HUNGARIAN BANKING ASSOCIATION

Hungarian Banking Association

Report On Activities

2001

Budapest, March 2002

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I. ECONOMIC AND FINANCIAL DEVELOPMENT IN 2001

1. Production, employment, equilibrium

Slowing economic growth was the main characteristic of economic development in 2001. Between 1997 and 2000, Hungary's economy grew by an average 4.8% p.a., steadily expanding month by month. This trend changed completely in 2001. Industrial production was practically stagnant (or barely grew) and income generation slackened in all production sectors. Exports slowed down, as well.

GDP quarterly growth rates between 1999 and 2001

Table No. 1

PERIOD		QUARTERLY GROWTH RATE (%)	ANNUAL GROWTH RATE (%)
1999	Q1	3.2	
1999	Q2	3.3	
1999	Q3	4.2	
1999	Q4	5.9	4.2
2000	Q1	6.5	
2000	Q2	5.6	
2000	Q3	4.5	
2000	Q4	4.2	5.2
2001	Q1	4.4	
2001	Q2	4.0	
2001	Q3	3.8	
2001	Q4	3.3	3.8

Source: Central Statistical Office

The slowdown was primarily due to the decline in external demand due to sluggish international economic development. The fact that despite an expanding state budget, demand for i**nvestment goods** fell dramatically within aggregate demand in 2001 may be a warning signal indicating the weakness of the internal components of a potential economic growth in 2002.

Chart No. 1

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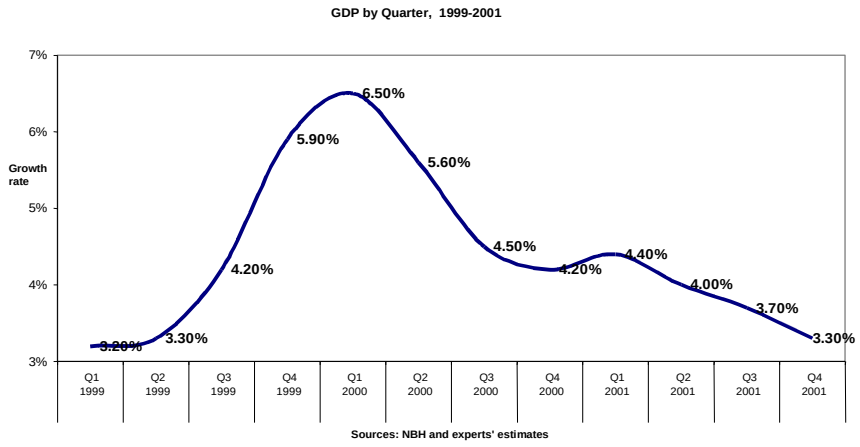
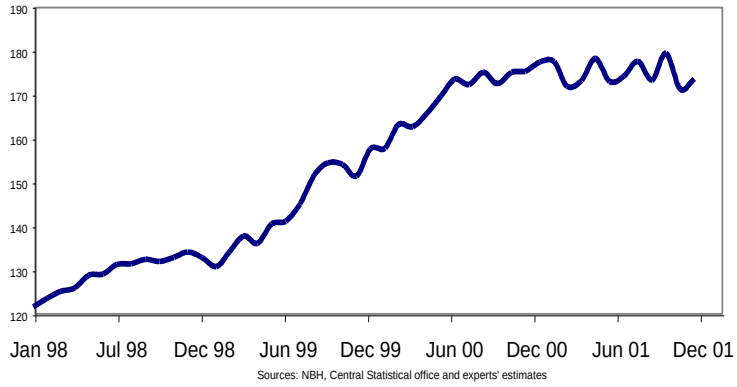


Industrial production was 2.2% lower in December than in the previous year. Production in the period between January and December 2001 was 4.1% higher than in the previous year. (It seems the slowdown did not stop at the end of the year).

Chart No. 2

Industrial Production

(1995=100, seasonally adjusted figures)

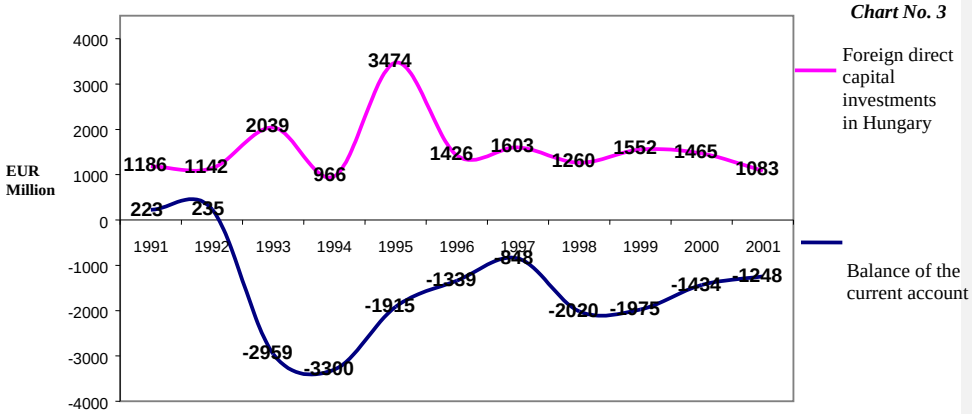


Sources: NBH, Central Statistical office and experts' estimates

Employment in December (3,835 million people) fell, roughly to the level in May. The unemployment rate was 5.6%. Although the rate of unemployment decreased, the number of those employed did not increase in 2001.

Foreign direct capital investments and the current account

Chart No. 3



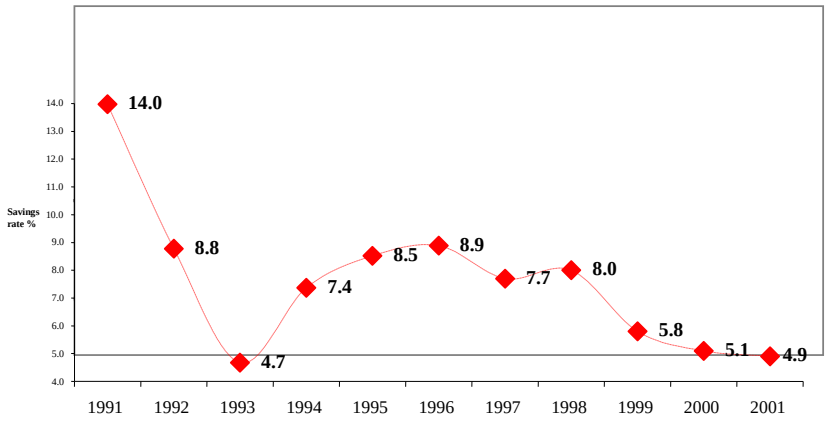
Source: NBH

The current account closed with the lowest deficit in eight years in 2001. However, except for 1994, ***foreign direct capital investment*** was also the lowest in 2001, ***failing to cover the current account deficit.***

The ***household savings rate*** continued to decline in 2001. After rapid growth in the previous years, households' net financial assets were stagnant or decreased relative to GDP in 2001, for the second year.

Household savings rate as a proportion of GDP

Chart No. 4

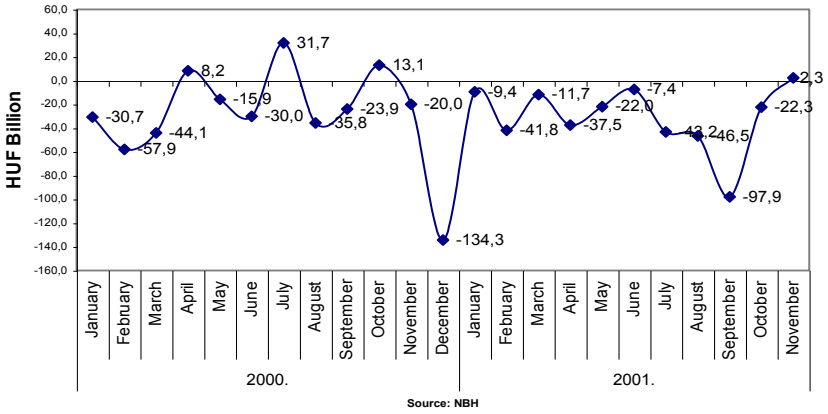


Source: NBH

Fiscal policy tried to offset the deterioration in international economic conditions and the ensuing decline in external demand by stimulating domestic, primarily consumer demand, rather than supply. While not a problem in the short run, this may weaken the chances of an economic pick-up in the long run, as indicated by preliminary data, which show that **investments** grew by an annual 3.5% in 2001, with growth declining in each quarter compared to the same period in the previous year (5.3%, 3.6%, 2.9% and 3.1% in Q1, Q2, Q3 and Q4, respectively). Production machinery investments also slowed significantly in each quarter: 2.4%, 0.8%, (5.3%) and 0,6%, respectively. Construction investments grew rapidly (quarterly: 6.4%, 5.4%, 9.7% and 4.3%), reflecting **the preferential lending rates on building loans (under government guarantees)**; this may, however, constitute an increased burden on the state budget by shifting the slackened accumulation capacity of the economy from production to consumption.

Chart No. 5

Net funding requirements of central government



Source: NBH

According to calculations of the National Bank of Hungary, the demand impact of the state budget accounted for 2.5% of GDP in 2001 against 0.6% in the previous year. *The fiscal policy having become expansive was manifested in the increasing net financial demand of the central government in 2001.

2. Inflation

The inflation path can be split into two marked stages in 2001. In the first half of 2001, the consumer price level rose month by month, from 10.1% in January to 10.8% in May compared to the same period of the previous year. This trend reversed from June onward and the inflation rate in December (6.8%) was 4 percentage points lower than in May. (If this trend prevails, the consumer price level in December 2002 could stand at 4-5% over that of the previous year.)

The annual inflation rate in 2001 was 9.2%, barely lower than in the previous year (9.8%). The rate of increase in producer prices was 10% in 2001, exceeding that in 2000 and 1999. So, the fact that the inflation rate decreased slightly compared to the previous year was mainly due to the one-digit increase in regulated prices (making up 20% of all product prices) and a 2% to 3% decrease in fuel prices.

