Notice on the terms and conditions of the three-year floating rate payer forint interest rate swaps conditional on lending activity[1]

I. Description of the transaction and access conditions

In order to reduce credit risk and boost economic growth through lending to SMEs, in 2016 the Magyar Nemzeti Bank (MNB) will launch its Market-Based Lending Scheme (MLS) designed to help banks change over to market-based financing. As part of the MLS the MNB will introduce an interest rate swap conditional on lending activity (LIRS), which is expected to promote lending through managing banks' interest rate risks arising from lending to SMEs, through the partial assumption of such risks by the MNB.

Under the facility, the MNB pays the six-month BUBOR interest rate based on the interest rate computation algorithm of the actual number of days/360 to the Counterparty during the six-month interest period, while the Counterparty pays the annual fixed interest rate defined in the transaction based on the interest rate computation algorithm of the actual number of days/365 to the MNB. Within the framework of the LIRS transaction all mutual obligations between the MNB and the Counterparty applying to the same value date will be offset and settled on a net basis by paying the resulting balance only. The MNB computes the floating interest rate for the first period by interpolating the value of the two nearest BUBOR reference interest rates prevailing on the transaction date bracketing the term of the first period.

The MNB will conduct variable-price tenders with T+2 value date.

The MNB defines a minimum fixed interest rate for specific tenders and publishes the announced quantity. Following the submission of bids, the MNB is entitled to define the accepted quantity, which may diverge upwards or downwards from the announced quantity. If the accepted quantity is lower than the amount of bids submitted, the MNB decides on the acceptance of bids after ranking them by interest rate. If the satisfaction of all bids linked to the lowest eligible fixed rate exceeds

[1] Included in a unified structure with modifications that have been in effect since 6 February 2017 and 1 July 2017.

the accepted quantity, the MNB will satisfy these bids based on the rules of card allocation in units of HUF 10 million until the maximum accepted quantity is reached.

The tenders are open to resident credit institutions (Counterparties) subject to reserve requirements with direct VIBER or BKR membership with the exception of the Hungarian Development Bank Plc. and the Hungarian Export-Import Bank Plc., as specialised credit institutions pursuing special activity. By participating in the tenders the Counterparty undertakes to comply with the condition pertaining to net lending to micro, small and medium-sized non-financial enterprises as well as self-employed persons during the term of the transaction in each calendar year, that is, in line with the interest rate swap volume used during the term of the LIRS, it ensures in each calendar year that the value of the reference credit aggregate indicator, based on the formula below, reaches 25 per cent of the nominal value of the used LIRS.

$$Indicator_t = \sum_{n=0}^{11} Tr_{t-n} - \sum_{n=0}^{11} El_{t-n} - 0{,}25 * \sum_{n=0}^{11} NHP_{t-n}$$

where

Tr_{t-n}: The balance of the loans disbursed to micro, small and medium-sized enterprises as well as self-employed persons during the period preceding the reference period by *n* months and repaid by them during the same period, based on reports SF07HT, SF07HA, SF07HB and the consolidated version of the same reports (reports K7HT, K7HA and K7HB). n=0,1,2,…,11. t= December of the respective calendar year.

In addition, at the initiative of the Counterparty the MNB leaves the part of redemption volumes out of consideration that was generated from prevailing non-performing stocks upon inspection of the reference indicator. The amount of redemption volume left unconsidered is determined by the MNB on the basis of the report of the Counterparty detailed in the Annex (NPLKKV) and all other data accessible to the MNB.

If the Counterparty has approved in its statement delivered to the MNB by 31 July 2017, that in assessing the delivery on its lending commitment, the MNB may take into account, based on data provided by an institution having a legal relationship of intermediary with the Counterparty, reports on Referred transactions pursuant to the Notice, and within the same deadline, it gives a written authorization to an institution having a legal relationship of intermediary with it for the provision of these reports to the MNB, furthermore, an institution having a legal relationship of intermediary with the Counterparty sends the relevant data to the MNB, then the MNB will take into account in the assessment of the reference indicator of the credit type financial

facilities (such as loan, leasing provided by the credit institution on its own or in credit programmes combined with non-refundable support) provided to micro, small and medium enterprises and self-employed persons, from sources of the European Union available in the Union budget cycle between 2014 and 2020, the outstanding balance of 75 per cent of principal lent related to transactions referred by the Counterparty (Referred transactions) and completed in the given period, on the one hand, and the repayment of principal completed in the same period on the other hand.

