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<p>In the published version of this decision, some information has been omitted, pursuant to articles 30 and 31 of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus [...]</p>		<p>PUBLIC VERSION</p> <p>This document is made available for information purposes only.</p>
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**Subject: State aid SA.40441 (2015/N) – Hungary
Restructuring of Magyar Kereskedelmi Bank Zrt.**

Sir,

The Commission wishes to inform Hungary that, having examined the information supplied by your authorities on the measure referred above, it has decided not to raise objections to the measure for the reasons set out below.

1. PROCEDURE

- (1) On 18 December 2014, the Hungarian resolution authority, Magyar Nemzeti Bank ("MNB"), decided to put Magyar Kereskedelmi Bank Zrt. ("MKB Bank"), the parent company of a banking group ("MKB Group"), in resolution¹.
- (2) In a meeting with the Commission's services on 4 June 2015 the Hungarian authorities updated the Commission on MKB Bank's resolution process and explained that its resolution would be based on a combination of the "asset separation tool" (within the meaning of Article 42 of Directive 2014/59)² and the

¹ See the decision of MNB here: <https://www.mnb.hu/letoltes/a-magyar-nemzeti-bank-hatarozata-az-mkb-bank-zrt-re-vonatkozo-szanalasi-eljaras-elrendelesrol-es-meginditasarol.pdf>

² Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending

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"sale of business tool" (within the meaning of Articles 38 and 39 of Directive 2014/59). They also informed the Commission's services that the asset separation tool would contain an element of State aid because the transfer of problematic assets to an Asset Management Company ("AMC") ("the measure"), the so-called Resolution Asset Management Vehicle ("RAMV"), would not take place at the market value ("MV") of those assets. Further pre-notification contacts followed.

- (3) On 23 November 2015, the Hungarian authorities notified the measure in favour of MKB Group. Together with that notification, the Hungarian authorities submitted the restructuring plan for MKB Group and a catalogue of commitments.
- (4) After the notification, a number of electronic mail exchanges and telephone conversations took place between the Commission's services and the Hungarian authorities in which additional information was requested and provided.
- (5) On 25 November 2015, the Hungarian authorities submitted the final work of their advisors on the valuation of the portfolio to be transferred to the RAMV. On 30 November 2015, the Hungarian authorities provided the Commission with a final valuation established pursuant to Article 36 of Directive 2014/59.
- (6) By letter dated 23 November 2015, Hungary agreed to waive its rights deriving from Article 342 of the Treaty on the Functioning of the European Union ("TFEU") in conjunction with Article 3 of Regulation 1/1958 and to have the present decision adopted and notified in English.

2. DESCRIPTION

2.1. The beneficiary

- (7) MKB Bank is a commercial bank domiciled in Hungary. It is the fifth-largest bank in Hungary. Together with its subsidiaries, they form the MKB Group³.
- (8) In recent years MKB Bank has refocused on the Hungarian market after it sold in 2013 and 2014 its remaining foreign operations. Concretely, it divested MKB Unionbank (i.e. its subsidiary in Bulgaria in August 2013), as well as MKB Nextebank S.A. and Corporate Recovery Management S.R.L. in Romania, respectively in April and September 2014. As a result of those transactions, MKB Group ceased all its operating activities outside Hungary.
- (9) At the time of the resolution decision on 18 December 2014, MKB Bank was fully State-owned as the Hungarian State had acquired - on 30 September 2014 – 100% of

Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU and Regulations (EU) No 1093/2010 and EU No 648/5245 of the European Parliament and of the Council, OJ L 173, 12.6.2014, p. 190.

³ The most important subsidiaries of MKB Group are: MKB Euroleasing Group (retail automobile financing and vehicle fleet management), Resideal Zrt. (a real estate management company), MKB Pénzügyi Zrt. (a financial asset management company), MKB Pension Funds, MKB Health Fund Management Company and MKB Investment Fund Management Company.

its shares from Bayerische Landesbank.^{4,5} Since then, MKB Bank has had no outstanding subordinated debt.

- (10) In terms of scope of its activities, MKB Bank is a universal bank, which provides all the usual products and services for enterprises and private individuals which are typical for a universal bank. They include a wide range of credit products, current account and deposit products, forfeiting and factoring, letters of credit, guarantees, international payments, portfolio management, project and structured finance, trade finance, investment and financial advisory services, credit and debit cards and portfolio management.
- (11) MKB Bank has a market share of 6.5% (based on total balance sheet figures of Q2 2015). As Table 1 illustrates, MKB Bank is the market leader in terms of corporate loans, which reflects MKB Bank's long tradition in that segment. The dominant part of corporate lending is project financing, where MKB Bank – with 26.3% - has the highest market share. It is in that segment that commercial real estate ("CRE") lending took place, which proved to be later – as described in recitals (18) to (24) - one of the sources of its problems.

Table 1: Market shares per segment⁶

	<u>Market share</u>	<u>Ranking</u>
Balance sheet total	6.5%	5
Total loans	6.2%	7
Total corporate loans	13.4%	1
Total deposits	7.7%	6
Total household deposits	5.0%	5

- (12) At the end of 2014, MKB Bank employed 1955 people (full time equivalents or "FTE"), while MKB Group employed 2155 people (FTE). MKB Bank currently has 77 branches.
- (13) Since 2010, MKB Group has reported losses every year. In 2014, the pre-tax loss (from continuing operations) amounted to HUF 144 billion, which followed a loss of HUF 87.9 billion in 2013.

⁴ As described e.g. in recital (64) of Commission Decision (EU) 2015/657 of 5 February 2013 on State aid granted by Germany and Austria to Bayerische Landesbank (Case SA.28487 C 16/09, ex N 254/09, OJ L 109, 28.04.2015, p. 1), the German authorities committed that BayernLB would divest MKB Bank.

⁵ See press release of 30 September 2014:
https://www.mkb.hu/about_us/announcements/index.html?useLang=en

⁶ Source: Restructuring Plan for MKB Group (based on June 2015 data), as submitted by the Hungarian authorities on 29 September 2015, with a last update on 16 November 2015.

- (14) The main reasons for the 2014 loss were high impairments and loss provisions (HUF 144.3 billion (EUR 456.7 million) as compared to HUF 97.3 billion (EUR 326.8 million) in 2013). MKB Group was obliged to recognize HUF 96.4 billion (EUR 305.1 million) of net impairments in 2014 (HUF 80.5 billion (EUR 270.3 million) in 2013). It also reported HUF 5.7 billion (EUR 18.0 million) of direct write-offs in 2014 (HUF 21.3 billion (EUR 71.5 million) in 2013). Moreover, the amount of HUF 144.3 billion (EUR 456.7 million) also included a provision of HUF 43.1 billion (EUR 136.4 million) for the settlement of consumer loans in foreign currency ("FX").⁷
- (15) In terms of balance sheet, MKB Group reported at the end of 2014 total assets of HUF 1944 billion at a consolidated level⁸ and Risk Weighted Assets⁹ ("RWA") of HUF 1272 billion¹⁰. Its equity amounted to HUF 189 billion¹¹ and its capital adequacy ratio was at 14.1%¹².

Table 2: Key financial data of MKB Group¹³

<u>Key financial data</u> <u>(profit, assets and RWA figures in HUF billion)</u>	<u>2014</u>	<u>2013</u>
Profit before tax (continuing operations)	-144.0	-87.9
Pre-tax return on average equity	-66.7%	-60.0%
Cost-to-income ratio	60.0% ¹⁴	84.1%
Total assets	1944	1962
Total equity	188	165
RWA	1272	1418
CET1 ratio ¹⁵	14.1%	8.6%
Total capital ratio	14.1%	11.82%

⁷ See MKB Bank Zrt. Consolidated Financial Statements as at December 31 2014, page 135.

⁸ See MKB Bank Zrt. Consolidated Financial Statements as at December 31 2014, page 111.

⁹ Including risk weights for market risk, large exposures and operational risk.

¹⁰ See MKB Bank Zrt. Consolidated Financial Statements as at December 31 2014, page 62.

¹¹ See MKB Bank Zrt. Consolidated Financial Statements as at December 31 2014, page 111.

¹² See MKB Bank Zrt. Consolidated Financial Statements as at December 31 2014, page 133.

¹³ Source: MKB Bank Consolidated Financial Statements as at 31 December 2014, pages 62, 111-112, 133-134.

¹⁴ Annex 3 to the notification of 23.11.2015, Commitments for MKB Bank, p. 4.

¹⁵ Common Equity Tier 1 as defined in Article 26 of 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 and amending Regulation (EU) No 648/2012, OJ L 176 of 27.06.2013, p. 1-337.

(16) In the first six months of 2015, MKB Bank was still loss-making but the loss was smaller than in the corresponding period of 2014 (HUF 4 billion versus HUF 15.4 billion). As MKB Bank managed to reduce its RWA (HUF 1170 billion), its capital adequacy ratio slightly improved to 14.68%.¹⁶

2.2. The events triggering the measure

(17) While MKB Bank showed strong growth in the pre-2008 period, the financial crisis exposed the weaknesses of its business model. The restructuring plan submitted by Hungary describes in detail the roots of the problems encountered by MKB Bank.

2.2.1. Problems related to CRE lending

(18) From 2003 until the onset of the financial crisis, MKB Bank's strategy was to be a leading CRE financier in Hungary and the surrounding region, which exposed it to important risks during the crisis.

(19) An important focus of MKB Bank was to grow in retail CRE loans (financing e.g. shopping centres) and to participate in the financing of all flagship retail projects in the region. Another major strategic focus was to build up a significant office financing portfolio. In numerous transactions, that aggressive volume strategy led to very significant risk-taking.

(20) An important part of MKB Bank's lending was denominated in foreign currency and it frequently used loan structures such as balloon or bullet loans¹⁷. Moreover, it conducted an aggressive pricing policy, which translated into low margins on assets in comparison to peers.

(21) MKB Bank also entered into a number of CRE loans which were not backed by cash-flow generating collateral but for instance by land plots, which is very speculative. The objective of those projects was to protect MKB Bank's leading position in the CRE financing market and to even strengthen its position by positioning itself for further lending volumes backed by cash-flow generating projects at a later stage. 20% of the "land plot" financing did not take place in the Hungarian market but in Romania.

