

Hungary: Recapitalization 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 pressure due to margin calls on FX swap contracts, prompting the MNB and Minister of Finance to seek assistance from the International Monetary Fund (IMF), European Central Bank (ECB) and the World Bank. The IMF and ECB approved the Hungarian government's (the State) requests in late 2008 to create a €19 billion facility, with HUF 600 billion (€2.2 billion) intended to back a bank support program (the Program). The Program would involve the creation of two schemes, one of which, the recapitalization scheme, would be financed by a Capital Base Enhancement Fund (CBEF), aimed at shoring up the capital ratio of large banks operating in Hungary and maintaining financial stability in Hungary. Only one institution, FHB Mortgage Bank plc, participated in the scheme, having drawn down HUF 30 billion in March 2009, which was fully repaid by February 2010. Nonetheless, some analyses of the recapitalization scheme deemed it relatively successful since its operation reassured banks and investors that financial institutions would have a capital buffer in the event of a sudden economic decline or to backstop the ongoing risks in long-term funding. However, due to the low usage of the overall Program, the State created a new liquidity scheme to provide direct on-lending measures to three of its largest domestic financial institutions in March 2009. The recapitalization scheme was repeatedly approved for extension by the European Commission, until it was finally allowed to expire in June 2013.

Keywords: recapitalization, capital injection, capital adequacy ratio, stand-by arrangement, IMF, World Bank, European Commission, Hungary

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At a Glance

In the years leading up to the global financial crisis, the Hungarian banking sector depended largely on foreign investment and was concentrated in the housing and real estate markets. In the wake of Lehman Brothers' bankruptcy and the ensuing credit crunch, investors began exiting investments from Hungary, leading to a selloff of 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), European Central Bank (ECB), and World Bank for assistance. The IMF and ECB granted Hungary €19 billion to support a national economic package that sought to address Hungary's fiscal needs and improve financial stability with the hope of reducing the risk of contagion in Central and Eastern Europe.

As part of the multilateral package, a HUF 600 billion (€2.2 billion) bank support program (the Program) was split between a guarantee scheme and a recapitalization scheme. The recapitalization scheme was financed by a fund called the Capital Base Enhancement Fund of HUF 300 billion (€1.1 billion) that intended to inject capital into banks through to increase their capital adequacy ratio to 14% and boost market confidence in the strength of the Hungarian financial system. In return for their investment, the Hungarian government (the State) received non-cumulative, non-voting preferred stock. The preferred stock paid dividends equal to the yield of a 5-year government bond, plus an add-on fee of 2%. The add-on fee would annually increase by 1% after 2011. The State also received a special veto share that granted the State the ability to veto major corporate decisions and sit on the participating institution's board of directors, while imposing behavioral conditions on the participating bank. Any use of acquired funds would have had to be approved by the Ministry of Finance, the HFSa, and the MNB, in compliance with systemic risk conditions.

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 inject capital into banks via the recapitalization scheme. The European Commission (EC) approved the scheme on February 12, 2009.

Summary Evaluation

The IMF claims that the Program's announcement, which signaled that the IMF was prepared to aid Hungary and its banking sector, boosted market confidence. Only one institution ever utilized the recapitalization scheme, accepting a HUF 30 billion capital injection, which it fully repaid to the State within a year. Due to the under-subscription of the overall Program, the State created a new liquidity scheme in March 2009 to finance

Summary of Key Terms

Purpose: To "increase the capital adequacy ratio of the participating banks in order to strengthen the credit institutions' capital base and thereby boost the confidence other market players" and "to improve the overall liquidity situation of the Hungarian banking system so as to maintain lending to the real economy."

Announcement Date November 6, 2008

Approval Date December 15, 2008
(Parliament)
February 12, 2009
(European Commission)

Operational Date February 12, 2009

Expiration Date June 30, 2013

Program Size HUF 300 billion (€1.1 billion, \$1.4 billion)

Dividend Yield German 5-Yr Gov't Bond yield, plus 2%

Usage HUF 30 billion (€0.1 billion) in March 2009

loans to all credit institutions in Hungary, including subsidiaries of foreign banks. The recapitalization scheme was continuously approved for extension every six months until it was allowed to expire in June 2013.

