Hungary: Guarantee Scheme

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Abstract

In the midst of the global financial crisis in October 2008, the Magyar Nemzeti Bank (MNB), the Hungarian national bank, noticed a selloff of government securities by foreign banks and a large depreciation in the exchange rate of the Hungarian forint (HUF) in FX markets. Hungarian banks experienced liquidity pressures due to margin calls on FX swap contracts, prompting the MNB and Minister of Finance to seek assistance from the International Monetary Fund (IMF), the European Central Bank (ECB) and the World Bank. The IMF and ECB approved Hungary's requests in late 2008 to create a €20 billion facility, with €2.2 billion (HUF 600 billion) intended to back a bank support package. The program would involve the creation of two schemes, one of which, the guarantee scheme, was funded by a Refinancing Guarantee Fund (RGF) and aimed to provide domestic banks with guarantees on interbank loans and wholesale debt contracts with foreign counterparties. Some analyses deemed the guarantee scheme unsuccessful, since no banks ever participated in the scheme, in large part due to Hungary's own low sovereign debt rating. This prompted the Hungarian government to use a portion of the bank support program to extend direct on-lending measures, under a liquidity scheme, to three of its largest domestic financial institutions in March 2009.

Keywords: Hungary, European Union, guarantee scheme, IMF, World Bank, stand-by arrangement

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At a Glance

Summary of Key Terms	
Purpose: To "secure the refinancing of the eligible banks and to strengthen the banks' position in an international market where their competitors already have access to similar guarantees."	
Announcement Date	December 22, 2008
Operational Date	February 6, 2009
Date of First Guaranteed Issuance	N/A
Issuance Window Expiration Date	Originally June 30, 2009; later extended to December 31, 2009
Program Size	HUF 300 billion (€1.1 billion); guarantee up to HUF 1.5 trillion (€5.5 billion)
Usage	N/A
Outcomes	N/A
Notable Features	High fees relative to value of guarantee given low sovereign credit rating

In the years leading up to the global financial crisis, the Hungarian banking sector depended largely on foreign investment and was heavily concentrated in the housing and real estate markets. In the wake of Lehman Brothers' bankruptcy and the credit crunch that ensued, investors began pulling out investments from Hungary and selling off Hungarian government bonds. The floating Hungarian forint depreciated drastically, motivating foreign investors to exit investments in FX swap contracts with Hungarian banks. Margin calls placed severe liquidity pressure on banks, straining the stability of Hungary's banking sector. In October 2008, Hungary's national bank, the Magyar Nemzeti Bank (MNB), reached out to the International Monetary Fund (IMF), the European Central Bank (ECB), and the World Bank for assistance. The IMF and the ECB granted Hungary €20 billion in aid that would support a national economic package that sought to address Hungary's fiscal needs, as well as reduce the risk of contagion throughout the Central and Eastern Europe region by improving financial stability in Hungary.

As part of the multilateral package, a HUF 600 billion (€2.3 billion) bank support program established two schemes, funded individually by a Capital Base Enhancement Fund (CBEF) and Refinancing Guarantee Fund (RGF). The recapitalization scheme intended to provide capital injections to banks to increase their capital adequacy ratio to 14%, while the guarantee scheme was designed to provide guarantees to Hungarian bank counterparties for any interbank wholesale loans and debt securities. To have been considered eligible for participation in the guarantee scheme, the original terms required banks to have their own funds of over HUF 200 billion (€766 million), while also participating in the recapitalization scheme. Under the HUF 300 billion (€1.1 billion) guarantee scheme, the State could guarantee interbank lending up to HUF 1.5 trillion (€5.5 billion). Any draw upon the scheme would be subject to an interest fee that the ECB calculated to be 123.50 bps. The scheme covered loan contracts and debt securities with maturities between three months and five years. Finally, the scheme was restricted to covering loans denominated in euros, Swiss francs, or Hungarian forints.

On December 15, 2008, the Hungarian Parliament passed Law CIV 2008, the Act on the Reinforcement of the Stability of the Financial Intermediary System, which granted the authority to guarantee loan and debt repayments for Hungarian banks. The European Commission approved the guarantee scheme on February 12, 2009. Although the issuance window for the MNB to guarantee debt under the guarantee scheme would originally expire on June 30, 2009, and was later extended to December 31, 2009, no banks ever utilized the State guarantees throughout the scheme's one-year lifespan.

