.12.2014	
I.2.–VI.2.	Net forint position	-43,602	-4,957,751	-4,914,149
II.3.–VII.2.	Net foreign currency position	-558	-48,596	-48,038
	Total	-44,160	-5,006,347	-4,962,187

Net liabilities to credit institutions increased from HUF 44.2 billion at end-2013 to HUF 5,006.3 billion as of 31 December 2014. Within this, net forint liabilities rose by HUF 4,914.1 billion, showing a balance of HUF 4,957.8 billion at end-2014. The appearance of the two-week MNB deposit considerably eroded the net position, as well as the increase in minimum reserves, termination of security-backed two-year loans, and the maturity of mortgage bonds. This was only partly compensated by the increase in FGS loans and the decline in overnight deposits.

Net foreign currency liabilities rose by HUF 48 billion compared to the previous year-end, showing a balance of HUF 48.6 billion at 31 December 2014. In addition to fix deposits amounting to HUF 15.7 billion at end-2014, the net balance of foreign currency deposits by credit institutions included the outstanding amount of foreign exchange swaps. Foreign exchange swaps concluded with credit institutions by the MNB were stated under liabilities at end-2013 and under receivables at end-2014. At the end of 2013, demand for the overnight swap amounted to just EUR 0.5 billion, whereas by end-2014 there was higher demand for the two-week and three-month swaps providing EUR liquidity to banking sector, and consequently the outstanding amount of these swaps amounted to EUR 1.5 billion altogether. The central bank's FX swap and currency swap tenders constituting Pillar III of the FGS ended as of 1 July 2014. The total swap portfolio allocated to credit institution counterparties amounted to EUR 568 million at end-2013, and to EUR 580 million at end-2014. According to the decision of the Monetary Council in September 2014, the MNB would provide the banking system with the foreign currency needed to phase out household foreign currency loans. In line with this, the total amount of EUR and CHF swaps and currency swaps concluded with credit institutions amounted to HUF 10 billion as at 31 December 2014.

Foreign currency receivables from and liabilities to credit institutions in a breakdown by remaining maturity*HUF millions*

No.	Remaining maturity	Balance		Change
		31.12.2013	31.12.2014	
1.	– within 1 year	0	2,263	2,263
2.	– within 1 to 5 years	13	8,237	8,224
3.	– over 5 years	0	0	0
4.	Total foreign currency receivables from credit institutions (1+2+3)	13	10,500	10,487
5.	– within 1 year	571	23,435	22,864
6.	– within 1 to 5 years	0	35,661	35,661
7.	– over 5 years	0	0	0
8.	Total foreign currency liabilities to credit institutions (5+6+7)	571	59,096	58,525
9.	Net foreign currency position (4-8)	-558	-48,596	-48,038

4.9 GOLD AND FOREIGN EXCHANGE RESERVES OF THE CENTRAL BANK**Forint balances***HUF millions*

B/S line	Description	Balance		Change
		31.12.2013	31.12.2014	
	Gold reserve	25,623	30,689	5,066
	Reserve position in the IMF	24,523	27,714	3,191
	Foreign currency deposits	984,062	958,795	-25,267
	Foreign currency securities	8,599,519	9,570,568	971,049
	Foreign currency repo transactions	300,112	226,721	-73,391
II.1.	Gold and foreign currency reserves	9,933,839	10,814,487	880,648

For statistical purposes, the MNB regularly publishes the amount of foreign currency reserves. According to the statistical rules, foreign currency reserves also include accrued interest, and consequently, gold and foreign currency reserves differ in amount according to the statistical and accounting rules.

Foreign exchange reserves not including accrued interest increased by HUF 880.6 billion to HUF 10,814.5 billion as at 31 December 2014.

The end-2014 balance of foreign currency securities contained only HUF 76.8 billion (less than 1 per cent) of securities managed by the external trustee and custodian on the grounds of the given mandate.

Euro balances*EUR millions*

B/S line	Description	Balance		Change
		31.12.2013	31.12.2014	
	Gold reserve	86	97	11
	Reserve position in the IMF	83	88	5
	Foreign currency deposits	3,314	3,045	-269
	Foreign currency securities	28,963	30,393	1,430
	Foreign currency repo transactions	1,011	720	-291
II.1.	Gold and foreign currency reserves	33,457	34,343	886

The official exchange rate of the forint was EUR/HUF 296.91 on 31 December 2013 and EUR/HUF 314.89 on 31 December 2014.

In the course of 2014, the most significant item increasing foreign currency reserves was the incoming EUR transfers from the European Commission, and the interest income on reserves also increased the balance. On the other hand, the level of reserves was reduced by the debt management and other activities of the Government Debt Management Agency, by the foreign currency conversion performed by the Hungarian State Treasury not related to debt financing, and by the EUR-liquidity providing EUR/HUF swap tenders. As a consequence of the aforementioned effects, the stock of foreign exchange reserves denominated in euro was EUR 0.9 billion higher as at 31 December 2014.

4.10 OTHER FORINT AND FOREIGN CURRENCY RECEIVABLES

Other forint receivables

HUF millions

B/S line	Description	Balance		Change
		31.12.2013	31.12.2014	
	Receivables from supervisory activities	1,876	3,894	2,018
	Employee loans	479	1,154	675
	Total other receivables in HUF in gross value	2,355	5,048	2,693
	Impairment loss for other receivables	-1,728	-3,732	-2,004
I.3.	Other forint receivables	627	1,316	689

The item 'Receivables from supervisory activities' includes supervisory fees, fines and default interest. This balance corrected with overpayments amounted to HUF 3.9 billion at 31 December 2014 and was impaired by HUF 3.7 billion in line with the internal rules of the MNB. Similarly to the former practice of HFSA, 'Employee loans' contains new items: personal loan and preferential property loan granted by the MNB to its employee and the total amount of them was HUF 1.2 billion at end-2014. The stock of property loans taken over by the MNB from the HFSA during integration was HUF 0.5 billion at end-2013, and was sold in April 2014.

Other foreign currency receivables

HUF millions

B/S line	Description	Balance		Change
		31.12.2013	31.12.2014	
	Forint payment of IMF quota	320,361	362,018	41,657
	Repurchased bonds by debt redempton	6,882	7,265	383
	Foreign hedging transactions*	28,389	68,720	40,331
	Other	674	500	-174
II.4.	Other foreign currency receivables	356,306	438,503	82,197

* The revaluation difference of hedging derivative transactions is stated in net terms, in accordance with the MNB Decree.

Due to the weakening of the forint exchange rate, the forint payment of the IMF quota rose in comparison to SDR by 13 per cent.

The amount of bonds issued abroad by the MNB and subsequently repurchased contains only one bond, which showed an increase owing to the depreciation of the forint exchange rate versus the Japanese yen by 5.6 per cent.

The item 'Foreign hedging transactions' includes the net credit balance of swap and forward transactions with non-resident counterparties concluded by the MNB.

4.11 OTHER DEPOSITS AND LIABILITIES

Other forint liabilities

HUF millions

B/S line	Description	Balance		Change
		31.12.2013	31.12.2014	
	Two-week MNB bills	5,169,021	0	-5,169,021
	International financial institutions' forint deposits	3,667	25,910	22,243
	Other liabilities	2,644	6,162	3,518
VI.4.	Other forint deposits and liabilities	5,175,332	32,072	-5,143,260

The end-2014 balance of other forint deposits and liabilities declined by HUF 5,143.3 billion compared to the previous year-end, almost entirely due to the fact that the two-week MNB bills were converted into central bank deposits from 1 August 2014.

