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Hungary: Magyar Reorganizációs és Követeléskezelő Zrt (MARK Zrt.)¹

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Abstract

Hungary saw a surge in commercial real estate (CRE) lending prior to the Global Financial Crisis. By 2014, the banking sector was saddled with a high ratio of nonperforming CRE loans and repossessed property, though Hungarian banks remained solvent with high capital adequacy ratios. The central bank of Hungary, the MNB, announced the creation of an asset management company, Magyar Reorganizációs és Követeléskezelő Zrt. (MARK), to purchase nonperforming CRE assets from Hungarian banks on a voluntary basis, to clear their balance sheets and allow for increased lending. MARK was fully-owned by the MNB, which provided MARK's share capital and a bridge loan of HUF 300 billion (USD 1.2 billion). MARK planned to purchase eligible assets at market price with the goal to purchase HUF 300 billion in assets at market value, or an estimated HUF 800 billion in book value. MARK launched on March 21, 2016, after receiving European Commission approval, and 23 financial institutions expressed interest in participating by June 2016. However, the MNB's funding of MARK violated the European Central Bank's monetary financing prohibition, which led the MNB to sell MARK to a private investment company in April 2017. The sale of MARK was finalized in June 2017.

Keywords: Hungary, commercial real estate, nonperforming loans, asset management company

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Magyar Reorganizációs és Követeléskezelő Zrt. (MARK)

At a Glance

After the Global Financial Crisis of 2007-08 (GFC), the Hungarian economy experienced a deep recession (IMF 2015a). Commercial real estate (CRE) lending in Hungary grew rapidly prior to the GFC, but the sector was adversely affected by the GFC and by 2014, the NPL ratio for CRE loans was 29%. In Hungary, problem loans consist of nonperforming loans and restructured loans (MNB 2014a). Because of an oversupply in the CRE market, banks were reluctant to sell foreclosed collateral on the market, and prices had not fallen enough to encourage demand (IMF 2015a). Despite high ratios of NPLs, most financial institutions in Hungary were solvent, with the average capital adequacy ratio (CAR) reaching 20.9 percent in June 2015 (EC 2016a).

In order to address the problem of nonperforming CRE loans, the Hungarian central bank, Magyar Nemzeti Bank (MNB), established the Magyar Reorganizációs és Követeléskezelő Zrt³ (MARK) in November 2014 (MNB 2014a; EC 2016a). The MNB established MARK with the objective of cleaning bank balance sheets through the purchase of problem CRE loans and related commercial properties (MNB 2014a). By removing nonperforming CRE assets from bank balance sheets, the central bank intended to boost credit supply (Reuters 2015). The MNB attributed its idea for managing nonperforming assets to the Swiss National Bank's StabFund, which was established in 2008 to manage impaired assets from UBS (Virág 2016; Swiss National Bank 2013).

When the MNB announced MARK in 2014, it planned to launch the asset purchase program in 2015 (MNB 2014a). Over the course of 2015, Hungarian authorities received assistance from the IMF, defining and modifying the design of the asset purchase program (IMF 2015a; 2015b). After discussions with the European Commission in 2015, the MNB revised its

Summary of Key Terms	
Purpose: "To accelerate the reduction of poor-quality commercial real estate loans in the Hungarian banking system" (MNB 2015a).	
Launch Dates	Announced: November 2014 (EC 2016a) Operational: March 21, 2016
Wind-down Dates	10-year maximum (EC 2016a) Sold on June 30, 2017 to a private investor
Size and Type of NPL Problem	18.5% of corporate loan stock in 2014 was nonperforming Only nonperforming CRE loans and repossessed CRE property
Program Size	Target of HUF 300 billion (\$1.2 billion) in assets at market price
Eligible Institutions	All Hungarian financial institutions Open bank only
Usage	None
Outcomes	Gain on sale to private investor of HUF 220 million (MNB 2017a)
Ownership Structure	Government-owned
Notable Features	Considered a macroprudential policy tool; violated the ECB's monetary financing prohibition and thus did not acquire assets

³ "Magyar Reorganizációs és Követeléskezelő Zrt." roughly translates to the Hungarian Restructuring and Debt Management Company.

valuation methodology to ensure that the prices paid for assets reflected the market price as required by Commission regulations on State aid (EC 2016a; MNB 2015a). Hungarian authorities submitted the final plans for MARK to the European Commission on January 19, 2016, and the European Commission confirmed that the asset purchase program did not constitute State aid on February 10, 2016 (EC 2016a).