El_{t-n}: Gross value of the performing outstanding lending to micro, small and medium-sized enterprises as well as self-employed persons, sold *n* months before the reference period based on reports SF07HT, SF07HA, SF07HB and the consolidated version of the same reports (reports K7HT, K7HA and K7HB). n=0,1,2,…,11. t= December of the respective calendar year.

In order to eliminate the exchange rate effect, the forint equivalent of the disbursements, repayments and sold items denominated in foreign currency is calculated at the same exchange rate, which is achieved by dividing it with the average (quarterly) exchange rate applicable to the reporting period and multiplying it with the average exchange rate valid for the first quarter of the tender's calendar year.

NHP_{t-n}: The volume of loans disbursed to micro, small and medium-sized enterprises as well as self-employed persons *n* months before the reference period within the framework of the Funding for Growth Scheme and the Funding for Growth Scheme Plus based on report AL8. n=0,1,2,…,11. t= December of the respective calendar year.

The MNB verifies compliance with the above criteria annually in retrospect, based on reports SF07HT, SF07HA, SF07HB and their consolidated version (reports K7HT, K7HA and K7HB), as well as on reports AL8 and the annual report detailed in the Annex, submitted after the last quarter of the calendar year (NPLKKV). The first verification will be performed in February 2017. During verification, the MNB will check the percentage rate of the Counterparty's compliance with the growth criterion prescribed for net lending to micro, small and medium-sized enterprises as well as self-employed persons, in the reference year preceding the verification. Upon non-compliance with the conditions the MNB is entitled to assess the external circumstances and the Counterparty's instrumentality.

The above criteria must be satisfied on a consolidated basis, as set out in the related reports; credit institutions forming part of the list of eligible MNB counterparties must satisfy the conditions jointly with their affiliates. In the case of Counterparties in which the Hungarian State has a qualifying

holding, the conditions of the central bank instruments shall be satisfied exclusively in respect of the credit institution and its own affiliated companies. Cooperative credit institutions keeping their account with the Magyar Takarékszövetkezeti Bank Zrt. may participate in the compliance with the condition by forming a group with Takarékbank. Following verification of the given year the MNB will notify the Counterparties that failed to comply with the conditions specified in this Notice, by the last working day of February.

After the first auction to be held on 28 January 2016, the MNB will hold auctions every two weeks. The MNB undertakes to announce at least five auctions. The MNB is entitled to announce additional auctions beyond that date. The maturity of LIRS transactions concluded at any tender will be 28 February 2019.

The Counterparty may terminate the LIRS transaction prior to maturity in full or in part with a value date of 28 February 2017 and 28 February 2018 (voluntary termination). The Counterparty must give advance notice to the MNB of its intention to close the transaction voluntarily by at least 6 working days before the closing date. The MNB provides an indicative valuation at the Counterparty's request prior to the initiation of termination.

If new lending by the Counterparty does not reach at least 50 per cent of the undertaken level in the given calendar year, the MNB will regard the Credit Institution as ineligible to use the LIRS and it will close the LIRS transaction of the given Credit Institution in full (involuntary termination). In this case the MNB closes the full LIRS holding of the Counterparty, while the Counterparty shall pay a penalty to the MNB in line with the realised income content. The realised income content in respect of the calendar year preceding the verification (the ineligible period) shall be the value of the difference, due for the period between March of the calendar year preceding the verification until February of the calendar year of the verification, between the closing interest rate of the given transaction and the actual interest rate reached at the auction at the closing date, increased by the interest accrued on it at the base rate (net of capitalisation).

$$Realised\ income\ content = -FV\left(\frac{CF_{fixleg,i}}{c_i} * s_i\right)$$

Where

c_i is the interest rate of the ith IRS' fixed rate leg in basis points

s_i is the difference between the interest rate of the ith IRS' fixed rate leg and the market reference rate prevailing at the start of the transaction, in basis points

FV is the given amount increased by the prevailing central bank base rate from the due date until the value date of the closing

$CF_{fixleg,i}$ is the cash flow of the ith IRS' fixed rate leg due until the end of February of the calendar year of the verification

The MNB calculates the closing value of the LIRS based on the following formula:

$$Closing\ value = \frac{NPV_{fixleg,i}}{c_i} * (c_i + s_i) + NPV_{float.leg,i}$$