Other foreign currency liabilities

HUF millions

B/S line	Description	Balance		Change
		31.12.2013	31.12.2014	
	Bonds	20,542	21,686	1,144
	Repo transactions	246,193	125,956	-120,237
	IMF deposit	649,520	733,981	84,461
	Foreign deposits and loans	28,560	158,821	130,261
	Other liabilities	318	383	65
VII.3.	Other foreign currency liabilities	945,133	1,040,827	95,694

The balance of other foreign currency liabilities rose by HUF 95.7 billion to HUF 1,040.8 billion as at 31 December 2014. The amount of IMF items increased by HUF 84.5 billion, due to depreciation of the forint exchange rate versus the SDR on the one hand and to a switch-over to the new official exchange rate ordered by the IMF, which is due once a year (every April) on the other hand. The total increase of HUF 130.3 billion in the balance of foreign deposits relative to 2013 appeared due to a significant rise in the volume of hedging transaction marked to market, which was reflected in the growth in the amount of mark-to-market deposit, which is for market price differences of transactions. In contrast to the foregoing, the sum of repo transactions which ensured euro liabilities to hedging swaps with the credit institutions was lower at the end of 2014.

Other foreign currency liabilities by remaining maturity

HUF millions

B/S line	Remaining maturity	Balance		Change
		31.12.2013	31.12.2014	
	– within 1 year	595,433	668,484	73,051
	– within 1 to 5 years	20,542	0	-20,542
	– over 5 years	0	0	0
	– without maturity	329,158	372,343	43,185
VII.3.	Other foreign currency liabilities	945,133	1,040,827	95,694

Currency structure of other foreign currency liabilities

HUF millions

No.	Description	Balance		Change
		31.12.2013	31.12.2014	
1.	– USD	4,271	12,154	7,883
2.	– EUR	270,800	273,006	2,206
3.	– JPY	20,542	21,686	1,144
4.	– SDR	329,158	393,726	64,568
5.	– Other	320,362	340,255	19,893
6.	Other foreign currency liabilities	945,133	1,040,827	95,694

The item 'Other' amounted to HUF 340.3 billion at the end of 2014 and mainly contains the revaluation-corrected forint coverage of the IMF quota. The SDR-denominated items increased by HUF 64.6 billion, mainly due to the 13 per cent weakening of the forint exchange rate versus the SDR.

4.12 INVESTED ASSETS

In addition to intangibles, tangibles and capital expenditure (HUF 32.4 billion), invested assets include shares in investments (HUF 9.1 billion in foreign investments and HUF 42.2 billion in domestic investments).

Changes in the gross value, depreciation, and net value of intangibles, tangibles, and capital expenditure

HUF millions

	Assets						Intangibles, tangibles and capital expenditure
	Immaterial goods		Tangible assets			Capital expenditure and advances given	
	Intangible assets	Software under development	Buildings	Equipment	Assets of banknote and coin		
Gross value							
31.12.2013	11,315	44	12,368	12,016	237	481	36,461
Commissioning/Acquisition	565	–4	15,362	3,567	2	889	20,381
Other addition/Reclassification	0	0	17	0	0	0	17
Scrapping	–605	–3	–3	–1	0	–7	–619
Selling	0	0	0	–231	0	0	–231
Transfer free of charge	0	0	0	–170	0	0	–170
Other disposal/Reclassification	–4	0	0	–169	–1	–1	–175
2014. 12. 31.	11,271	37	27,744	15,012	238	1,362	55,664
Details of depreciation							
31.12.2013	9,901	0	3,257	9,080	0	0	22,238
Ordinary depreciation	590	0	595	925	0	0	2,110
Other addition due to reclassification	0	0	9	0	0	0	9
Derecognition	–595	0	–2	–514	0	0	–1,111
Decrease due to reclassification	0	0	0	–9	0	0	–9
31.12.2014	9,896	0	3,859	9,482	0	0	23,237
Balance							
31.12.2013	1,414	44	9,111	2,936	237	481	14,223
31.12.2014	1,375	37	23,885	5,530	238	1,362	32,427
Change	–39	–7	14,774	2,594	1	881	18,204

The item 'Buildings' contains the Tiszaroff Castle Hotel bought during 2014 as training and leisure centre and the Eiffel Palace Office Building, with a total gross value of HUF 15.2 billion. The devices and equipment received in connection with these buildings caused a HUF 3.1 billion increase in tangible assets. The net value of the state-owned, managed buildings taken from HFSA (3 buildings and 2 plots of land) was HUF 68 million at 31 December 2014.

Foreign investments and dividends from investments

HUF millions

Description	Ownership share (%)		Book value		Dividends received*	
	31.12.2013	31.12.2014	31.12.2013	31.12.2014	2013	2014
BIS	1.43	1.43	6,596	7,294	920	650
<i>SDR millions</i>			10	10		
<i>CHF millions</i>			13.5	13.5		
European Central Bank	1.37	1.38	1,656	1,764	–	–
<i>EUR thousands</i>			5,578	5,601		
SWIFT	0.02	0.02	2	3	0	0
<i>EUR thousands</i>			8.6	8.6		
Total investments			8,254	9,061	920	650

* Dividends financially settled in the given year.

Ownership distribution in the ECB at 31 December 2014

The Republic of Hungary joined the European Union on 1 May 2004. Consequently, the MNB became a member of the ESCB. The ESCB comprises the European Central Bank (ECB) and the national central banks of the 28 EU Member States. The Eurosystem is composed of the ECB and of the national central banks of Member States which have already adopted the euro. Pursuant to the provisions of Article 28 of the Statute of the ESCB and the ECB (hereinafter referred to as 'the Statute'), the MNB has become an owner of the ECB. Subscriptions depend on shares which are fixed in accordance with Article 29 of the Statute and must be adjusted every five years based on demographic and GDP data provided by the European Commission. Shares can additionally change with a new accession to the EU or with capital increase.

Pursuant to Article 47 of the Statute, non-euro area NCBs are required to pay 3.75 per cent of their subscribed capital to the ECB as a contribution to the operational costs of the ECB. As a non-euro area NCB, the MNB is not entitled to receive any share of the distributable profits of the ECB, nor is it liable to fund any loss of the ECB.

The MNB's participation in the ECB is represented under the sub-item 'Invested assets' among 'III. Banking assets' in the balance sheet of the MNB. The value of the investment (i.e. paid-up capital) amounted to EUR 5.6 million in the MNB's balance sheet as at 31 December 2014.

National Central Banks (NCBs)	Subscribed capital	Paid-up capital	Capital key (%)
	EUR thousands		
Nationale Bank van België/ Banque Nationale de Belgique	268,222	268,222	2.4778
Deutsche Bundesbank	1,948,209	1,948,209	17.9973
Eesti Pank	20,871	20,871	0.1928
Central Bank of Ireland	125,646	125,646	1.1607
Bank of Greece	220,094	220,094	2.0332
Banco de España	957,028	957,028	8.8409
Banque de France	1,534,900	1,534,900	14.1792
Banca d'Italia	1,332,645	1,332,645	12.3108
Central Bank of Cyprus	16,378	16,378	0.1513
Latvijas Banka	30,537	30,537	0.2821
Banque centrale du Luxembourg	21,975	21,975	0.2030
Central Bank of Malta	7,015	7,015	0.0648
De Nederlandsche Bank	433,379	433,379	4.0035
Oesterreichische Nationalbank	212,506	212,506	1.9631
Banco de Portugal	188,723	188,723	1.7434
Banka Slovenije	37,400	37,400	0.3455
Národná banka Slovenska	83,623	83,623	0.7725
Suomen Pankki – Finlands Bank	136,005	136,005	1.2564
Subtotal for euro area NCBs	7,575,156	7,575,156	69.9783
Bulgarian National Bank	92,987	3,487	0.8590
Česká národní banka	174,012	6,525	1.6075
Danmarks Nationalbank	161,000	6,038	1.4873
Hrvatska narodna banka	65,199	2,445	0.6023
Lietuvos banka	44,729	1,677	0.4132
Magyar Nemzeti Bank	149,363	5,601	1.3798
Narodowy Bank Polski	554,565	20,796	5.1230
Banca Națională a României	281,710	10,564	2.6024
Sveriges riksbank	246,042	9,227	2.2729
Bank of England	1,480,244	55,509	13.6743
Subtotal for non-euro area NCBs	3,249,851	121,869	30.0217
Total NCBs	10,825,007	7,697,025	100.0000