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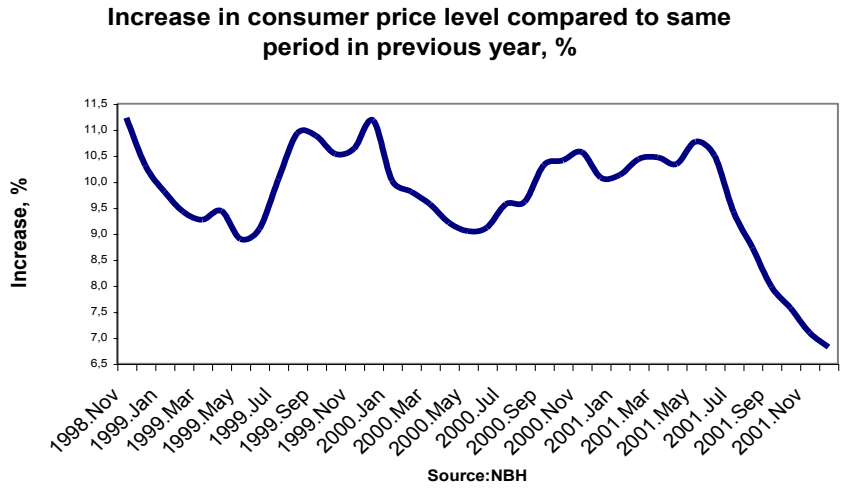
* *State budget expenditures increased aggregate demand by 2.5%. This means a clear change in fiscal policy, a shift from the former tight, equilibrium-focused or neutral policy to an expansion policy in 2001.*

Chart No. 6



3. Exchange rates, interest rates

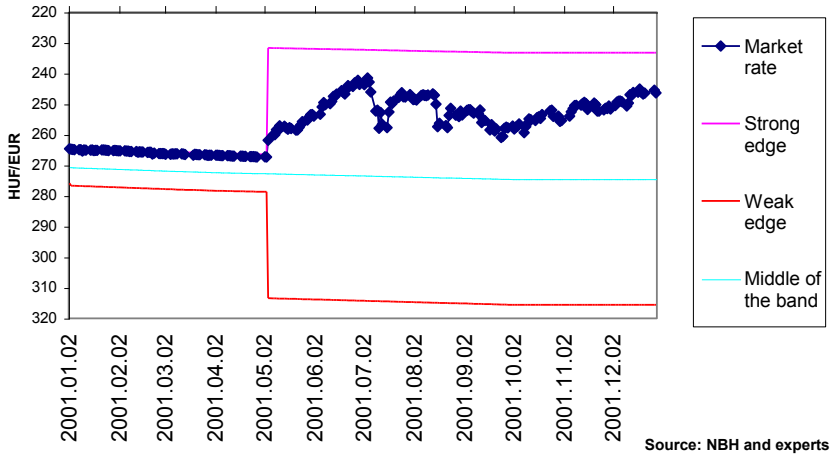
a) The pre-announced crawling peg regime for the forint that had been in place since 1995 was basically transformed in 2001. The +/-2.25% intervention band was first widened to +/-15% in May. From 1 October, the National Bank of Hungary abolished the crawling regime and pegged the middle of the band at HUF 276.1/EUR.

The widening of the forint intervention band in May 2001 to +/- 15% largely contributed to reducing inflation expectations and to slowing consumer price increases in the second half of the year.

The widening of the intervention band has made it possible to predict exchange rates relatively well in the long run; thus, it will be a matter for central bank interest rate policy to avoid and hot capital influx. This is also indicated by the fact that until May the exchange rate of the forint had been frozen to the strong edge of the intervention band and continued strengthening even after the widening of the band, getting even closer to the strong edge of the band.

Chart No. 7

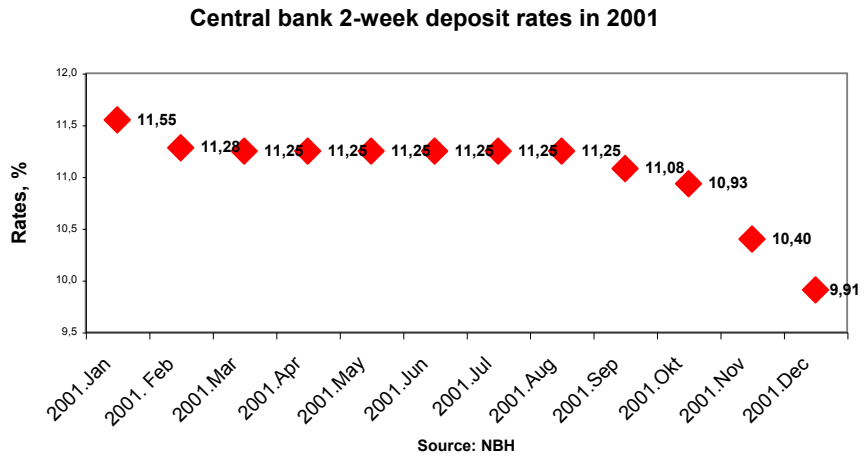
HUF/EUR exchange rates and the intervention band



Source: NBH and experts

b) ***Central bank 2-week deposit rates*** were reduced by 0.25 of a percentage point in Q1, remained virtually unchanged in Q2 and Q3 (11.25%) and then fell by 1 percentage point in Q4 to 10.40%, 9.91% and10.93% in October, November and December, respectively. (Computation of the rate: the arithmetic average of daily interest rates on central bank instruments calculated on the number of working days in a given month).

Chart No. 8



c) **Government securities** benchmark yields fell overall in 2001. The decrease was 1.52 percentage points for 2-year securities and somewhat lower (but typically above 1 percentage point) for other maturities. Time-wise, yields increased in the first quarter, fell in the second, stagnated in the third and again fell in the fourth quarter. Yield curves remained inverse (short-term yields being higher than long-term), indicating market confidence in a continued fall of inflation. Fifteen-year government securities appeared in December 2001.

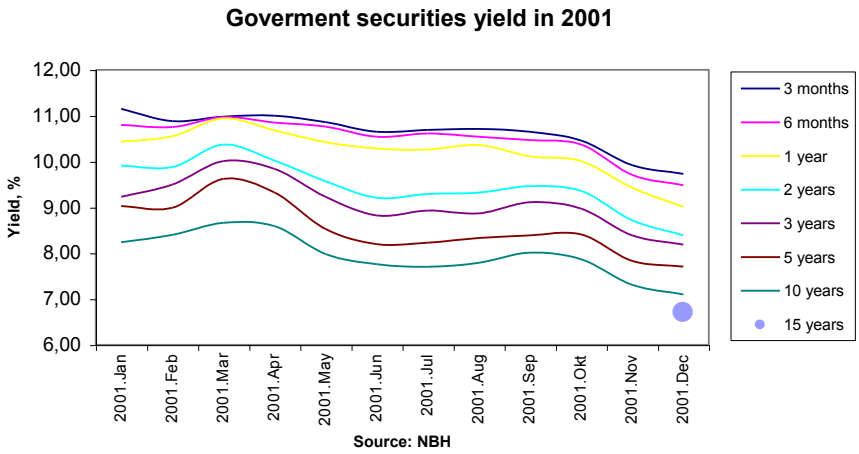
Table No. 2

Government securities benchmark yields (%)

Month-end		3 months	6 months	1 year	2 years	3 years	5 years	10 years	15 years
2001	January	11.15	10.80	10.43	9.91	9.23	9.03	8.24	
	February	10.88	10.75	10.55	9.88	9.50	8.99	8.40	
	March	10.98	10.97	10.94	10.37	10.01	9.62	8.66	
	April	11.00	10.85	10.68	10.02	9.84	9.32	8.59	
	May	10.86	10.76	10.42	9.57	9.23	8.53	7.98	
	June	10.65	10.54	10.28	9.21	8.82	8.20	7.76	
	July	10.69	10.61	10.26	9.29	8.93	8.23	7.70	
	August	10.71	10.54	10.36	9.32	8.87	8.33	7.79	
	September	10.65	10.47	10.11	9.46	9.11	8.39	8.01	
	October	10.46	10.37	10.01	9.36	8.97	8.41	7.87	
	November	9.92	9.71	9.43	8.72	8.39	7.83	7.31	
	December	9.73	9.48	9.01	8.39	8.19	7.71	7.10	6.70

Sources: National Bank of Hungary, Government Debt Management Agency

Chart No. 9



d) Slowing inflation was barely reflected in corporate forint lending and deposit rates, which declined by 1 or 2 percentage points, with slightly decreasing interest margins.

Non financial corporate sector loan and deposit rates and interest margins (%)

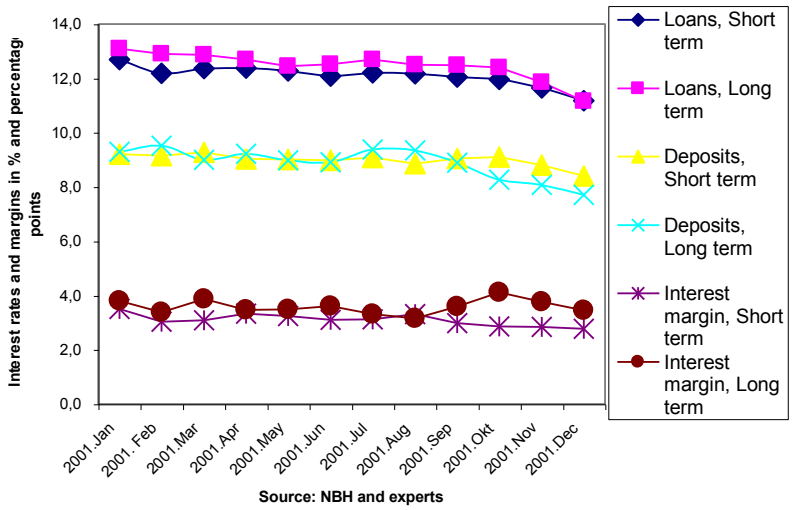
Table No. 3

2001	LOANS Short-term	LOANS Long-term	DEPOSITS Short-term	DEPOSITS Long-term	INTEREST MARGINS Short-term	INTEREST MARGINS Long-term
January	12.7	13.1	9.2	9.3	3.5	3.8
February	12.2	12.9	9.2	9.5	3.0	3.4
March	12.4	12.9	9.3	9.0	3.1	3.9
April	12.4	12.7	9.0	9.2	3.3	3.5
May	12.3	12.5	9.0	9.0	3.2	3.5
June	12.1	12.5	9.0	8.9	3.1	3.6
July	12.2	12.7	9.1	9.4	3.1	3.3
August	12.2	12.5	8.8	9.3	3.3	3.1
September	12.0	12.5	9.1	8.9	3.0	3.6
October	12.0	12.4	9.1	8.3	2.9	4.1
November	11.7	11.9	8.8	8.1	2.8	3.8
December	11.2	11.2	8.4	7.7	2.8	3.5

Source: National Bank of Hungary

Chart No. 10

Non-financial corporate sector
Falling loan and deposit rates, stagnant interest margins



Source: NBH and experts

In ***household*** lending, consumer credit rates decreased by 0.5 of a percentage point. Deposit rates fell by the same rate. Accordingly, interest margins between long-term deposit and consumer loan rates remained unchanged, staying above 12% during the year. A more significant change was observed in the area of real estate loans with market rates, where the decline was more than 3%.