Where

c_i is the interest rate of the ith IRS' fixed rate leg in basis points

s_i is the difference between the interest rate of the ith IRS' fixed rate leg and the market reference rate prevailing at the start of the transaction, in basis points

$NPV_{fixleg,i}$ is the present value of the ith IRS' fixed rate leg

$NPV_{float.leg,i}$ is the present value of the ith IRS' floating rate leg

If new lending by the Counterparty reaches 50 per cent of the undertaken level, but falls short of 100 per cent, the MNB regards the Counterparty as partially ineligible to use the LIRS. In this case the Counterparty shall pay a penalty to the MNB corresponding to the undue realised income content, being the product of the full realised income content and the ineligibility ratio. Upon verifying compliance with the conditions of the LIRS transaction, the MNB defines the Counterparty's ineligibility ratio. The ineligibility ratio shows the degree of the shortfall in the Counterparty's actual net lending in the given calendar year of the net lending value it has undertaken by concluding the LIRS transaction (stipulating that the ratio is not negative and may not exceed 100 per cent):

$$Ineligibility\ ratio = \frac{(HIRS_t * 0{,}25) - Indicator_t}{(HIRS_t * 0{,}25)}$$

Where

$LIRS_t$: The nominal value of the LIRS holding outstanding at the end of the given period. t = December of the calendar year.

The Counterparty shall pay the penalty to the MNB by authorising the MNB to debit the Counterparty's settlement bank account – subject to prior notice to the Counterparty – within 30 days from the assessment of the penalty. If the Counterparty's MNB forint settlement account does not provide sufficient cover for the debit entry, the MNB shall – without the Counterparty's

separate request, but subject to simultaneous notification – shall provide the Counterparty with an overdraft up to the required amount. The repayment of this overdraft shall become due simultaneously with the disbursement. The interest rate on this overdraft shall be the double of the prevailing central bank base rate; the MNB charges no default interest on the overdraft.

The MNB maintains a margin account for the Counterparty and evaluates the transactions concluded in the context of tenders daily. The MNB offsets the potential future adverse shift in the value of the LIRS transactions through the margin account.

The Counterparty's margin account balance must correspond to the amount calculated as follows: the MNB manages the future potential valuation changes by the initial margin part and the actually incurred valuation changes by the variation margin part. The initial margin values – applicable to the remaining term of the transactions – are summarised in the table below.

Initial margin value of the LIRS transactions

Maturity	**Margin %**
0-1 year	**0.5**
1-2 year	**1**
2-3 year	**2**

The margin is calculated based on the following formulas:

$$M_i = \frac{NPV_{fixleg,i}}{c_i} * (c_i + s_i) + NPV_{float.leg,i} + N_i * h_i$$

$$M = \sum_i M_i$$

where

M	is the margin account balance expected in the context of the IRS, by Counterparty
M_i	the margin account balance part expected in the context of the ith IRS
$NPV_{fixleg,i}$	is the present value of the ith IRS' fixed rate leg
c_i	is the interest rate of the ith IRS' fixed rate leg in basis points
s_i	is the difference between the interest rate of the ith IRS' fixed rate leg and the market reference rate prevailing at the start of the transaction, in basis points

$NPV_{float.leg,i}$	is the present value of the ith IRS' floating rate leg
N_i	is the nominal value of the ith IRS
h_i	is the multiplier applicable to the maturity of the ith IRS, which may take the values shown in the table above.

II. Detailed parameters and technical criteria

Type of transaction	Three-year floating rate forint interest rate swap conditional on lending activity (LIRS)
Date, place and contents of notice/invitation	The MNB will announce the tender on Reuters NBH0 and Bloomberg NBH5 at 12:00 pm on the tender day. The first auction will be held on 28 January 2016. The invitation defines the transaction date, the minimum eligible fixed rate, the spread on the floating interest rate applied in the transaction, the floating interest rate of the first period, the announced quantity and the interest rate applicable upon the termination of transaction.
Eligible counterparties	Resident credit institutions subject to reserve requirements with direct VIBER or BKR membership, committing to the terms set out herein by participating in the tender. The Hungarian Export-Import Bank Plc. and the Hungarian Development Bank Plc. do not qualify as eligible counterparties.
Maturities	Defined in the tender notice.
Proposed by	Counterparty
Business hours for receiving bids	On tender days between 12:00 pm and 1:00 pm
Content and formal requirements for the bids	Bids can be submitted via Reuters Dealing platform or, alternatively, by fax, specifying the nominal forint value of the requested interest rate swap and the offered interest rate specified as a percentage rounded to the second decimal place
Number of bids accepted from any bidder	3
Offer limit	At least HUF 100 million per bid, as an integer multiple of HUF 10 million
Corrections	The last bid is valid among the amended bids submitted within the window of acceptance.
Bid increment	HUF 10 million

