3.19 HUNGARY

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I. FRAMEWORK

Act No. XXX of 1997 on Mortgage Loan Companies and Mortgage Bonds (hereinafter referred as the Mortgage Bank Act) contains the specific rules applicable to mortgage loans companies and mortgage bonds. Act No. CCXXXVII of 2013 on Credit Institutions and Financial Enterprises is applicable generally to the establishment, operation, supervision and liquidation of mortgage loan companies, unless otherwise provided by the Mortgage Bank Act. On July 8, 2022 the amended Mortgage Bank Act became effective providing full compliance with the Directive (EU) 2019/2162 of the European Parliament and of the Council on the Issue of Covered Bonds and Covered Bond Public Supervision and Amending Directives 2009/65/EC and 2014/59/EU (hereinafter referred as the Directive).

II. STRUCTURE OF THE ISSUER

Mortgage loan companies are specialized credit institutions in Hungary whose business activity is limited to mortgage lending, mortgage refinancing, providing appraisal services to determine the market value and the mortgage lending value of real properties, and auxiliary financial services. Mortgage loan companies shall grant financial loans secured by mortgages on real estate property located on the territory of Hungary and other European Economic Area (EEA) countries. Funds are raised by way of issuing mortgage bonds ("jelzáloglevél"). In the Hungarian banking sector only mortgage loan companies are entitled to issue mortgage bonds (Section 11 (1) of Mortgage Bank Act). Cover assets are held on the balance sheet of the mortgage loan company. All the outstanding mortgage bonds are covered by an unified cover pool. The cover pool is segregated by operational of law in case of insolvency and is reserved for the claims of the bond holders. The operating model of Hungarian Mortgage Loan Companies did not have to be modified in connection with the implementation of the Directive.

Introduction of a new refinancing model
From 1st of January 2023 the Section 8 (5b) and (5c) of Mortgage Bank Act provide a new refinancing model (portfolio refinancing). The condition for disbursing a refinancing mortgage loan provided by a mortgage credit institution is that – as security for the refinancing mortgage loan – the mortgage is legally registered to the benefit of the mortgage credit institution. The new model allows the credit institution to be refinanced in the long term by a Mortgage Loan Company with a single time disbursement of a refinancing mortgage loan.

III. COVER ASSETS

The Mortgage Bank Act and the Directive provide that mortgage loan companies shall at all times have sufficient cover assets to ensure that all liabilities of the mortgage bonds are covered. The liabilities referred shall include the

i) obligation for payment of the principal amount of outstanding mortgage bonds,

ii) the obligation for payment of any interest on outstanding covered bonds,

iii) the obligation attached to derivative contracts (in line with the requirements set out in the Act) and

iv) the expected costs related to maintenance and administration for the winding-down of the mortgage bond program (calculated as a lump sum at a rate of 1‰ of the outstanding mortgage bond volume).

A mortgage loan companies shall ensure that the cover assets for mortgage bonds are provided at all times both on a nominal basis and based on present value calculation. Furthermore, mortgage loan companies shall adopt a policy of keeping a register of cover assets ("fedezetnyilvántartás"), which also requires the approval of the Magyar Nemzeti Bank (MNB, Hungarian Central Bank) in its capacity as the financial supervisory authority, and the approval of the cover pool monitor ("vagyonellenőr").

The Mortgage Bank Act defines (Part III. Section 14 (1b) four different qualities of eligible cover pool assets:

a) ordinary assets; b) supplementary assets; c) liquid assets held in accordance with Section 14/B,; and d) claims for payment attached to derivative contracts held in accordance with the requirements set out in the Mortgage Bank Act.

Pursuant Section 14 (3) Type of assets that can serve as ordinary assets for a mortgage bank include outstanding principal from mortgage loans and from refinancing mortgage loans, as well as interest and service charges due under the contract. For these assets to be considered as ordinary assets, the mortgage must be legitimately registered in the land register to the benefit of the mortgage loan company. In the case of refinancing mortgage loan the liens defined in the Mortgage Bond Act that secure the refinanced mortgage loan must be ultimately transferred to the benefit of the mortgage loan company, and the mortgage loan company must be given an unconditional right to request registration of the liens in the land register under its name.