(22) Once the financial crisis started, MKB Bank's real estate financing strategy became more conservative. The CRE loan portfolio was put in rundown and new deals (or increases of existing exposures) were only allowed in exceptional cases. In line with that new strategy, MKB Bank established - in September 2011 - the so-called *Special Credit Unit* (SCU) to handle separately all CRE exposures. At the end of

¹⁶ Consolidated Interim Financial Statements, prepared under International Financial Reporting Standards as at 30 June 2015, 26 August 2015, pages 32, 65:
https://www.mkb.hu/dl/media/group_463afc792a1fd/group_46e7a0856ede6/group_55e080c94dc2c/item_5760.pdf

¹⁷ A balloon loan is a loan which does not fully amortize over the term of the contract, thus leaving a balance due at maturity. A bullet loan is an extreme example of a balloon loan where there is no amortization at all and where the entire loan amount must be repaid with a single large payment at the end of the term of the loan.

2011, total gross exposures ("GEX") equivalent to EUR 2.6 billion were transferred to the SCU (75% of which denominated in EUR, 14% in CHF and only 9% in HUF). During the economic crisis the increased FX volatility hit those EUR and CHF loans and led to substantial increases in non-performing loans ("NPLs"). Although the proportion of EUR and CHF exposures decreased in the past few years, those loans still represent a significant portion¹⁸ of the SCU portfolio.

- (23) The status of MKB Bank's substantial CRE loan portfolio as a problem was also confirmed in the 2014 Asset Quality Review (AQR) conducted by the European Central Bank ("ECB") as part of its comprehensive assessment. The ECB examined two portfolios of MKB Bank: the CRE loan portfolio and the residential real estate loan portfolio, which covered 76% of the SCU portfolio. According to its findings, the two portfolios were under-provisioned on 31 December 2013 by EUR 437 million, i.e. by EUR 326 million for CRE loans and EUR 111 million for residential real estate loans.
- (24) In conclusion, an aggressive volume-driven strategy in CRE lending without sufficient regard to loan quality caused major problems for MKB Bank. As internal solutions did not allow for a sufficiently fast solution of those problems, the restructuring plan submitted by Hungary now implies hiving-off those assets into an AMC.

2.2.1. Problems related to corporate/SME lending

- (25) MKB Bank historically had its core competence in the financing of large corporates but its processes and practices lacked appropriate risk management in a number of aspects: in underwriting and contracting, in monitoring, as well as treating problem loans. Those problems became even more important when MKB Bank sought expansion in the SME segment.
- (26) In that segment, MKB Bank quickly built up a loan portfolio with lax risk control: before the financial crisis, the number of newly acquired clients amounted to 500-600 per year. By contrast, that number decreased to below 150 in 2011. Unhedged FX lending (especially in CHF) was very significant, which led to a deteriorating portfolio quality and massive losses, in particular when the HUF started depreciating heavily.

2.2.2. (Forex) problems related to household lending

- (27) Mortgage-backed loans (housing and home equity loans) originated between 2005 and 2009 and denominated in CHF represent the vast majority of MKB Bank's household lending portfolio. Until the end of 2009, the mortgage portfolio had increased continuously to more than EUR 1.8 billion. The level of NPL was relatively low until the end of 2008. However, thereafter and until March 2015, NPL formation substantially accelerated due to HUF depreciation and increasing interest rates, which increased monthly debt service payments of the borrowers substantially.

¹⁸ End of September 2015, for the portion of the SCU portfolio to be transferred to the asset management vehicle), EUR net exposures still represent around 40% of the total net exposure, and CHF net exposures still represent around 20% of the total net exposure.

- (28) A number of government measures had also significant negative impact on the profitability of mortgage lending.
- (29) The first government measure was announced in Q3 2011 which provided an early repayment option for FX mortgage loans at fixed, preferential exchange rates. Between September 2011 and February 2012, around 13 000 customers applied for that option, which resulted into a loss of EUR 120 million for MKB Bank (mostly booked for 2011).
- (30) The second government measure was announced in Q3 2014. It made HUF conversion compulsory for FX-denominated loans, and ordered the repayment of income from past unfair (unilateral) interest rate increase and unfair exchange rate margin. The 2014 Annual Report of MKB Bank states that a HUF 43 billion provision was booked to cover the consequences of that second measure.
- (31) Altogether, MKB Bank lost roughly one-third of its retail portfolio as a result of those government measures. MKB Bank was mostly hit by the loss of the best performing and most profitable long-term part of its retail mortgage portfolio, which apart from the immediate effects on the balance sheet, resulted in losing the most stable part of the source of future income and profit.

2.2.3. *Miscellaneous problems*

- (32) MKB Bank's cost-to-income ratio (CIR) historically belonged to the highest in the sector. In 2014, MKB Bank's CIR was 60%¹⁹, while the average of the peer group was 45%. By comparison, the best performers in the sector had a CIR in the lower 30%-area.
- (33) The main reason for the lower structural profitability of MKB Bank is the unusually high presence of large corporates both on the asset and the liability sides. In general, large corporates have relatively more bargaining power when it comes to interests paid on their loans and interest received on their deposits. It was reinforced due to the lack of risk/return controls before the financial crisis. MKB Bank's heavy reliance on the large corporate segment resulted in significantly lower interests earned on corporate assets (yearly average of 2.7% of gross exposures, versus 4.1% average of the peer group), and one of the highest interests paid for corporate deposits on the market (2.1% yearly average compared to 1.8% peer group average).
- (34) Moreover, MKB Bank also had important problems in terms of risk management. Up to a certain exposure limit (ca. EUR 1 million) the risk department was not involved in the loan decision-making process and the preparation of the loan application documentation before the crisis. The decision to take on credit risk and even the pricing decision was the sole competence of the business unit. As a result, MKB Bank did not have consistent principles in the credit analysis and the setting of loan conditions, and pricing was not aligned with the risk rating of the counterparty. In general, business was continuously encouraged to realise loan volume growth and the incentive system of the business segments disregarded the risk cost of the portfolio. As the portfolio quality issues became apparent, it turned out that MKB

¹⁹ Annex 3 to the notification of 23.11.2015 by the Hungarian authorities, Commitments, page 4.

Bank had to face significant losses (partly due to non-appropriate loan documentation). In some cases, the enforcement of collateral was difficult or even impossible to implement.

- (35) Finally, apart from the government measures described in recitals (29) and (30), MKB Bank's profitability also fell because of the introduction of the bank levy²⁰ in 2010 and the introduction of free monthly cash withdrawals up to a certain limit in 2014.

3. DESCRIPTION OF RESOLUTION PROCESS, RESOLUTION TOOLS AND THE AID MEASURES

3.1. The resolution process

- (36) On 16 December 2014, the supervisory department of MNB informed the resolution department of MNB that MKB Bank was judged "likely to fail" within the meaning of Article 32(1)(a) of Directive 2014/59. The supervisor was of the opinion that - within 12 months - MKB Bank would infringe its capital requirements in a way that would justify the withdrawal of its banking licence. The supervisor concluded that the AQR (see recital (23)) would require additional provisioning and, together with a number of other negative items under the International Financial Reporting Standards to be recorded in January 2015, MKB Bank's capital adequacy ratio would drop to [8-15]% and [7-14]% by end 2014 and end 2015 respectively, below the 16% SREP²¹-based capital adequacy requirement.
- (37) On 17 December 2014, the owner of MKB Bank, the Hungarian State, declared that it had no intention to inject the required capital. As a result, the resolution authority concluded that the resolution condition set out in Article 32(1)(b) of Directive 2014/59 was also met. Finally, based on financial stability considerations, the resolution authority considered that the public interest criterion of Article 32(1)(c) of Directive 2014/59 was also fulfilled.
- (38) On 18 December 2014, the resolution authority decided to place MKB Bank under resolution.
- (39) On 25 February 2015, the resolution authority approved a detailed "resolution action plan" which was based on three groups of measures:
1. clean up MKB Bank's balance sheet to increase capital adequacy and improve profitability;
 2. reorganise with a view to enhance efficiency; and
 3. sell MKB Bank after the implementation of the asset separation tool.
- (40) First, the resolution authority tried to clean MKB Bank's balance sheet by selecting 158 loan lines for spin-off, mainly based on the former SCU portfolio. An attempt was made to sell as much as possible on the market via three methods:
1. Sale through data room;

²⁰ Tax on the Hungarian banking sector introduced in 2010 by the Hungarian authorities and calculated on basis of the total assets of the banks.

²¹ Supervisory Review and Evaluation Process of the financial supervisor.

2. Sale through bilateral negotiations (mainly to syndication partners); and
3. Other methods (loan workout processes, refinancing by other institutions, etc).

Table 3: Assets to be divested (status as of Q4 2014)²²

<u>All figures in EUR million</u>	<u>Number of items</u>	<u>Gross exposure</u>	<u>Net exposure</u>
Former SCU portfolio	233	1993	[1200-1500]
Portfolio selected for spin off	158	1311	[650-900]
Dataroom 1	127	738	[250-350]
Dataroom 2	4	308	[250-300]
Not eligible for dataroom	27	265	[150-250]

- (41) As regards the first method, that of sale through data rooms, MKB Bank set up two virtual datarooms. In Dataroom 1, there were mainly non-cash-flow-based speculative financing deals and other types of CRE loans. Although four bidders participated in the final stage of the process, there was no compliant bid. In Dataroom 2²³, out of four shopping centres for sale, two were sold²⁴, one not, and there is also an offer on the claim backed by the Mammut Plaza shopping center²⁵ ("the Mammut deal"). As regards the bilateral negotiation solution, syndication partners acquired 7 exposures from MKB Bank.
- (42) However, after that "private" process, a substantial part of the assets still remained unsold. Those assets constitute the portfolio to be transferred to the RAMV owned and funded by the resolution fund (i.e. the measure), which will be described more in detail in section 3.2.
- (43) In the course of 2015, MKB Bank also started to implement several reorganization measures to improve its efficiency and restore its viability, in particular:
- it sold its stake in the loss-generating insurance companies by retaining only 1% ownership;
 - it terminated the joint control over the MKB Euroleasing Group: MKB Bank gained sole control over the car financing business while it terminated its

²² Source: Annex 1 to the notification of 23.11.2015 by the Hungarian authorities, Restructuring plan, p. 24.