Summary Evaluation

Although the guarantee scheme served as a backstop for Hungarian banks on interbank loans, many bank executives and international organizations believed that the scheme itself was useless, often citing Hungary's low sovereign credit rating, "junk status," as the cause. A low rating made it difficult for domestic banks to use the scheme because counterparties did not deem state guarantees credible. Ultimately, the State created a separate liquidity scheme to finance State loans to Hungary's three largest financial institutions in March 2009.

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I. Overview

Background

In October 2008, in the midst of the global financial crisis and the credit crunch that ensued, investors began pulling out investments from Hungary and selling off Hungarian government bonds. The floating Hungarian forint depreciated drastically, motivating foreign investors to exit investments in FX swap contracts with Hungarian banks. Margin calls placed severe liquidity pressure on banks, straining the stability of Hungary's banking sector.

The Hungarian government (the State) requested financial assistance from the International Monetary Fund (IMF), the European Central Bank (ECB), and the World Bank. The following month, the IMF and ECB authorized a €20 billion assistance package to Hungary, HUF 600 billion (ca. €2.3 billion)[2] of which was devoted to a bank support program to create two schemes – a guarantee scheme and a recapitalization scheme – designed to alleviate liquidity pressures and increase financial stability in domestic banks. (IMF November 2008)

The bank support program included the creation of a Refinancing Guarantee Fund (RGF), also referred to as the Debt Guarantee Fund by the World Bank, that financed the guarantee scheme. The scheme would provide State-backed guarantees to participating financial institutions for interbank loans and wholesale debt securities. (Ibid.)

On December 15, 2008, the Hungarian Parliament passed the Act on the Reinforcement of the Stability of the Financial Intermediary System of 2008 (the Act), which, under Article 1(1) of the Act, authorized the State to implement the guarantee scheme using the funds provided through the RGF. The recapitalization scheme under the bank support program was also enabled, funded by a Capital Base Enhancement Fund (CBEF). (EC N664/2008) See Appendix A for an overview of the request of international assistance from the three institutions and for other details on the bank support package. For more information on the recapitalization scheme, please refer to Buchholtz 2018a.

Program Description

On February 12, 2009, the European Commission (EC) approved the guarantee scheme, therefore making it operational. (EC N664/2008) The guarantee scheme intended to provide guarantees on new interbank loans requested and any wholesale securities issued by domestic banks. Subordinated loans and capital investments were not eligible for guarantee under the scheme. (IMF November 2008) According to the IMF stand-by arrangement request, the guarantee scheme "[was] meant to bring comfort to the providers of wholesale funding and secure the refinancing of the eligible banks." (Ibid.) Moreover, the State believed that the guarantee scheme would "establish a level-playing

[2] The exchange rate of October 31, 2008 was $1 = HUN 204 and €1 = 261.

field for the Hungarian banks in an international environment where their competitors already have access to similar guarantees." (Ibid.) The scheme's RGF was invested completely in euro-denominated EU government bonds and managed by the MNB. (Hungary LOI 2008)

Initially, the guarantee scheme required any private domestic bank to be "of systemic importance with own funds above HUF 200 billion" and to have secured capital under the program's other component, the recapitalization scheme, in order to access the guarantees under the guarantee scheme. (IMF November 2008) As a result, the guarantee scheme effectively only covered three of Hungary's largest financial institutions. Liquidity facilities enacted in October 2008 protected the thirty three other domestic banks that were under the HUF 200 billion requirement. (Ibid.)

The guarantee scheme guaranteed interbank loans up to a maximum of HUF 1.5 trillion (€5.7 billion). The scheme only guaranteed loans that had a maturity date of between three months and five years. All loans with a maturity between three years and five years could only utilize up to a third of the scheme's budget. (EC N664/2008) Guarantees would come with an annual guarantee fee, calculated by the ECB Recommendations on Government Guarantees on Bank Debt to be 123.50 bps. The ECB calculated this guarantee fee using a flat fee of 50 bps, used for short-term loans, plus the fee for the lowest CDS rating category of A, which was 73.50. (Ibid.)

The guarantee scheme also came with a limited issuance period of up to June 30, 2009, with the ability by the EC to approve an extension until December 31, 2009. Under EC regulations, any institution that drew guarantees and was deemed fundamentally unsound by the EC would also have to present a restructuring or liquidation plan within six months of receiving assistance. (Ibid.)