The ratio of ordinary coverage (assets) shall at all times reach the 80% of the outstanding mortgage bonds with remaining maturity of more than 180 days.

Supplementary coverage may exclusively consist of eligible liquid assets with an upper limitation listed and defined in the Mortgage Bank Act Section 14 (11) and (12). Pursuant to the Mortgage Bank Act, cover assets must be entered into the register of cover.

The availability and quality of cover assets are permanently monitored by the cover pool monitor, reports on availability and quality of cover assets are disclosed on a daily basis. The composition of the cover pool can only be modified with the prior permission of the cover pool monitor ("vagyonellenőr"), acting in the interest of mortgage bond holders. (Read more below in part VII.)

According to Section 14 (5) of the Mortgage Bank Act, in the case when mortgage bonds and their coverage are not denominated in the same currency, the mortgage loan company is obligated to hedge the currency exchange risk by entering into derivative transactions. Section 3 (10) of the Mortgage Bank Act provides that mortgage loan companies are entitled to conclude such transactions exclusively for hedging purposes, i.e. risk management and liquidity. The Mortgage Bank Act entitles mortgage loan companies to include claims arising from derivatives concluded with the aforementioned objectives as a cover asset as well, while the NPV based balance of these liabilities cannot exceed 12% of the NPV of liabilities deriving from outstanding mortgage bonds.

IV. VALUATION AND LTV CRITERIA

Pursuant to the Section 14 (7) if the amount of the principal outstanding from a mortgage loan or refinancing mortgage loan, or the repurchase price exceeds 60 per cent of the of mortgage lending value ("hitelbiztosítéki érték") of the mortgaged real estate property, the principal outstanding or the repurchase price may be taken into account as ordinary asset up to not more than 60 per cent thereof. If the mortgaged real estate is a residential property the abovementioned limit increases up to 70 per cent. These provisions mean that part of the mortgage loan or refinancing mortgage loan, up to 60% or 70% LTV, will remain eligible for inclusion in the cover pool.

The provisions of calculation of the mortgage lending value are included in the Decree of the Minister of Finance No. 25/1997 on the Calculation Methods of the Mortgage Lending Value of Real Estate not Qualifying as Agricultural Land and in the Decree of the Minister of Agriculture No. 54/1997 on the Calculation Methods of the Mortgage Lending Value of Real Estate Qualifying as Agricultural Land.

Mortgage lending value calculation provisions refer to the sustainable aspects of the property. The mortgage loan company's internal regulation for determining mortgage lending value is based on methodological principles defined in the above decrees. Such internal regulations are also subject to the former approval of the MNB.

With the amendment of Decree 25/1997 PM in February 2021, the AVM (Automated Valuation Method) practice for properties has become applicable in Hungary, according to which it is possible to disburse mortgage loans and to reassess the mortgage lending value of properties, on the basis of statistical valuation for certain types of properties, LTVs and geographical locations.

V. ASSET – LIABILITY MANAGEMENT

As indicated before, the Mortgage Bank Act provides that mortgage loan companies shall always provide coverage that surpasses, at least by 2 % (overcollaterization), the principal of outstanding mortgage bonds and the accrued interest thereon. Mortgage loan companies shall comply with the above requirements as follows:

> The aggregate amount of the outstanding principal claims considered as coverage, reduced by the amount of any value adjustments, shall exceed 100% of the amount of the nominal value of the outstanding mortgage bonds; and

> The aggregate amount of interest accrued on the outstanding principal claims considered as coverage, reduced by the amount of any value adjustments, shall exceed 100% of the amount of interest accrued on the nominal value of the outstanding mortgage bonds.

Under Section 14 (4) of the Mortgage Bank Act the amount of coverage for mortgage bonds shall always be calculated and published at both their nominal and present value.

In the case of currency mismatch between mortgage bond and its collateral assets, mortgage loan companies are obliged to enter into derivative transaction to reduce currency risk with restrictions defined in the Mortgage Bank Act and mentioned before.

In order to cover the net liquidity outflow, mortgage banks are required to maintain a cover pool liquidity buffer composed of segregated liquid assets which are in compliance with the Mortgage Bank Act and the Directive. The cover pool liquidity buffer shall cover the maximum cumulative net liquidity outflow over the next 180 days under Section 14/B (1) and (2).