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I. Overview

Background

During October 2008, in the midst of the global financial crisis, the Hungarian government (the State) requested financial assistance from the International Monetary Fund (IMF), European Central Bank (ECB), and the World Bank. The following month, the IMF and ECB authorized a €20 billion assistance package to Hungary, from which HUF 600 billion (€2.2 billion) was devoted to a bank support program (the Program) to create two schemes – a guarantee scheme and a recapitalization scheme – designed to strengthen capital positions and increase the liquidity of domestic banks, ultimately to ensure financial stability in Hungary. (*IMF November 2008*)

To address concerns over bank capitalization, the Recapitalization scheme, financed by the Capital Base Enhancement Fund (CBEF), allowed the State to inject capital into large and systemically important banks operating in Hungary providing a capital buffer and boosting their ability to lend to the real economy. The State also sought to improve market confidence in Hungary’s banking sector and “restore the trust of third parties in Hungarian credit institutions.” (*EC N664/2008*)

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 recapitalization scheme using the funds provided through the CBEF. The guarantee scheme under the program was also enabled, funded by a Refinancing Guarantee Fund (RGF). (*Ibid.*) See Appendix A for an overview of the request of international assistance from the three institutions and for more details about the Program. For more information on the guarantee scheme, please refer to Buchholtz 2018a.

Program Description

On February 12, 2009, the European Commission (EC) approved the recapitalization scheme, thereby making it operational. (*EC N664/2008*) According to the EC review of the Program, the recapitalization scheme aimed to “[increase] the capital adequacy ratio of the participating banks in order to strengthen the credit institutions’ capital base and thereby boost the confidence of other market players.” (*Ibid.*) Doing so would, in the view of the State, could “improve the overall liquidity situation of the Hungarian banking system so as to maintain lending to the real economy.” (*Ibid.*) Based on the terms of the Program, the recapitalization scheme was to close on March 31, 2009.

The State would utilize the recapitalization scheme, supported by the HUF 300 billion CBEF, to inject capital into financial institutions with the aim of boosting their capital adequacy ratio (CAR) up to 14%. (*Ibid.*) To have been considered eligible for assistance from the recapitalization scheme, a bank must have had its own funds of at least HUF 200

billion, be considered systemically important, and considered a sound credit institution in accordance with the Law on Credit Institutions 1996.² (*IMF November 2008*) According to the EC, the CBEF was sized in order to increase the capital position of eligible banks to the 14% CAR standard. (*Ibid.*)

The State would inject capital directly into eligible financial institutions by investing in a class of preference shares, which were senior to all other dividend-paying stock in the institution. (*EC N664/2008*) The preference shares were non-cumulative and non-voting, and paid dividends equal to the average yield of the EU's benchmark 5-Yr government bond from the preceding 20 days, which was the German 5-Yr. Government Bond, plus an add-on fee of 2%. If the State held these preferred shares past 2010, the add-on fee would annually increase by 1%. (*Ibid.*) Finally, the State would receive a put option on the preference shares five years after the issuance of the shares, February 12, 2014, under which the State could request full repayment by the institution of its investment. However, the State agreed to not exercise the option if any redemption at the point would hurt the participating bank's solidity or the stability of the Hungarian financial system. (*Ibid.*)

In return for recapitalization, the State would also receive a special share that gave the State the ability to veto major corporate decisions, place at least one member onto each of the managing and supervisory boards of the participating institution, and remove managers. (*Ibid.*) The special share would terminate upon redemption of the preference shares. The State said the powers under this special share would only be exercised if the bank undertook unfair business practices for expansion that would damage the Hungarian financial system, the bank's ability to repay the State for any assistance, or distort the lending market. (*Ibid.*)

Six months following any recapitalization, participating banks "considered not to be fundamentally sound" by the EC had to submit a restructuring plan to the EC. (*Ibid.*) Finally, the institution had the ability to repurchase the preference shares from the State, only after the bank held a stronger capital position. (*Ibid.*)

Outcomes

FHB Mortgage Bank plc (FHB) was the only Hungarian bank to utilize the recapitalization scheme throughout its existence. (*IMF June 2011*) The State injected HUF 30 billion (€0.1 billion) into FHB in exchange for Series C Special Dividend Preference Shares at the end of March 2009. The State was fully repaid by FHB after it repurchased in February 2010 with a return of 10.59% of the original price. (*Ibid.*)

Although the recapitalization scheme expired on March 31, 2009, the State subsequently sought approval from the EC to reinstitute the scheme. The EC approved an extension of the recapitalization scheme's deadline seven separate times afterwards, until it ultimately allowed the scheme to expire on June 30, 2013. (*EC SA.36088*)