Any institution participating in the guarantee scheme also was required to grant the State a special veto share, which ultimately gave Hungary "potential influence in the financial institution's decision-making." (Ibid.) The special share gave Hungary the right to "appoint at least one member to both the managing and the supervisory boards" of the participating institution. (Ibid.) Lastly, the institution also was subject to two "behavioral conditions" that stated the institution was not allowed to publicize any state assistance it received and that it had to impose compensation and benefit restrictions on its top managers. (Ibid.)

Outcomes

It was apparent early on to the State through conversations with domestic bank executives that banks were hesitant to participate in the scheme since banks were uncertain that Hungary would be able to pay off its own balance of payments. (IMF June 2011) Between the request for assistance and the passage of the Financial Stability Act in December 2008, the Hungarian Parliament changed some of the terms of the guarantees in order to cover more banks affected by the crisis. To promote "non-discriminatory" practices and avoid "threaten[ing] to distort competition," the Hungarian Parliament removed the prerequisite that required a bank to have funds greater than HUF 200 billion in order to receive guarantee assistance. In addition, Parliament removed the requirement that a bank could only participate in the guarantee scheme if it had sought prior participation in the recapitalization scheme. (EC NN68/2009)

While the EC did extend the guarantee scheme through the end of 2009, the absence of any participation by credit institutions in the guarantee scheme, in part due to Hungary's lingering credit risks, gave the EC reason to allow the scheme to expire without further prolongation. (IMF June 2011)

Due to the under-subscription of both the recapitalization scheme and guarantee scheme by Hungarian financial institutions, banks still required immediate liquidity assistance. In March 2009, the Hungarian Parliament amended Law IV of 2009, which was based on Law XXXVIII of 1992, or the Act on Public Finances, to authorize the State to extend uncollateralized medium-term FX loans, under commercial terms, to credit institutions in Hungary, including subsidiaries of foreign banks. At the end of March, the State extended loans to three different credit institutions.[3] (Ibid.) Although the EC was not notified until late 2009 of the liquidity scheme's implementation, which breached European Union law, the EC nonetheless approved the liquidity scheme in January 2010. (EC NN68/2009)

The liquidity scheme had an overall budget of HUF 1.1 trillion (€4 billion), financed by the multilateral assistance package. (IMF June 2011) The loans had durations of three years from disbursement and were provided at the higher of either a market benchmark interest rate, plus an add-on fee, or the SDR Interest Rate published on the IMF's website, plus an add-on fee. (Ibid.) The State decided to extend the loans since any sale of local Hungarian currency to meet FX needs would have placed further "downward pressure on the exchange rate." (Ibid.) The Hungarian FHB bank, which received capital under the recapitalization scheme, also benefitted via a loan under the new liquidity scheme. (Ibid.) For more information on the Hungarian liquidity scheme, please refer to Buchholtz 2018b.

II. Key Design Decisions

1. **The Guarantee Scheme was part of a bank support program funded as one component of an IMF, ECB and World Bank assistance package for Hungary.**

On November 4, 2008, the State reached out to the IMF to request financial support via a Stand-By Arrangement of 17 months of special-drawing rights of SDR 10.5 billion (€12.5 billion) for a large economic assistance package that would facilitate macroeconomic policies and promote financial stability throughout Hungary. The State listed three goals under the program (IMF November 2008):

1. To reduce the government's financing needs and improve long-term fiscal sustainability

[3] Three domestic financial institutions received loans under the liquidity scheme: OTP Bank, the largest Hungarian domestic bank, received HUF 400 billion (€1.4 billion); MFB, a state-owned development bank, received HUF 170 billion (€617.7 million); and FHB Mortgage Bank plc, a mortgage lender, received HUF 120 billion (€436.1 million). (EC NN68/2009)

2. To maintain adequate capitalization of the domestic banks and liquidity in domestic financial markets
3. To underpin confidence and secure adequate external financing

The State also reached out to the ECB and the World Bank for additional funding. Under the package, the State specifically wanted to sponsor a bank support program aimed at boosting the credibility and ensuring the soundness of all banks operating in Hungary. More specifically, the goal of the program was to increase domestic parent banks' ability to provide for its foreign subsidiaries. (Ibid.) The program funded the creation of two schemes, a recapitalization scheme and a guarantee scheme. The purpose of the recapitalization scheme was to strengthen the capital positions of major credit institutions, increase liquidity across the Hungarian banking sector, and encourage lending to the real economy. (EC N664/2008) To read more about the recapitalization scheme, you may refer to Appendix A or Buchholtz 2018a.