VI. TRANSPARENCY

Mortgage loan companies shall publish all the information defined in the Mortgage Bank Act's Section 18 (2). The information shall be sufficiently detailed to allow investors to assess and evaluate the profile and risks of the issuer and its issuances. Mortgage loan companies are obliged to ensure that they provide information to mortgage bond investors at least on a quarterly basis and submit to the MNB the minimum portfolio information defined in the Mortgage Bank Act.

Based on the amendment of MNB's Business Conditions of forint and foreign exchange transactions – effective from 11 November 2019 – domestic mortgage bond issuers are required to publish on their own websites the transparency report defined by the MNB at the end of each quarters with the reporting date of the end of the previous quarter, as a condition for ensuring the repo-eligibility of issued mortgage bonds at MNB. Since the MNB announced its green programmes including the Green Covered Bond Purchasing Programme, the required transparency report mentioned above is supplemented with data of green coverage and green covered bond issued.

The European Covered Bond Label and its Premium version may be used for securities issued in Hungary that meet the requirements laid down in the Mortgage Bank Act, and in the case of Premium Label the securities must comply with all the provisions of Article 129 of Regulation 575/2013/EU of the European Parliament and of the Council (CRR) as well. The Issuers need the MNB's authorization to use these.

VII. COVER POOL MONITOR AND BANKING SUPERVISION

The cover pool monitor shall be appointed by the mortgage loan company and approved by MNB and must not be identical with the auditor of the mortgage loan company.

The cover monitor is responsible for monitoring and verifying the assets in the cover pool on a permanent basis. The main responsibilities of the cover pool monitor include to continually monitor that:

> whether the cover assets of mortgage bonds are available and meet the eligibility criteria and are in compliance with the Mortgage Bank Act at all times and,

> the registration of the eligible assets and their required data in the coverage register. In accordance with Section 11 (3) n) of the Mortgage Bank Act, a certificate from the cover pool monitor shall be attached to each mortgage bond regarding the availability and registration of the cover assets.

Within the scope of his coverage supervision activities, the cover pool monitor may not be instructed by the mortgage loan company. The cover monitor shall immediately report in writing to the MNB if the cover assets of the mortgage bonds do not comply with the requirements of the Mortgage Bond Act's criteria.

According to section 16 (7) of the Mortgage Bank Act, a cover monitor may be appointed for a fixed period of time, not exceeding five years, however, he may be re-appointed following the termination of the period of his engagement. The engagement contract may not be lawfully terminated without the approval of the MNB.

The MNB is responsible for verifying the compliance of the credit institutions, including the mortgage loan companies, with the Credit Institutions Act and other acts e.g. the Mortgage Banks Act, and other applicable banking regulations. If required, the MNB is entitled to impose various sanctions on credit institutions, including warnings of non-compliance, withdrawing licenses and imposing fines on credit institutions and their management. Section 22 and 23 of the Mortgage Bank Act provides that the MNB shall exercise special supervision over mortgage loan companies in addition to the provisions of the Credit Institutions Act and the provisions of the Capital Markets Act. Within the framework of such special supervision, MNB is entitled for example to conduct offsite and onsite audits of mortgage loan companies according to its examination plan, or to examine and approve the policies, processes and methodologies aimed at investor protection applied by the mortgage loan companies.

VIII. SEGREGATION OF COVER ASSETS AND BANKRUPTCY REMOTENESS OF COVERED BONDS

Covered bonds do not automatically accelerate when the mortgage loan company becomes insolvent but will be repaid at the time of their contractual maturity. This rule applies to derivatives as well. Pursuant to the Mortgage Bank Act a cover pool administrator (bond trustee) is delegated to the insolvent mortgage loan company to safeguard the interests of bondholders and derivative partners. The cover pool administrator cannot be identical with the insolvency administrator of the mortgage loan company. The cover pool administrator should provide for the timely satisfaction of principal and interest claims of bondholders and derivative partners in case of a possible insolvency situation. The transfer of the portfolio or parts of it to another mortgage loan company may grant for liquidity, however, the transfer of the portfolio or parts of it requires the prior written consent of the MNB.