² Based on the scheme's requirement that a participating institution must have "its own funds" of above HUF 200 billion, the IMF identified only three institutions could be covered by the recapitalization scheme: FHB Mortgage Bank plc, OTP Bank, and MFB Hungarian Development Bank plc. (*IMF November 2008*)

Due to an under-subscription of both the recapitalization and guarantee schemes under the Program by Hungarian financial institutions, the entire Hungarian banking system still required immediate liquidity assistance. In March 2009, the Hungarian Parliament amended the Law IV of 2009, based on Law XXXVIII of 1992, also known as 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 (*IMF June 2011*) 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.*) FHB, 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 State sought approval for funds to finance a bank support program.

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 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
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 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.

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*)

More specifically, the goal of the Program was to increase domestic parent bank's 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 guarantee scheme was to guarantee interbank loans and wholesale securities issued by major Hungarian banks and increase confidence by their counterparty investors. (*EC N664/2008*) To read more about the guarantee 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 inject capital into banks under a recapitalization scheme.

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

3. The European Commission approved the Program and the recapitalization 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 the benefit to the overall Hungarian economy. (*Ibid.*)

The EC stated that the recapitalization scheme was similar to previous capital programs approved, that successfully helped strengthen banks and restore market confidence in the participating country. Moreover, the EC said that because the scheme was temporary and limited in scope and size, it could not be abused by institutions or the State itself. (*Ibid.*)

Capital interventions, the EC states in its analysis of the scheme, "must be done at terms that minimize the amount of aid." (*Ibid.*) It concluded that the annual return on the preference shares, as well as the inclusion of a put option granted to the State after five years of share issuance and the dividend policy, were all contributors to ensuring repayment to the State and incentivized participating institutions to repay their assistance sooner. (*Ibid.*)

4. Initially, the recapitalization scheme was to expire on March 31, 2009. Hungary received multiple extensions of the scheme.

While the Hungarian Parliament passed the Financial Stability Act in December 2009, the State did not receive approval from the EC to implement the recapitalization scheme until February 12, 2009. (*EC N664/2008*) Therefore, the scheme was only available originally for just under two months until its expiration on March 31. Since the scheme was open for such a short period and general market conditions had not improved, Hungary sought

approval from the EC to extend the deadline for participation by six months. (*EC N335/2009*)

Although only one institution had participated in the recapitalization scheme throughout its existence, the State continued to seek six-month extensions from the EC until 2013 with the goal of maintaining financial stability in Hungary in the midst of on-going volatility across global financial markets. (*Ibid.*) The State believed that maintaining the existence of the recapitalization scheme boosted market confidence by reassuring banks and foreign investors that funding was available for Hungarian financial institutions in the case of sudden declines in the economy, as well as to buffer banks subject to long-term funding risks. (*EC N335/2009*) The MNB believed that banks likely did not need additional capital in a baseline scenario, but that under a stress scenario, it was likely bank banks would draw upon the recapitalization scheme. (*Ibid.*)

5. Initially, domestic banks of systemic importance, with their own funds of over HUF 200 billion, were eligible to request a capital injection under the recapitalization scheme. This requirement was removed.

33 other banks in Hungary's system were deemed ineligible for this program by the MNB since they were small in size and posed a low systemic risk to the rest of Hungary's banking system and abroad. (*IMF November 2008*) These smaller banks located in Hungary were protected by a Hungarian deposit guarantee scheme announced on October 8, which provided a blanket guarantee by the government over all deposits. (*Ibid.*)

When the recapitalization scheme would be reintroduced in late-2009, the participation funds minimum condition was removed.

6. The recapitalization scheme aimed to boost the capital adequacy ratio of eligible banks up to at least 14%.

Based on IMF stress test results, it was found that if the largest Hungarian bank's CAR was boosted to at least 14%, that bank would be able to maintain the international CAR standard of at least 8% in the event of catastrophic declines across domestic currency loans, foreign currency loans, and foreign subsidiary assets. (*IMF November 2008*)

7. Any capital injected by the State would be invested into a non-cumulative, non-voting class of preference shares.

The ECB required that capital provided to financial institutions be in exchange for Tier 1 capital, with the goal of "protecting the interest of taxpayers and respecting the level playing fields for institutions." (*ECB Opinion December 2008*)

8. The preference shares were to pay a dividend, plus a 2% add-on fee. The scheme included a "step-up" clause, where the add-on fee would annually increase by 1% after 2011.