2. **The Hungarian Parliament passed Law CIV 2008, the Financial Stability Act, to authorize the State to guarantee interbank debt and loan contracts.**

On December 15, 2008, the Hungarian Parliament passed the Financial Stability Act aimed at "strengthening the financial intermediary system" and "limit[ing] the effects of the global financial crisis in Hungary and maintain[ing] its financial stability." (ECB Opinion March 2009)

3. **The European Commission approved the bank support program and its guarantee scheme.**

After two months of analysis and deliberation over the program, the EC approved the program in February 2009 under Article 87(3)(b) of the EC Treaty, which "enables the EC to declare aid… if it is necessary to remedy a serious disturbance in the economy of a Member State." (EC N664/2008) The EC believed that the program's objectives could sufficiently address the issues of the lack of liquidity and confidence in the Hungarian banking sector, as well as provide a benefit to the overall Hungarian economy. (Ibid.)

Regarding the EC's assessment of the guarantee scheme, the EC believed that guarantee schemes as a whole could help overcome global market failures that inhibited banks from accessing liquidity or constrained a healthy bank from serving as a financial intermediary. Given that the goal of the Hungarian guarantee scheme was "to provide a safety net to investors that purchase the newly issued debt of, or lend to, the participating institutions," the EC was satisfied with the objectives of the guarantee scheme. (Ibid.)

4. **The guarantee scheme was administered by the Ministry of Finance, the Financial Supervisory Authority and the Magyar Nemzeti Bank, the Hungarian national bank.**

5. **The guarantee scheme was financed by a HUF 300 billion Refinancing Guarantee Fund and could provide guarantees up to HUF 1.5 trillion in total.**

6. **Domestic banks that were considered fundamentally sound and considered systemically important were eligible to participate in the guarantee scheme.**

In order to have been considered fundamentally sound, a credit institution was evaluated by the MNB and the *Pénzügyi Szervezetek Állami Felügyelete*, or the Hungarian Financial Supervisory Authority (PSZAF). (EC N664/2008) The MNB would evaluate the impact of the institution on markets, financial infrastructure, and other regulated entities, as well as assess its short-term liquidity position. Meanwhile, the PSZAF would evaluate the medium-term and long-term liquidity positions of the applicant. Afterwards, the MNB and PSZAF would provide a recommendation to the Hungarian Minister of Finance to assess if an institution was eligible for assistance and the extent of assistance to that institution should be. (Ibid.)

7. **Initially, banks had to have its own funds of over HUF 200 billion to participate in the guarantee scheme. The requirement was later removed.**

Initially, banks could only participate in the guarantee scheme if the bank had already secured capital under the recapitalization scheme.

8. **The guarantee scheme would cover interbank loans, which included the rollover of loans and wholesale debt securities.**

9. **The guarantee scheme would guarantee loans with a maturity of between three months and five years.**

Since a major portion of the Hungarian financial market relied on the housing market and mortgage loans, whose maturities often exceeded three years, the fund would guarantee interbank loans between three years and five years. However, the EC noted that it was in the best interest of all parties to cover loans with as short a duration as possible, defined by the EC as three months. Therefore, the guarantee scheme only allowed up to approximately a third of the RGF to be utilized to guarantee loans with maturities between three and five years. Loans with a maturity between three and five years could only be guaranteed a maximum of HUF 450 billion. (EC N664/2008)

10. **Loan and debt contracts guaranteed by the guarantee scheme had be denominated in euros, Swiss francs, or Hungarian forints.**

11. **There does not appear to have been any cap on an institution's participation.**

12. **The annual guarantee fee of 123.50 bps was based on the lowest CDS rating available.**

Based on the European Central Bank Recommendations on Government Guarantees on Bank Debt that was released on October 20, 2008, any guarantee provided by the State would include a flat fee of 50 bps for newly issued short-term loans, in addition to an add-on fee derived from CDS spreads. Because CDS spread data was generally unavailable for

Hungary, the ECB used the lowest CDS rating category of A, equal to 73.50 bps to calculate that the annual fee should be 123.50 bps. (EC N664/2008)

13. Participating banks had to abide by a set of "behavioral conditions." In addition, a special veto share was issued to the State as a safeguard on any guarantee.

