



MAGYAR NEMZETI BANK

# Cross Border Issues - Systemic Where, and For Whom?

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Monitoring

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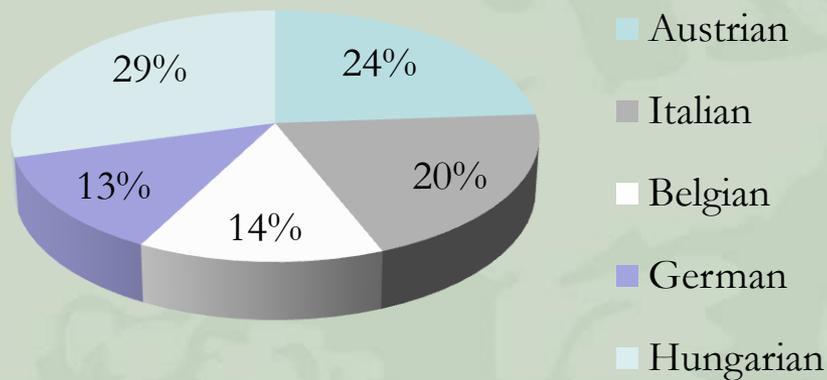


# Home and host: the Janus-faced country

Hungary in dual role:

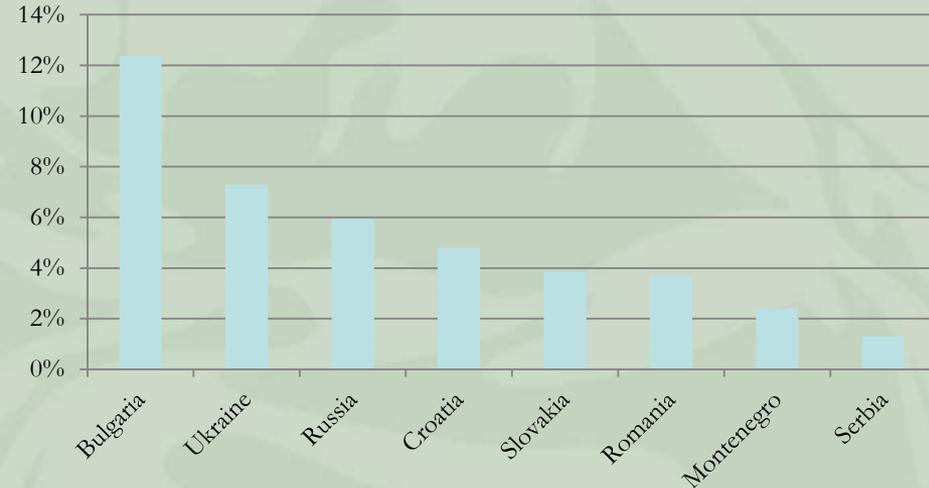
- host country of several EU-based financial groups
- home of a large regional banking group

**The 7 largest commercial bank's ownership structure in Hungary**



Source: MNB.

**Subsidiaries of the largest Hungarian banking group (share in total assets)**



Source: OTP.

# Some key figures

<b>December 2009</b>	<b>Banking sector</b>	<b>Financial enterprises</b>
Total assets (% of GDP)	120%	11%
Total assets (€ bn)	115	10,9
Capital (% GDP)	10%	8%
Capital (€ bn)	9,7	0,8

<b>2009. December</b>	<b>Credit institutions (with branches and cooperatives)</b>	<b>Credit institutions (without branches and cooperatives)</b>	<b>Savings and credit cooperatives</b>	<b>Financial enterprises</b>
Number of institutions	184	35	133 + 4	268

Sources: MNB, HFSA.