The terms of the recapitalization scheme required that the preference shares, designated as Tier 1, equal in price to the amount of capital injected by the State into the institution, were

to payout dividends so that the State could recoup some of its investment over time. (*EC N664/2008*)

The return of the preference share was calculated based on ECB recommendations, where the return would equate to the average 20-day yield of the benchmark 5-Yr European Monetary Union government bond, which at the time was the German 5-Yr government bond. (*Ibid.*)

One requirement from the ECB was that any securities exchanged for capital injections must incentivize financial institutions to repurchase the preference shares sooner rather than prolong their dependence on State support. (*ECB Opinion December 2008*) The add-on fee of 2%, as well as the 1% annual “step-up” clause of the add-on fee, served to incentivize the participating bank to repurchase the preference shares and repay the State as soon as possible, likely when the institution was financially strong enough to sustain itself. (*EC N664/2008*) The add-on fees were meant to cover operational costs of the transaction, as well as were required of preference shares in general corporate banking law. (*Ibid.*)

9. Hungary received a special veto share as a safeguard condition.

Given that the State would inject capital of loaned funds from international institutions, the terms of the recapitalization scheme included a provision that the institution must grant a special veto share to the State. 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. (*EC N664/2008*) Some examples of the misappropriations of funds might have included issuing large dividend payments, providing large executive compensation and bonus payments, or expropriation of funds by management. (*Ibid.*)

10. Banks had to abide by “behavioral conditions” in return for capital assistance.

Hungarian authorities believed that to ensure that the Program did would “not allow the credit institutions to expand their business in an unfair manner,” the government would impose behavioral conditions on any participating institution. (*EC N664/2008*) Those conditions included requiring any participating institution not to advertise any government assistance they received and imposing restrictions on salary, compensation, and other benefit plans on the top executive officers of the banks. (*Ibid.*)

11. The State received a put option of the preference shares five years after issuance.

12. Any participating institution considered to be fundamentally unsound by the EC must submit a restructuring plan six months after recapitalization.

According to the decision by the EC to approve the Program, one indicator of a bank’s unsoundness might be if the participant receives State assistance greater than 2% of its risk-weighted assets. (*EC N664/2008*) Prior to any injection, the State would assess an institution’s soundness and then report to the EC on their findings. If the EC considered the institution to be unsound, a restructuring plan would have to be submitted, and the capital

provided under the scheme could only have been used as a condition for a bank's windup or towards accomplishing a complex restructuring. (*Ibid.*)

13. The participating institution had the ability to repurchase the preference shares from the State.

III. Evaluation

The IMF stated that the “timeliness and size” of the overall Program was crucial to avoiding a systemic banking crisis, as well as contagion across central and southern Europe. The announcement of the Program signaled to the market the IMF's readiness and willingness to provide immediate assistance to Hungary during the crisis. (*IMF June 2011*) Specifically however, the EC continued to extend the recapitalization scheme repeatedly with the belief that its operation contributed to elevated market confidence in Hungary and the ability for Hungarian credit institutions to lend to the broader economy. (*EC SA.36088*)

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European Commission. "Prolongation of Hungarian bank support scheme." European Commission. March 1, 2013. (EC SA.36088).

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V. Key Program Documents

Summary of Program

- June Oversight Report: The AIG Rescue (Congressional Oversight Report, 06/10/2010) – *Congressional Oversight Panel releases information on AIG's rescue, highlighting hearing testimonies, government actions, and impacts of government intervention*
<https://cybercemetery.unt.edu/archive/cop/20110401232818/http://cop.senate.gov/documents/cop-061010-report.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>
- State Aid N 664/2008: 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/471940JP0P11101Official0Use0Only1.pdf>
- State Aid N 355/2009: Prolongation and modification of the Hungarian bank support scheme (European Commission – 09/03/2009) – *European Commission approves a six-month extension of the recapitalization scheme under the bank support program to Hungary until December 31, 2009.*
http://ec.europa.eu/competition/state_aid/cases/231722/231722_990884_29_2.pdf