Table No. 4

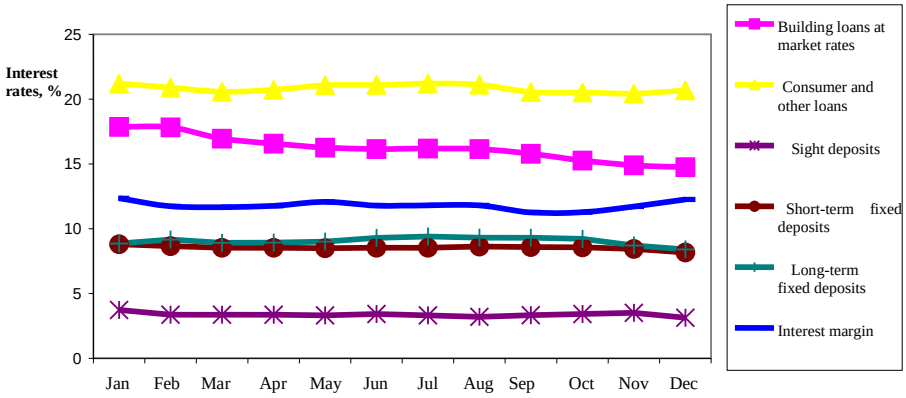
Household loan and deposit rates and interest margins in 2001 (%)

	Jan	Feb	Mar	Apr	May	Jun	July	Aug	Sep	Oct	Nov	Dec
Loans												
Building loans at market rates	17.86	17.82	16.95	16.57	16.26	16.15	16.18	16.14	15.78	15.26	14.90	14.74
Consumer and other loans	21.21	20.88	20.57	20.70	21.08	21.09	21.21	21.10	20.55	20.50	20.41	20.66
Deposits												
Sight deposits	3.72	3.37	3.37	3.36	3.32	3.42	3.31	3.20	3.33	3.42	3.51	3.13
Short-term deposits	8.81	8.66	8.52	8.53	8.50	8.53	8.53	8.61	8.58	8.57	8.44	8.16
Long-term deposits	8.86	9.16	8.91	8.93	9.00	9.30	9.41	9.31	9.30	9.23	8.71	8.41
Interest margin	12.35	11.73	11.66	11.77	12.07	11.79	11.80	11.79	11.25	11.28	11.71	12.26

Source: National Bank of Hungary

Chart No. 11

Household rates



Source: NBH and experts' estimates

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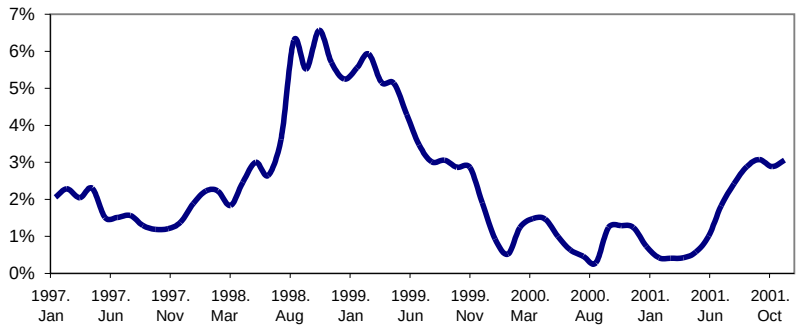
e) There are several methods for computing real interest rates**.** In this case we used estimates on 3-month discounted T-bills, at a projected inflation rate. Real interest rates fluctuated between 0.5% and 1% in the first three quarters and increased to 3% in the last quarter of 2001.

Chart No.12

Real interest rates
(3-month discounted Treasury Bill yields, calculated at a projected inflation rate)



II. PROFESSIONAL ACTIVITIES

The main focuses of the activities of the Hungarian Banking Association in 2001 were determined by the Association's 28 March Board Meeting as follows:

- Continue discussions with the National Bank of Hungary (NBH) on further reducing the income transfer of commercial banks and abolishing unnecessary temporary restrictions on certain commercial banking operations (e.g. limitation of long forint positions). Continue to support the National Bank of Hungary's efforts aimed at enforcing monetary policy through reasonable monetary policy instruments and making the central bank's decisions more sound and transparent;
- Work closely with the National Bank of Hungary in preparing for the introduction of EURO coins and banknotes in 2002;
- Participate in the drafting of the proposed new Securities Act. The new act will directly affect commercial banks in respect of the regulation of investment services.
- Assume a role (as required and reasonable and in agreement with member banks) in the coordination of e-banking operations, while taking into consideration banks' individual business interests.
- Publicise international banking standards in Hungary by drawing on the Association's involvement in the work of the European Committee for Banking Standards.
- Continue giving special attention to loan facilities where banks play a major role, such as
    - building loans and mortgage loans
    - agricultural financing
    - student loans
    - SME loans

The directives adopted by the Board Meeting were closely adhered to in the Association's 2001 activities, as shown by the extensive reviews and co-ordination work the Association performed during the drafting of new laws and amendments to legislation. The success of this work is indicated by the fact that the Association's proposals and comments were generally taken into account when legislation was being drafted.

Specialists from member banks were actively involved in the Association's activities. The activities of the Association's working groups were further strengthened, with two new working groups being set up to address ***e-banking*** and ***macro-economic*** issues. The new working groups further contributed to supporting the Association positions in specific issues.

The Association further developed its cooperation with the International Training Center for Bankers in managing the banking information system.

International activities in 2001 were focused on promoting the banking sector's integration with the European Union, developing banking relations in the region, and publicising and promoting the adoption of international banking standards in Hungary. The Association's presence in the working groups of the European Committee for Banking Standards greatly contributed to accomplishing these tasks.

The publicising of international standards is also promoted by the Association's participation in the work of the professional working committees of the European Banking Federation (Banking Supervision Committee, Accounts Committee) since 2001.

The Association continued organising bi-lateral meetings and conferences in 2001. Within this framework, bilateral conferences were held on bank security issues with Estonian banking professionals in the first half of the year, and on customer relations and consumer protection issues with the Banking Association of Poland in the second half of 2001.

The Presidium continued organising press conferences in 2001, aimed at informing the media and the general public about the Association’s objectives and about banks' opinions on specific issues.

1. LAWS AFFECTING THE BANKING SECTOR

1.1 Capital Market Act

1.1.1. Revisions to capital market laws

The assignment of the Capital Market Regulation Development Team expired at the end of 2000. From the beginning of this year, the task of reviewing current capital market regulations was taken over by the Money and Capital Market Department of the Ministry of Finance. Originally, the law package was to be presented to Parliament by the end of March 2001. This deadline was then extended to the end of May. The Ministry of Finance asked the ministries and interest representation organisations concerned to give their opinions and submit their proposals concerning this law. The proposed amendment was not aimed at any comprehensive re-codification of the Securities Act and the idea of cutting up the Securities Act into four separate Acts was also abandoned.

As for the legal definition of securities, the version drafted by the regulation development team (and criticised by us) was dropped: the current definition of the Civil Code is governing.

Although the proposed amendments to the rules of acquisitions were to be included in the new Securities Act, the modification of rules for the acquisition of public joint stock companies was incorporated in the draft law on amendments to the financial laws. As this draft law was not reconciled with the interest representation organisations, we could not have it reviewed by our member banks. The section related to the Securities Act in the draft law contains provisions for the acquisition of control in public joint stock companies, the announcement of acquisition of such control, the contents of the public bid, the relevant procedures, the counter-bid, the closing of the bidding procedure and the acquisition of control through a voluntary public bid.

1.1.2. Capital Market Act

The Finance Ministry sent us for review the draft of the proposed capital market Act in May.

The document consists of 437 sections and 22 appendices. The fact that only six days were given for the review is perhaps the reason why only few banks submitted their comments.

The objective in this proposed law was to enact a standard capital market law, including regulations on the offering of securities, on investment services and on the operation and supervision of investment service providers, investment management service providers, investment funds, the stock exchange and the clearing house. The proposed act was intended to harmonise Hungarian laws with the relevant EU legislation. The only exception was the amount insured by the Investor Protection Fund, where an interim period will be requested for reaching the EUR 20,000 (approx. HUF 6 million), required by the relevant EU directive, by the end of 2007.

While the draft law does not change the definition of securities, it allows certain securities to be regulated by the Ministry of Finance, to allow flexibility in adjusting to innovations in the market. The regulations on dematerialised securities will be changed: in the future, dematerialised securities will be created at KELER and the securities account manager will only register the ownership. Securities will remain with KELER during sales. The draft law provides that only dematerialised securities can be offered publicly in the future.

Public issues in excess of equity will be subject to credit rating and the results shall be disclosed. Introduction to the stock exchange will not be compulsory.

In line with foreign exchange liberalisation, restrictions on international securities trade will also be lifted; securities issued abroad will be available for purchase and other services will also be made available under the condition that such securities or services are purchased or utilised through Hungarian brokers.

The rules for establishing investment companies are adjusted to those applied to credit institutions, except that here there are no separate founding and operating licences. The minimum capital requirement for investment companies will increase: from HUF 20 million to HUF 50 million for stockbrokers and from HUF 100 million to HUF 200 million for securities dealers. The minimum capital requirement for securities investment companies will remain unchanged. The draft law provides detailed rules for the internal control and auditing of investment enterprises, the separation of client assets and for shareholder proxies, securities lending and contractual netting.

The regulations on the Investor Protection Fund will change: the fund's obligation to pay indemnification will arise upon the issue of a court order for the liquidation of a fund member. Parallel with raising the indemnification limit, a 10% franchise will be introduced for indemnifications exceeding HUF 1 million. The membership fee base will be the average value of the stock of funds and securities managed by the fund member. The minimum fee will be HUF 500,000, the maximum 0.1% of the fee base.

Investment management services and investment management companies will appear as new elements in the legislation. Investment management services will include investment fund management and portfolio management services. The draft provides general liability rules for investment managers and stipulates the essential contents of internal procedures.

The regulations on the stock exchange are aimed at allowing the operation of the stock exchange in the form of a joint stock company, with detailed interim rules for the transition. The draft law provides uniform rules for all types of exchanges, regardless of the subject of trading.

The Association offered several comments on the proposed law.

The presentation to government as well as Sub-section /3/ Section 23 of the draft law provide that the public offering of securities other than government securities may exclusively be done in the form of dematerialised securities. We stressed that, in view of the existing infrastructure, this measure would be premature. In addition, it would constitute an undue discrimination between government securities and other securities, and would exclude clients and sales opportunities that - under adequate guarantees - could mediate public offering to a wide range of investors.

We expressed our objections to the excessive scope of client information provided by the draft law. We proposed that information on the market situation of the investment instrument, public information, information on the risks involved in the transaction and on the investor protection system should only be required to be provided if the customer so requests. Otherwise, order taking would become rather cumbersome.

In view of the amendment to the Act on Judiciary Distraint and to ensure a stronger and unequivocal protection of client receivables, we proposed that the regulation on investor protection (Sub-section /5/ Section 208/) be complemented by a provision to the effect that client assets (securities, accounts, etc.) may not be involved in distraints instituted on investment service providers (or other services providers), even if the service provider in question has such assets on bank accounts or custodian accounts registered under its own name and at is own disposal.

The Finance Ministry sent us for review the new version of the capital market draft law in July. Reviewing the draft we found some of our previous comments were reflected in the new proposal, some only partly; in our comments we maintained the latter. As a general comment we pointed out that according to banks, the compulsory stock exchange introduction was a legitimate requirement; at the same time, banks proposed that the current equity limit should be maintained.