The MNB provided MARK with a bridge loan of up to HUF 300 billion (USD 1.2 billion) to finance asset purchases⁴ (EC 2016a). MNB anticipated that MARK would come to rely less on the central bank through market refinancing of the bridge loan following the first rounds of the asset purchase program (OECD 2016). This funding decision violated the European Central Bank's (ECB) prohibition against monetary financing as EU national central banks are prohibited from providing overdraft or credit facilities to governments or EU institutions, as well as purchasing any issuances of primary market debt instruments by such governments or institutions (ECB 2016).

MARK launched on March 21, 2016, with a three-month window for prospective participants to submit a complete list of their eligible CRE assets (MNB 2016e). Eligible participants for the program included financial institutions and their subsidiaries with operations in Hungary or the European Economic Area, while eligible assets included nonperforming CRE loans and repossessed CRE property. From each institution's list of eligible assets, MARK randomly selected a portfolio. The asset selection process for a single institution continued until the portfolio met the following criteria: the total value was at least HUF 50 billion, it consisted of more than 15 assets, and the gross outstanding amount of any single asset was not more than 50% of the total portfolio value. After completing the asset selection process, MARK determined the pricing for the portfolio. An asset's transfer price depended on its type and underlying collateral value (EC 2016a).

By the June 2016 deadline, 23 financial institutions registered their interest in the voluntary asset purchase program. The face value of the loans registered totaled more than HUF 300 billion, with an estimated transfer price between HUF 90 and 125 billion. According to the MNB, all of the banks with the largest CRE NPL exposures registered, except for MKB Bank which was undergoing resolution (MNB 2016e).

However, MARK did not ultimately acquire any assets. In 2016, the ECB determined the asset purchase program to be a "violation of the monetary financing prohibition that need[ed] to be corrected" (ECB 2016). The MNB offered MARK for sale to investors through a private tender in 2017 (MNB 2017b). On June 30, 2017, the MNB sold MARK to APS Investment s.r.o., an investment management company that specialized in distressed debt management and recovery (MNB 2017a; APS Holding S.A. 2017). According to the MNB's 2017 Annual Report,

⁴ According to the IMF, HUF 300 billion was equivalent to \$1.2 billion, an exchange rate of \$1 = HUF 250 (IMF 2015a).

the central bank had a gain of HUF 220 million on invested financial assets, which included the gain on the sale of MARK to APS (MNB 2017a).

In 2017, the ECB noted that the MNB had “taken corrective action and no longer own[ed] or control[ed] MARK Zrt.” but that the case remained open yet in 2017 (ECB 2017). By 2018, the ECB noted that it had closed the case against the MNB and MARK Zrt. given the “completion of the necessary corrective actions” (ECB 2018).

Summary Evaluation

In the IMF’s technical assistance report, the authors noted that MARK was “established on a sound basis” with a “clear, well-defined mandate to focus on maximizing the value of its assets” (IMF 2015b). The IMF attributed the decline in the corporate NPL ratio—which fell from approximately 20% in 2015 to 11% in 2016—to the establishment of MARK and the introduction of the systemic risk buffer that targeted CRE assets. The IMF noted that MARK played a “crucial role in jump-starting the market for nonperforming commercial assets by improving the quality of information on assets and creating asset management services” even though it did not acquire such assets itself (IMF 2017). However, the IMF raised conflict-of-interest concerns about the MNB’s significant involvement in the financing and governance of MARK (IMF 2015b). Specifically, maximizing the recovery value of assets and loans had the potential to be at odds with the MNB’s monetary policy objectives (IMF 2015a). The MNB’s financing of MARK violated the ECB’s monetary financing prohibition for national central banks, a concern which ultimately led the MNB to sell the AMC to a private investor (ECB 2017).