- State Aid N 662/2009: Prolongation and modification of the Hungarian bank support scheme (European Commission – 12/17/2009) – *European Commission approves a six-month extension of the recapitalization scheme under the bank support program to Hungary until June 30, 2010.*
http://ec.europa.eu/competition/state_aid/cases/234056/234056_1154236_22_2.pdf
- State Aid N 224/2010: Prolongation of the Hungarian bank support scheme (European Commission – 06/23/2010) – *European Commission approves a six-month extension of the recapitalization scheme under the bank support program to Hungary until December 31, 2010.*
http://ec.europa.eu/competition/state_aid/cases/236543/236543_1116155_24_2.pdf
- State Aid SA.31928 N 536/2010: Extension of the Hungarian bank support scheme (European Commission – 12/07/2010) – *European Commission approves a six-month extension of the recapitalization scheme under the bank support program to Hungary until June 30, 2011.*
http://ec.europa.eu/competition/state_aid/cases/238370/238370_1172105_63_2.pdf
- State Aid SA.32995 (2011/N): Prolongation of the Hungarian bank support scheme (European Commission – 06/23/2011) – *European Commission approves a six-month extension of the recapitalization scheme under the bank support program to Hungary until December 31, 2011.*
http://ec.europa.eu/competition/state_aid/cases/240612/240612_1237611_58_2.pdf
- State Aid SA.34077 (2011/N): Extension of the Hungarian bank support scheme (European Commission – 03/08/2012) – *European Commission approves a six-month extension of the recapitalization scheme under the bank support program to Hungary until June 30, 2012.*
http://ec.europa.eu/competition/state_aid/cases/243017/243017_1307976_58_2.pdf
- State Aid SA.35145 (2012/N): Prolongation of the Hungarian bank support scheme (European Commission – 07/30/2012) – *European Commission approves a six-month extension of the recapitalization scheme under the bank support program to Hungary until December 31, 2012.*
http://ec.europa.eu/competition/state_aid/cases/245410/245410_1354012_106_1.pdf
- State Aid SA.36088 (2013/N): Prolongation of the Hungarian bank support scheme (European Commission – 01/03/2013) – *European Commission approves a six-month extension of the recapitalization scheme under the bank support program to Hungary until June 30, 2013.*

http://ec.europa.eu/competition/state_aid/cases/247584/247584_1416251_224_2.pdf

Legal/Regulatory Guidance

- Reinforcement of the Stability of the Financial Intermediary System Act of 2008 (Financial Stability Act) – *a financial stability act passed by the Hungarian Parliament on December 15, 2008, effective on December 23, 2008, that authorized the Hungarian government to inject capital and provide guarantees on interbank loans to systemically important financial institutions to promote stability in the Hungarian financial system, provide liquidity support, and stimulate lending operations between institutions and markets.*
<https://net.jogtar.hu/jogszabaly?docid=A0800104.TV>

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 program.*
<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

- Hungary likely to pay price for IMF package (Financial Times – 10/27/2008) – *news story summarizing the multilateral package extended to Hungary from the IMF, EU, and World Bank to help stabilize Hungary's economy.*
<https://www.ft.com/content/829d904c-a457-11dd-8104-000077b07658>
- 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

- Hungary: Support Measures for the banking industry (Global Trade Alert – 07/31/2013) – updates to the bank support program are highlighted, including changes to the schemes created by the program, extensions of support, and legal basis for the state aid from the European Commission
<https://www.globaltradealert.org/intervention/9070>

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

VI. 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*)

Prior 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 sell off 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 the Hungarian 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 (SDR) up to 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 providing a two-year €6.5 billion balance of payments loan to Hungary that would transfer in three installments.⁴ Although the World Bank approved assistance to Hungary in September 2009, the World Bank's contribution was never drawn upon by the State. (*Kerényi 2011*)

The IMF-EU package was intended to support a variety of different Hungarian economic initiatives, including a bank support program (the Program) aimed to promote the stability

⁴ The EU loan 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*)

of the Hungarian financial sector and its domestic banks. (*IMF November 2008*) The Program included HUF 600 billion to be split evenly between two separate schemes. The recapitalization scheme was financed by a newly created Capital Base Enhancement Fund (CBEF) and intended to help raise the capital adequacy ratio of eligible domestic banks to 14% via 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 scheme's fund, 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 1500 billion. (*Ibid.*) For more information on the RGF and guarantee scheme, please refer to Buchholtz 2018.

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 schemes formed under the Program. (*EC N664/2008*) On February 12, 2009, the EC approved the Program, effectively starting the schemes. (*Ibid.*)