# Earnings, lending activity and loan portfolio quality in recent years

Banking sector	2005	2006	2007	2008	2009
ROE/ROA	29.7%/2.4%	28.4%/2.2%	22.1%/1.7%	13.8%/1.1%	11.5%/0.9%
FX deposits (households /corporate)	13.7%/ 24.9%	17.1%/ 35.2%	17.9%/ 29.6%	17.6%/ 30.4%	19.0%/ 32.9%
FX loans (households /corporate)	32.6%/ 47.7%	46.8%/ 47.2%	59.0%/ 52.8%	70.2%/ 59.4%	69.5%/ 59.8%
NPL (+90 days due)	2.3%	2.6%	2.3%	3.0%	6.7%

Source: MNB.

# Home and host: some conflicts of interest

	<b>Home interest</b>	<b>Host interest</b>
Supervision	More and more powers at home country level	Some powers must stay at host country level (e.g. liquidity)
Regulation	Common rules applying to all entities of the group	Specific factors may necessitate additional rules
Deposit guarantee scheme	Common rules/common fund at EU level	Common rules/separated funds
Resolution framework	Common rules/home country supervisory tools	Specific rules/host country supervisory tools
Information sharing	Less need (more information because of consolidation)	More need (less information about the parent and other subsidiaries)
Coordination	Less need (more information and supervisory tools)	More need (limited information and tools)

# Balancing home and host interests is crucial to prevent contagion

A possible future institutional solution: common EU wide supervision

## Possible advantages

- Special rules for cross-border institutions
- Better balance between home and host country interests

## Limitations

- Some supervisory functions can not be transferred to EU level
  - ✓ Solvency problems
  - X Liquidity problems
- Structure of deposit insurance system
- Funding of resolution/bail-out
- Systemic institutions in small countries can be important (but not at EU level)

But these changes require more time and work



**What can be done now?**

# Other strategies to stop contagion

## Ring-fencing

- could stop the contagion in the single markets but...
- ... can lead to potentially suboptimal financial solutions: Fortis bank
  - instead of an agreement among relevant countries the Netherlands nationalized the Dutch part
  - final solution not based on economic rationale
- the cost of separate intervention could be more than that of coordination
- in integrated financial markets separation can cause difficulties
- new entities may be non-viable because of the break-down



## Close cross-border coordination among authorities

- supervisory colleges have an important coordinating role in Europe
- more incentive for taking into consideration home and host countries' financial stability aspects
- European Banking Authority will mediate among college members
- **non-supervisory central banks could add macroprudential view**