²³ Initially, four assets were dedicated for sale in Dataroom 2: P4 Plaza; Shopping Center; Arena; and Mammut. P4 Plaza and Arena were sold, Mammut is currently under sale process. Shopping Center (located in Zagreb, Croatia) was not sold and remained in the SCU portfolio.

²⁴ The sale of two loans related in total to GEX of approximately EUR 188 million and the consideration received was in a range between [70-90]% of GEX.

²⁵ Gross exposure of EUR 118 million.

affiliation in three other businesses (a car dealer business, a car insurance business and a sport club); and

– it launched a significant cost-cutting programme.

(44) MKB Bank also started to design the sale process of the remaining so-called "core bank" (i.e. MKB Bank without the assets transferred to the RAMV). According to the commitments submitted by the Hungarian authorities, MNB as the resolution authority expects to launch the sale of business process soon after the finalisation of the asset separation process [...]²⁶.

3.2. Description of the asset separation tool

3.2.1. Objective

(45) The aim of the asset separation tool measure is to remove uncertainty about the future value of MKB Bank's most problematic assets (i.e. problematic CRE loans) so that it can concentrate on the implementation of the restructuring plan and restore its viability by the end of the restructuring period, i.e. by 31 December 2019.

3.2.2. Set-up and characteristics

(46) The RAMV is established in accordance with Article 42(2) of Directive 2014/59 and is designed to be a permanent entity which could also be used for future resolutions. The resolution fund will provide all funding to the RAMV, which includes both the foundation costs and the funds needed to pay for the acquisition of the assets. The consideration for the transferred assets will be paid in cash.

3.2.3. Scope of the transfer

(47) The portfolio selection was mainly based on the former SCU portfolio of MKB Bank as explained in recitals (40) and (41). In the end, the portfolio earmarked for transfer contains 104 positions corresponding to gross exposures of HUF 213.6 billion (EUR 681.8 million²⁷) and net exposures of HUF [100-150] billion (EUR [319-479] million).²⁸

3.2.4. Transfer value/market value

(48) The transfer value is capped at the real economic value ("REV") of the assets in line with the Impaired Assets Communication²⁹. The REV of the assets of MKB Bank that are transferred to the RAMV, as assessed by the Hungarian authorities, amounts

* [...] Covered by the obligation of professional secrecy

²⁷ Using 30 September 2015 data, EUR/HUF conversion rate of 313.32 and a CHF/HUF conversion rate of 286.62. About 45% of the exposure is in HUF, 35% is in EUR and 20% is in CHF, so that foreign currency amounts and their conversion rates determine the effective exposure value in HUF.

²⁸ See footnote 27.

²⁹ See point (40) of the Communication from the Commission on the treatment of impaired assets in the Community banking sector, OJ C72, 26.3.2009, p. 1 ("the Impaired Assets Communication").

to 45% of the gross book value of the 104 exposure line items³⁰. When taking the gross book value cited above, the REV would correspond to HUF 96.1 billion (EUR 306.8 million³¹) compared to net exposures after impairments of HUF [100-150] billion (EUR [319-479] million³²) as of 30 September 2015. Hungary commits that the transfer value of the assets to the RAMV will not exceed their REV (in this case 45% of the gross book value of the assets) as established and proposed by the Hungarian authorities based on an independent final valuation carried out in accordance with Article 36 of Directive 2014/59.

- (49) The MV of the assets was also established and proposed by the Hungarian authorities. The MV of the assets transferred to the RAMV amounts to [20-40]% of the gross book value of the exposures. When taking the gross book value cited above, the MV would correspond to HUF [43-85] billion (EUR [137-274] million³³).
- (50) To meet the requirements of Article 36 of Directive 2014/59, the Hungarian authorities commissioned independent appraisers to determine the REV and the MV of the portfolio to be transferred to the RAMV. Firstly, PriceWaterhouseCoopers ("PwC") performed an individual valuation of each individual loan of the portfolio to be transferred. For performing loans, PwC used the discounted cash flow approach and discounted the expected repayments of principal and interest to the valuation date. For NPLs, PwC used a collateral-based valuation approach. It then applied a portfolio discount and arrived at a valuation range for the REV and the MV for the entire portfolio. The proposals of the Hungarian authorities are broadly in the middle of those ranges. Secondly, in addition to the valuation by PwC, the Hungarian authorities also commissioned CBRE and Ernst & Young to carry out in parallel a valuation for a selected sample of the portfolio to be transferred. That sampling exercise confirmed the ranges proposed by PwC and provides further underpinning for the valuations used by the Hungarian authorities (i.e. REV equivalent to 45% of gross exposures, MV equivalent to [20-40]% of gross exposures).
- (51) The Commission, supported by an independent and external expert, verified the Hungarian submissions as to the REV and MV, by analyzing a sample of 9 loans representing EUR 194 million or just below one-third of the total portfolio, measured by gross exposures. At the end of its analysis, the expert concurred with Hungary that a REV of 45% (of the gross book value) and an MV of [20-40]% (of the gross book value) were plausible for that portfolio.

3.2.5. *Impact on burden-sharing*

- (52) Based on the valuation report provided on 30 November 2015, an independent appraiser assessed the market value of MKB Bank (value of the equity) as being negative (EUR [(-20)-0] million). The valuation was a final valuation carried out for

³⁰ This includes the exposure to "Resideal", a special purpose subsidiary of MKB Bank to manage some of its repossessed CRE assets.

³¹ Using 30 September 2015 gross book value of HUF 213.4 6 billion and a EUR/HUF conversion rate of 313.32.

³² See footnote 27.

³³ See footnote 27.

the purposes of Article 36 of Directive 2014/59, and the valuation was performed with MKB Bank still holding the spin-off portfolio, which was valued at market price. The value of the core bank was lower than the State aid element of the asset separation measure. Therefore, the resolution design of the Hungarian authorities implied that the existing shareholder of MKB will be fully wiped out. RAMV (i.e. the entity which will grant the State aid) will become the 100% shareholder of the core bank.

- (53) The independent appraiser also considered an insolvency scenario, with a liquidation of MKB Bank. The ex-ante "no creditor worse off" estimation of insolvency treatment shows a shortfall in capital of EUR [20-60] million, which means that creditors would suffer higher losses in case of liquidation than in a resolution process.

4. THE RESTRUCTURING PLAN AND COMMITMENTS

4.1. The restructuring plan

- (54) Together with the notification, on 23 November 2015 the Hungarian authorities submitted the restructuring plan which describes in detail the roots of the problems of MKB Bank, and contains projections for both a base case and an adverse case scenario.
- (55) The restructuring period will start with the adoption of this Decision and last until 31 December 2019, when the financial projections show that MKB Bank will be achieving again an appropriate return on equity, after having covered all its costs including loan loss provisions.
- (56) For the base case, the Hungarian authorities assumed moderate GDP-growth of 2.3% in 2016 and 1.8% for the period 2017-2019, while for inflation it used forecasts of 2.3% and 2.9% respectively for 2016 and 2017-2019. For the 3-month BUBOR rate, the Hungarian authorities assumed a rising trend (1.63% in 2015; 2.12% in 2016; 2.93% 2017 and 3% in 2018/2019).
- (57) In the base case scenario, MKB Group will gradually improve its financial performance mainly as a result of improving lending volumes, lower impairment projections and tight cost control. The profit improvement is broad-based across segments with only the retail segment performing weaker over the restructuring period.
- (58) At the end of 2019, MKB Bank's return on equity is projected to be [6-11]%, with at that point in time a total capital ratio of [10-15]%. The latter compares to a total required capital ratio of 12.5%³⁴.

³⁴ The capital ratio will increase from 10% in 2015 because of the gradual phasing in of the capital conservation buffer.

Table 4: Financial projections MKB Group in base case scenario

<u>All figures in bio HUF</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>CAGR 2019-2015</u>
Gross margin	[...]	[...]	[...]	[...]	[...]	[...]
Net margin	[...]	[...]	[...]	[...]	[...]	[...]
Loan Loss Provisions	[...]	[...]	[...]	[...]	[...]	[...]
Operational result	[...]	[...]	[...]	[...]	[...]	[...]
Net income	[...]	[...]	[...]	[...]	[...]	[...]
RoE	[...]	[...]	[...]	[...]	[...]	[...]
Cost-to-income ratio	[...]	[...]	[...]	[...]	[...]	[...]
Total assets (bio EUR)	[...]	[...]	[...]	[...]	[...]	[...]

(59) In an adverse case scenario, GDP growth would be negative in 2016 (-0.2%) before gradually improving to 0% in 2016, 0.5% in 2017 and 1% in 2018. Inflation would move to 3.5% in 2016 and would then marginally decrease to 3% in 2019. The 3-month BUBOR rate would increase quite markedly from 1.6% in 2015 to 5.1% in 2016; 5.9% in 2017, 5.4% in 2018 and to 4.9% in 2019. In that adverse scenario, MKB Bank would remain loss-making over the period 2015-2017 to then become profitable first in 2018 according to the stress scenario (in 2016 in the baseline scenario). In the adverse scenario, MKB Bank's total capital ratio would still be at [10-15]% at the end of the restructuring period.

4.2. Commitments³⁵

(60) The Hungarian authorities have provided a set of commitments aiming to restore and maintain the long-term viability of MKB Group, as well as commitments to limit the distortion of competition. The commitments set out below are forward-looking, and concern the period from the date of this Decision to the end of the restructuring period, i.e. 31 December 2019, unless the commitment says otherwise.

4.2.1. Commitments to restore long-term viability

(61) Divestment of CRE lending³⁶: MKB Group will not enter in CRE financing in any form throughout the restructuring period, and will amortize the remaining SCU

³⁵ Please refer to Annex I for the detailed description of commitments.

³⁶ CRE lending definition for the purposes of the commitment: any real estate financing where the repayment of the loan is coming from the sale or the regular income of a real estate and the borrower is a legal entity or a private entrepreneur. Typical purpose or use: office, commercial areas (department store, plaza, etc.), logistics, warehouses, hotel, leisure and hospitality, residential developments, industrial real estates, parking garages, land plots, and their combination.

portfolio in a way that by the end of the restructuring period the total outstanding gross exposure on the remaining SCU will be decreased from HUF 412 billion (SCU portfolio without the spin-off portfolio at the end of 2014) to below 15% (HUF 0-60 billion) of the SCU portfolio at the end of 2014 without the spin-off portfolio (i.e. a reduction by at least 85%).