The State believed that to ensure that the bank support program would "not allow the credit institutions to expand their business in an unfair manner," the government should impose behavioral conditions on any participating institution. (EC N664/2008) Those conditions included requiring any participating institution not to advertise any government assistance they receive and imposing restrictions on salary, compensation, and other benefit plans on the top executive officers of the banks. (Ibid.)

Given that the State would provide large guarantees on interbank loans, the terms of the guarantee scheme said that the participant must grant a special veto share to the government. The share provided "veto rights" that would allow the State to deter decisions "which would lead to a misuse of funds" or could have threatened financial stability at home and abroad. (Ibid.) Some examples of the misappropriations of funds might have included issuing large dividend payments, providing large executive compensation and bonus payments, or extraction of funds by management. (Ibid.)

14. Banks that requested guarantees and that were deemed fundamentally unsound by the EC had to submit a restructuring plan.

15. Initially, the issuance window of the guarantee scheme was set to expire on June 30, 2009. It was extended once until December 31, 2009.

After a request by Hungary to prolong the issuance window of the guarantee scheme until the end of 2009, the EC approved the extension in spite of the fact that no institution had sought participation in the guarantee scheme. The EC believed that keeping the scheme open provided reassurance to the global economy that the State had assistance measures in place and that restoring market confidence in Hungary would lower sovereign risk, thus stimulating participation in the guarantee scheme. (EC N355/2009)

III. Evaluation

The IMF stated that the "timeliness and size" of the bank support package was crucial to avoiding a systemic banking crisis, as well as contagion across central and southern Europe. The announcement of a package signaled to the market the IMF's readiness and willingness to provide immediate assistance to Hungary during the crisis. (IMF June 2011) However, the IMF viewed the guarantee scheme as having been ineffective, essentially since no bank or institution ever utilized the scheme. A post-evaluation report of the assistance to Hungary by the IMF concluded that the central drawback to the guarantee scheme was its design, which like other guarantee programs linked the credit rating of the guarantee fund to the country's sovereign credit rating. (Ibid.) The drawback however was that the guarantee scheme was designed based on similar guarantee programs created in

EU countries with relatively high sovereign credit ratings, whereas Hungary had a relatively low rating. Two major credit rating agencies listed Hungary as having 'junk status' credit that consequently made it an unattractive and risky fund for financial institutions to rely on the guarantee. (Ibid.) Hungary largely designed its guarantee scheme based on the UK credit guarantee program of September 2008. For more information on the UK Credit Guarantee Scheme, please refer to McNamara 2018.

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V. Key Program Documents

Summary of Program

- Support Measures for the banking industry in Hungary (European Commission – 02/12/2009) – *European Commission approves a support package to Hungary to stabilize markets in response to the financial crisis, including a guarantee program for short to medium-term debt contracts for domestic banks.* http://ec.europa.eu/competition/state_aid/cases/229073/229073_959557_53_2.pdf

Implementation Documents

- Hungary: Request for Stand-By Arrangement (IMF – 11/04/2008) – *Hungary requested a 17-month, SDR 10.5 billion (€12.5 billion, $15.7 billion, 1015% of quota) stand-by arrangement to provide funds for an economic program that aims to change the Hungarian government's fiscal budget, and to provide capital and liquidity support for the Hungarian banking sector.* http://www.imf.org/~/media/websites/imf/imported-full-text-pdf/external/pubs/ft/scr/2008/_cr08361.ashx

- Letter to Managing Director of IMF (Magyar Nemzeti Bank – 11/04/2008) – *the Governor of the Hungarian National Bank and the Minister of Finance wrote to the Managing Director of the IMF in order to outline the details of the economic program that the IMF's financial assistance would support.* http://www.imf.org/external/np/loi/2008/hun/110408.pdf

- Support Measures for the banking industry in Hungary (European Commission – 02/12/2009) – *European Commission approves a support package to Hungary to stabilize markets in response to the financial crisis, including a guarantee program for short to medium-term debt contracts for domestic banks.* http://ec.europa.eu/competition/state_aid/cases/229073/229073_959557_53_2.pdf