# Central banks have unique role in identifying systemic importance

## Conflict of interest in defining the scope of systemic importance

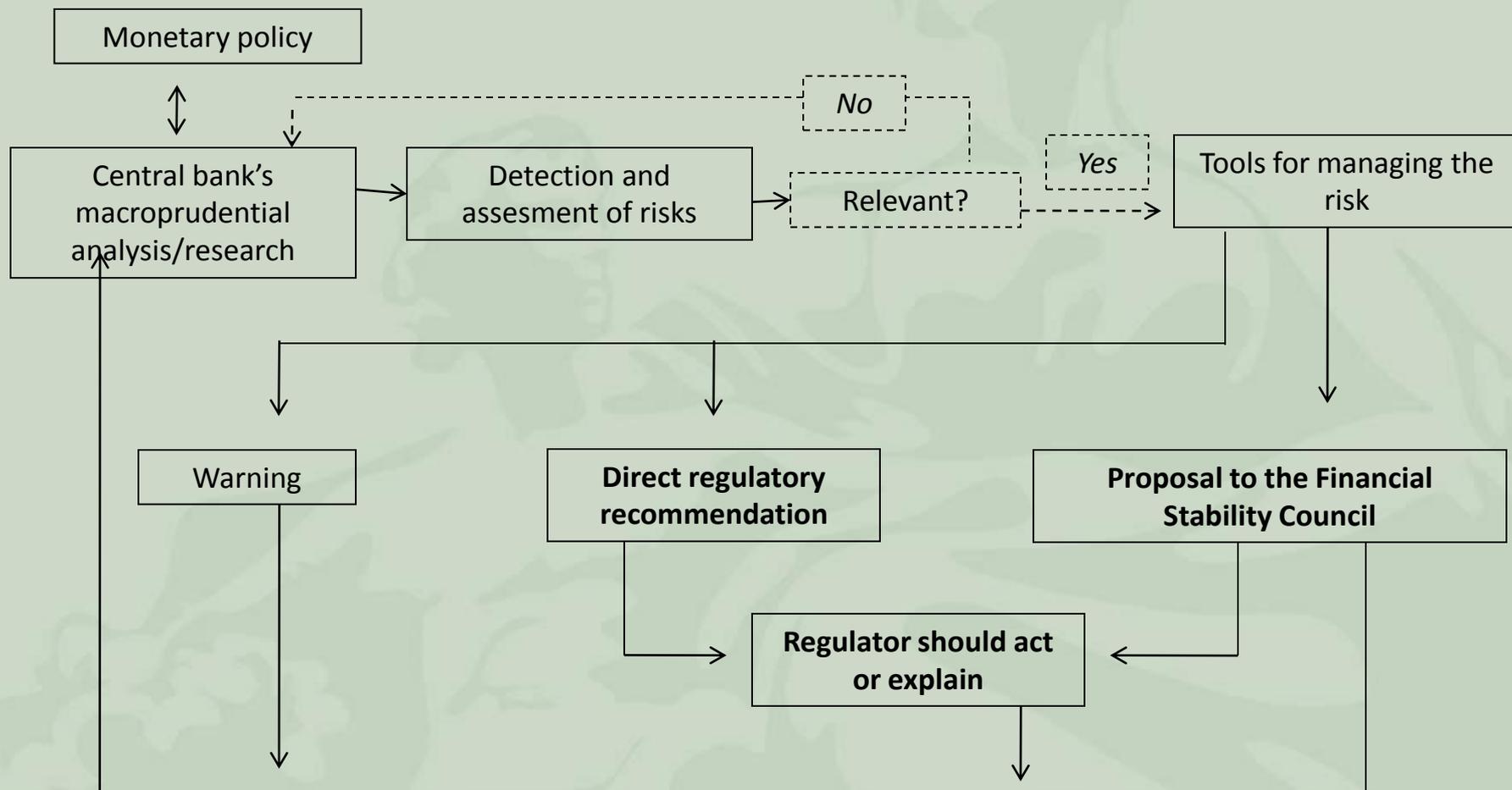
**Fiscal:** limit the scope (number) in order to reduce potential expenditure

**Financial stability :** extend the scope to safeguard financial stability

**Central bank priority:** preventing contagion

- *Don't* look at single institutions only but on financial groups
- *Broaden* the scope from country level to the geographic area of operation
- *Never* underestimate the potential contagion effect of a small entity
- *Always* take into account both directions of the contagion (home => host / host => home)

# New macroprudential framework in Hungary



*Monitoring, backtesting, feedback*

# Financial Stability Council: highest forum of financial stability coordination

## Composition

the heads of the central bank, the supervisory authority and the Ministry of Finance



different roles, incentives and tools are put together

- inter-relation between micro- and macroprudential aspects
- continuous monitoring by the three authorities
- financial stability and economic policy

## **FSC has the responsibility to intervene when the need arises**

- can propose regulatory solution
- can initiate temporary (90-day) suspension of services, activities or trading to preserve systemic stability
- during this 90 days, a long-term solution could be developed in cooperation with all relevant authorities

# Summary

Balancing home/host interests is essential to prevent contagion

A future possible solution is a common (EU) supervisory system

Because of the time needed for completing this institutional reform, other areas should be strengthened



- More emphasis on mapping contagion channels
- National intervention tools should be strengthened to manage risks as fast as possible
- Coordination should be strengthened between national authorities and also at international level
- Central banks should develop their macroprudential frameworks for timely problem detection