(62) Prohibition of FX lending: MKB Group will not issue new FX-denominated loans to private individuals during the restructuring period and corporate FX lending will be restricted to cases where a natural hedge is provided on the client's side.³⁷

(63) Cost-reduction measures:

(a) MKB Group will reach a [50-60]% cost-to-income ratio in 2016, and keep that ratio below [50-55]% from 2017 on throughout the entire restructuring period.

(b) The maximum number of FTE of MKB Group will be reduced to [2000-2100] by 31 December 2015, to [1950-2050] by 31 December 2016, and to [1950-2050] by 31 December 2017. MKB Group will cap the FTE level from 2018 onwards at [1950-2050] until the end of the restructuring period.

(c) MKB Group will reduce its total branch number from 79 in 2014 to [70-76] by 31 December 2017 and cap it at that level until the end of the restructuring period.

(d) MKB Group will constantly analyse the profitability of its branch network and implement the necessary steps to avoid potential future losses. MKB Group will close further branches after 2017 within one year if the branch is generating loss for MKB Group by not being able to cover its direct cost in the previous calendar year and there is an adequate solution for substitution.

(64) Improving risk management:

(a) MKB Group will operate in line with the principles of the new risk strategy from January 2016. Throughout 2016, MKB Group will implement sector strategies, management reporting and controlling, credit committee decision making, and business planning aligned with the new risk strategy and risk appetite framework, with a view to have full implementation by 31 December 2016, including supporting IT infrastructure.

(b) MKB Group will price every new corporate loan (considering as new loan any new business which is not related to an existing transaction) by using an appropriate internal pricing tool. Pricing for new loans will be considered adequate if the new corporate loan contributes to achieve a positive RoE before tax of at least [3-10]% in 2017, [4-11]% in 2018 and [5-12]% in 2019 on either the individual loan or on each client relationship. The calculation of the RoE of a client relationship can include interest income, fees as well as other combined products of the same client. The calculation of RoE on client level and pricing according to minimum RoE has to be implemented no later than 31 December 2016.

³⁷ There is a natural hedge if the following criteria are fulfilled: i) the client has foreign currency revenue based on existing contracts; or ii) foreign currency assets are used as collateral behind the FX loan. Currency match at least in equal amount of the repayment obligation is required in all cases.

- a. Any deviation from the pricing resulting in a lower price level will be documented. That documentation will include robust commercial reasoning for the deviation and will be presented to the Monitoring Trustee. If the total amount of deviations exceeds the total volume per client of more than HUF [0-15] billion of deals, corrective measures will be implemented by MKB Group.
 - b. Credit deals not falling under that pricing policy regime: Transactions with related parties (i.e. group members and employees), restructuring cases and cases with more than 90 days overdue, as well as all money market transactions. However, MKB Group will develop a policy to restructure non-performing loans in a net present value maximising manner and will strictly adhere to that policy.
- (65) Limitation on certain investments: MKB Group will only purchase investment-grade securities, European Economic Area ("EEA") sovereign securities or EEA State-guaranteed securities, as well as securities that are eligible as collateral for MNB.
- (66) Dividend ban: MKB Group will not pay any dividends on shares for the fiscal years until the end of 2017. For the fiscal year 2018 and onwards, MKB may distribute dividends from its accumulated reserves to the shareholder such an amount of dividend based on the shareholder's stake in the ownership structure of MKB Group, which does not affect the compliance of MKB Group with the required, in a horizon of two years, supervisory minimum capital adequacy as defined by MNB.
- (67) Divestment of business lines: MKB Group will sell the non-core car fleet management business, MKB Euroleasing Autópark Zrt. - jointly owned (50-50 per cent) by MKB Group and Euroleasing Letét Kft. (external investment group) - via a competitive auction by the end of Q2 2016.
- (68) Introduction to the regulated capital market: MKB Bank will be transformed into a "Public Limited Company" and will be introduced to the regulated capital market after at least two profitable business years but by the end of the restructuring period at the latest.

4.2.2. *Commitments to limit distortions of competition*

- (69) Balance sheet and RWA target:
- (a) MKB Group will bring its balance sheet below HUF [1800-2000] billion by the end of the restructuring period. The growth of the balance sheet cannot exceed the growth rate of the nominal GDP in each year during the restructuring period.
 - (b) The RWA of MKB Group will constantly decrease during the restructuring period. The RWA including only credit risk and the overall RWA including credit, market and operational risks will be below HUF [750-900] billion and HUF [900-1000] billion respectively at the end of the restructuring period.
 - (c) If MKB Group fails to sell the Mammut deal by 31 March 2016, the balance sheet will be kept under HUF [1700-1900] billion during the restructuring period, thus the RWA including only credit risk will be decreased below HUF [700-800] billion, and the RWA including credit, market and operational risks will be decreased below HUF [800-900] billion by the end of the restructuring period.

- (d) MKB Group will try to sell the "Mammut deal" at the latest by 31 March 2016. If conclusion of the transaction fails by that date, the total outstanding gross exposure on the remaining SCU portfolio will be decreased by another 9% to under 6% (HUF 0-24 billion) of the SCU portfolio at the end of 2014 without the spin-off portfolio until the end of the restructuring period.
- (70) Acquisition ban: MKB Group will not acquire any stake in any undertaking until 31 December 2018. This covers both undertakings which have the legal form of a company or pool of assets which form a business. Some exemptions are allowed, as specified in the list of commitments contained in Annex 1 to this Decision.
- (71) Cap on marketing expenses: MKB Group will cap its marketing expenditures at the 2014 level of HUF [1000-1500] billion until the end of the restructuring period.
- (72) Advertising ban: The Hungarian authorities commit to impose a ban on advertising related to the State support to MKB Group and to the State ownership in MKB Group or to any competitive advantages arising in any way from the State aid or State ownership.
- (73) Cap on remuneration: The total remuneration, including all possible fixed and variable components and pensions, of any of the staff members of MKB Group, including members of the board and the senior management, will not exceed 15 times the national average salary or 10 times the average salary of the employees of MKB Group, whichever is higher. That commitment will apply until the State aid has been fully repaid or until the end of the restructuring period, whichever occurs earlier.
- (74) Deadline for the sale of the Core Bank: 100% of shares of the core bank will be sold by 30 June 2016. The sales process will be open, transparent, competitive, non-discriminatory and fully compliant with the requirements of the EU State aid law and Directive 2014/59.
- (75) Ban on aggressive commercial practices: MKB Group will not advertise its products and services in an aggressive manner and will not apply aggressive pricing.
- (76) Monitoring Trustee: The Hungarian authorities approve a Monitoring Trustee for MKB Group as set out in Annex 2 to this Decision.
- (77) Renotification: The Hungarian authorities commit to re-notify any change to the restructuring plan and in particular changes that influence the viability, burden-sharing and competition analysis performed by the Commission in this Decision approving the restructuring plan.

5. POSITION OF HUNGARY

- (78) The Hungarian authorities are of the opinion that the transfer of impaired assets to the RAMV constitutes a State aid measure in favour of MKB Bank within the meaning of Article 107(1) of the Treaty but that the measure is compatible with the internal market under Article 107(3)(b) of the Treaty.
- (79) In particular, the Hungarian authorities are of the opinion that:

- the restructuring plan of MKB Bank and MKB Group complies with all conditions set forth in the Restructuring Communication³⁸ and the Impaired Assets Communication³⁹, as supplemented by the 2013 Banking Communication⁴⁰; and
- the restructuring plan of MKB Bank and MKB Group as described from recitals (54) to (59), together with the list of commitments provided by the Hungarian authorities described from recitals (60) to (77) and annexed to this Decision, ensures the restoration of long-term viability of the institution without reliance on State resources other than the buying of assets at REV by the RAMV, provides sufficient own contribution to the restructuring costs and adequate burden-sharing, and limits competition distortions.

(80) The Hungarian authorities also explain how it has transposed Directive 2014/59 for resolution cases which take place in 2015. In particular, the Hungarian authorities explain that the Hungarian Resolution Act⁴¹ does not yet contain the second part of Article 101(2) of Directive 2014/59 which says that indirect loss absorption by the resolution fund would trigger bail-in beyond subordinated debt.

6. EXISTENCE AND AMOUNT OF STATE AID

(81) Article 107(1) TFEU provides that any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings is, insofar as it affects trade between Member States, incompatible with the internal market. Thus, in order for a measure to fall within the scope of Article 107(1) TFEU, four cumulative criteria must be met:

(82) First, the measure must involve the use of State resources. The aid measure in favour of MKB is granted via the resolution fund. The resolution fund was created on 21 July 2014 on the basis of Act XXXVII of 2014, the Hungarian Resolution Act⁴². The purpose of the resolution fund is to provide financial assistance for resolution measures. Even though the resolution fund is financed by participating credit institutions and investment companies, financing from the resolution fund has a public nature as the fund is completely under public control and therefore - in line with established case law⁴³ - its resources must be considered as State resources. The

³⁸ Commission communication on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules, OJ C 195, 19.8.2009, p. 9.

³⁹ Communication from the Commission on the treatment of impaired assets in the Community financial sector, OJ C 72, 26.3.2009, p. 1.

⁴⁰ Communication from the Commission on the application, from 1 August 2013, of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication'), OJ C 216, 30.7.2013, p. 1.

⁴¹ Act XXXVII of 2014 on the further development of the system of institutions strengthening the security of the individual players of the financial mediating system (Hungarian Resolution Act), transposing the Bank Recovery and Resolution Directive (BRRD) in Hungarian law.

⁴² See footnote 41.

⁴³ See Case C-345/02 *Pearle and others* EU:C:2004:448, paragraphs 37 and 38. That approach was applied in Commission decision in the State aid case NN 61/2009 – "Rescue and restructuring of Caja Castilla-La Mancha", Spain, 29.06.2010, C(2010)4453 corr., recitals 96-118.

envisaged transfer of impaired assets from MKB Bank to RAMV, owned by the resolution fund, will limit the risks that MKB Bank has to take in order to clean up its balance sheet and implement the restructuring plan, by transferring the risky assets from MKB Bank's balance sheet at a price which exceeds the current MV. According to point 64 of the 2013 Banking Communication, the compatibility of State aid in the form of interventions by a resolution fund shall be assessed on the basis of that communication.