Domestic investments and dividends from investments

HUF millions

Description	Ownership share (%)		Book value		Dividends received*	
	31.12.2013	31.12.2014	31.12.2013	31.12.2014	2013	2014
Pénzjegynyomda Zrt. 1055 Budapest, Markó utca 17.	100.0	100.0	8,927	8,927	0	0
Magyar Pénzverő Zrt. 1239 Budapest, Európa u. 1.	100.0	100.0	575	575	104	52
Pénzügyi Stabilitási és Felszámoló Nkft. 1071 Budapest Damjanich u. 11-15.	100**	100.0	50	50	–	–
MARK Magyar Reorganizációs és Követeléskezelő Zrt. 1054 Budapest, Szabadság tér 8-9.	–	100.0	–	21,700	–	0
MNB-Jóléti Kft. 1054 Budapest, Szabadság tér 8-9.	–	100.0	–	50	–	–
MNB-Biztonsági Zrt. 1054 Budapest, Szabadság tér 8-9.	–	100.0	–	200	–	0
GIRO Elszámolásforgalmi Zrt. 1054 Budapest, Vadász utca 31.	8.1	100.0	266	9,779	123	0
KELER Zrt. 1074 Budapest, Rákóczi út 70-72.	53.3	53.3	643	643	0	0
KELER KSZF Zrt. 1074 Budapest, Rákóczi út 70-72.	0.2	0.2	7	7	0	0
Budapesti Értéktőzsde Zrt. 1062 Budapest, Andrásy út 93.	6.9	6.9	321	321	39	39
Total investments			10,789	42,252	266	91

* Dividends financially settled in the given year.
** As the MNB exercises the ownership rights, it reported the state-owned company in its financial accounting.

In addition to banknotes, **Pénzjegynyomda Zrt.** produces documents, tax stamps and securities for domestic and foreign clients. Developments were implemented to ensure the modern, secure production of forint banknotes and documents satisfying customer needs. The dominant strategy of the company aims for banknote production in adequate quantity and excellent quality, and for its increased penetration in market segments other than banknote production based on competitive advantages. This target system can ensure the long-term growth path for Pénzjegynyomda Zrt. and maintain and enhance shareholders' value. In March 2015, the Executive Board of the MNB decided to increase Pénzjegynyomda's share capital by HUF 1.7 billion, and consequently a cash contribution amounted to HUF 425 million will take place by the end of March 2015 and a further HUF 1,275 million at the end of September.

Pursuant to the MNB's order, the primary duty of **Magyar Pénzverő Zrt.** is to produce circulation coins for cash turnover and commemorative coins issued by the MNB. Utilisation of the company's free capacity allows for the production of non-legal tender commemorative coins and coins for foreign markets on the basis of its own coin programme and customised orders. Within the range of its commercial activities, the company sells commemorative coins, collector banknotes, medals and gold investment products in Hungary and abroad as a wholesaler and retailer as well.

Pursuant to the MNB Act, the state-owned share of **Pénzügyi Stabilitási és Felszámoló Nonprofit Kft.** (PSFN Kft., Financial Stability and Liquidator Non-profit LLC), formerly known as Hitelintézet Felszámoló Nonprofit Kft., was transferred to the MNB on 25 February 2014. PSFN Kft. basically performs the tasks related to the organised market derecognition of credit institutions and financial enterprises in crisis (hereinafter institutions). If the stability of an institution is shaken, the company is responsible for designation of supervisory commissioners and supporting their work to restore the normal operation of the institution. If the institution can no longer be restored to a normal operating framework, PSFN Kft. provides for its termination, in the framework of liquidation in the case of the insolvent institutions and in the framework of winding-up proceedings for solvent institutions. In the second half of 2014, the scope of institutions under the control of PSFN Kft. expanded

significantly. Consequently, the company's headcount and infrastructure must be gradually developed, and there is demand and also opportunity for developing new solutions in crisis management. Over the long term, the strategic aim of the company is to develop modern and professional approaches and procedures which can be useful for liquidator companies striving for fair proceeding on the market.

The primary objective of **Magyar Reorganizációs és Követeléskezelő (MARK) Zrt.** (MARK Hungarian Restructuring and Debt Management Private Company Limited by Shares, MARK Ltd.) is to accelerate the reduction of poor-quality commercial real estate loans in the Hungarian banking system. The asset management company frees the banking system from its problematic assets by the acquisition of non-performing or unstable commercial real estate loan portfolios. The company can contribute to the strengthening financial stability by easing credit supply constraints and can improve the effectiveness of the credit channel and thus the monetary transmission mechanism, as well as support the achievement of the inflation target. The aim is to clean the entire banking system's portfolio of project loans which are distressed or non-performing the under current circumstances and were financed in the overheated environment of the 2008 economic crisis. MARK supports the tasks of the MNB determined by MNB Act: it strengthens financial stability and significantly improves the effectiveness of monetary policy, and can support the economic policy of the government without infringement upon the two mandates listed above.

MNB-Jóléti Humán Szolgáltató és Üzemeltető Kft. is responsible for the maintenance and operation of Tiszaroff Castle Hotel owned by the MNB and for provision of recruitment and other services determined by the MNB at an appropriate level on-site (conferences, trainings, courses, external assemblies). The book value of the investment increased to HUF 70 million due to the share capital increase of HUF 20 million in March 2015.

MNB-Biztonsági Zrt. begins its activities from 1 March 2015. Basically, the company will carry out the personal guarding and protecting of the office objects and premises of the MNB by armed security guards under legal obligation and will be involved in performing the tasks of money and valuables transport. The company does not provide services to third party outside the MNB. Highly trained guards with above-average expertise and abilities are essential for discharging these tasks successfully. Consequently, the company pays particular attention to the education, training and advanced training of the armed security guards. The book value of the investment increased to HUF 740 million due to the HUF 540 million payment as capital reserves in February 2015.

GIRO Elszámolásforgalmi Zrt. operates the payment system for domestic interbank forint credit transfers and direct debits, the so-called Interbank Clearing System. In addition, it provides information services, IT and communication networking, as well as authentication services for banking and public partners. In July 2014, the MNB became the sole owner of the company. The renewed strategy includes the following objectives of the central bank among others: stable and safe operation, development of the current clearing services, implementation of new clearing services, and increasing the competitiveness of clearing fees.

Key indicators of domestic investments

Upon compilation of the Annual Report, these are the latest data and audited data for affiliated firms subject to compulsory audit with 100 per cent ownership, as shown in the following tables.

HUF millions

Investment	Share capital	Reserves	Profit/loss for the year	Equity	Profit/loss for the year after taxation
	31.12.2014	31.12.2014	31.12.2014	31.12.2014	2014
Pénzjegynyomda Zrt.	8,927	1,879	889	11,695	889
Magyar Pénzverő Zrt.	575	469	59	1,103	59
Pénzügyi Stabilitási és Felszámoló Nkft.	50	3	0	53	0
MARK Zrt.	200	21,500	19	21,719	19
MNB-Jóléti Kft.	50	0	0	50	0
MNB-Biztonsági Zrt.	200	0	-40	160	-40
GIRO Elszámolás-forgalmi Zrt.	2,496	4,692	952	8,140	952
KELER Zrt.	4,500	19,626	1,612	25,738	1,612
KELER KSZF Zrt.	1,823	3,386	189	5,398	189
Budapesti Értéktőzsde Zrt.	541	4,926	520	5,987	520

HUF millions

Investment	Net sales revenue		Financial income		Other income		Extraordinary income	
	2013	2014	2013	2014	2013	2014	2013	2014
Pénzjegynyomda Zrt.	6,758	7,433	94	75	14	37	3	919**
Magyar Pénzverő Zrt.	1,840	2,034	9	11	1	10	0	0
Pénzügyi Stabilitási és Felszámoló Nkft.	73	32	0	1	267	407	0	0
MARK Zrt.	-	-	-	76	-	0	-	0
MNB-Jóléti Kft.	-	107	-	0	-	0	-	0
MNB-Biztonsági Zrt.	-	0	-	0	-	0	-	0
GIRO Elszámolásforgalmi Zrt.	-	-	4,234	4,035	1,529	1,443	0	0
KELER Zrt.	-	-	10,655	8,737	316	339	513	0
KELER KSZF Zrt.	792	901	196	131	31	84	5	0
Budapesti Értéktőzsde Zrt.	2,281*	2,072*	34	36	71	37	0	0

* Income from Stock Exchange related activities.