As a general rule, Section 20/A (4) of the Mortgage Bank Act declares that the cover pool administrator is obliged to maintain the liquidity of the cover pool on a constant basis. Within two years after the commencement of the liquidation procedure, both the cover pool administrator and the bondholders may request the court to complete the cover from the general insolvency estate (Section 20/A (7)). The cover pool administrator shall be entitled to receive remuneration for his work and refund of appropriate expenses. Although holders of the mortgage bonds, derivative partners or the coverage supervisor may inform MNB or the competent Court on issuer default, after proving all relevant circumstances, it is only the MNB who is entitled to initiate an insolvency proceeding against the mortgage loan company.

Hungarian legal provisions also provide for a wide-range of measurements, including extraordinary measurements, to be taken by the MNB prior to any insolvency situation.

For example, the MNB is entitled to delegate a supervisory commissioner to the mortgage loan company. This extraordinary measurement may be taken by the MNB prior to the commencement of any insolvency procedure – in accordance with Section 157 (1) of the Credit Institution Act. In this case both the rights of the owners of the mortgage loan company and the rights of the management of the mortgage loan company will be restricted in order to guarantee the satisfaction of the claims of the mortgage loan company's creditors, e. g. bondholders' and derivative partners' claims. Pursuant to the Section 21 (1) in the course of execution proceedings against a mortgage loan company, Act no LIII of 1994 on Execution by Court shall be applied with the deviations set forth in subsections (2)-(3).

Moreover, pursuant to the Section 58 (1) c) of the Act XXXVII of 2014 on the Further Development of the Institutional Framework to Strengthen the Safety of Certain Actors in the Financial Intermediation System, the scope of the bail-in does not extend to mortgage bonds.

IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION

The legislation when taken together with the practices, processes and procedures across the industry should fall within the criteria of Article 129 of the CRR. Hungarian mortgage bonds comply with the requirements of Article 52(4) UCITS as well as with those of Article 129 (1) CRR.[1]

Hungarian covered bonds issued in euro zone countries qualify as European Central Bank (ECB) eligible.

X. ADDITIONAL INFORMATION

The 20/2015. (VI.29.) MNB Decree introduced the Mortgage funding adequacy ratio (MFAR) from 1 April 2017. MFAR = HUF liabilities backed by household mortgage loans / net stock of residential HUF mortgage loans with a residual maturity longer than 1 year. The original minimum required level of the ratio was set at 15%, while it was raised to 20% from 1 October 2018. The ratio was increased further to 25% from 1 October 2019, and it has been kept unchanged since then (22/2022. (VI.11.) MNB Decree).

MNB's Green Covered Bond Programme had been temporary suspended in April 2022 and it was still inactive at the end of 2022. However, the MNB's Mortgage Bond Rollover Facility has been still accessible for domestic mortgage bond issuers. Within the framework the central bank places bid for the 50% of the indicative amount to be sold at the public auction (but not more than the rollover limit) if the twofold – in terms of the eligible instrument for the rollover and the newly issued 'target' covered bonds - requirements are met.

The Government introduced a cap on the interest rate of mortgage loans in several steps until June 30, 2023. Based on the referring Government Decrees–No. 782/2021. (XII.24.), 2015/2022 (VI.17.), 390/2022 (X.14.)– interest rates of the defined mortgage loan types (floating rate mortgage loans, mortgage loans with a fixed, but maximum 5-year interest rate periods) are capped at levels based on reference rates valid as of October 27, 2021.

Issuers: OTP Jelzálogbank Zrt. (OTP Mortgage Bank Ltd.), MBH (ex Takarék) Jelzálogbank Nyrt. (MBH ex Takarék) Mortgage Bank Ltd.), UniCredit Jelzálogbank Zrt. (UniCredit Mortgage Bank Ltd), Erste Jelzálogbank Zrt. (Erste Mortgage Bank Ltd.), and K&H Jelzálogbank Zrt. (K&H Mortgage Bank Ltd.).

For the most up-to-date information, please consult the new ECBC Covered Bond Comparative Database webpage on the Covered Bond Label website www.coveredbondlabel.com or via the following QR code:

1 Please click on the following link for further information on the UCITS Directive and the Capital Requirements Regulation (CRR): https://hypo.org/ecbc/covered-bonds/.