We pointed out again that the provision stipulating that only dematerialised securities would be allowed to be offered on the non-government securities market were prejudicial to the interests of both service providers and customers.

Also, we submitted specific comments concerning the wording of certain provisions of the draft law.

1.1.3. Finance Ministry decrees related to capital market laws

At the request of the Finance Ministry, we asked our member banks to review the following decrees related to the Capital Market Act:

a) criteria for the rating and valuation of accounts receivable, investments and off-balance-sheet items of investment enterprises;

b) country risk capital requirements for investment enterprises;

c) information obligation of investment service providers, organisations performing clearing house activities and the exchanges;

d) provisioning requirements for non-clearing house organisations performing clearing house activities.

Having reviewed the above draft decrees, we drew the legislators' attention to the fact that, under the new Capital Market Act, banks performing comprehensive investment and supplementary investment services are excluded from the scope of investment enterprises and, therefore, the provisions of the decree do not apply to credit institutions providing universal banking services. However, the presence of similar regulations applying to credit institutions requires the use of a standard terminology and the harmonisation of the rules that apply to both credit institutions and investment enterprises. Under this objective, several comments, including specific proposals and details, were formulated in respect of the decrees related to capital market laws and investment services, primarily those mentioned under a) and b).

1.2. Amendments to the Act on the Prevention and Impeding of Money Laundering

The need to amend the Act on the Prevention and Impeding of Money Laundering arose in the summer of 2001 due to the fact that, however regretfully, the Financial Action Task Force on Money Laundering (FATF) listed Hungary among the non-cooperative countries. (The Association's Presidium reviewed the issue of unregistered financial instruments in April and, changing its previous opinion, agreed to the abolition of such instruments effective from January 2002.)

The draft law was presented to Parliament in the autumn of 2001, in connection with the proposed amendment to the Foreign Exchange Code. The provisions of the comprehensive Anti-Terrorism Act are also more stringent than those presented in previous draft amendments to the Act on Money Laundering. The effect of the Act on Money Laundering was extended to cover real estate mediators, precious metal jewellery and precious metal fancy articles traders, organisations selling cultural goods under auctions or as commissioned agents, attorneys-at-law managing attorney's custody, notaries, auditors and the customs authority.

The draft law regulated the obligation of client identification in a more detailed manner and transferred certain provision from the Implementation Decree into the act itself. As a new regulation, the act provides that persons holding HUF 1 million or more in foreign currency when crossing the border shall declare this fact to the customs authority, giving their personal ID and the currency and amount in question.

Foreign exchange organisations are obliged to identify the client in each case where a transaction amount exceeds HUF 300,000.

A new provision affecting banks is that the financial service provider may, in exceptional cases, suspend suspicious transactions, should it find it necessary to contact the police to check certain data, facts or circumstances that may indicate the likelihood of money laundering. In such cases the financial service provider should forthwith notify the police so that it can perform the necessary checks. Should the police fail to identify any information substantiating the suspicion of money laundering or if the financial service provider is not notified for any other reason within four hours from receipt of the report by the police, the transactions should be completed without delay.

In our comments we pointed out that the proposed provisions would be rather difficult to implement. In case of electronic transfer systems there is only a retrospective check; as for other transfers, the regulations on payments require same day or next day performance. Delaying a transaction without a major trouble may only be done if the police can be notified in the morning. In order to implement the proposed regulation, a special night duty service should be set up by the banks and the National Police Headquarters. Another problem is that if the police fails to confirm the suspicion and the transaction extends beyond duty hours, then claims for damages may be anticipated.

At the discussion held before the administrative review of the proposed regulation on 1 October we repeated our request to exempt agents classified under Category "B" in the Credit Institutions Act from the effect of the Act on the Prevention on Money Laundering.

At the request of banks engaged in retail lending, the Association proposed an amendment to Act XXIV of 1994 on the prevention and impeding of money laundering. The

amendment to the Act on Credit Institutions from 1 January 2001 introduced two separate categories for the definition of agents. Clause 12 Chapter I of Appendix 2 to the act was complemented by sub-clause b/, which basically defines the activity of performance aids, while sub-clause a/ defines the existing comprehensive agency activities formerly defined by the act. According to sub-clause b/ the agent performs its activities in **preparation** of the financial services to be provided by the financial institution, **without managing the client's funds and without assuming any independent responsibility.**

The amendment to the act on money laundering became necessary due to the fact that activity-wise, agents qualifying under sub-clause b/, although not considered as financial enterprises, come under the scope of the act. Accordingly, agents are also required to draw up procedures against money laundering and to operate respective internal control and information systems, despite the fact that their activities do not involve any money movements and thus money laundering through these mediating activities is by definition out of the question.

1.2.1. Act LXXXIII of 2001 on the tightening of anti-terrorism and anti-money laundering regulations and on the introduction of certain restrictive measures

The Association was involved in the review of the above draft law through the Inter-Ministerial Committee on Money Laundering. As we were normally given only one or two day's notice, the proposal was only reviewed within a limited circle of banks.

Nevertheless, several comments and amendatory motions were made on the proposal as well as on the draft law and the drafts already presented to Parliament. Most observations were incorporated in the draft. **It was accepted that agents type b) under the Credit Institutions Act will be exempted from the obligations related to money laundering**; certain comments on the methods of customer identification and the suspension of transactions were also incorporated in the law. It was also accepted that the act should enter into force with a two-week delay after promulgation, in order to give the organisations affected enough time for the necessary preparations.

The Association was actively involved in the drafting of the implementation decree to the act in consultation with bank counsels and the Anti-Money Laundering Sub-Committee of the Bank Security Committee.

The Association requested that the Finance Ministry issue a list of those countries with whom Hungary has no judicial assistance agreement, and of those whose anti-money laundering laws do not meet the relevant OECD requirements.

Several observations were submitted regarding the procedure of beneficial owner identification. Most of these observations were also incorporated in the draft law. Following the relevant government decision, the Association e-mailed the document to all banks, given that the decree was enacted with a retroactive effect, simultaneously with the act.

We provided detailed information to the European Banking Federation on the new regulations and on the Association's involvement in the legislation process; the Association's representative regularly attended the meetings of the Inter-Ministerial Committee on Money Laundering. On 4 December 2001, the Association received a delegation of the European Commission's Committee on the Evaluation of Anti-Money Laundering Measures. Specialists

from member banks were also present at the meeting. The Association's Secretary General informed the Committee about the Association's anti-money laundering activities and about issues related to the implementation of the new legislation. The delegation was especially interested in issues relating to beneficial owner identification, the abolition of deposit certificates, procedures for reporting suspicious cases and the methods of filtering such reports.

The Association organised a consultation with the involvement of specialists from the Hungarian Financial Supervisory Authority and the Ministry of Finance on 18 December 2001. The consultation was opened by László Balogh, government commissioner on money laundering. Banks were represented by legal experts, bank security experts and managers responsible for activities related to the prevention of money laundering. Following this consultation, the Association initiated with the Hungarian Financial Supervisory Authority the holding of further consultations to settle still open or disputed issues, and requested that the Supervisory Authority publish its relevant rulings on its home page.

1.2.2. Abolition of anonymous deposits

The Association received for review the draft of the proposed regulation in July. We made a number of comments with a view to making the provisions of the regulation more specific. Part of our comments were taken into consideration during the drafting process. However, neither the Association nor its member banks were involved in the subsequent reviews of the proposed legislation. The relevant amendment to Law Decree No. 2 of 1989 on Deposits was incorporated by the Ministry of Finance in the draft law on amendments to certain financial laws, submitted to Parliament under No. T/5001.

Pursuant to the draft law, only registered savings deposit contracts may be concluded from 1 January 2002. Credit institutions shall identify the depositor and if named, the beneficiary, and shall retain the identification data for at least 10 years following the termination of the deposit contract.

In the case of bearer savings deposit contracts, made with the reservation of disposal rights before 1 January 2002, the person presenting the deposit note will be entitled to dispose of the deposit; the presenter shall be identified and the deposit shall be converted into a registered deposit. In cases where the first transaction order for such deposits is given after 1 January 2003 and the amount of the deposit reaches or exceeds HUF 2 million, the client's ID details shall be submitted to the National Police Headquarters, in accordance with the relevant provisions of the Act on the Prevention of Money Laundering. We requested the cancellation of this latter provision for constitutional and data protection reasons and because it was not reconciled with the provisions of the Credit Institutions Act and the Act on Money Laundering.

Following the 11 September attack, a comprehensive Anti-Terrorism Act was drafted by the government, with more stringent regulations to be enacted under amendments to the Act on Money Laundering and the Law Decree on Savings Deposits. The proposed amendment to the Law Decree on Savings Deposits provides for the abolition of anonymous deposits in the manner described above. However, for savings deposits converted into registered deposits, reaching or exceeding HUF 2 million in value, it required the submission of ID data to the police already from 30 June 2002.

1.3. Amendments to the Credit Institutions Act

1.3.1. Finance Ministry Decree No. 13/2001. (III.9.) on the computation of capital adequacy ratio

The Association received the drafts of the proposed Finance Ministry Decree at the end of January and, subsequently, at the end of February 2001. The drafts were forwarded to our member banks for review. In addition to raising some important conceptual issues, banks challenged certain provisions of the proposal in terms of both accuracy and appropriateness. We submitted specific wording proposals for modifications concerning the provisions related to prudential rules, definitions and some new provisions.

Most of our comments were taken into consideration during the drafting of the new versions of the proposed regulation and the ministry expressed its appreciation for our proposals and for the co-operation extended by bank specialists during the drafting process. Since certain conceptual issues in the February version still remained open, another discussion was held at the Ministry of Finance, with the participation of the Ministry of Justice, the National Bank of Hungary, the Association and specialists from member banks.

In relation to the proposed rules for the computation of capital adequacy ratio, we drew attention to a problem concerning the proposed new text of Subsection (4) of Section 79 of the amendment to the Credit Institutions Act. Namely, Subsection (2) of Section 53 of the act has, from 1 January 2001, modified the inclusion of open positions in the high risk limit by providing that such positions can only be included in the computation of capital adequacy ratio and weighted at 50% if such positions are qualified by the Finance Ministry Decree on the computation of capital adequacy ratio as low-risk or risk-free. Formerly, Subsection (4) of Section 79 provided that, for the purpose of computing high risks, all open transactions should be taken into account at a 50% maximum value.

The modification of the above provision caused serious problems, as reflected in the fact that starting from the HUF 2,136 billion of open transactions in 1999, aggregate liabilities in the banking sector to be computed at 100% instead of 50% may reach HUF 1,500 billion - HUF 1,600 billion. Because of the changes in the rules related to high-risk transactions, aggregate regulatory capital in the banking sector might have dropped by as much as HUF 70 billion. This might have had an adverse impact on Hungary's international image and the international ratings of Hungarian banks.