Date and place of announcements	On the day of the tender at 2:00 pm on Reuters' NBH0 and Bloomberg's NBH5
Contents of the announcement	Amount of the bids submitted, amount of the bids accepted, average accepted fixed rate, minimum accepted fixed rate and maximum accepted fixed rate
Time of daily revaluation and margin account transactions	Published: Until 4:00 pm on the transaction day and until 12:00 pm on all other trading days. Counterparties are notified via a SWIFT message. Time of account transactions: Between 12:00 pm and VIBER closing.

The "Terms and Conditions of the Operations of the Central Bank in Forint and Foreign Currency Markets" shall govern any matters not regulated herein.

Budapest, 7 June 2017

MAGYAR NEMZETI BANK

Annex – NPLKKV report: instructions for completion

At the initiative of the Counterparty, upon inspection of the reference credit aggregate indicator the MNB leaves out of consideration the part of redemption volumes calculated in reports SF07HT, SF07HA, SF07HB, and in their consolidated versions (reports K7HT, K7HA and K7HB) that are related to the prevailing non-performing resident SME stocks, if the Counterparty makes the required data available for the MNB using the report in this Annex, in a manner and by the deadline specified in this Annex.

For the Counterparty where the review of compliance is completed on a consolidated basis cumulatively and is based on reports with identification codes K7HT, K7HA and K7HB, report NPLKKV shall also be done in a consolidated manner.

The report shall be submitted by Counterparties that made a LIRS transaction, and who initiate that the MNB should not consider the amount of the redemption volume of non-performing stocks upon the review of the reference credit aggregate indicator.

Reports shall be submitted in the KAP system once quarterly until the last day of the month following the quarter under review. The classification and value definitions of the report are identical with those applied in reports K7HT, K7HA and K7HB (this way e.g. the non-performing loan, SME classification, the gross redemption volumes, the definition of gross opening and closing stocks in particular).

Details regarding the volumes and transactions of the residents' non-performing SME transactions must be recorded in a breakdown by quarters. The transaction should be reported for first time from the quarter, when the transaction became non-performing.

<u>The rows in the template</u>

Transactions with a gross outstanding principal not exceeding HUF 100 million shall be reported together in row ***NPLKKV2 Not detailed***. Volumes over the maximum amount shall be reported by contracts on a stand-alone basis, in rows ***NPLKKV3 Detailed in total***.

<u>The columns in the template</u>

In the opening stock in the reference quarter [columns d1), e1), f1), g1)] only transactions shall be reported that were reclassified as non-performing at the end of the previous quarter.

Redemptions in the reference quarter [columns d2), e2), f2) and g2)] contain the amount of redemption of transactions that are included in the opening stock and became non-performing in the specified quarter.

NPLKKV

Changes in non-performing loans granted to micro, small and medium-sized enterprises as well as self-employed persons by the credit institution and details of linked transactions

Unit: HUF million

Sequence number	Row code	Description				Q1				Q2				Q3				Q4				
			Registration number	Bank ID code of the contract	CCIS code of the contract	Opening stock (gross book value)	Repayment in reference quarter	Claims sold in reference quarter (gross book value)	Closing stock (gross book value)	Opening stock (gross book value)	Repayment in reference quarter	Claims sold in reference quarter (gross book value)	Closing stock (gross book value)	Opening stock (gross book value)	Repayment in reference quarter	Claims sold in reference quarter (gross book value)	Closing stock (gross book value)	Opening stock (gross book value)	Repayment in reference quarter	Claims sold in reference quarter (gross book value)	Closing stock (gross book value)	Method
			1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
			a	b	c	d1	d2	d3	d4	e1	e2	e3	e4	f1	f2	f3	f4	g1	g2	g3	g4	z
001	NPLKKV1	TOTAL																				
002	NPLKKV2	Not detailed in total																				
003	NPLKKV3	Detailed in total																				
004	NPLKKV300001																					
	...	...																				
	NPLKKV399999																					

Legend	
	Forbidden