** The net profit impact of Diósgyőr Papermill's capital decrease was HUF 52 million, taking into account the extraordinary expense.

Persons

Investment	Average number of staff	
	2013	2014
Pénzjegynyomda Zrt.	298	321
Magyar Pénzverő Zrt.	38	39
Pénzügyi Stabilitási és Felszámoló Nkft.	24	27
MARK Zrt.	–	11
MNB-Jóléti Kft.	–	20
MNB-Biztonsági Zrt.	–	13
GIRO Elszámolásforgalmi Zrt.	133	136
KELER Zrt.	125	122
KELER KSZF Zrt.	10	16
Budapesti Értéktőzsde Zrt.	53	44

The MNB's receivables from and liabilities to affiliated companies

HUF millions

Investment	Receivables	Liabilities
	31.12.2014	31.12.2014
Pénzjegynyomda Zrt.	0	890
Magyar Pénzverő Zrt.	23	0
Pénzügyi Stabilitási és Felszámoló Nkft.	0	0
MARK Zrt.	0	0
MNB-Jóléti Kft.	70	0
MNB-Biztonsági Zrt.	0	0
GIRO Elszámolásforgalmi Zrt.	0	2
KELER Zrt.	0	0
KELER KSZF Zrt.	0	0
Budapesti Értéktőzsde Zrt.	0	2
Total	93	894

The above table presents short-term receivables and liabilities.

4.13 IMPAIRMENT LOSSES AND PROVISIONS

HUF millions

B/S line	Description	31.12.2013	Interim changes in 2014		31.12.2014
		Impairment losses / provisions	Increase (+)	Reversal (–)	Total impairment losses / provisions
1	2	3	4	5	3+4+5
I.2.	Forint receivables from credit institutions	0	1,455	0	1,455
I.3.	Other forint receivables	1,728	2,004	0	3,732
II.4.	Other foreign currency receivables	134	1	–117	18
III.	Invested assets	55	0	0	55
III.	Other assets	25	0	–3	22
VIII.	Liabilities	4,075	1,464	–1,272	4,267
	– litigation related liabilities	1,433	581	–296	1,718
	– derivatives	2,093	866	–515	2,444
	– bond lending	549	17	–461	105
Total		6,017	4,924	–1,392	9,549

Impairment losses and provisions increased by HUF 3,532 million to HUF 9,549 million in 2014.

On the forint receivables from credit institution, an impairment loss of HUF 1,455 million was created based on the expected recovery.

In relation to the forint receivables from supervisory activities, a HUF 2,002 million impairment loss appeared in total during the quarterly qualifications, and in relation to other forint receivables another impairment loss of HUF 2 million was recognised in 2014.

From the total impairment balance of other foreign currency receivables, an impairment loss of HUF 117 million was reversed because debt settlement. The remaining impairment loss increased by HUF 1 million due to revaluation.

The impairment loss on the other banking assets decreased by HUF 3 million because of settlement and write-backs in 2014.

In connection with litigation-related contingent liabilities, a provision of HUF 1,718 million was necessary as of 31 December 2014; compared to end-2013, in total there was a reversal of HUF 296 million and the formation of a provision in the amount of HUF 581 million.

The additional provision created due to the changes in the market value of derivatives for purposes other than hedging amounted to HUF 866 million, while a provision of HUF 515 million was reversed in 2014.

According to the international securities lending contracts, the MNB is charged with the entire amount of potential losses arising from cash-hedge investments made by agents. Based on the principle of prudence, a provision must be created to cover this loss as a future liability. The end-2013 balance of provisions created for forint bond lending amounted to HUF 549 million, which fell to HUF 105 million by 31 December 2014, caused by the decrease in the balance of the securities for which the provisions were created on the one hand, and due to the better market qualification of most securities on the other hand.

4.14 PREPAID EXPENSES/ACCRUED INCOME AND ACCRUED EXPENSES/DEFERRED INCOME

HUF millions

B/S line	Description	Balance		Change
		31.12.2013	31.12.2014	
	Due to banking transactions	136,015	111,765	-24,250
	Due to internal operation	97	239	142
IV.	Prepaid expenses/accrued income	136,112	112,004	-24,108
	Due to banking transactions	27,176	30,969	3,793
	Due to internal operation	114	485	371
X.	Accrued expenses/deferred income	27,290	31,454	4,164

Prepaid expenses, accrued income, accrued expenses, and deferred income include interest received/charged and interest related income/charges and expenses incurred in the reporting period, independently of the date of financial settlement.

4.15 CHANGES IN EQUITY

HUF millions

B/S line	Description	31.12.2013	Interim changes	31.12.2014
XI.1.	Share capital	10,000	0	10,000
XI.2.	Retained earnings	9,762	26,295	36,057
XI.3.	Valuation reserves	0	0	0
XI.4.	Revaluation reserves due to exchange rate changes	509,603	8,381	517,984
XI.5.	Revaluation reserves of foreign currency securities	-91,100	145,577	54,477
XI.6.	Profit/Loss for the year	26,295	1,065	27,360
XI.	Equity	464,560	181,318	645,878

The share capital consists of a single registered share with a nominal value of HUF 10 billion.

Pursuant to the MNB Act, the MNB's dividend is specified by the Executive Board. According to the decision of the Executive Board, the MNB will not pay any dividend from the profit and retained earnings for the year 2014.

For more details on revaluation reserves, see Section 4.16.

4.16 REVALUATION RESERVES

HUF millions

B/S line	Description	31.12.2013	31.12.2014	Change
XI.4.	Revaluation reserves due to exchange rate changes	509,603	517,984	8,381
XI.5.	Revaluation reserves of foreign currency securities	-91,100	54,477	145,577
	Total revaluation reserves	418,503	572,461	153,958

The official forint exchange rate versus the euro fluctuated in a range between EUR/HUF 296.91 and 316.61 in 2014. It reached its lowest value at the beginning of the year and its highest value in the first half of September. Compared to 31 December 2013, the exchange rate weakened by 6.1 per cent. The exchange rate was EUR/HUF 314.89 as at 31 December 2014. The average cost rate weakened by HUF 12.27 to EUR/HUF 293.42. As a result, the difference between the official and average cost rate was higher compared to end-2013 (an increase from EUR/HUF 15.76 to EUR/HUF 21.47). Consequently, the revaluation reserves due to exchange rate changes, calculated as the difference of foreign exchange items converted into forints using the official and average cost rate, increased by HUF 8.4 billion to HUF 518 billion.

Revaluation reserves of foreign currency securities are calculated as the difference between the market value and the amortised book value of securities due to the implementation of amortisation from end-2014. Market value differences on the foreign currency securities in the MNB's portfolio showed a balance of HUF 54.5 billion as at 31 December 2014. Compared to the end-2013 balance, from the positive change of HUF 145.6 billion the amortisation of foreign currency interest-bearing securities' premium and discount amounted to HUF 100 billion in proportion to the time until conversion, accounted as interest related income.

According to the MNB Act, the central government is not required to reimburse the negative balance, while the aggregated balance of the two revaluation reserves was positive.