- Program Document: For a Proposed Loan in the Amount of €1.0 Billion to the Republic of Hungary for a Financial Sector and Macro Stability Policy Loan (World Bank – 08/21/2009) – *a program document for a Financial Sector and Macro Stability Loan to Hungary worth €1 billion approved by the World Bank on September 22, 2009, to close on December 31, 2010.* http://documents.worldbank.org/curated/en/897101468252313806/pdf/471940PJPR0P11101Official0Use0Only1.pdf

Legal/Regulatory Guidance

- Article 6 of the Act on Public Finances – *amendment to the 1992 Act on Public Finances that grants the Hungarian government the power to extend capital and liquidity guarantees or loans to financial institutions in order to promote financial stability and avoid regional contagion.*

Press Releases/Announcements

- IMF Executive Board Approves 12.3 Billion Euro Stand-By Arrangement for Hungary (IMF – 11/06/2008) – *press release by the IMF announcing the approval of a 17-month SDR 10.5 billion (€12.3 billion) stand-by arrangement to be provided to Hungary, with SDR 4.2 billion (~€4.9 billion) provided up front, with access to IMF funds up to 1015% of Hungary's IMF quota. The stand-by arrangement would facilitate the creation of an economic program, which includes a banking-sector support package. https://www.imf.org/en/News/Articles/2015/09/14/01/49/pr08275*

- Hungary: Financial Sector and Development Policy Loan (World Bank – 09/22/2009) – *press release by the World Bank announcing the extension of a €1 billion loan program to Hungary.* http://www.worldbank.org/en/news/loans-credits/2009/09/22/hungary-financial-sector-and-macro-stability-development-policy-loan

Media Stories

- IMF bailout lifts Hungarian markets (New York Times – 10/29/2008) – *news story summarizing the multilateral package extended to Hungary from the IMF, EU, and World Bank to help stabilize Hungary's economy.* http://www.nytimes.com/2008/10/29/business/worldbusiness/29iht-forint.1.17341173.html

- IMF, European Union and World Bank support credit crisis relief measures (International Law Office – 11/21/2008) – http://www.internationallawoffice.com/Newsletters/Banking/Hungary/Grdos-Fredi-Mosonyi-Tomori/IMF-European-Union-and-World-Bank-support-credit-crisis-relief-measures?redir=1

Key Academic Papers

- Ex-Post evaluation of Balance of Payments support operation to Hungary decided in November 2008 (Thissen et al. – 02/06/2013) – http://ec.europa.eu/dgs/economy_finance/evaluation/pdf/final_evaluation_bop_hungary_en.pdf

- Financial assistance for Hungarian crisis management – a case study (Kerenyi – June 06/2011) – http://www.eco.u-szeged.hu/english/research/scientific-publications/studies-in-international-economics-and-finance/adam-kerenyi

Reports/Assessments

- Hungary: Stand-By Arrangement: Interim Review under the Emergency Financing Mechanism (IMF – 01/23/2009) – *an IMF staff team reviewed the arrangement to Hungary under the Emergency Financing Mechanism, taking into account the policy implementations thus far, as well as the then-new bank support law.* http://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/scr/2009/_cr0921.ashx

- Hungary: First Review under the Stand-By Arrangement and Request for Modification of Performance Criteria (IMF – 03/30/2009) – *an IMF staff team reviewed the performance and terms of the stand-by arrangement that provide Hungary the funds to support its economic program and bank support package.* http://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/scr/2009/_cr09105.ashx

- Hungary: Second Review under the Stand-By Arrangement, Request for Waiver of Nonobservance of Performance Criterion, and Request for Modification of Performance Criteria (IMF – 06/30/2009) – *an IMF staff team reviewed the performance and terms of the stand-by arrangement that provide Hungary the funds to support its economic program and bank support package.* http://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/scr/2009/_cr09197.ashx

- Hungary: Third Review under the Stand-By Arrangement, Request for Waiver of Nonobservance of Performance Criterion, and Request for Modification of Performance Criteria (IMF – 10/19/2009) – *an IMF staff team reviewed the performance and terms of the stand-by arrangement that provide Hungary the funds to support its economic program and bank support package.* http://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/scr/2009/_cr09304.ashx