- (83) Second, the measure must distort or threaten to distort competition by conferring an advantage on undertakings. The Commission finds that that condition is met because MKB Bank is allowed to continue its business and compete with other private operators on the market, while in the absence of aid its licence should be withdrawn⁴⁴. There is nothing to indicate that the measure has been carried out by the resolution fund acting as a market economy operator and, on the contrary, it has been presented by the Hungarian authorities as part of an action undertaken by the public authorities acting to fulfil public policy objectives.
- (84) Third, the measure must provide a selective advantage to certain undertakings. In the case at hand, the measure confers an advantage only to MKB Bank. Therefore, that condition is fulfilled.
- (85) Fourth, the measure must be likely to affect trade between Member States and distort competition. Financial services are global markets and by their nature affect trade between Member States. The measure strengthens the position of MKB Bank compared to that of its competitors. Therefore, that condition is also fulfilled.
- (86) On the basis of the foregoing, the Commission finds that the measure fulfils all the conditions laid down in Article 107(1) TFEU and that the measure qualifies as State aid in favour of MKB Bank.
- (87) In order to assess the amount of aid in the transfer of assets to the RAMV, footnote 2 to point 20(a) of the Impaired Assets Communication defines the aid amount in an asset relief measure as the difference between the transfer value of the assets, i.e. the REV, and the market price, i.e. the MV. The Commission, supported by an external and independent expert, has verified the MV of the portfolio to be transferred to the RAMV as proposed by the independent experts of the Hungarian authorities. The Commission concurs with Hungary's analysis that a REV of 45% and a MV of [20-40]% of gross exposure for that portfolio are plausible. Concretely, as already indicated in recitals (48) and (49), if the gross book value of the transferred positions is equal to HUF 213.6 billion (EUR 681.8 million⁴⁵) the transfer price will not exceed the REV of HUF 96.1 billion (calculated as 45% of the gross book value), while the MV would correspond to HUF [43-85] billion. Therefore, the amount of State aid due to the transfer, being the difference between REV and MV as defined in the Impaired Assets Communication⁴⁶, is equal to [5-25]% of the gross book value of the transferred portfolio. Using the gross book value of HUF 213.6 billion, it

⁴⁴ See also recital (36).

⁴⁵ Using 30 September 2015 gross book value of HUF 213.4 6 billion and a EUR/HUF conversion rate of 313.32

⁴⁶ See point (40) of the Impaired Assets Communication.

would amount to HUF 32.0 billion (EUR 102.3 million⁴⁷). It corresponds to approximately 2.8% of MKB Bank's RWA⁴⁸.

- (88) The Hungarian authorities do not dispute either the existence of State aid or its amount and the way it is calculated.

7. ASSESSMENT OF COMPATIBILITY

7.1. Legal basis for the assessment of compatibility

- (89) Article 107(3)(b) TFEU enables the Commission to find aid compatible with the internal market if it is "to remedy a serious disturbance in the economy of a Member State." The Commission has acknowledged that the global financial crisis may create a serious disturbance in the economy of a Member State which can be addressed through State measures supporting financial institutions. This has been successively detailed and developed in the six Crisis Communications⁴⁹, as well as in the 2013 Banking Communication.

- (90) The requirements of the Restructuring Communication, as adapted by the 2013 Banking Communication, apply to the compatibility assessment of the restructuring plan for MKB Group and the specific provisions of the Impaired Assets Communication, as adapted by the 2013 Banking Communication, apply to the compatibility assessment of impaired asset measures. It is appropriate to examine the Measure first on the basis of those specific provisions.

7.2. Legality of the aid

- (91) Hungary sought the approval of the Commission before implementing the Measure, thereby complying with its notification obligation as set out in Article 108(3) TFEU.

7.3. Compatibility with the Impaired Assets Communication as adapted and complemented by the 2013 Banking Communication

- (92) The Impaired Assets Communication defines impaired asset relief as any measure which 'free[s] the beneficiary bank from (or compensate[s] for) the need to register either a loss or a reserve for a possible loss on its impaired assets and/or free

⁴⁷ Using 30 September 2015 EUR/HUF conversion rate of 313.32.

⁴⁸ Based on MKB Bank Zrt. Consolidated Interim Financial Statements as per June 30 2015, in particular page 32, and using the 30 June 2015 ECB EUR/HUF reference rate of 314.93.

⁴⁹ Communication on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis ("2008 Banking Communication"), OJ C 270, 25.10.2008, p. 8; Communication on the recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition ("Recapitalisation Communication"), OJ C 10, 15.1.2009, p. 2; the Impaired Assets Communication; the Restructuring Communication; Communication from the Commission on the application, from 1 January 2011, of State aid rules to support measures in favour of financial institutions in the context of the financial crisis ("2010 Prolongation Communication"), OJ C 329, 7.12.2010, p. 7 and Communication from the Commission on the application, from 1 January 2012, of State aid rules to support measures in favour of financial institutions in the context of the financial crisis ("2011 Prolongation Communication"), OJ C 356, 6.12.2011, p. 7.

regulatory capital for other uses' and sets out criteria for the compatibility of such measures with the internal market. Those compatibility criteria comprise:

- (i) the eligibility of the assets;
- (ii) transparency and disclosure of impairments;
- (iii) the management of the assets;
- (iv) the correct and consistent approach to valuation; and
- (v) the appropriateness of the remuneration and burden-sharing.

7.3.1. Eligibility of assets

- (93) As regards the eligibility of the assets, section 5.4 of the Impaired Assets Communication indicates that asset relief requires a clear identification of impaired assets and that certain limits apply in relation to eligibility to ensure compatibility.
- (94) The Impaired Assets Communication however further sets out that a balance needs to be found between meeting the objective of immediate financial stability and the need to ensure the return to normal market functioning, which would plead in favour of flexibility when identifying classes of assets. In particular, whilst the Impaired Assets Communication cites as eligible assets those that triggered the financial crisis (the Impaired Assets Communication explicitly refers to US mortgage-backed securities), it also allows for the possibility to 'extend eligibility to well-defined categories of assets corresponding to a systemic threat upon due justification, without quantitative restrictions'.
- (95) As regards the present case, the impaired assets measure is targeted at non-performing assets related to the Hungarian CRE market. They include speculative transactions with land plots and hotels, as well as foreign currency-denominated assets that are not backed up by revenues in the same currency. All transactions in the transfer are non-performing. The Commission concludes that the assets are therefore in line with the eligibility criteria of the Impaired Assets Communication.

7.3.2. Transparency and disclosure

- (96) As regards transparency and disclosure, section 5.1 of the Impaired Assets Communication requires full ex-ante transparency and disclosure of impairments on the assets which will be covered by the asset relief measures, based on an adequate valuation, certified by recognised independent experts and validated by the relevant supervisory authority. The Impaired Assets Communication requires that disclosure and valuation should take place prior to government intervention.
- (97) A list of assets to be transferred was provided and included 104 line items. Moreover, Hungary provided upon request extensive valuation reporting and loan documentation connected to the assets. It also gave the Commission's expert the opportunity to ask the necessary questions, thus facilitating the Commission's assessment. Therefore, the Commission can conclude that Hungary has provided sufficient transparency and disclosure on the entirety of MKB Bank's impaired assets to be transferred.

7.3.3. Management of assets

- (98) As regards the management of assets, section 5.6 of the Impaired Assets Communication explains the necessity of ensuring a clear functional and organisational separation between the beneficiary bank and its assets, notably as to their management, staff and clientele. The Communication provides in that respect that such arrangements should allow the bank to focus on the restoration of viability and to prevent possible conflicts of interest.
- (99) The non-performing assets will be managed by the RAMV, which is fully independent from MKB Bank. It can therefore be concluded that the separate asset management is in line with the requirements of the Impaired Assets Communication.

7.3.4. Valuation

- (100) As regards the impaired assets measure in favour of MKB Bank, the Commission notes that independent consultants have been engaged by Hungary to provide an assessment of both the REV and the MV of the assets.
- (101) Section 5.5 of the Impaired Assets Communication notes that a correct and consistent approach to valuation is of key importance to prevent undue distortions of competition. The main aim of valuation is to establish the REV of the assets. That value constitutes the benchmark level in so far as a transfer of impaired assets at that value indicates the compatibility of aid – it creates a relief effect because it is in excess of the current MV, - but keeps the aid amount to the minimum necessary.
- (102) The Hungarian authorities have provided detailed documents explaining how the MV and the final transfer value, i.e. the REV, of the asset transfer to the RAMV was calculated.
- (103) As described in recital (87), the Commission has scrutinized the valuation and, in particular the underlying general methodology in order to ensure a consistent approach at Union level. For that purpose, the Commission has contracted an external expert, to provide technical support on the valuation of the portfolio to be transferred, assessing how the existing materials submitted could be used to assess the REV; and to verify the REV and current MV of the portfolio earmarked to be transferred. The Commission's expert submitted its final valuation report on 8 December 2015, concurring with Hungary's assessment of the MV and the REV.

7.3.5. Burden-sharing

- (104) As regards burden-sharing, section 5.2 of the Impaired Assets Communication repeats the general principle that banks ought to bear the losses associated with impaired assets to the maximum extent so as to ensure equivalent shareholder responsibility and burden-sharing. Thus, the assets should be transferred at a price that matches or remains below their REV.
- (105) As the Hungarian authorities undertake to transfer the impaired assets of MKB Bank at or below the REV established by the experts of MNB and as verified by the Commission, the Commission considers that the pricing proposed by Hungary is in line with the Impaired Assets Communication.

(106) However, it is to be noted that the provisions of the Impaired Assets Communication with respect to burden-sharing had been updated by the 2013 Banking Communication, in particular by imposing additional conditions, which will be assessed in section 7.4.2.

7.3.6. Conclusion on compatibility with the Impaired Assets Communication

(107) In light of the above, the Commission considers that the transfer of impaired assets from MKB Bank to the RAMV meets all the conditions and requirements of the Impaired Assets Communication as adapted and complemented by the 2013 Banking Communication.