To resolve the problem, we proposed that a two-year grace period be allowed for open transactions concluded prior to the effective date of the decree, in order to allow time for restructuring and offsetting the negative effects of such transactions.

As agreed with the legislators and incorporated in the effective text of the decree, for the purpose of the provisions of Subsection (4), Section 79 of the Credit Institutions Act, liabilities arising from contracts concluded prior to the effective date of the decree shall, up to 1 January 2002, be qualified as low-risk liabilities during the computation of risks as per Subsections 2 and 7 of Section 79 of the Credit Institutions Act. In other words, a one-year grace period was granted instead of the two years requested; nevertheless, banks were able to restructure their liabilities during this time.

Another technical problem raised by bank specialists (and challenged in the former decree) was that when weighting receivables from derivative transactions (e.g. uncalled credit lines), the original expiry date was to be taken into account rather than the actual remaining time (according to banks, the latter is more appropriate). The new decree now provides for two options: the market price method based on the remaining time, or the original risk method where the individual contract values (actual total amounts) are weighted by the relevant weights specified in the decree; credit institutions not keeping a trading book shall, by 15 December of each year, decide on the method to be applied and report the decision to the Supervisory Authority by 20 December at the latest. Credit institutions keeping trading books and investment companies may exclusively apply the market price method. Thus, the problem was resolved.

In relation to derivative transactions, the treatment of written options as risks partners was also strongly debated. Banks insisted that written options should not be considered as credit risks with partners, given that the writer of the option has no credit risks once the option premium has been paid, as the option will either be called or not. The 8% capital adequacy ratio should only apply to calls, and calls can be considered as spot deals. After long discussions, the Ministry of Finance, the Supervision and banks finally managed to develop a technically viable solution, which was then incorporated in the decree accordingly. Decree No. 13/2001. (III.9.) PM on the Computation of Capital Adequacy Ratio was issued on 9 March 2001.

1.3.2. Proposed decree on the computation of consolidated capital adequacy ratio; related amendment to the Credit Institutions Act.

The Hungarian Financial Supervisory Authority sent us for review the draft decree on the computation of consolidated capital adequacy ratio and the proposed amendment to the provisions of the Credit Institutions Act on consolidated supervision and on the rules for the computation of capital adequacy ratio. The two draft documents were sent to our member banks for review. We received several comments, particularly from banks with financial conglomerates. These comments were forwarded to the institutions drafting the legislation.

Some comments related to the concept of the proposed regulations, others were aimed at making provisions more specific and harmonising the two regulations. Several questions were raised concerning the interpretation and practical application of the proposed regulations. Conceptual issues raised by banks included the following:

- The scope of business organisations affected by the capital adequacy requirements was inconsistent with the circle of businesses subject to consolidated financial reporting under the Accounting Act (the scope of such businesses was considerably wider in the proposed regulation than in the Accounting Act).

The discrepancy was due to the fact that under the Accounting Act certain subsidiaries and associated and jointly controlled businesses may be exempted from the consolidation rules. Such exemptions were disregarded in the proposed regulation.

Overall, we objected to obliging credit institutions to make two different consolidations. We submitted specific proposals for the approximation of the scopes of businesses affected and for standardising the consolidation methods.

- Due to the delay in the first round of discussions and in view of the complexity of the issues involved, we proposed that the entry into force of the new regulations be postponed from 1 October 2001 to 1 January 2002 in order to allow time for further consultations and for completing the necessary preparations for the implementation of the new rules.

- We pointed out that certain new terms in the proposed regulations (such as the term "close relationship") caused interpretation problems. We also objected to the fact that some definitions related to consolidated capital adequacy were to be applied not only to institutions obliged to consolidate, but, with a wider effect, to other financial institutions as well. Accordingly, we submitted proposals for making these definitions more lucid and reconciling them in the Credit Institutions Act and the proposed Finance Ministry Decree.

The Association's comments were reviewed in detail at a discussion held by the Hungarian Financial Supervisory Authority with the participation of representatives from the Ministry of Finance, the National Bank of Hungary and the Association, which was also represented by specialists from member banks. During the discussion the Vice-President of the Supervisory Authority and the Head of the Finance Ministry's Accountancy Department agreed that a compromise should be sought in order to reconcile the circle of businesses subject to consolidation and that the problematic definitions should be adjusted. While certain differences in the prudential rules and in the rules of consolidation still remained, the extent of these differences is relatively minor (around 1%).

In accordance with our request it was agreed that the date of entry into force of the new regulations would be 1 January 2002.

A new conceptual issue was also raised during the discussion: pursuant to Section 18 of Appendix 5 to the Credit Institutions Act, some credit institutions will be affected by the modification which provides that, in addition to controlling shares in financial intermediaries, controlling shares in non-core businesses and investment fund management companies will also have to be deducted from the regulatory capital. This would mean several billions of forints in extra deductions on a sectoral level and would significantly spoil capital adequacy in the sector; in the case of some banks this would also result in a serious overstepping of prudential limits related to regulatory capital. We requested the Supervisory Authority to check whether this provision was in compliance with the relevant EU legislation and, if this modification was a must, to provide, through an interim regulation, adequate lead-time for adapting to the new regulation.

1.3.3. Regulations on the computation of consolidated capital adequacy ratio, regulatory capital and capital adequacy requirements

The review of the proposed regulation took place in the second and third quarters of 2001. The new version incorporating the Association's comments was reviewed at a discussion held with the involvement of specialists from member banks and the Supervisory Authority. Some previously raised issues came to a satisfactory conclusion:

- Agreement was reached on the date of entry into force of the new regulation: the new capital adequacy requirements will enter into force on 31 December 2002;

- The new rules for the non-consolidated computation of capital adequacy and the changes affecting Appendix 5 of the Credit Institutions Act are to be first applied from the end of February 2002;

- In accordance with banks' request, it was agreed that the capital of non-core businesses and investment fund management companies would be included in the computation of regulatory capital;

- As proposed by credit institutions, agreement was reached on the interim rules and on a postponed application of sanctions;

- Regarding the rules on controlling interest, the relevant provisions of the Accounting Act were incorporated in the regulation.

After the October review it turned out that, due to the short time left, the proposed amendment to the Credit Institutions Act could not be included in Parliament's working schedule and so the regulation in question could not be enacted, either. The review process will resume in 2002.

1.3.4. Amendment to the Decree on capital requirements related to country risk

The most important point regarding this amendment is that, in contrast to the former regulation, the part of country risks between the country risk limit and the bank's prudential regulatory capital and an assumed country risk exceeding the prudential regulatory capital should be covered by capital instead of provisions. Banks made the following comments on the proposed regulation.

- The transition between the current Finance Ministry Decree No.25/1998 (X. 9) and the new rules is not ensured. Under the decree in force, country risks should be covered by provisions. The deadlines provided by the various decrees are inconsistent: pursuant to Subsection (6) Section 31 of the Decree No. 250/2000. (XII.24.) on Specific Rules for the Annual Reports and Book-Keeping of Credit Institutions and Financial Enterprises, country risk provisions should be cleared against other revenues; however, the proposed decree would have only entered into force on 1 April 2001; until that date, Decree No. 25/1998. (X.9.), requiring provisioning, would have remained in force.

Adding to this contradiction: pursuant to the amended Act on Credit Institutions, effective as of 1 January 2001, the regulatory capital should be reduced by the capital requirement for country risks when computing the capital adequacy ratio.

We proposed that a transitory provision be included in the proposed decree to resolve the date discrepancy and to enable banks to comply with the new regulation.

In accordance with our request, a new Section 8 was incorporated in the decree, providing that country risk provisions duly accounted for according to the relevant accounting rules may, up to 31 December 2001, be considered as capital available for covering country risks, provided that the bank in question has generated an after-tax profit equivalent to the amount in question.

The new decree also contains provisions for the procedure to be followed where a bank has made a loss.

- Although not in close relation to the proposed amendment to the decree, banks again submitted their proposals for re-ranging certain countries in the Annex containing the country lists. Banks also contended that the criteria on which the lists are updated in each quarter are unknown.

The Hungarian Financial Supervisory Authority supported the Association's proposal that, to ensure transparency, the National Bank of Hungary give an explanation its method of rating and publish a comparative list showing the ratings provided by major international rating companies for all countries. The relevant explanation should then be sent to the Association, the Finance Ministry and the Hungarian Financial Supervisory Authority.

Many of our comments were incorporated in the decree. The Decree was issued in March, under No. 16/2001. (III.9.).

1.3.5. Amendment to Finance Ministry Decree No. 41/1996. (XII.28.) on foreign exchange open positions

In connection with the proposed amendment to the Credit Institutions Act, the Finance Ministry sent us for review the drafts of the proposed amendment in two rounds. During the preliminary technical discussion, banks challenged the requirement to apply two methods for the computation of foreign exchange open positions: total foreign exchange open positions should once be computed as the sum of the forint equivalent (without signs) of the various foreign currency positions (short-term and long-term), and then, also as provided in Section 40 of Government Decree No. 244/2000 (XII.24) on Trading Book. The Finance Ministry and the National Bank of Hungary insisted that the regulation on the size of foreign exchange open positions - determined as percentage of the regulatory capital - should be maintained. However, as requested by banks, the regulatory capital to be taken into account for this purpose is now precisely defined by a reference to the Credit Institutions Act (Subsection (5), Section 1).

The second problem banks raised was that formerly, under Subsection (8) Section 2 of the decree, banks had had the option of deciding - depending on their own accounting systems - whether or not to include foreign currency outstanding but not yet due interest and due but not yet paid interest in the computation of open positions.

Under the proposed amendment the Finance Ministry intends to annul the relevant provision of the decree (Subsection (8), Section 2). The proposed modification would have posed a problem for those banks which, using the option provided by the former decree, did not include passive and active foreign exchange settlements in their open positions. We indicated to the ministry that abolishing the provision in question would entail serious IT investment needs and costs, which banks could not undertake due to the late issue of the decree. We emphasised that if this provision was cancelled, then banks should be given enough time for implementing the required changes under the new regulation.

Finance Ministry Decree No. 15/2001 (III. 9) amending Decree No. 41/1996. (XII. 28.) annulled Subsections (8) and (9) of Section 2 of the latter; this, however, with effect from 1 October 2001, to give banks time to implement the changes.

Banks indicated that the provisions of Finance Ministry Decree No. 35/1999. (XII.26.) on reporting obligations on foreign exchange open positions and the daily operative reporting obligation to the National Bank of Hungary required under the proposed decree contradict each other. Accordingly, banks could only meet one of the two provisions. Under the new accounting rules, the daily reports required by the National Bank of Hungary cannot be compiled based on net book value.

After further discussions with the Finance Ministry, the issue was resolved: pursuant to Subsection (2) Section 7 of the amended Decree, No. 15/2001. (III.9.), instead of the net book value, banks were allowed, up to 30 September 2001, for the purpose of computing daily foreign open positions, to use the gross book value as specified by Decree No. 14/2001 (III.9.) on rules for the qualification and rating of receivables, investments, off-balance-sheet items and collaterals.