Annual changes in the forint exchange rate

EUR/HUF

Date	MNB official exchange rate	Average cost rate
31.12.2013	296.91	281.15
31.12.2014	314.89	293.42
Annual appreciation (+) / depreciation (-)		
In 2013	-1.9%	
In 2014	-6.1%	

4.17 OFF-BALANCE SHEET LIABILITIES AND OTHER SIGNIFICANT OFF-BALANCE SHEET ITEMS OF THE MNB

Liabilities arising from hedging transactions and derivative transactions for purposes other than hedging with related receivables

HUF millions

No.	Description	31.12.2013			31.12.2014		
		Receivables	Liabilities	Net market value	Receivables	Liabilities	Net market value*
1.	Interest rate swap transactions	1,120,668	1,120,668	-20,015	1,706,451	1,706,451	1,579
2.	Bond future transactions	0	268,230	745	0	253,725	-842
3.	FX swap and forward transactions	1,412,604	1,385,476	27,449	4,545,709	4,478,330	62,573
4.	Currency swap transactions (including transactions without capital replacement)	1,365,134	1,360,789	21,552	3,323,474	3,384,534	-123,142
5.	Total hedging transaction (1+2+3+4)	3,898,406	4,135,163	29,731	9,575,634	9,823,040	-59,832
6.	CDS transactions	178,146	178,146	-2,075	188,934	188,934	-1,578
7.	FX swap and forward transactions	2,562	2,564	-2	3,149	3,154	-9
8.	Total derivative transactions for purposes other than hedging (6+7)	180,708	180,710	-2,077	192,083	192,088	-1,587
9.	Total (5+8)	4,079,114	4,315,873	27,654	9,767,717	10,015,128	-61,419

* Based on valuation at the balance sheet date.

The table above includes all types of off-balance sheet liabilities arising from derivative transactions; it also includes FX swaps, currency swaps and forward transactions for hedging purposes, which are part of the foreign currency position and are recorded in the balance sheet, except for currency swaps without capital movement. Hedging transactions reduce risks related to the net foreign currency position and arising from cross-rate fluctuations and interest rate changes. These transactions support the creation of the benchmark foreign currency structure determined by the Monetary Council.

Some interest rate swap transactions have been concluded with the Government Debt Management Agency and serve to limit the interest rate risks of FX debt. These are hedged by the MNB through reverse transactions on the capital market. Furthermore, the MNB concluded interest rate swap tenders with domestic credit institutions in 2014; the approved transactions have a maturity of 3 and 5 years.

The aim of bond futures transactions is to reduce the duration of the reserve portfolio; these are hedging transactions maturing within 1 year.

FX swap and forward transactions are the main instruments for hedging foreign exchange risk. The aim of interest rate swap transactions for hedging purposes linked to the specific bond issuance is to achieve the interest structure deemed desired by the MNB.

In 2014, in relation to the transactions related to the phasing-out of households' foreign currency loans in the banking system, the MNB provided the necessary amount of the foreign currency by spot FX sales transactions, complemented by available reverse, scrollable one-week FX swap transactions. In addition, the MNB concluded currency swap transactions with maturities of over one year with domestic credit institutions to provide the foreign currency needed for the conversion of household FX loans into forints.

Of the end-2014 balance, 16 per cent of the currency swap transactions consisted of transactions without capital replacement concluded in February and November 2013.

The item 'CDS transactions' (Credit Default Swap) is used to record transactions, the aim of which is to decrease the credit risk of two benchmark securities. The transactions will mature in 2016.

The FX swap and forward transactions for purposes other than hedging are based on expectations related to foreign exchange rate changes; their aim is to achieve the targeted foreign currency position, and their maturity is less than 1 year (typically 1 or 2 month).

Liabilities from derivative transactions by remaining maturity

HUF millions

No.	Remaining maturity	Balance		Change
		31.12.2013	31.12.2014	
	– within 1 year	1,683,756	5,128,008	3,444,252
	– within 1 to 5 years	855,874	2,795,580	1,939,706
	– over 5 years	1,595,533	1,899,452	303,919
1.	Hedging transactions	4,135,163	9,823,040	5,687,877
	– within 1 year	2,564	3,154	590
	– within 1 to 5 years	178,146	188,934	10,788
	– over 5 years	0	0	0
2.	Derivative transactions for purposes other than hedging	180,710	192,088	11,378
3.	Total (1+2)	4,315,873	10,015,128	5,699,255

Other off-balance sheet liabilities

HUF millions

No.	Description	Balance		Change
		31.12.2013	31.12.2014	
1.	FGS residual drawable credit facilities	31,629	43,747	12,118
2.	Litigation-related contingent liabilities	2,935	3,557	622
3.	Guarantees	1,364	1,634	270
4.	Other off-balance sheet liabilities	11	11	0
5.	Total (1+2+3+4)	35,939	48,949	13,010

The balance of FGS residual drawable credit facilities shows the amount from Pillars I and II of the FGS which has been contracted with commercial banks, but has not yet been disbursed.

Litigation-related contingent liabilities are to record the legal proceedings for which provisions have been formed. The majority of the proceedings are connected to the supervisory activities and contain proceedings against penalty resolutions as well as indemnity cases.

The item 'Guarantees' consists of export guarantees, to which an irrevocable indemnity bond is always linked. When exercising a guarantee, the MNB has the right to a reverse guarantee if needed. In 2014, the MNB was exempted from one guarantee, the increase in the balance was caused by exchange rate changes.

Other off-balance sheet liabilities by remaining maturity

HUF millions

No.	Remaining maturity	Balance		Change
		31.12.2013	31.12.2014	
	– within 1 year	34,603	47,348	12,745
	– within 1 to 5 years	38	44	6
	– over 5 years	0	0	0
	– without maturity	1,298	1,557	259
1.	Total other liabilities	35,939	48,949	13,010

Recording off-balance sheet security transactions

HUF millions

No.	Description	Balance		Change
		31.12.2013	31.12.2014	
1.	Face value of securities lent	607,596	613,892	6,296
	– automatic securities lending	16,969	35,093	18,124
	– agency securities lending	590,627	578,799	–11,828
2.	Purchase cost of the non-cash hedge arising from security lending transactions	133,544	126,627	–6,917
3.	Investment of cash hedge arising from security lending transactions			
	– at purchase cost	477,018	471,300	–5,718
	– at market value	476,469	471,196	–5,273
4.	Face value of securities bought under repo transactions	286,845	203,861	–82,984
5.	Face value of securities sold under reverse repo and blocked to ECB repo transactions	381,232	113,338	–267,894

4.18 NET INTEREST INCOME AND REALISED NET INCOME OF FINANCIAL OPERATIONS

Net forint and foreign currency interest and interest related income

HUF millions

P/L line	Description	2013	2014	Change
1	2	3	4	4-3
(I.1.+II.2.)–(X.1.+XI.1.)	Central government	–17,235	–24,575	–7,340
(I.2.+II.3.)–(X.2.+XI.2.)	Credit institutions	–12,750	–51,276	–38,526
(I.3.+II.1.+II.4.)–(X.3.+XI.3.)	Other	–17,132	84,354	101,486
	Net profit/loss from interest	–47,117	8,503	55,620
	Forint securities	400	611	211
	Foreign currency securities	0	–99,952	–99,952
	Derivative transactions for hedging and other purposes*	–2,696	4,575	7,271
	Other	–18	–16	2
(I.4.+II.5.)–(X.4.+XI.4.)	Net interest related profit/loss	–2,314	–94,782	–92,468
(I.+II.)–(X.+XI.)	Net interest and interest related income	–49,431	–86,279	–36,848

* For details on derivative transactions for hedging and other purposes, see the last table in this section.

In 2014, the MNB recorded a net interest and interest related loss of HUF 86.3 billion, representing a deterioration of HUF 36.8 billion compared to the figure for end-2013, which was a loss of HUF 49.4 billion.

Net interest income improved by HUF 55.6 billion in comparison to end-2013, mainly due to the decrease in the average base rate.

Positive factors in net interest income:

- interest expenses on the 2-week central bank instruments (on two-week MNB bills until August 2014 and on two-week MNB deposits from August 2014) were HUF 77 billion lower;
- interest expenses on other foreign currency liabilities decreased by HUF 7.2 billion, in part due to the maturity of foreign exchange bonds issued in the past by the MNB and in part due to repayment of the IMF loan in August 2013.