- Hungary: Ex-Post Evaluation of Exceptional Access under the 2008 Stand-By Arrangement (IMF – 06/21/2011) – *an IMF staff team evaluated the stand-by arrangement that provide Hungary the funds to support its economic program and bank support package.* https://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/scr/2011/_cr11145.ashx

VI. Appendices

Appendix A: Hungary Requests International Assistance

By 2008, Hungary had become an especially integrated investment and trade center in Europe. Specifically, Hungary's integration into international banking markets left it extremely vulnerable to external credit shocks. The Hungarian banking sector mostly consisted of foreign bank subsidiaries and of a few domestic banks that depended largely on international bank flows. (IMF June 2011)

In addition to the global credit crunch in 2008, Hungary's high debt levels had lingered since the early 2000s, causing concern that Hungary was susceptible to exchange rate and maturity risks. Due to the risks Hungary presented at the time and a weakened FX market, many foreign investors began to selloff Hungarian government bonds. (Ibid.) Consequently, the Hungarian forint (HUF) depreciated drastically, which consequently devalued the collateral of FX swap contracts (denominated in HUF) with domestic Hungarian banks. This only furthered the concerns of foreign banks, who accelerated margin calls on FX swap contracts creating liquidity pressures on Hungarian banks. (Ibid.)

A major concern for Europe was that a Hungarian financial crisis could spread contagion into other European financial systems, such as in Austria, Belgium, and Ireland who had considerable bank claims and investments in Hungarian bonds. (Ibid.) With only enough cash to relieve pressures on its banking system for about two months, the Hungarian government (the State) and central bank, the Magyar Nemzeti Bank (MNB) reached out to the European Central Bank (ECB) for assistance. On October 16, 2008, the Swiss National Bank and ECB each extended their own €5 billion FX swap and repo facility to the MNB "to support MNB's newly introduced euro-liquidity operations." (Gardos 2008) Although Hungary was part of the European Union (EU), it was not part of the Eurozone, thus marking this as "the first instance of the ECB providing financing to a central bank outside the Eurozone." (Ibid.) Unfortunately, since the ECB's facility required Hungary to provide collateral with a credit rating of at least A-, for which Hungarian bonds did not suffice, Hungary was unable to draw upon the facility. (IMF June 2011)

Hungary's growing economic problems motivated the State to request greater support from the IMF, EU, and World Bank. First, on November 6, 2008, the IMF approved a seventeen-month stand-by arrangement to Hungary with special drawing rights up to SDR 10.5 billion (€12.5 billion), with SDR 4.2 billion (approx. €4.9 billion) available up front. (IMF PR 11/06/2008) The EU soon followed in December 2009 by making available up to €6.5 billion in a two-year balance of payments loan to Hungary.[4] The World Bank did not approve any assistance to Hungary until September 2009. (Kerényi 2011)

Although the IMF-EU package was intended to support a variety of different Hungarian economic programs, one program became a HUF 600 billion bank support facility to promote the stability of the Hungarian financial sector and its domestic banks. (IMF

[4] The EU loan was transferred to Hungary via three installments: the first €2 billion on December 9, 2008; the next €2 billion on March 26, 2009; and the final €1.5 billion on July 6, 2009. (Kerényi 2011)

November 2008) The bank support program included HUF 600 billion to be split evenly between two separate funds. The first fund was called the Capital Base Enhancement Fund (CBEF) which supported a recapitalization scheme aimed at raising the capital adequacy ratio of eligible domestic banks to 14% through capital injections. It was determined that any remainder of the CBEF's HUF 300 billion not utilized by banks by the expiration of the recapitalization scheme on March 31, 2009 would transfer over to the second fund of the bank support program, the Refinancing Guarantee Fund (RGF). (Ibid.) The RGF financed a guarantee scheme, under which the State could guarantee the wholesale loans received and debt securities issued by domestic banks, up to a maximum of HUF 1.5 trillion. (Ibid.) For more information on the CBEF and recapitalization scheme, please refer to Buchholtz 2018a.

The Hungarian Parliament passed the Reinforcement of the Stability of the Financial Intermediary System Act (the Financial Stability Act) on December 15, 2008, which became effective on December 23. The Financial Stability Act granted the State the authority to recapitalize any banks operating in Hungary and guarantee the interbank loans of domestic banks using the two funds formed under the bank support package. (EC N664/2008) Finally, the EC approved the bank support package, putting the two schemes into effect, on February 12, 2009. (Ibid.)