1.3.6. Amendment to the Decree on rules for the qualification and rating of receivables, investments, off-balance-sheet items and collaterals.

The Ministry of Finance sent us the versions of this draft decree first in January and then in February 2001. Banks submitted several comments and observations on the drafts.

Banks made a number of comments concerning the planned changes in the structure of mandatory internal procedures; banks were of the opinion that in view of recent regulatory changes (amendments to the Credit Institutions Act and the Accounting Act, the Government Decree on Accounting Rules for Credit Institutions, the new decree on trading book), it was unnecessary to introduce new procedures in the draft decree. Banks also asked for the elimination of overlaps between the various procedures and proposed that the current structure of mandatory internal procedures be maintained.

Supporting this request, banks submitted a detailed list of overlapping provisions, with specific references to the relevant sections of the decree. They also presented proposals for improving the structure of certain procedures, with more specific definitions, and presented a list of provisions conflicting with other laws and regulations.

The decree was reviewed in a narrow circle with the involvement of the Ministry of Finance, the Hungarian Financial Supervisory Authority, the National Bank of Hungary, the Ministry of Justice and the Association. The Finance Ministry and the Supervision insisted on the proposed new mandatory procedures, arguing that in many cases only the headings have changed. However, our comments were addressed in detail and most of our proposals for making the provisions of the decree more specific as well as some of our technical observations were accepted (e.g. items not subject to rating; no mandatory limits for retail loans and small loans, etc.).

The Ministry expressed its appreciation for the Association's work in preparing the decree. The decree was issued under No. 14/2001. (III. 9.) PM on 9 March 2001.

1.3.7. Amendment to Government Decree 41/1997. (III. 5.) on the publication of deposit rates, returns on securities and indicators of total charges on credits

At the request of the Ministry of Finance, we asked our member banks to review the proposed amendment to Government Decree 41/1997. (III. 5.) on the publication of deposit interest rates, returns on securities and indicators of total charges of credits . (The draft amendment was presented by the State Debt Management Agency,) The following comments were submitted on the proposal.

Banks expressed their view that the amendment to the government decree should be extended to all types of securities, as the current deviations from EMU standards affect all securities. To ensure comparability, we proposed that the computation of returns on interest-bearing securities marketed by various issuers be based on the relevant EU standards, as is the case with government securities. Since the different computation methods are confusing, market players would certainly accept a one-off change that would ensure transparency, comparability and conformity with EU standards.

As part of this observation, we proposed that the amendment be introduced in one step (as opposed to the proposal of the State Debt Management Agency, according to which, in the first stage, effective from 1 January 2002, the EU-compliant computation of returns would only be introduced for fixed-rate Hungarian government securities with a maturity over one year on issue).

We pointed out that the proposed date of entry into force, 1 January 2002, was unrealistic, as the changeover would require new software and the time was too short to acquire it in 2001. The amended decree was not issued in 2001.

1.3.8. Regulation on the outsourcing of activities of credit institutions

The Ministry of Finance sent us for review the draft of the proposed decree on the outsourcing of activities by banks, after it received the relevant statutory authorisation to draft this legislation, in June. (According to the Credit Institutions Act, this regulation should have been enacted in the form of a supervisory authority order.)

The draft defined the activities that can be outsourced by banks and provided a detailed list of the activities in question (divided into activities to be announced to the Supervision and those not).

Banks disagreed with both the concept and the method. The following were the main objections:

- The definitions and the list of activities were inconsistent (this may cause subsequent interpretation problems).
- Essential common activities such as claim workout, real estate valuation, office equipment maintenance, car maintenance, etc.) were missing from the list. Without specifically mentioning these activities in the list, banks may be required to take these activities back.
- The security and prudential requirements concerning the continuous monitoring of the bank and, if required, the authority, over the activity to be outsourced, were rather sketchy.

- The relationship between currently outsourced activities and those to be outsourced in the future was not addressed in the draft; consequently, it might happen that two different regulations apply to the same activity.

The above points were reflected in the comments sent to the Ministry of Finance. The proposal we presented reflected the opinion of banks according to which the Supervision should only regulate the outsourcing of major activities involving direct operational risks; the Supervision should compile a list of the activities in question in close consultation with the banks and should specify the relevant security and monitoring requirements; apart from this, the Supervision should not concern itself (whether in terms of specification, listing or reporting) with any other activities. The regulator should provide for an interim period after which the same rule would apply to current outsourced activities and those to be outsourced in the future.

The Association set up a meeting with the participation of representatives from the Ministry of Finance, the Hungarian Financial Supervisory Authority (the organisation actually drafting the legislation), the National Bank of Hungary (bank card specialists) and member banks.

In response to comments received from member banks, representatives of the Supervisory Authority said they had been acting in accordance with the letter and spirit and within the constraints of the relevant law (the Credit Institutions Act); therefore, their hands were tied. The detailed list of activities provided in the proposal (and criticised by banks) was intended to avoid future disputes.

Bank specialists acknowledged the Supervision's intention to take a professional approach. However, due to

- the incompleteness of the activities list (e.g. claim workout) and its non-bank specific contents (e.g. catering., cleaning),
- major contradictions in the definition of outsourcing and in the list of activities,
- the excessive and inconsistent application of prudential rules,
- ignorance of current outsourced activities,
- the indiscriminate treatment of outsourcing within the group and outside the group, and
- other significant problems,

bank specialists proposed the following.

- The Supervisory authority should reconsider the legitimacy of this regulation, with special regard to the fact that there is no such legal approximation requirement under the EU integration process and EU member countries trying to regulate this issue have been working on the drafting process for years now.
- Enacting such a regulation is provided as a possibility but not an obligation for the authority under the Credit Institutions Act. The Ministry of Finance may as well issue a recommendation that could serve as a guidance for banks, without prompting them to make any unnecessary actions.
- Should the Authority insist on this regulation, it should try to provide a comprehensive and standard definition, without specifying the activities in details and then, develop a uniform approach in the course of its licensing practice.
- The Supervisory Authority should not make the regulation too broad and should only focus on the prudential aspects.

The legislators promised to take into consideration our comments and to revise the drafts accordingly.

1.3.9. Recommendations and information documents of the Hungarian Financial Supervisory Authority

Hungarian Financial Supervisory Authority Recommendation on the prevention and impeding of money laundering

The Supervisory Authority information document and recommendation were received well by banks. Several banks confirmed that their rules and procedures were in compliance with the recommendation. Banks raised the need to provide adequate definitions for financial and banking operations for the purpose of Section 303 of the Criminal Code. Several comments were received from banks on the checking of unusual financial transactions processed through electronic transfer systems. This task will require the setting up of a complex monitoring system and for this banks will need technical assistance. Several proposals were received for making the provisions on client identification more specific. Banks proposed that the name and signature of the employee detecting the suspicious transaction should not be a mandatory requisite of the report sheet to be initiated by the bank branch. It is expected that more cases would be reported if anonymity is guaranteed. Banks would find it expedient for government agencies and especially for the investigating authorities to play a greater part in training. Banks objected to the system of appointing two responsible managers. Also, they did not support the idea of developing a special manual on money laundering, given that all the necessary rules are provided for in the relevant procedures for the prevention and impeding of money laundering.
The final recommendation was published on the Supervisory Authority's home page (Recommendation No. 7/2001).

Hungarian Financial Supervisory Authority Recommendation on security requirements related to the operation of financial organisations

The proposed recommendation primarily applies to organisations providing financial and supplementary financial services, investment services, securities custody and clearing house services. Nevertheless, they can also be used by other financial organisations seeking to develop procedures for transaction, physical and IT security. Pension funds, self-support funds and health care funds may also use the elements of the recommendation as appropriate.

In terms of technical content the recommendation is basically identical with the proposed government decree, the drafting of which has been underway for quite some time and which banks have reviewed and discussed in several rounds with the Supervisory Authority and its predecessor organisation. According to the text of the recommendation: "The requirements contained in this recommendation are not compulsory; however, this commendation contains the requirements that are advisable to follow". The recommendation specifies the laws and regulations on operational security requirements and provides that the recommendation should be implemented with due regard to those laws and regulations.

At the same time, the recommendation fails to resolve the inconsistencies caused by provisions taken over from the proposed government decree, such as the provisions on bank secrets under Hungarian Banking Supervision Decree No. 3/1994. (PK. 13.) and the provisions

on the transport, protection and safekeeping of valuables under Government Decree No. 204/1996 (XII 23). Issuing a recommendation with provisions conflicting with effective laws, while maintaining such laws in force, would only cause uncertainty. **We pointed out that the problem should be resolved by annulling the old regulations and regulating the relevant personal and material requirements under a Government Decree.**

We submitted proposals to make the provisions of the recommendation more specific with regard to the qualification of the security officer, security service, mechanical and physical protection and asset insurance.

Hungarian Financial Supervisory Authority Draft Recommendation on the control of activities of agents employed for the mediation of services provided by financial organisations and on related risk management

In their comments on the proposed recommendation, banks expressed their queries regarding the role of recommendations as an administrative tool. The key question here is what legal form recommendations represent and to what extent are the contents of a recommendation compulsory, and whether any departure from the provisions of a recommendation was subject to any sanctions. According to the draft recommendation, the provisions of the recommendation are not compulsory; however, the Supervisory Authority may check on the practical application of the recommendation in the course of its on-site inspections. The recommendation leaves open the issue of any legal consequences for any departure from the recommendation. In view of current experience, banks are concerned that any non-compliance with the provisions of the recommendation may be deemed by the Supervisory Authority as a default followed by the imposition of fines.

We expressed our position that any new standard requirements for credit institutions should be stipulated by a statutory regulation, not a recommendation, and the contents of the recommendation should be confined to explaining supervisory practices in implementing the law.

Another problem we raised was that the recommendation was intended to cover all financial organisations (except insurance companies) falling within the Supervision's scope of competence. From banking points of view we proposed issuing separate recommendations for credit institutions and financial agency activities, respectively. For agency activities, the two different categories stipulated in the Credit Institutions Act should be taken into consideration.

We contended that the tasks related to agents and their inspection were excessively detailed in the recommendation. Also, we submitted a number of specific comments on the draft. We challenged the excessive administrative measures related to preparing agency contracts and the provision which makes the credit institution employing the agent responsible for the agent's compliance with its obligations under the Act on Money Laundering. We also opposed the provisions charging banks with such inspection responsibilities in respect of their agents which fall beyond their capacities.

Hungarian Financial Supervisory Authority Draft Recommendation on customer service activities of financial organisations

The proposed recommendation is intended to provide a standard regulation on the customer service activities of all financial organisations falling under the Supervision's scope of authority. The recommendation emphasises that customer service activities should not be confined to

activities performed on the customer floor, but should also include other forms of communication with the consumer.