7.4. Compatibility with the Restructuring Communication supplemented by the Banking Communication

(108) According to point (31) of the 2013 Banking Communication, any restructuring plan involving restructuring aid will, with the exception of the requirements on capital raising and burden-sharing, continue to be assessed on the basis of the Restructuring Communication.

(109) According to the Restructuring Communication and the 2013 Banking Communication, first, the restructuring plan has to demonstrate that the restructuring process a beneficiary of State aid is undergoing is suitable to restore its long-term viability. Secondly, the aid amount must be limited to the minimum necessary and both shareholders and subordinated creditors must contribute to reducing the capital shortfall to the maximum extent. Thirdly, measures need to be in place to limit distortions of competition created by artificially supporting the market power of the beneficiary and to ensure a competitive banking sector.

(110) In its analysis, the Commission took positive note of the reorganisation measures taken since 18 December 2014, when MKB Group was put into resolution.

7.4.1. Restoration of long-term viability

(111) As set out under the Restructuring Communication, the Member State needs to provide a comprehensive restructuring plan which demonstrates how the long-term viability of the beneficiary will be restored without State aid within a reasonable period of time, but within a maximum of five years. Long-term viability is achieved when a bank is able to compete in the marketplace for capital on its own merits in compliance with the relevant regulatory requirements. For a bank to do so, it must be able to cover all its costs and provide an appropriate RoE, taking into account the risk profile of the bank. The return to viability should mainly derive from internal measures and be based on a credible restructuring plan.

(112) As the financial projections summarized in recital (58) indicate, Hungary has submitted a restructuring plan for MKB Group which shows a return to viability in 2016 under the base scenario, and in 2018 under the stress scenario, both of which are before the end of the restructuring period on 31 December 2019.

(113) Point 10 of the Restructuring Communication requires that the proposed restructuring measures remedy the entity's weaknesses. The restructuring plan explains in a detailed manner the internal factors causing MKB Bank's difficulties.

MKB Bank will no longer be active in CRE lending and risky FX lending and it will bring its risk management in line with market standards. In the past loans were granted under generally loose credit and collateral standards, with poor risk management practices, which resulted in the accumulation of a large portfolio of non-performing loans. After the adoption of this Decision, MKB Group – in line with the commitments – will only enter into new loan agreements when they offer an economically attractive return. Finally, MKB Group will also continue to focus on cost-cutting by keeping FTEs and the number of branches in check. As a result, the cost-to-income ratio should come down to levels which are normal in the sector.

7.4.2. *Own contribution and burden-sharing*

- (114) For restructuring aid to be declared compatible, sections 3.1.1 and 3.1.2 of the 2013 Banking Communication should be complied with.
- (115) Section 3.1.1 of the 2013 Banking Communication requires that a capital raising plan for the bank in question is endorsed by the competent supervisory authority, in which the beneficiary should identify and to the extent possible, without endangering viability, carry out all capital raising measures that can be implemented. As explained in recitals (39) to (42), on 25 February 2015, i.e. soon after MKB Group was put under resolution, the resolution authority approved a detailed "resolution action plan". As part of that resolution action plan, the resolution authority tried to clean MKB Bank's balance sheet in the course of 2015, by selecting 158 NPLs for sale on the market via three different methods: sale through data room; sale through bilateral negotiations; and sale via other methods (loan workout process, refinancing by existing institutions, etc.). However, after those private sales processes, a substantial part of the assets still remained unsold. The Commission considers that those efforts constitute compliance with the requirements of section 3.1.1 of the 2013 Banking Communication.
- (116) Section 3.1.2 of the 2013 Banking Communication explains that shareholders and subordinate debtholders have to contribute to a maximum to the cost of the intervention. Point 41 of the 2013 Banking Communication explains that adequate burden-sharing implies that equity providers have to absorb losses first and point 44 provides that State aid must not be granted before equity providers have fully contributed to offset any losses.
- (117) As mentioned in recital (9), there are no subordinated shareholders in MKB Bank, the sole shareholder of MKB Bank, the Hungarian State, will be fully written down, and the resolution fund via the RAMV will become the sole shareholder of the core bank.
- (118) As a result, the Commission concludes that shareholders and subordinated debt holders will have contributed to the maximum extent possible, thereby satisfying the burden-sharing requirement.
- (119) The Commission also takes positive note of the fact that MKB Group sold non-core activities, like the non-core car fleet business described in recital (67) to minimise the amount of aid to the minimum necessary. The Commission looks positively at the acquisition ban, which will ensure that restructuring aid will be limited to covering costs which are necessary to the restoration of viability.

- (120) In addition, the dividend ban should ensure that financial means stay in the next year in the company and can only be released where the supervisor considers it poses no risk under prudential rules, thereby reducing the potential need for additional State aid in the coming years.
- (121) Finally, the Commission also observes that the remuneration cap is in line with point (38) of the 2013 Banking Communication, which should ensure that MKB Group's management will in future focus on the long-term objectives for the company, thereby minimising the risk for future State aid.

7.4.3. *Measures limiting distortions of competition*

- (122) Section 4 of the Restructuring Communication requires that the restructuring plan contains measures limiting distortions of competition. Such measures should be tailor-made to address the distortions on the markets where the beneficiary bank operates post-restructuring. The nature and form of such measures depend on two criteria: first, the amount of the aid and the conditions and circumstances under which it was granted and, second, the characteristics of the markets on which the beneficiary will operate. Furthermore, the Commission must take into account the extent of the beneficiary's own contribution and burden-sharing over the restructuring period as is also explained in point 20 of the 2013 Banking Communication.
- (123) MKB Group will receive State aid in the form of an impaired asset measure amounting to approximately HUF 32.0 billion (EUR 102.3 million) in total, equivalent to 2.8% of its RWA. It is to be noted that in Hungary, MKB Group, the fifth-largest bank in Hungary, is the only bank in that Member State that received restructuring aid other than FHB⁵⁰, which repaid the capital injected into it by the State less than one year after it received State aid, and therefore the distortive effects of the aid are greater in the market.
- (124) To limit distortions of competition, MKB Group will reduce its balance sheet below HUF [1800-2000] billion by the end of the restructuring period. MKB Group's RWA including only credit risk and the overall RWA including credit, market and operational risks will be below HUF [750-900] billion and HUF [900-1000] billion respectively at the end of the restructuring period, thereby reducing its market presence.
- (125) The totality of the shares of the remaining MKB Bank will be sold by 30 June 2016. The sales process will be open, transparent, competitive, non-discriminatory and fully compliant with the requirements of EU State aid law and Directive 2014/59.
- (126) In addition to those structural measures, Hungary also committed to behavioural constraints. The Commission welcomes a ban on advertising State support, thus preventing MKB Group from using the aid for purposes other than its own

⁵⁰ Commission Decision 2014/296/EU of 22 February 2012 on the State aid No SA.29608 (C37/10) implemented by Hungary for the recapitalisation of FHB Jelzálogbank Nyrt, OJ L 152, 122.5.2014, p. 18.

restructuring and return to long-term viability. The fact that MKB Group will also only enter new corporate loans when they have an appropriate return also helps to avoid undue distortions of competition by preventing MKB Bank from undercutting the market. Hungary also committed to an acquisition ban designed to ensure that the beneficiary will not use the State aid received to acquire any stake in any undertaking in line with point (40) of the Restructuring Communication, as well as a ban on aggressive commercial practices designed to ensure that the beneficiary will not use the State aid received to acquire market share that it would not be able to do absent the State aid.

(127) In conclusion, the Commission considers that there are sufficient safeguards to limit distortions of competition in particular taking into account also the fact that there was full burden-sharing in line with the 2013 Banking Communication.

7.4.4. Conclusions on compatibility with the Restructuring Communication supplemented by the 2013 Banking Communication

(128) In light of the foregoing, the Commission considers that the restructuring aid measure meets all the conditions and requirements of the Restructuring Communication and the 2013 Banking Communication and is therefore compatible with the internal market within the meaning of Article 107(3)(b) TFEU.

7.5. Conclusion on compatibility

(129) In light of the foregoing, the Commission considers that the aid measure notified by Hungary meets all the conditions and requirements of the Impaired Assets Communication and the Restructuring Communication and the 2013 Banking Communication. It therefore concludes that the aid measure is compatible with the internal market pursuant to Article 107(3)(b) TFEU.

7.6. Monitoring

(130) Point 88 of the 2013 Banking Communication notes that the Commission must be in a position to monitor the resolution process and its impact on competition. In that regard, the Commission takes positive note of the commitment by the Hungarian authorities to appoint a Monitoring Trustee to ensure compliance with the commitments given which underpin the authorisation of the measures. The Monitoring Trustee will provide half-yearly reports within 30 days after the end of each six-month period until the end of the restructuring period, i.e. 31 December 2019.

8. COMPLIANCE OF THE RESOLUTION OF THE BANK WITH THE PROVISIONS OF DIRECTIVE 2014/59/EU

- (131) Although Hungary has already transposed Directive 2014/59 into national law⁵¹, the Commission needs to assess whether the measure violates indissolubly linked provisions of Directive 2014/59.
- (132) That obligation is in line with the jurisprudence of the Union Courts, which have consistently held⁵² "*that those aspects of aid which contravene specific provisions TFEU other than [Articles 107 and 108 TFEU] may be so indissolubly linked to the object of the aid that it is impossible to evaluate them separately to that their effect on the compatibility or incompatibility of the aid viewed as a whole must therefore of necessity be determined in the light of the procedure prescribed in [Article 108]*".⁵³
- (133) To ascertain whether a violation of a provision of Union law is indissolubly linked to the object of the aid, a relation of necessity has to be established. It means that the State aid measure has to be connected with a national measure in a way that necessarily breaches a specific provision of Union law which is relevant for the compatibility analysis under paragraphs 2 and 3 of Article 107 of the Treaty.
- (134) In this decision, according to the information provided by Hungary, the Commission has identified the use of at least the following provisions of Directive 2014/59:
- (135) The Commission notes that the provisions of the measure are in line with Article 34(1)(a) of Directive 2014/59. Taking into account that MKB Bank has no subordinated debt, all equity will be transferred to the resolution fund and the original sole shareholder, i.e. the Hungarian State, will be fully diluted. Therefore, the shareholders are not shielded from bearing 100% losses, and as there are no subordinated debt-holders, the same condition on them does not apply.
- (136) The Commission notes that the measure applies the provisions of Article 32(1) of Directive 2014/59 specifying the conditions required to take a resolution action. Article 36(1) of Directive 2014/59 also applies, and details how a final valuation exercise should be used to inform all important resolution decisions and as explained in recitals (52) and (53), that final valuation underpins the burden-sharing by shareholders.
- (137) The Commission notes that the restructuring aid measure seems an application of the "asset separation" tool provided by Article 42 of Directive 2014/59.
- (138) The Commission also notes that the funding of the aid measure appears to be in compliance with Article 101(1) of Directive 2014/59 on the requirement to establish and use resolution financing arrangements.