In the OECD’s 2016 evaluation of the financial sector in Hungary, it noted that MARK should develop a strategy to sell nonperforming assets in order to “increase transparency and reduce public sector contingent liabilities” (OECD 2016). In 2019, the OECD recognized that MARK “had an initial positive effect” on reducing NPLs in Hungary, but it noted that the sale of MARK ran counter to the EU reform efforts to develop a secondary market for NPLs and prevent their accumulation (OECD 2019).

Magyar Reorganizációs és Követeléskezelő Zrt (MARK): Hungary Context	
GDP (SAAR, Nominal GDP in LCU converted to USD)	\$140.9 billion in 2014 \$125.1 billion in 2015 \$128.5 billion in 2016
GDP per capita (SAAR, Nominal GDP in LCU converted to USD)	\$14,246 in 2014 \$12,652 in 2015 \$12,992 in 2016
Sovereign credit rating (5-year senior debt)	As of fourth quarter, 2014: Fitch: BBB- Moody's: Ba1 S&P: BB As of fourth quarter, 2015: Fitch: BBB- Moody's: Ba1 S&P: BB+ As of fourth quarter, 2016: Fitch: BBB- Moody's: Baa2 S&P: BBB-
Size of banking system	\$83.5 billion in 2014 \$70.6 billion in 2015 \$70.7 billion in 2016
Size of banking system as a percentage of GDP	59.3% in 2014 56.5% in 2015 55.0% in 2016
Size of banking system as a percentage of financial system	100% in 2014 100% in 2015 100% in 2016
5-bank concentration of banking system	69.7% in 2014 90.4% in 2015 85.9% in 2016
Foreign involvement in banking system	Data not available for 2014-16
Government ownership of banking system	Data not available for 2014-16
Existence of deposit insurance	Yes in 2014-2016
<i>Sources: Bloomberg; World Bank Global Financial Development Database; World Bank Deposit Insurance Dataset</i>	

Key Design Decisions

- 1. Part of a Package: Hungary's central bank, the MNB, established MARK to purchase problem CRE loans from banks; it later announced a targeted capital charge on CRE exposures to encourage banks to sell those assets.**

The MNB proposed the creation of MARK in 2014, more than five years after the Global Financial Crisis, because problem CRE loans continued to burden Hungary's financial institutions (IMF 2015a). After announcing MARK, Hungary activated a targeted systemic-risk buffer, imposing a special capital charge on banks' stock of commercial real estate exposures. Hungary announced the activation of the buffer in 2015, but it would not become effective until the beginning of 2017 in order to give banks an incentive to further reduce exposures to problem loans and avoid the capital add-on (ESRB 2016).

The asset management company was not established alongside a recapitalization program.

- 2. Legal Authority (1): The MNB established MARK under its macroprudential policy mandate.**

The Hungarian central bank announced that it was establishing MARK under its macroprudential mandate (Virág 2016). Act CXXXIX of 2013 on the National Bank of Hungary requires that the MNB adopt a macroprudential policy framework for the stability of the financial system. This framework should "help to mitigate or eliminate the systemic risks that may already exist" and "introduce incentive measures to stimulate the credit market" in the event of a negative shock (Act CXXXIX of 2013).

- 3. Legal Authority (2): The European Commission evaluated the asset purchase program as it related to State aid rules, and in February 2016, the Commission confirmed that MARK did not constitute State aid.**

Hungary submitted its plans for the asset purchase program to the European Commission in October 2015. On February 10, 2016, the European Commission determined that MARK's asset purchase program did not constitute State aid (MNB 2015a; EC 2016a; EC 2016b). Under EU law, Member states can implement different tools to address problem assets but can only use government funds to support banks that have been placed into resolution under bank recovery and resolution rules (EC 2016b).

After examining MARK's valuation and pricing methodology, the European Commission confirmed that the assets would be purchased at market price (EC 2016a). If the government were to pay above market price for nonperforming loans or charge guarantee fees lower than a private market participant, the intervention would be considered State aid (EC 2016b). By paying market price for assets, the asset purchase program did not constitute State aid (EC 2016a).

4. Special Powers: It does not appear that the central bank delegated MARK with special powers or authority.

In establishing MARK, it does not appear that the AMC received special authority to resolve, restructure, or liquidate nonperforming assets.