In our comments we pointed out that customer service activities do not necessarily require separate premises (most banks would not be able to meet such a requirement, anyway). We proposed that customer service hours be adjusted to the business hours of the bank branch. Pursuant to the recommendation, financial organisations should ensure that customers are not prejudiced by location. Here, we remarked that while it is a natural objective of credit institutions to adjust to demographic factors when developing their networks, no bank has the comprehensive network that could guarantee that all citizens are provided with services at their very location. The proposed recommendation provides that financial organisations should cooperate with consumer interest representation organisations in addressing customer complaints. Here, we emphasised that bank secret and other secrecy rules should be strictly observed in the course of such cooperation. We also submitted a number of other specific comments on the draft.

Hungarian Financial Supervisory Authority Recommendation on the management of credit risks

Overall, the recommendation was received by banks positively. However, they raised some general questions and we added some specific remarks concerning certain provisions of the recommendation. The question of the role of recommendations as an administrative tool was raised again. The philosophy reflected in the recommendation was that the provisions of the recommendation were compulsory and any non-compliance would be subject to supervisory sanctions. We expressed our opinion that the role of recommendations should be confined to providing guidelines in respect of best practices and desirable development trends in banking. We contended that the recommendation provides extra requirements beyond the relevant laws: such requirements should be specified by statutory regulations and the function of recommendations should be to present the Supervision's expectations.

We also pointed out the problem that the recommendation was formulated with a general effect to all financial institutions assuming credit risks. In our opinion, separate recommendations should be issued according to institution category, given that the various financial organisations falling under the Supervision's scope of authority comprise heterogeneous groups, with different legal regulations and different risk exposures.

The recommendation addresses issues related to the future of credit risk management, such as the recommendations of the Basle Committee on internal rating based systems. Although the calculation by statistical methods of non-payment probabilities in the various risk categories and the generation of migration matrices is currently impossible due to the absence of adequate databases, the Supervisory Authority should play a coordinating role in providing for the conditions required for a gradual adoption of the Basle Directives. We also submitted several specific comments concerning the proposal.

We do not find it justified to make the application of migration matrices compulsory. This, in many cases is unnecessary due to the structure of the portfolio and the number of portfolio elements. Also, not all financial institutions have the IT infrastructure required for migration matrix calculations. In relation to collateral rating we proposed that the recommendation should be confined to the listing of the issues to be regulated and should give banks the discretion to develop regulatory models according to their own regulatory structures. Pursuant to the recommendation, financial organisations should set up separate units to control

credit risk assumption (units independent from the business area). We proposed that the recommendation only specify the task, without necessarily requiring the setting up of a separate organisation. Banks should then be allowed to determine the organisational measures required according to their own specific features. We also indicated that some of the provisions related to the measuring of credit risks on a portfolio level can only be met in the longer run, with due differentiation between the various credit institutions.

We proposed allowing appropriate lead-time for the implementation of the recommendation.

Recommendation of the Hungarian Financial Supervisory Authority on the separation of financial and investment activities

In the process of transformation of credit institutions into universal banks, a new legislation was introduced on the separation of financial and investment activities within an organisation.

However, the relevant section of the Credit Institutions Act, Section 69/A, failed to provide a clear practice for this separation. Banks requested that a detailed regulation be issued to provide guidance for interpreting the law. Responding to this request, the Hungarian Financial Supervisory Authority sent us the draft of the relevant recommendation for review.

Commenting on the proposed recommendation, banks challenged the organisational separation approach of Section 69/A, arguing that this approach was not reflected in international practice; the separation should be implemented based on activities and the recommendation should also provide rules for the transfer of confidential information. Banks recommended adopting the international practice of using monitoring and prohibitive lists to guarantee that confidential information obtained in the course of providing financial services cannot be used during the provision of investment services.

In our comments submitted to the Supervisory Authority we proposed that, in accordance with the provisions of the Credit Institutions Act and the new capital market law effective from 1 January 2001, the recommendation should specify those activities where financial and investment information should be separated. Credit institutions proposed that the recommendation should not only specifically define the exceptions but also all those activities, which should be critically separated.

Credit institutions said the recommendation should also provide certain definitions concerning universal banking activities.

- The Credit Institutions Act does not contain any provision that would define liquidity and risk management as services. With the enactment of the new Capital Market Act, these activities no longer fall under the capital market law, either. Consequently, bank specialists say the provisions of Section 69/A of the Credit Institutions Act and the proposed recommendation do no apply to these activities. We asked the Supervisory Authority to confirm this interpretation in order to clarify the situation.
- The issue of asset management was also raised in lieu of the proposed recommendation. The relevant provisions of the Credit Institutions Act and the Capital Market Act distinguish between three forms of asset management, all three well-established activities in the market. With the integration of these activities into banks, the question arises whether the two branches of asset management (voluntary insurance and private pension funds), regulated by the

Credit Institutions Act as financial services, should really be separated from the third branch (portfolio management), regulated by the Capital Market Act as investment services.

- The recommendation introduces new terms, such as Compliance Officer, "Chinese Wall", doubtful and/or suspicious information, compliance principles and the principle of independence. These terms should be defined clearly in the recommendation.
- Compliance procedures should be comprehensive procedures providing detailed rules on business secrets, banking secrets, securities secrets, insider information and internal transfer of information.
- We challenged the provisions of the recommendation concerning the method and requirements of physical separation. We expressed our opinion that these restrictions were unnecessary and impossible to comply with. We proposed that the relevant provision be omitted and instead of the general prohibition of exchange of information, information flows to different persons should be regulated through internal procedures.
- We made several observations concerning the role of Compliance Officer and proposed some new tasks to be included in this role. Meanwhile, we challenged certain HR functions which the recommendation proposed to assign to the Compliance Officer.

We expressed our opinion that once complemented and the controversies resolved, the recommendation would be a useful guide in implementing the separation of confidential information related to financial and investment activities at universal banks. Credit institutions also confirmed that the recommendation was useful and should be issued. The final recommendation was not issued in 2001.

1.4. Foreign exchange liberalisation

Following the widening of the intervention band of the forint, the Hungarian government decided to lift the remaining foreign exchange restrictions, thereby completing the process of making the forint fully convertible. The draft amendment to the relevant government decree was received at an unrealistically short notice. The very short deadline (2 days) only allowed consultations with a few bank specialists who were only able to give their initial impressions. While challenging the short notice, in our comments sent to the National Bank of Hungary we welcomed the legislators' intention, given that thereby

- the remaining money market barriers would removed,
- new opportunities would open up for market actors,
- strong and experienced investors offering state-of-the-art services would be attracted to the market,
- credit institutions would be rid of excessive administration work.

Meanwhile we drew the legislators' attention to the dangers of the appearance of hot money and a high volatility on the money markets, which should be anticipated and adequately managed by the government. We highlighted that the widening of the intervention band created a new situation for companies in the real sphere; the sudden liberalisation and the appearance of foreign investors may hinder the cooperation between Hungarian banks and companies in managing the changes.

Regarding the situation of credit institutions we pointed out that while we did not intend to protect Hungarian banks from competition, the legislators should be aware of the fact that a significant volume of deposit, lending and securities operations will move away from Hungarian

banks after liberalisation,. Therefore, banks should be allowed time to implement the necessary strategic shifts. Also, the rate of mandatory reserves should be reduced to ensure equal conditions for Hungarian banks with those provided to banks in the EU.

Although we failed to have the date of introduction of the decree postponed (mid-June), we saw some positive moves in respect of mandatory reserves.

Parallel with the government decree, two related central bank ordinances were also amended. Notwithstanding the short notice (again), an achievement was that the ambiguous provisions of higher statutory regulations related to convertible forint accounts are at least partly rectified by Ordinance No. 15/1995, and that guidance is provided in respect of the titles applied. (Ordinance No. 15/1995 is one of the main regulations on foreign exchange management.)

1.5. Act on the status of the Hungarian Financial Supervisory Authority

The Ministry of Finance sent us for review the draft law on the Hungarian Financial Supervisory Authority. The purpose of the proposed Act is to transform the Supervisory Authority into a joint stock company. According to its presenters, this is the best way to ensure the independence of the Authority and the development of its activities, the approach being in conformity with international trends in the development of supervisory authorities.

In our comments we agreed with the need to have strong, independent and efficient money and capital market supervision. However, we conveyed our member banks' opinion that the proposed approach to achieving these fundamental goals was unrealistic and did not fit in the Hungarian legal system. In addition, it might also give rise to some constitutional queries. In our opinion, the changes required for strengthening the Supervision's independence - by giving it independent regulatory rights and ensuring its independence in financial, staffing and payroll terms as well - could be implemented through amendments to the current Act on the Supervision. We also expressed our opinion that the Supervision's complete independence from government was not a realistic objective.

We submitted some proposals for giving interest representation organisations more rights in the Supervisory Council and proposed that separate provisions be added to regulate the communication between the Supervision and the interest representation organisations and associations involved. We challenged the Supervision's intention to perform market organising services, as this, in our view, was in conflict with the basic tasks of the Supervision and was contrary to international practice.

1.5.1. Administration and service charges for administrative Supervisory procedures

In December 2001, the Finance Ministry sent us for review its proposed decree on administrative and service charges payable for administrative procedures conducted by the Hungarian Financial Supervisory Authority.

The draft decree contained standard provisions for the charges payable by financial institutions, non-financial institutions providing supplementary financial services, companies

providing currency exchange services, bank representations, investment service providers, the clearing house, the exchanges, investment fund management companies, members of the commodity exchange and venture capital fund management companies.

Based on our member banks' observations we submitted comments to make the definitions and provision of the proposed decree more specific.

2. OTHER LAWS AFFECTING THE BANKING SECTOR

2.1. Act CXLIV of 2000 on quotas in agricultural co-operatives

In January 2001, the Association submitted a motion to the Constitutional Court, requesting the Court to declare Act CXLIV of 2000 unconstitutional and to annul it retrospectively as of its date of coming into force (1 January 2001). The Association's Presidium issued a statement on this draft law in December 2000, drawing attention to the fact that the draft law was prejudicial to both co-operatives and creditors (banks, suppliers, the tax authority and the social security funds). In addition to the economic risks, the Presidium also drew attention to questions of constitutionality concerning this law.

After the Act entered into force, the Association submitted a motion to the Constitutional Court. The motion was drafted with the involvement of financial law and banking law experts. We submitted that the draft law violated the freedom of contracting, with restrictions going beyond the requirements of necessity and proportionality. Obliging co-operatives to purchase the quotas at face value, that is, at a price considerably higher than the market price, is injurious to the ownership rights of co-operatives and members of co-operatives. The Act withdraws the right of legal representation from the executive bodies of co-operatives and transfers it to the state. Further, it excludes co-operatives from concluding contracts. The procedures of agriculture offices and the one-man representation of co-operatives and quota holders are against the rule of law. Also, the Act contains discriminative provisions.