⁵¹ Act XXXVII of 2014 on the further development of the system of institutions strengthening the security of the individual players of the financial mediating system (Hungarian Resolution Act), transposing the Bank Recovery and Resolution Directive (BRRD) in Hungarian law.

⁵² See *inter alia* Joined Cases C-134/91 and C-135/91 *Keramina-Keramische v Greece* EU:C:1992:434, paragraph 20; Case T-184/97 *BP Chemicals v Commission* EU:T:2000:217, paragraph 55; and Case T-289/03 *BUPA and others v Commission* EU:T:2005:78, paragraphs 313 and 314.

⁵³ Case 74/76 *Ianelli v Meroni* EU:C:1977:51 paragraph 14.

(139) Therefore, the Commission concludes that the restructuring aid in the form of an impaired asset measure does not seem to violate the intrinsically linked provisions of Directive 2014/59 in the context of the State aid rules.

(140) This is without prejudice to the prerogative of the Commission to initiate infringement procedures against a Member State for breach of Union law, including breach of the provisions of Directive 2014/59.

CONCLUSION

The Commission has accordingly decided to consider the aid to be compatible with the internal market pursuant to Article 107(3)(b) of the Treaty on the Functioning of the European Union, and not to raise objections to the restructuring aid in favour of MKB Bank and MKB Group.

The Commission notes that Hungary exceptionally accepts that the adoption of the Decision be in the English language.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: <http://ec.europa.eu/competition/elojade/isef/index.cfm>.

Your request should be sent electronically to the following address:

European Commission,
Directorate-General Competition
State Aid Greffe
B-1049 Brussels
Stateaidgreffe@ec.europa.eu

Yours faithfully
For the Commission

Margrethe VESTAGER
Member of the Commission



Annex 1 – Commitments

György H MATOLCSY
GOVERNOR



THE CENTRAL BANK OF HUNGARY

Reference No 234737-1/2015
Budapest, 7 December 2015

European
Commission
Directorate General for
Competition
Place Madou 1, B-1210
Bruxelles

Subject: SA.40441– State aid for MKB Bank Zrt. – Commitments'
Letter

Hungarian authorities ensure that MKB Bank Zrt. and its affiliates ("MKB Group") will implement the restructuring plan submitted on 23 November 2015. In connection with this, Hungarian authorities commit to implement in particular the measures and actions and to achieve the objectives listed below (the "Commitments") which are integral part of the restructuring plan.

The Commitments shall take effect upon the date of adoption of the European Commission's decision (the "Decision") approving the restructuring plan.

The restructuring period will end on 31 December 2019. The Commitments apply throughout the restructuring period unless the individual Commitment states otherwise.

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STRUCTURAL AND BEHAVIOURAL COMMITMENTS OF MKB GROUP

1. Divestment of loss-generating business lines

MKB Group will sell the car fleet management business, Aut6park jointly owned (50-50%) by MKB Bank Zrt. and Letét Ltd. (external investment group) via competitive auction by the end of Q2 2016.

2. Divestment of CRE lending

MKB Group will not enter in commercial real estate ("CRE") financing in any forms throughout the restructuring period.

CRE lending definition for the purposes of the Commitment: any real estate financing where the repayment of the loan is coming from the sale or the regular income of a real estate and the borrower is a legal entity or a private entrepreneur.

Typical purpose of use:

- o office
- o commercial areas (department store, plaza, etc.)
- o logistics, warehouses
- o hotel, leisure and hospitality
- o residential developments
- o industrial real estates
- o parking garages
- o land plots
- o any combination of the above.

MKB Group will amortize the remaining Special Credit Unit ("SCU") portfolio, in a way that by the end of the restructuring period the total outstanding gross exposure on the remaining SCU will be decreased from HUF 412 billion (SCU portfolio without the spin-off portfolio at the end of 2014) under 15 per cent (HUF 0-60 billion) of the SCU portfolio at the end of 2014 without the spin-off portfolio.

MKB Group will sell the Mammut deal at latest by the end of March 2016. If MKB Group fails to conclude the transaction, the total outstanding gross exposure of MKB Group on the remaining SCU will be decreased by another 9 percentage points to under 6 per cent (HUF 0-24 billion) of the SCU portfolio at the end of 2014 without the spin-off portfolio until the end of the restructuring period.

3. Prohibition of FX lending

MKB Group will not issue new FX denominated loans to private individuals during the restructuring period.

For Corporate FX lending is restricted to cases where natural hedge is provided on the client's side. There is a natural hedge if the following criteria are fulfilled:

- o the client has foreign currency revenue based on existing contracts; or
- o foreign currency assets are used as a collateral behind the FX loan; and

currency match at least in equal amount of the repayment obligation is required in all cases.

4. Cost reduction

MKB Group will reach a [50-60] per cent cost-to-income ratio in 2016, and keep the ratio below [50-55] per cent from 2017 on through the entire restructuring period.

The maximum number of full-time equivalent employees ("FTE") of MKB Group will be reduced to [2000-2100] by the end of 2015, to [1950-2050] by the end of 2016, and to [1950-2050] by the end of 2017. MKB Group will cap the FTE level from 2018 onwards at [1950-2050] until the end of the restructuring period.

MKB Group will reduce its total branch number from 79 in 2014 to [70-76] by the end 2017 and cap at this level until the end of the restructuring period. MKB Group will close further branches after

2017 within one year:

- o if the branch is generating loss for MKB Group by not being able to cover its direct cost in the previous calendar year and
- o there is an adequate solution for substitution, hence client churn is manageable.

5. Improving the risk management framework

MKB Group will operate in line with the principles of the new risk strategy from January 2016. Throughout 2016, MKB Group will implement sector strategies, management reporting and controlling, credit committee decision making, and business planning aligned with the new risk strategy and risk appetite framework, with a view to have full implementation by 31 December 2016, including supporting IT infrastructure.

MKB Group will price every new corporate loan (considering as new loan any new business not related to an existing transaction) by using an appropriate internal pricing tool. Pricing for new loans will be considered adequate if the new corporate loan contributes to achieve a positive Return on Equity before tax ("RoE") of at least [3-10] per cent in 2017, [4-11] per cent in 2018 and [5-12] per cent in 2019 on either the individual loan or on each client relationship. The calculation of the RoE of a client relationship can include interest income, fees as well as other combined products of the same client. The calculation of RoE on client level and pricing according to minimum RoE has to be implemented no later than 31 December 2016.

- o Any deviation from the pricing resulting in a lower price level will be documented. This documentation will include robust commercial reasoning for the deviation and will be presented to the Monitoring Trustee. If the total amount of deviations will exceed the total volume per client of more than HUF [0-15] billion of deals, corrective measures shall be implemented by MKB Group.
- o Credit deals not falling under this pricing policy regime: Transactions with related parties (i.e. group members and employees), restructuring cases and cases with more than 90 days overdue, as well as all money market transactions. However, MKB Group will develop a policy to restructure non-performing loans in a net present value maximising manner and will strictly adhere to this policy.

6. Dividend ban

MKB Group will not pay any dividends on shares for the fiscal years until end 2017. For the fiscal year 2018 and onwards, MKB Group may distribute to the shareholder such an amount of dividend based on their stake in the ownership structure of the Group, from its accumulated reserves that does not affect the compliance of the Group with the required, in a horizon of 2 years, supervisory minimum capital adequacy as that is defined by the Central Bank of Hungary.

7. Limitation on certain investments

MKB Group will only purchase investment grade securities, European Economic Area ("EEA") sovereign securities or EEA state guaranteed securities as well as every security that are eligible as collateral for Central Bank of Hungary.

8. Introduction of the Bank to a regulated capital market

The Bank will be transformed to Public Limited Company and shall be introduced to a regulated capital market after at least two profitable business years but until the end of the restructuring period at the latest.

9. Balance-sheet and RWA target

MKB Group will keep the balance sheet below HUF [1800-2000] billion by the end of the restructuring period. The growth of the balance sheet cannot exceed the growth rate of the nominal GOP in each year during the restructuring period.

The risk weighted assets ("RWA") of MKB Group will constantly decrease during the restructuring period. The RWA including only credit risk and the overall RWA including credit, market and operational risks will be below HUF [750-900] billion and HUF [900-1000] billion at the end of the restructuring period.

If MKB Group fails to sell the Mammut deal by the end of March 2016, the balance sheet will be kept under HUF [1700-1900] billion during the restructuring period; the RWA including only credit risk

will be decreased below HUF [700-800] billion, and the RWA including credit, market and operational risks will be decreased below HUF [800-900] billion by the end of the restructuring period.

10. Acquisition ban

MKB Group will not acquire any stake in any undertaking until 31 December 2018 (the date of reference is the date of the signing of the acquisition). This covers both undertaking which have the legal form of a company or pool of assets which form a business.

- Exemption requiring Commission's prior approval: notwithstanding the acquisition prohibition, MKB Group may, after obtaining the Commission's approval, acquire businesses if in exceptional circumstances, it is deemed necessary to restore financial stability or to ensure effective competition in line with the idea to restore MKB Group's viability;
- Exemption not requiring Commission's prior approval: MKB Group may acquire stakes in undertakings provided that the purchase price is less than [0-10] per cent of MI<B Group's total assets as of 31 December 2014 (HUF [0-20] billion) in each individual case and that the cumulative purchase prices paid by MI<B Group for all such acquisitions over the whole restructuring period is less than [0-10] per cent of MKB Group's total assets as of 31 December 2014 (HUF [0-20] billion).
- Activities not falling under the acquisition ban: (i) acquisitions that take place in the ordinary course of the banking business in the management of existing claims towards ailing firms, including debt to equity swaps; (ii) disposals and restructuring within MI<B Group.