5. Mandate: MARK had a mandate to acquire nonperforming CRE assets and maximize their recovery value.

The MNB established MARK to resolve nonperforming CRE assets including loans and property, with the goal of maximizing recovery (EC 2016a).

6. Communication: The MNB publicly announced the launch of MARK's asset purchase program via a press release and news coverage in order to communicate to all eligible selling institutions.

The MNB sought to communicate to all eligible institutions that the asset purchase program was launching. The MNB framed MARK as a cost-effective and efficient method for resolving NPLs and incentivizing financial institutions to dispose of their problem CRE exposures (MNB 2016e).

When the MNB launched MARK, it noted that the program was “clearly and fundamentally distinguished from previous bad banks or asset management companies established within the European Union, where capital relief had occurred in case[s] of banks in severe financial distress” (Virág 2016). The MNB further framed MARK as a model for other European countries, as the MNB's stated goal for MARK was to set “a successful precedent at the European level set by the operation of MARK” (MNB 2016b).

7. Ownership Structure: MARK was wholly owned by MNB, the central bank of Hungary.

MARK was fully owned and funded by the Hungarian central bank and it received a bridge loan from the MNB to finance its operations (OECD 2016). The MNB established MARK with HUF 21.7 billion in equity (EC 2016a). When MARK began operating in 2016, the MNB noted that MARK would initially rely on the central bank but would be operating entirely with market funding in the medium-term, though it did not provide a specific timeframe (MNB 2016a).

MARK established a wholly owned subsidiary, MARK Ingatlan Zrt.,⁵ in order to manage real estate trading and activities because repossessed commercial property was eligible for the asset purchase program (EC 2016a).

⁵ “Ingatlan” translates to “real estate.”

8. Governance/Administration: MARK's Board of Directors was comprised of MNB officials, which concerned the IMF; MARK was also subject to oversight, supervision, and auditing.

The Hungarian central bank established MARK as an independent company without operational links to the MNB (IMF 2015a), though the MNB was its sole owner when it launched. Hungary consulted with the IMF in 2015 on the establishment and operations of MARK (IMF 2015a; 2015b). The IMF raised concerns about the connection between the MNB and MARK, noting that there was potential for conflicting policy goals (IMF 2015a). The IMF later noted that MARK's "governance and decision-making structure [was] dominated by the MNB and its officials." In addition to a Supervisory Board charged with oversight and audit, MARK had a Board of Directors responsible for strategy. Both the Supervisory Board and the Board of Directors had three members (IMF 2015b).

The Board of Directors of MARK was comprised of external members of the MNB's Monetary Council (IMF 2015b). From 2014 to 2016, Csaba Kandrác served as the Chairman and CEO of MARK (IMF 2015b; MARK Zrt. 2016). He was succeeded by Gergely Fábíán in 2016 (MARK Zrt. 2016). Though the IMF recognized that including MNB officials on the Board of MARK would defend the MNB's interest as the sole shareholder, it noted that this composition would not provide "sufficient insulation" from pressure from the MNB (IMF 2015a).

In addition to the oversight from the Supervisory Board, MARK's portfolio selection process was overseen by an independent auditor. Hungarian officials also committed to providing the European Commission with detailed information about each asset purchase. MARK agreed to provide an annual portfolio summary to the European Commission and provide the annually audited balance sheet and income statement (EC 2016a).

9. Size: MARK had a target program size of HUF 300 billion in problem CRE assets at market price, representing an estimated HUF 800 billion at book value.

The MNB set an objective for MARK to purchase HUF 300 billion in CRE assets at market price for an estimated HUF 800 billion in bad debt at book value (IMF 2015a).

10. Funding Source: MARK was fully government funded, as it received a bridge loan of HUF 300 billion from the Hungarian central bank loan to finance its asset purchases; however, the European Central Bank prohibits national central banks from providing any type of overdraft facility or credit facility to governments or government institutions.

The MNB planned to provide the initial HUF 300 billion in funding for MARK in the form of a bridge loan (EC 2016a). The central bank funding was provided at a spread over the monetary policy rate, and it was provided through the creation of reserve money in MARK's account—an action that has monetary implication and is prohibited by the European Central Bank (ECB) (IMF 2015a; ECB 2017). In 2016, the ECB noted that the MNB funding for MARK "constituted a violation of the monetary financing prohibition" and that the MNB should take corrective action. The ECB prohibits EU national central banks from providing overdraft or

credit facilities to government agencies or institutions, as well as purchasing their issuances of primary market debt instruments (ECB 2016).