Negative factors in net interest income:

- a decrease in interest income on foreign exchange reserves of HUF 22.4 billion relative to 2013;
- a decline of HUF 6.7 billion in interest income on loans to credit institutions and mortgage bonds;
- interest paid on the forint and foreign currency deposits of the central government was higher by HUF 4 billion compared to 2013, due to the increasing balance of deposits;
- lower interest income on forint-denominated government bonds of HUF 3.3 billion caused by the maturity of bonds on the one hand, and by lower interest rates on the other hand.

Net interest related income decreased by HUF 92.5 billion, caused mainly by the one-off impact of the methodological changeover related to the recognition of the premiums and discounts of securities. For more information on the changes in accounting rules, see Section 4.1.1.

Details of income from derivative transactions for hedging and for purposes other than hedging represented in interest related income

HUF millions

No.	Description	2013	2014	Change
1.	– interest income on currency swaps	33,380	51,164	17,784
2.	– income like interest margin on hedge interest rate swaps	4,866	11,096	6,230
3.	– interest gains on hedge FX swaps	2,501	3,614	1,113
4.	– interest gains on hedge forward transactions	550	14,479	13,929
5.	– interest gains on hedge futures transactions	2,621	298	–2,323
6.	– interest related gains on hedge swap transactions	0	0	0
7.	– income from fees on hedge option transactions	0	151	151
8.	– interest income and interest related gains on other transactions	1,365	653	–712
9.	Income from derivative transactions (1+2+3+4+5+6+7+8)	45,283	81,455	36,172
10.	– interest expenses on currency swaps	39,271	63,758	24,487
11.	– expense like interest margin on hedge interest rate swaps	0	0	0
12.	– interest loss on hedge FX swaps	2,864	3,276	412
13.	– interest loss on hedge forward transactions	21	62	41
14.	– interest loss on hedge futures transactions	791	9,674	8,883
15.	– interest related losses on hedge swap transactions	4,147	0	–4,147
16.	– expenses from fees on hedge option transactions	0	0	0
17.	– interest expenses and interest related losses on other transactions	885	110	–775
18.	Expenses on derivative transactions (10+11+12+13+14+15+16+17)	47,979	76,880	28,901
19.	– net interest on currency swaps (1-10)	–5,891	–12,594	–6,703
20.	– interest margin on hedge interest rate swaps (2-11)	4,866	11,096	6,230
21.	– net interest gains on hedge FX swaps (3-12)	–363	338	701
22.	– net interest gains on hedge forward transactions (4-13)	529	14,417	13,888
23.	– net interest gains on hedge futures transactions (5-14)	1,830	–9,376	–11,206
24.	– net interest related income on hedge swap transactions (6-15)	–4,147	0	4,147
25.	– net interest related income on hedge option transactions (7-16)	0	151	151
26.	– net interest and interest related income on other transactions (8-17)	480	543	63
27.	Net income from derivative transactions (9-18)	–2,696	4,575	7,271

Currency swap transactions include derivative transactions concluded with foreign partners, with the Government Debt Management Agency, and with domestic credit institutions. The transactions concluded with foreign partners serve to hedge exchange rate and interest rate risks arising from bonds issued abroad by the MNB in the past. The amount of transactions concluded with the Government Debt Management Agency did not change significantly in 2014, and changes in FX market yields (euro and US dollar yields) had an unfavourable impact on the result. The amount of transactions concluded with domestic credit institutions was considerably higher compared to end-2013, caused by transactions related to Funding for Growth Scheme (FGS) and to the phasing-out of households' foreign currency loans. The net interest result of the currency swaps was a loss of HUF 12.6 billion, and accordingly there was a decline of HUF 6.7 billion compared to 2013.

The HUF 6.2 billion increase in the interest result on interest rate swaps was caused by the rising number of transactions and by the favourable changes in FX market yields.

Hedge FX swaps include short-term transactions concluded with foreign partners, with the Government Debt Management Agency, and with domestic credit institutions. Net interest gains on these swaps rose by HUF 0.7 billion caused mainly by transactions related to the phasing-out of households' foreign currency loans.

The amount of hedge forward transactions increased due to the transactions related to the foreign currency bond issue of the Government Debt Management Agency in March; the average amount of these transactions in 2014 was significantly higher than in 2013. Net interest gains on hedge forward transactions increased by HUF 13.9 billion, resulting from the difference in interest on the higher amount.

Net interest gains on hedge futures transactions decreased by HUF 11.2 billion, due to the higher interest expense on bond futures transactions.

Realised gains/losses from financial operations

HUF millions

P/L line	Description	2013	2014	Change
IV.	Realised gains from financial operations	26,221	3,435	-22,786
XIV.	Realised losses from financial operations	138,819	123,012	-15,807
IV.-XIV.	Net financial gains/losses	-112,598	-119,577	-6,979

Realised gains and loss from financial operations include gains and losses arising from sales and maturities of securities, from sales of investments arising from security lending transactions and gains and losses related to CDS transactions.

Net realised losses from financial operations amounted to HUF 119.6 billion in 2014, deteriorating by HUF 7 billion compared to 2013. Losses mainly occurred upon the maturity of bonds with high coupons which were bought over nominal value.

4.19 COMPONENTS OF INCOME FROM THE REVALUATION OF FOREIGN EXCHANGE HOLDINGS

HUF millions

Description	2013	2014
Net income from exchange rate changes (realised and conversion spread)*	200,339	510,989
Change in revaluation reserves in the balance sheet** (due to unrealised revaluation net income)	-54,438	8,381
Total effect of exchange rate changes	145,901	519,370

* P/L line: III.-XII.
 ** Revaluation reserves due to exchange rate changes (balance sheet line XI.4.).

In 2014, the total exchange rate change effect was a gain of HUF 519.4 billion, due to the changes in the exchange rate of the forint. In the sales related to decreasing the daily net FX position, the MNB realised a gain of HUF 511 billion, while the amount of the revaluation reserve was increased by the unrealised exchange rate changes gains of HUF 8.4 billion during the year.

For more details on revaluation reserves, see Section 4.16.

4.20 COST OF ISSUING BANKNOTES AND COINS

HUF millions

P/L line	Description	2013	2014	Change
	Cost of banknote production	2,864	3,660	796
	Cost of coin production	1,027	1,159	132
	Cost of production of commemorative and collector coins	266	369	103
XIII.	Cost of issuing banknotes and coins	4,157	5,188	1,031

The cost of issuing banknotes and coins was HUF 5.2 billion in 2014, up 24.8 per cent compared to the preceding year. In particular, the cost of banknote production rose by 27.8 per cent, mainly as a result of the increase in production needs due to the banknote issuance program. The cost of coin production went up by 12.9 per cent, which was caused by the higher price per unit of several denominations compared to the previous year. The increase in the production costs of commemorative coins of 38.7 per cent stemmed from two reasons: 1) from the near threefold increase in the quantity of coins produced in 2014 relative to the quantity in 2013 due to the growing demand for silver and non-ferrous coins; and 2) from the fact that in 2013 only 8 types of coins were issued, while in 2014 there were 13.

4.21 OTHER INCOME/EXPENSES

HUF millions

P/L line	Description	2013	2014	Change
V.1.	Income from fees and commissions	1,423	936	-487
XV.1.	Expenses of fees and commissions	755	837	82
	Net income from fees and commissions	668	99	-569
V.2.	Income from other than fees and commissions	6,343	1,588	-4,755
XV.2.	Expenses of other than fees and commissions	2,545	251,564	249,019
	Net income from other than fees and commissions	3,798	-249,976	-253,774
V.3.	Income from supervisory activities	2,870	13,002	10,132
V.-XV.	Other net results	7,336	-236,875	-244,211

Income from fees and commissions mainly relates to payment services. In 2013, the higher income from fees and commissions stemmed from the commission related to the residual drawable FGS credit facilities, while in 2014 no similar income was recorded.