11. Marketing expenses

MKB Group will cap its marketing expenditures at the 2014 level of HUF [1000-1500] billion until the end of the restructuring period.

12. Advertising ban

Hungarian authorities will impose a ban on advertising related to the state support to MI<B Group and to the state ownership in MKB Group or to any competitive advantages arising in any way from the state aid or state ownership.

13. Remuneration cap

The total remuneration, including all possible fixed and variable components and pensions, of any of the staff members of MKB Group, including members of the board and the senior management will not exceed 15 times the national average salary or 10 times the average salary of the employees of MKB Group, whichever is higher. This commitment will apply until the State aid has been fully repaid or until the end of the restructuring period, whichever occurs earlier.

14. Deadline for the sale of the Core Bank

100 per cent of shares of the Core Bank will be sold by end of June 2016.

The sales process will be open, transparent, competitive, non-discriminatory and fully compliant with the requirements of the EU State aid law and the BRRD.

15. Ban on aggressive commercial practices

MKB Group will not advertise its products and services in an aggressive manner and will not apply aggressive pricing.

16. Monitoring Trustee during the restructuring period

Hungarian authorities approve a Monitoring Trustee for MKB Group as set out below.

- (1) The Monitoring Trustee will have the duty to monitor the full compliance with the Commitments until the end of the Restructuring Period of MKB Group.
- (2) The Monitoring Trustee may be natural person(s) or legal person(s) or institution(s).
- (3) The Monitoring Trustee must be independent of MKB Group. The Monitoring Trustee must possess, for example as an investment bank, consultant or auditor, the specialised knowledge, expertise and manpower that is required in order to carry out its mandate, and must at no time be exposed to any conflict of interest.
- (4) The Monitoring Trustee is to be remunerated by MKB Group in a way that must not impede the independent and effective fulfilment of its mandate.
- (5) Hungarian authorities will submit at least two proposals to the Commission for approval as Monitoring Trustee no later than four weeks after the date of adoption of the Decision.

17. Re-notification

The Hungarian authorities commit to re-notify every change to the restructuring plan and in particular changes that influence the viability, burden sharing and competition analysis performed by the Commission in its present decision approving the restructuring plan.

Best wishes,

György Matolcsy

Governor
Chairman of the Financial Stability Council

Central Bank of Hungary as Resolution Authority



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Annex 2 – Monitoring Trustee

1. MONITORING TRUSTEE

- (1) Hungary is to ensure that the full and correct implementation of the present decision on approving the restructuring plan (the “Decision”) and all the Commitments are continuously monitored by independent and sufficiently qualified Monitoring Trustee.
- (2) The appointment, duties, obligations, replacement, discharge and reappointment of the Monitoring Trustee, as well as the duties and obligations of MKB Group) in this context, must follow the conditions and procedures set out in this Annex.
- (3) If in the course of implementing the Commitments there are reasons to assume that MKB Group is reasonably likely to fail to meet any Commitment, it has to work out on its own initiative a plan with Remedial Actions that are apt to ensure that all targets will be met. The Remedial Actions have to be presented to the Monitoring Trustee who will analyse them and report to the Commission on its views concerning their adequacy.
- (4) Hungary and MKB Group are to ensure that during the implementation of the Decision, the Commission and the Monitoring Trustee have unrestricted access to all information needed to monitor the implementation of the Decision. The Commission or the Monitoring Trustee may ask MKB Group for explanations and clarifications. Hungary and MKB Group are to cooperate fully with the Commission and the Monitoring Trustee with regard to all enquiries associated with monitoring of the implementation of the Decision and the Commitments.

2. APPOINTMENT OF THE MONITORING TRUSTEE

- (5) Hungary undertakes to ensure that the Resolution Fund approves a Monitoring Trustee for MKB Group as set out below.
- (6) The mandate of the Monitoring Trustee applies until the end of the Restructuring Period of MKB Group. At the end of the mandate, the Monitoring Trustee will submit a final report to the Commission.
- (7) The Monitoring Trustee may be natural person(s) or legal person(s) or institution(s).
- (8) The Monitoring Trustee must be independent of MKB Group. The Monitoring Trustee must possess, for example as an investment bank, consultant or auditor, the specialised knowledge, expertise and manpower that is required in order to carry out its mandate, and must at no time be exposed to any conflict of interest.
- (9) The Monitoring Trustee is to be remunerated by MKB Group in a way that must not impede the independent and effective fulfilment of its mandate.
- (10) Hungary will submit at least two proposals to the Commission for approval as Monitoring Trustee no later than four weeks after the date of adoption of the Decision. These proposals must contain sufficient information about the potential trustees to enable the Commission to verify whether they fulfil the requirements, and must in particular include the following:
 - a. the full terms of the proposed mandate with all the provisions which are necessary to enable the Monitoring Trustee to fulfil his/her duties; and
 - b. the draft of a work plan describing how the proposed trustee intends to carry out the assigned duties if s/he is appointed.
- (11) The Commission has the discretion to approve or reject the proposed persons and to approve the proposed mandate subject to any modifications that it deems necessary in order to enable the Monitoring Trustee to fulfil its obligations. If only one name is approved, MKB Group will appoint the person

concerned as Monitoring Trustee or cause that person to be appointed, in accordance with the mandate approved by the Commission, or submit alternative proposal(s) to be reviewed and approved by the Commission. If more than one name is approved, Hungary is free to decide which of the approved persons should be appointed as Monitoring Trustee. The Monitoring Trustee will be appointed within one week of the Commission's approval, in accordance with the mandate approved by the Commission.

- (12) If all the proposed persons are rejected, Hungary shall submit the names of at least two different persons within two weeks of being informed of the changes or the rejection.
- (13) If all further proposed persons are also rejected by the Commission, the Commission will nominate a Monitoring Trustee which the Resolution Fund will appoint, in accordance with a trustee mandate approved by the Commission.

3. DUTIES AND OBLIGATIONS OF THE MONITORING TRUSTEE

- (14) The Monitoring Trustee is to assist the Commission to ensure MKB Group 's compliance with the Commitments. The Monitoring Trustee is to carry out the duties under his/her mandate in accordance with the work plan, as well as revisions of the work plan that have been approved by the Commission. The Commission may, on its own initiative or at the request of Hungary, issue orders or instructions to the Monitoring Trustee in order to ensure compliance with the Commitments. MKB Group is not entitled to issue instructions to the Monitoring Trustee.
- (15) The duty of the Monitoring Trustee is to monitor full and correct compliance with the obligations set out in the Commitments, and full and correct implementation of the Decision. The Commission may, on its own initiative, or at the request of the Monitoring Trustee, issue any orders or instructions to the Monitoring Trustee or MKB Group in order to ensure compliance with the Commitments attached to the Decision.
- (16) The Monitoring Trustee shall:
 - a. propose to the Commission in its first report a detailed work plan describing how it intends to monitor compliance with the Commitments;
 - b. monitor the full and correct implementation of the Decision;
 - c. assume the other functions assigned to the Monitoring Trustee in the Commitments attached to the Decision;
 - d. submit a half-yearly draft written report on MKB Group to the Commission, Hungary, and MKB Group within thirty days after the end of each semester. The Commission, Hungary, and MKB Group can submit comments on the drafts within ten working days of receipt. Within five working days of receipt of the comments, the Monitoring Trustee is to prepare the final report and submit it to the Commission and to Hungary. Only afterwards the Monitoring Trustee is to send a copy of the final report to MKB Group. If the draft report or the final report contains any information that may not be disclosed to the Bank, only a non-confidential version of the draft report or the final report is to be sent to MKB Group. Under no circumstances is the Monitoring Trustee to submit any version of the report to Hungary and/or MKB Group before submitting it to the Commission;
 - e. the reports are to focus on compliance with the Commitments by MKB Group, thus enabling the Commission to assess whether MKB Group is being managed in accordance with the Commitments. If necessary, the Commission may specify the scope of the reports in more detail. In addition to the reports, the Monitoring Trustee is to report promptly in writing to the Commission if it has reasons to suppose that MKB Group is failing to comply with the Commitments.

4. DUTIES AND OBLIGATIONS OF MKB GROUP

- (17) MKB Group is to provide and require its advisors to provide the Monitoring Trustee with all such cooperation, assistance and information as the Monitoring Trustee may reasonably require performing his/her tasks under the mandate. The Monitoring Trustee is to have unrestricted access to any books, records, documents, management or other personnel, facilities, sites and technical information of MKB Group or of the business to be sold that are necessary to fulfil the duties under the mandate. MKB Group is to make available to the Monitoring Trustee one or more offices at its business premises and all employees of MKB Group are to be available for meetings with the Monitoring Trustee in order to provide him/her with all the information it needs to perform his/her duties.
- (18) The Monitoring Trustee may appoint advisors (in particular for corporate finance or legal advice), if the Monitoring Trustee considers the appointment of such advisors is necessary or appropriate for the performance of his/her duties and obligations under the mandate, provided that any costs and other expenses incurred by the Monitoring Trustee are reasonable. Should MKB Group refuse to approve the advisors proposed by the Monitoring Trustee, the Commission may approve their appointment instead, after hearing MKB Group 's reasons. Only the Monitoring Trustee or the Commission are entitled to issue instructions to the advisors.

5. REPLACEMENT, DISCHARGE AND REAPPOINTMENT OF THE MONITORING TRUSTEE

- (19) If the Monitoring Trustee terminates his/her mandate or there are any other significant grounds, such as a conflict of interest on the part of the Monitoring Trustee, the Commission can, after hearing the Monitoring Trustee, Hungary and MKB Group, require its replacement.
- (20) If the Monitoring Trustee is removed, he/she may be required to continue in the function until a new Monitoring Trustee is in place to whom the previous Monitoring Trustee has effected a full handover of all the relevant information. The new Monitoring Trustee is to be appointed in accordance with the procedure referred to in section 2 of the present Annex.
- (21) Besides replacement in accordance with paragraph (19) of the present Annex, the Monitoring Trustee is to cease his/her activities only after the Commission has discharged him/her from his/her duties. This discharge is to take place when all the obligations with which the Monitoring Trustee has been entrusted have been implemented. However, the Commission may at any time require the reappointment of the Monitoring Trustee if it is subsequently found that the relevant Commitments have not been fully and properly implemented.