Prior to the ECB's decision, the IMF representatives engaged in providing technical assistance on MARK recommended that the MNB reconsider the funding for MARK. Rather than MNB financing of MARK's acquisitions, it recommended that "the acquisitions be (partly) paid with bonds issued by MARK—possibly with a government guarantee" (IMF 2015b). However, the Hungarian officials did not ultimately change the plans for MARK's initial financing but planned to refinance the loan in the market in the medium term (MNB 2016a).

11. Eligible Institutions (1): Solvent Hungarian financial institutions and their subsidiaries could voluntarily participate in the asset purchase program.

Solvent financial institutions or their subsidiaries that were active in Hungary, registered in Hungary, or registered in the European Economic Area were eligible to participate in MARK's asset purchase program (EC 2016a).

12. Eligible Institutions (2): Participation in MARK was voluntary but the Hungarian government incentivized participation through a targeted capital surcharge.

To encourage banks to dispose of problem CRE assets, the MNB announced a capital surcharge on such assets (ESRB 2016). The surcharge was to be implemented in 2017 and the rate was dependent on the bank's ratio of problem CRE assets to its capital (ESRB 2016). The motivation behind the targeted capital surcharge was to address the "[s]ystemic risk resulting from problem exposures to the commercial real estate sector" (ESRB 2016). Though MARK was designed as a voluntary program, this additional surcharge for holding problem CRE loans could further incentivize banks to participate in the asset purchase program.

13. Eligible Assets: Problem CRE loans and repossessed CRE property were eligible for the asset purchase program.

MARK could purchase NPLs collateralized by commercial real estate and commercial real estate property that had been repossessed (EC 2016a).

For repossessed commercial real estate collateral to be eligible, the property was required to be located in Hungary and have a market value of at least HUF 200 million (EC 2016a).

Nonperforming loans had to meet the following criteria in order to be eligible for transfer:

1. At least 80 percent of the collateral value was derived from commercial real estate in Hungary, such as offices, hotels, retail projects, industrial projects, or land plots for a commercial real estate development;

2. The borrower was not in default according to Article 178 of Regulation (EU) No 575/2013⁶;
3. The total gross outstanding claim on the borrower was HUF 500 million or more;
4. The borrower was not undergoing liquidation or bankruptcy proceedings (EC 2016a).

Loans issued to churches and political parties were ineligible. Syndicated loans were also excluded, as were properties related to the selling institution's operations, such as its branch or headquarters buildings (EC 2016a).

14. Acquisition – Mechanics: Participating institutions would submit a complete list of their eligible assets to MARK, which would then randomly select a pool of assets to purchase in each round; however, the sale would not be mandatory, and a financial institution could decline the offer.

After MARK announced that it would begin acquiring assets, eligible institutions voluntarily applied to participate in the asset purchase program. An institution that wanted to participate was required to provide MARK with a list of its entire portfolio of eligible assets as of the date of its application. Applicants were required to include the asset type (repossessed CRE or CRE NPL) and the gross outstanding amount of each asset (EC 2016a).

MARK managed the pricing and acquisition process in rounds. Applicants provided MARK with the entire list of eligible assets when applying, but in order to manage the acquisition and pricing process, MARK would select, from each institution, a list of assets to be included in the first portfolio MARK utilized a random selection process to determine which assets would be included in the portfolio. Each asset had a serial number, and MARK used a random number generator to determine which assets to include. The random selection of assets continued until the portfolio of assets from a single institution totaled at least HUF 50 billion and consisted of at least 15 assets. A single asset could not account for more than 50% of the total gross outstanding amount of the portfolio. This first portfolio would be offered for sale within three months of the launch of MARK. If the participant agreed to proceed with the sale of the portfolio, it had to provide MARK with specific details about the assets in the portfolio and establish a data room for MARK. The rationale behind random selection was to both ensure that assets were purchased at market price and mitigate the risk of adverse selection where an eligible entity would sell only the worst assets (EC 2016a).