For more details on income other than fees and commissions, see Section 4.22; in respect of income related to supervisory activities, see Section 4.24.

4.22 INCOME OTHER THAN FEES AND COMMISSIONS

HUF millions

P/L line	Description	2013	2014	Change
	Income from sales of employee loans	0	312	312
	Income related to coins and commemorative coins	419	472	53
	Non-repayable money received	2,532	0	-2,532
	Profit from the withdrawal of notes and coins	2,145	0	-2,145
	Dividends from investments	1,187	741	-446
	Income from assets assigned free of charge	52	2	-50
	Other income	8	61	53
V.2.	Income from other than commissions and charges	6,343	1,588	-4,755
	Financial money transfer	2,352	248,240	245,888
	Expenses from sales of employee loans	0	443	443
	Expenses related to coins and commemorative coins	176	436	260
	Expenses from assets assigned free of charge	3	2,423	2,420
	Other expenditures	14	22	8
XV.2.	Expenses from other than commissions and charges	2,545	251,564	249,019
V.2.-XV.2.	Net income/expenses from other than commissions and charges	3,798	-249,976	-253,774

Income other than fees and commissions includes the following in 2014:

- The item ‘Financial money transfer’ includes final money transfers for financial and professional purposes mainly to foundations and to schools, as well as donations for charitable purposes. The majority (HUF 245 billion) of the balance is the allocation of founders’ financial assets related to the Pallas Athena Public Thinking Programme launched by the MNB. For more details, see Section 4.23.
- Expenses from assets assigned free of charge includes the transfer of non-financial assets (real property) of HUF 2.4 billion to the foundations established in the framework of the Pallas Athena Public Thinking Programme.
- Dividends from investments decreased by HUF 0.4 billion compared to 2013. In the first half of 2014, Magyar Pénzverő Zrt. paid a dividend of HUF 52 million to the MNB, and BÉT paid HUF 39 million to the MNB. The BIS paid the dividend of HUF 650 million (EUR 2.1 million) in July. In line with the decision of the shareholder, KELER Zrt. and KELER KSZF Zrt., according to the decision of their general meetings, Pénzjegynyomda Zrt. and GIRO Zrt. did not pay any dividend from their 2013 results, and the whole amount was transferred to retained earnings.
- Net income related to coins and commemorative coins depends on the commemorative coin programme, and arises mainly from the difference between the income from sales of commemorative coins (of HUF 462 million) and the expenses related to the removal of the coins’ face value (of HUF 426 million). From 2014, by agreement, the sale of commemorative coins is accounted with the Pénzverő Zrt. at face value, except when the production cost exceeds the face value. Consequently, the net income is generated mainly in the issuance of piedfort weight coins. In 2014, in line with the commemorative coin programme, 13 new types of coins were issued, while in 2013 only 8 types were produced and issued.
- The item ‘Income and expenses from sales of employee loans’ refers to the loans granted by the HFSA to its employees before the integration and taken over by MNB upon integration of the HFSA. These employee loans were sold to a credit institution. The items include the income arising from the sale and book value of the loans.

4.23 PALLAS ATHENA PUBLIC THINKING PROGRAMME

The priority goals of the Pallas Athena Public Thinking Programme are to facilitate easier access for Hungarian researchers to the latest approaches in economics, to raise the quality of Hungarian education in economics, and to improve the general population's economic literacy through educational and individual talent management programmes and by the establishment of training centres (internationally recognised doctoral school and research centre).

In order to realise these objectives, the MNB has established six foundations in the framework of its public thinking programme, and in 2014 it allocated to the foundations monetary founders' assets amounting to a total of HUF 245 billion, and non-monetary assets (real property) worth HUF 2.4 billion, as follows:

HUF millions

Name of the foundation	Money transfer	Real estate transfer
Pallas Athena Domus Animae Foundation	56,000	1,850
Pallas Athena Domus Scientiae Foundation	48,000	572
Pallas Athena Domus Mentis Foundation	28,000	
Pallas Athena Domus Concordiae Foundation	48,000	
Pallas Athena Geopolitical Foundation	28,000	
Pallas Athena Domus Innovationis Foundation*	37,000	
All Pallas Athena Foundations	245,000	2,422

** Registration was in progress at 31 December 2014; registration took place on 10 April 2015.*

The allocation of assets worth HUF 245 billion and HUF 2.4 billion was recorded in the P/L under item 'expenses from other than commissions and charges'. See Section 4.22.

Foundations were established to achieve the following objectives:

The objectives of the Pallas Athena Domus Animae Foundation are to

- support the training of economists and finance professionals, and promote research programmes in economics, finance and interdisciplinary studies;
- embrace and develop arts, education and science through the establishment of institutional, financial and social frameworks allowing for the creation and/or implementation of higher education institutions and other related institutions and endeavours;
- develop educational activities, create and support research facilities;
- provide professional and financial assistance for higher education institutions and related scientific organisations;
- facilitate and support collaboration with similar organisations in Hungary and abroad, while also operating joint projects, programmes and institutions, thereby strengthening Hungary's international relations in education and research;
- ensure education, competence development and the spread of information;
- support the higher education of ethnic Hungarians abroad and the related activities in scientific research and development.

The goals of the Pallas Athena Domus Scientiae Foundations are as follows:

- support and facilitate the training and development of economic and finance professionals, particularly those involved in banking;
- promote and advance the development of education in economics and the organisation of banking seminars, as well as accredited programmes, internationally accredited courses and trainings in connection with the management of EU-funded grants;
- publish books, journals and other forms of professional literature on credit institutions;
- promote and support collaboration with similar organisations in Hungary and abroad while also operating joint projects, programmes and institutions.

The goals of the Pallas Athena Domus Mentis Foundations are as follows:

- to support the training of economists and finance professionals, and promote research programmes in economics, finance and interdisciplinary studies, across Bács-Kiskun County and primarily in Kecskemét;
- to embrace and develop arts, education and science through the establishment of institutional, financial and social frameworks allowing for the creation and/or implementation of higher education institutions and other related institutions and endeavours in Kecskemét;
- to develop educational activities and to create and support research facilities across Bács-Kiskun County and primarily in Kecskemét;
- to provide professional and financial assistance to higher education institutions and related scientific organisations based in Bács-Kiskun County;
- to facilitate and support collaboration with similar organisations in Hungary and abroad, while also operating joint projects, programmes and institutions, thereby strengthening Hungary's international relations in education and research;
- to ensure education, competence development and the spread of information;
- to support, in cooperation with Kecskemét College, the higher education of ethnic Hungarians abroad and the related activities in scientific research and development.

The objectives of the Pallas Athena Domus Concordiae Foundation are to:

- support and facilitate the training of economists and finance professionals beyond Hungary's borders, particularly within the Carpathian Basin, and promote and support economic, financial and interdisciplinary research;
- embrace and develop arts, education and science through the establishment of institutional, financial and social frameworks allowing for the creation and/or implementation of higher education institutions and other related institutions and endeavours;
- develop cross-border educational activities, particularly within the Carpathian Basin; set up and support research facilities;
- provide professional and financial assistance for higher education institutions and related scientific organisations abroad;

- facilitate and support collaboration with similar organisations in Hungary and abroad, while also operating joint projects, programmes and institutions, thereby strengthening Hungary’s international relations in education and research;
- education, competence development and transmission of knowledge;
- support the higher education of ethnic Hungarians abroad, particularly within the Carpathian Basin, and the related activities in scientific research and development.

The objectives of the Pallas Athena Geopolitical Foundation are as follows:

- to promote knowledge generation in geostrategy and geopolitics which, while describing and forecasting global processes and local development, can be used to foster the economic development of Hungary and its regions as well as the broader region;
- to advocate and monitor a more in-depth exploration of fields related to geopolitics, such as industry and policy trends, security policy, economic history and urban development;
- to ensure the networked sharing of knowledge and experiences in the given field, encourage collaboration with international geostrategic institutes (think tanks), promote Hungary’s participation in international programmes and implement international achievements at home;
- to establish and invite to Hungary a network featuring the most prominent strategists and experts in geostrategy and geopolitics;
- to facilitate research in economic geography, economic theory and local economics that can be used in economic policy, social management and planning;
- to stimulate professional activity in economic strategy and planning, particularly through support for workshops, research groups and forums;
- to establish an institute for geostrategy and geopolitics with the involvement of workshops;
- to promote publication activity in geostrategic and geopolitical literature;
- to study the correlations between economics, its related fields in social sciences and geography, and geopolitics;
- publish the most significant international literature in Hungarian.

The objectives of the Pallas Athena Domus Innovationis Foundation are to:

- establish and operate a scientific, research and development, innovation and modernisation knowledge centre;
- promote knowledge creation, and the sharing of scientific knowledge and experience;
- promote and support interdisciplinary research, new scientific and economic knowledge and the achievement of results in breakthrough thematic areas of the economy and domestic competitiveness (bionics, robotics, healthcare, health industry, health services, tourism, start-up enterprises);

- promote research and development applicable in the economy and disseminate the achieved results and thus facilitate the competitiveness of small and medium-sized enterprises;
- strengthen high value-added employment;
- foster Hungarian and international cooperation in science and technology, research and development and modernisation;
- build corporate clusters and networks in the fields of science, research and development, innovation and modernisation; promote and support their establishment;
- enrich the Hungarian intellectual heritage;
- promote and develop international economic relations, implement international results;
- support the acquisition of professional experience abroad;
- improve the quality of educational methods;
- publish and support the publication of textbooks, books, journals and other forms of professional literature dedicated to the subjects of science, innovation and modernisation;
- facilitate and support collaboration with similar organisations, operate joint projects and programmes;
- participate in Hungarian and European Union assistance programmes and tenders;
- provide consulting and information services.

4.24 INCOME FROM SUPERVISORY ACTIVITIES

HUF millions

P/L line	Description	2013	2014	Change
	Supervisory fee and default interest	1,982	8,503	6,521
	Received penalties and reimbursement from public proceedings	862	4,373	3,511
	Administrative servicing fee from public proceedings	26	126	100
V.3.	Income from supervisory activities	2,870	13,002	10,132

Income from supervisory activities amounted to HUF 13 billion in 2014; the increase compared to 2013 was caused by the fact that the integration of the MNB with the HSFA was realised from 1 October 2013, and consequently the numbers for 2013 included only the income of one quarter.

The main item of income from supervisory activities is the supervisory fee received from the supervised institutions obliged to pay this fee. In 2014, the income arising from the assessment of the minimum charges for the entire year and of the quarterly payable variable-rate fees amounted to HUF 8.5 billion. Penalties imposed by the MNB, which became final and from reimbursements added up to HUF 4.4 billion in 2014. In connection with penalties, an impairment of HUF 2 billion was also created in the period under review for the recoveries, as well as for litigation items based on the probability of losing a lawsuit (see Section 4.13). The item 'Administrative servicing fee' includes the magisterial exam fees.

4.25 OPERATING INCOME AND EXPENSES

HUF millions

P/L line	Description	2013	2014	Change
	Income from assets and inventories	174	90	-84
	Income from subcontracted services	24	63	39
	Income from invoiced services	115	364	249
	Other income	19	43	24
VIII.	Total operating income	332	560	228
	Cost of materials	3,792	14,276	10,484
	Personnel-related costs	9,076	16,329	7,253
	Depreciation	1,733	2,109	376
	Transfer of costs of other activities	-249	-539	-290
	Total operating costs	14,352	32,175	17,823
	Expenses incurred on assets and inventories	177	56	-121
	Expenses incurred on subcontracted services	23	63	40
	Expenses incurred on invoiced services	115	366	251
	Other expenses	92	79	-13
	Total operating expenses	407	564	157
XVIII.	Total operating costs and expenses	14,759	32,739	17,980
VIII.-XVIII.	Net operating expenses	-14,427	-32,179	-17,752

Net operating expenses amounted to HUF 32.2 billion in 2014, representing an increase of HUF 17.8 billion compared to the year 2013.

Operating costs were 124.2 per cent (HUF 17.8 billion) higher than previous year. The main reason for this increase was that until 30 September 2013 the MNB's scope of competence did not include supervisory activity. Moreover, the communication costs related to the Funding for Growth Scheme and the personnel costs of standardisation of the benefit system increased expenditures. Due to the HFSA – MNB integration, most cost elements increased.

The *cost of materials* in the reporting year was nearly HUF 14.3 billion, up significantly compared to the costs incurred in the previous year; this was mainly due to the following reasons:

Other costs rose considerably in 2014 compared to the previous year. The main reason for this increase is the communication costs for the Funding for Growth Scheme, approved by the MNB's Board of Directors. In addition, in relation to supervisory activity, membership fees rose significantly as the institutional memberships of the HFSA were transferred. In the case of the largest membership fees, EU regulations prescribe mandatory contribution to the EU organisation's budget. Legal costs also increased significantly, in particular due to the establishment of the central bank's asset management, and as a result of a various of legal expenses related to real estate purchases.

- The audit fee for 2014 amounted to HUF 37.2 million.
- Compared to the previous year operating costs also increased. This is mainly due to the total annual rent of the property at Krisztina krt. In line with the increased number of properties owned by the MNB, the utilities, property maintenance, cleaning and guarding costs were also higher.
- In 2014, IT costs increased to a lesser extent than in the past. The impact of the signed support contracts and the decisions made in 2013 was felt throughout 2014. The costs also include the financial requirements of the contracts previously concluded by the HFSA, and the costs of the IT investments, which were implemented.

Personnel-related costs increased by 79.9 per cent (nearly HUF 7.3 billion) compared to the previous year. The events of 2013 had a fundamental impact on the 2014 costs. The most important of these was the integration of the HFSA into the MNB on 1 October 2013, modification of the remuneration system, and the phasing-out of the bonus system.

Depreciation increased by 21.7 per cent (by HUF 0.4 billion) in 2014 versus the previous year, mainly as a full-year depreciation charges on the assets taken over from the HFSA, and the properties purchased during the year.

The *transfer of costs* is intended to ensure that the total amount of operating expenses reflects only the actual expenses incurred by the MNB. Transfer of costs amounted to HUF 0.6 billion, more than twice the amount from 2013. This was due, on the one hand, to the transferred depreciation of leased areas of the office building purchased during the year, and on the other hand to the performance settlement of developments implemented from own resources, which was transferred from April 2014.

4.26 INFORMATION ON WAGES AND NUMBER OF STAFF

HUF millions

Description	2013	2014	Change (%)
Payroll costs incurred on staff	5,580	10,625	90
Other staff costs*	599	429	-28
Payroll	6,179	11,054	79
Other payments to personnel	922	1,720	87
Taxes on personnel related payments	1,975	3,555	80
Payments to personnel	9,076	16,329	80

* Other wage costs include payments on termination and in exchange for vacation time used and amounts paid to non-staff and non-MNB workers.

Persons

Description	2013	2014	Change (%)
Average number of staff	727	1,192	64

Remuneration of executive officers

		<i>HUF millions</i>
Bodies	Compensation	
Monetary Council*	138	
Supervisory Board	28	
<i>* Includes the salaries and employer's voluntary pension fund contributions of external members of the Monetary Council in an employment relationship with the MNB, pursuant to Article 9 (4) c) of the MNB Act.</i>		

The senior officers, such as members of the Board of Directors and the Supervisory Board, had employer's loan outstanding vis-à-vis the Bank in the amount of HUF 68 million as at 31 December 2014.

The Bank has no obligation to pay pension benefits to its former senior officers.

27 May 2015, Budapest

Dr György Matolcsy
Governor of the Magyar Nemzeti Bank

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Print: Prospektus–SPL consortium
H-8200 Veszprém, Tartu u. 6.