After the pricing process was completed for the first portfolios of each participating institution, an eligible participant could offer its second portfolio for sale to MARK. If an institution declined MARK's offer on its portfolio, all assets selected as a part of the portfolio

⁶ For the definition, see "Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 Text with EEA relevance" at <http://data.europa.eu/eli/reg/2013/575/oj>.

were excluded in selecting subsequent portfolios (EC 2016a).

15.Acquisition – Pricing: MARK planned to purchase portfolios of assets at market price, which was determined by an independent valuer and was dependent on asset type.

MARK developed a detailed pricing methodology to determine the theoretical market price of the portfolio of purchased assets in order to comply with EC requirements. Each eligible asset was valued by an “independent valuer” selected by MARK. Each valuation was required to be performed in accordance with MARK’s Property Valuation Manual, which was based on international valuation standards. Valuations were also required to follow the standards based on the asset class of the eligible asset. Each valuation was reviewed in a due diligence process by a validator, who assessed whether the valuation was made in conformance with the Valuation Manual and methodology for that asset class. The validator also performed an independent valuation using their own valuation software (EC 2016a).

MARK’s pricing methodology was multi-step. First, the independent valuer determined the value of the underlying real estate collateral for NPLs or the value of the actual real estate for CRE. The valuation depended on the type of CRE, which included offices in or outside of Budapest, hotels in or outside of Budapest, land plots, industrial projects, and retail properties (EC 2016a).

Second, the value of the CRE was used as an input to determine the theoretical maximum price of the asset. For all assets, MARK deducted between 1% and 8% from the real estate valuation for operations and risk costs and discounted the valuation using a weighted cost of capital (WACC) of 7% to 15% based on the expected time to sale. These deductions and discounts were used for repossessed CRE, while NPLs were subject to additional adjustments. For an NPL, the theoretical maximum price was dependent on whether the loan could be restructured. If the NPL could be restructured, MARK deducted 4% to 10% for the restructuring cost. If the NPL could not be restructured, MARK had to forecast if the NPL could be enforced or liquidated. For NPLs that were to be liquidated, the maximum price was calculated by deducting a liquidation cost between 9% and 18%, depending on the asset type. For enforced NPLs, the maximum price was equal to the real estate value less 6% to 13% for the enforcement cost (EC 2016a).

Beyond the calculation for each eligible asset, MARK calculated a maximum price, the “Cap Price,” for each portfolio. This was equal to the sum of the gross outstanding amount of each NPL in the portfolio and the gross outstanding amount of the original NPL at the time when the CRE was repossessed. If the valuation under MARK’s methodology exceeded the Cap Price, the maximum price for the portfolio would be reduced to the Cap Price (EC 2016a).

MARK and the selling institution could negotiate the price of the portfolio as long as the final price did not exceed the Cap Price. If an institution accepted the indicative offer, MARK performed a second round of due diligence based on the information provided in a financial institution’s data room to ensure that the assets had not deteriorated in a manner that would lead the indicative offer to exceed market prices (EC 2016a).

16. Management and Disposal: MARK could use a variety of methods to manage and dispose of its portfolio but ultimately never acquired any assets.

For nonperforming loans, MARK could restructure the loan, acquire the real estate collateral through an arrangement with the borrower, or acquire the real estate collateral through liquidation. MARK could sell assets in its portfolio, but it had to conduct sales in a transparent and non-discriminatory manner (EC 2016a).

17. Timeframe: Though the MNB proposed a maximum 10-year timeframe for MARK, the central bank sold MARK to a private investor in 2017 in order to remedy its violation of the ECB's monetary financing prohibition.

The MNB proposed that MARK would operate for a maximum of 10 years (MNB 2014a). If MARK continued to hold assets by the end of 2024, or was still owned by the MNB, it was required to sell all remaining assets and wind down or be privatized. Similarly, MARK intended to sell all shares in MARK Ingatlan, its subsidiary company for real estate management, to private investors or float all shares of a stock by the end of 2024 (EC 2016a).

Because the ECB required the MNB to correct its violation of the monetary financing prohibition, the MNB sold MARK through a private tender, and the winning bidder was APS Investment s.r.o., a firm that specialized in distressed-debt management (MNB 2017b).

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