The Act is prejudicial to the legal interests of both co-operatives and creditor. Encumbering co-operative assets with new liabilities will jeopardise the repayment of bank loans and will force banks to make extra risk provisions. Furthermore, the Act gives the state unilateral advantages over banks. The technique of forced lending under the Act is against any lending practice. Under the Act, default in paying the purchase price of the quota within 15 days is automatically considered as an application for loan. Further, the provision on entering a mortgage on the assets of co-operatives as collateral for such a unilaterally forced government loan is prejudicial to the contractual rights of banks. The withdrawal of collaterals provided for previous loans may entail even more serious consequences.

In summary, the Act endangers the viability of the entire agricultural sector and may cause banks serious losses. Due to the close deadlines set in the Act (contracts to be concluded by 1 July 2001), we requested the Constitutional Court to hear the case under an extraordinary proceeding. In accordance with our motion, the Constitutional Court declared the entire Act unconstitutional, with a retroactive effect.

2.2. Proposed Implementation Decree to the Act on quotas in agricultural co-operatives

We obtained informally the draft of the proposed government decree on detailed rules for the purchase of agricultural co-operative quotas. In our comments, based on the opinions of our member banks, we pointed out that several provisions of the decree exceeded or contradicted the provisions of the Act. We also expressed our objection to the fact that retail or wholesale activities, classified in economic statistics as commercial activities, were treated in the Appendix

to the decree as agricultural activities (apparently to extend the scope of the Act to as many co-operatives as possible). We also objected to the fact that agriculture office decisions cannot be appealed against and inheritance rules are interpreted and provided at a government decree level without any relevant authorisation by any Act. Further, we expressed our objection to the fact that contrary to the provisions of the Bankruptcy Act, the draft decree does not exempt co-operatives under liquidation and bankruptcy procedures from the scope of the regulation. We made some additional specific observations and proposed that the whole draft be revised.

2.3. Tasks related to the entry into force of the amendment to the Act on Judicial Distraint

Act CXXXVI of 2000 on the implementation of Act LIII of 1994 on Judicial Distraint and the related statutory regulations entered into force on 1 September 2001. The amendment constituted important changes for banks.

Since many provisions of the Act can be interpreted differently, a consultation was held at the initiative of banks on 24 May 2001 with the involvement of representatives of the Ministry of Justice and the Legal Department of the National Bank of Hungary. The purpose of the discussion was to develop a common understanding and practice for implementing the law. The consultation was partly initiated by the Ministry of Justice, in connection with the drafting of the implementation decree to the Act.

The interpretation problems raised by banks and the issues to be regulated in the proposed implementation decree were reviewed. The rules for extending the execution procedure to amounts that are not subject to transfer or collection writ are to be established by the government under its authorisation provided by the Act.

The need to amend the Act on Credit Institutions was also raised in connection with the proposed implementation decree. Shared accounts and deposits can be fully executed under a distraint procedure instituted against any of the account holders; however, data of the account holders not involved in the distraint procedure are bank secrets. The question is whether or not the data of non-debtor account holders can be disclosed and whether the contradiction between the Act on Judicial Distraint and the Act on Credit Institutions can be resolved. The opinion of the Ministry of Finance was requested on the issue.

Act CXXXVI of 2000, amending the Act on Judicial Distraint, may provide other rules for the sales of assets without a judicial distraint procedure. The relevant provisions may affect lien obligors, secured lenders authorised to sell pledges, their agents, as well as independent bailiffs and insolvency practitioners. The Ministry of Justice requested us to submit our proposals for the possible regulatory approach and contents of the regulation. Only few banks responded; we requested the ministry to hold a consultation on the issue with the involvement of legal counsels from our member banks.

2.3.1. Draft law on debt management for private individuals

The draft law on the management of debts of private individuals was developed by the Ministry of Justice based on Government Resolution No. 2011/2001/II 2 related to the concept of amending the regulations on judicial distraint.

According to the draft law, debt management may be performed for natural persons with permanent residence in Hungary (except for persons with property specified by the law). Debt management may involve undisputed claims against the debtor, which are overdue or will become due during the period of debt management (with certain exceptions as specified by the law).

Debt management may include the postponement of the debt, instalment payments, reduced instalments, and the combination thereof. The procedure is managed by county or municipal administrative offices, based on written requests. The debtor and the creditors should be heard during the procedure. An attempt should be made to find a composition between the parties involved. If no agreement is reached and the authority finds that the debtors financial situation does not allow the meeting of the obligation promptly but the obligation or at least part of it could be met later through debt management, the authority will determine the contents of the debt management. If the majority of creditors agree with the contents, the debt management will be instituted by the authority, for a maximum period of three years.

No judicial or administrative procedures can be instituted against the debtor in respect of the claims subject to debt management during the debt management period. Upon the successful conclusion of the debt management period, the debt management ends. In this case, the proper performance of the instalments established by the authority as payable during the debt management period would be deemed as if the amounts otherwise becoming due during the period of debt management had been paid in time, according to the original instalment schedule. (This means an implicit remission of debt.)

The draft law basically affects the activities of banks and debtors' payment discipline. In our comments we pointed out that the issue of easing debt burdens on the individual in question or preserving his or her social or living/housing conditions should be resolved through strengthening the social net by government measures, rather than imposing undue measures on creditors.

According to banks, the draft law can only be supported if accompanied by state guarantees for the reimbursement of the debts involved in the debt management. In our opinion the law in its present form would adversely affect repayment discipline as well as the lending propensity of banks; the provisions of the draft law are not elaborate enough; the provisions extending the composition agreed on by the majority of creditors to the rest of the creditors is prejudicial; the authority interferes in a bilateral civil law relation and as a result, the debtor gains at the creditor's expense. Referring the debt settlement process to county administration offices is not a good solution; the draft law fails to provide for satisfactory protection in respect of creditor's mortgage claims and the regulation is injurious to the creditor from data protection points of view as well. We offered specific wording proposals for the various provisions of the draft law and proposed that the entire document be revised. Also, we proposed that an impact study be conducted on the effect of the law on the banking sector. The results of the study should then be comprehensively reviewed at a discussion to be held with the involvement of specialists from banks and the Justice Ministry.

2.3.2. Detailed rules for the execution of deposits and savings deposits

Act CXXXVI of 2000 amending the Act on Judicial Distraint (Act LIII of 1994) and related laws came into force on 1 September 2001. The new laws significantly changed the rules for the execution of amounts placed with financial institutions, in accordance with the legislators' objective of extending the execution to the widest possible range of such financial assets. Given that the Act fails to regulate the rules for the execution of debtors' funds placed with financial institutions under deposit books or other deposit notes (defined under Sections 530 and 533 of the Civil Code), the government decided to provide for the relevant rules under a government decree. The Association reviewed the proposed decree in several rounds with the Ministry of Justice and member banks; direct personal consultations were also held in order to clarify separate opinions.

The decree contains regulations related to obtaining the necessary data for the execution and involving deposits in the execution process, contents of the bailiff's call and public notice, payment of the deposit amount, payment of the amount collected under the execution process and security measures.

The final text of the draft decree to be presented to the government was forwarded to all member banks to enable them to make the necessary preparations for the implementation of the decree.

2.4. Proposed Act on Lobbying

The objective of the proposed Act on Lobbying is to improve the transparency of the legislation process and the enforcement of public, social policy, economic and other interests.

The draft law defines lobbying as an activity performed in the interest of certain social or economic groups with the objective of influencing the contents of laws and other statutory administrative instruments. Organisations intending to lobby (including interest representation organisations as well as companies and private entrepreneurs) may apply for registration in the list of lobbyists, after which they may lobby with the competent organisations in respect of the decisions included in these organisation's work plans. Lobbying may be done in the form of requesting personal hearings, participation in meetings and conferences, requesting written information, etc. The draft law vests lobbying organisations with special rights.

The proposed law directly affects the Association as a professional interest representation organisation.

In our comments we pointed out that in our opinion it would be more appropriate to update the Act on Legislation and incorporate the regulations on lobbyists into the provisions on legislation procedures rather than enacting a separate Act. We found it problematic that the draft law makes no reference to Act XI of 1978 and the relationship between the two is unclear. We expressed our concern for the neglected role professional interest representations have been given in recent years in the legislation process and voiced our fears that extending the legislation process with additional elements may lead to unnecessary delays in the legislation and a further ignorance of professional interests.

2.5. Data protection laws

We forwarded the draft laws on the protection of personal data and on data and information of public interest to our member banks in August. Banks offered several comments on the proposed laws.

In our comments sent to the Ministry of Justice we expressed our objection to the idea of splitting the current standard law (Act LXIII of 1992 on the protection of personal data and the publicity of data of public interest) into two laws. We also pointed out that the draft law failed to really reflect the stated objective of the proposed legislation of guaranteeing the widest possible publicity of data of public interest.

We challenged the fact that the draft law on the protection of personal data failed to determine the conditions and guarantees for the use of video cameras in places of work. We also challenged the fact that the proposed regulation only provided for the protection of personal data. The effect of secrecy laws also applies to the protection of data of organisations; accordingly, the relevant data protection rules should be extended to data of organisations. We also objected to applying the new institution of internal data protection ombudsman to credit institutions.

In connection with the proposed law on data and information of public interest, we pointed out that in respect of publishing information before a decision is made, the leader of the authority in question will not be able to reconcile (due to his position) the interest of publicity with the authority's aspects in making the decision. The related responsibility should be given to an independent information officer or to the parliamentary ombudsman.

We submitted several suggestions to make certain provisions of the proposed laws more specific.

2.5.1. Supervisory and central bank reporting requirements

The amendment to the Act on Credit Institutions came into force on 1 January 2001; however, the supervisory and central bank data supply requirements (allowing inspection of banks' compliance) could not be finalised by that date, mainly due to the late enactment of the Act and delay in drafting the relevant associated laws and regulations. The Supervision made extraordinary efforts and set itself an extremely tight schedule for issuing its data requirements; this had a negative impact on the review process and on the time given for banks for preparations. The Association repeatedly emphasised that the Supervision should allow itself enough time for compiling its requirements and that banks should only be involved in the review after the work is completed. Banks accepted that the data supply should also be consistent with the decree on trading book, enacted as of 1 April 2001 (accordingly, after another accelerated review, an amendment to the decree on data supply on investment activities was issued). At the same time, banks expressed their strong objection to starting the traditional data supply from 1 April. To ensure that enough time is allowed for preparations, the President of the Supervision postponed the start of the new data supply by one month. Likewise, the National Bank of Hungary also agreed to starting the new data supply from the new date.

2.5.2. Supervisory reporting requirements

Banks asked for the Association's intervention concerning the fining procedures applied by the Hungarian Financial Supervisory Authority. The Supervisory authority fined some credit institutions performing universal banking activities for non-compliance with the data requirements provided by sub-clause b/ Clause /1/ of Section 127 of the Securities Act. This measure was contested by one-person-owned credit institutions, as in their case the required data supply is performed and met under their reporting obligation pursuant to Finance Ministry Decree No. 35/1999 (XII 26).

Following the Association's approach, the Supervisory Authority promised to withdraw the fining decisions upon requests to be filed individually by the banks concerned. The Supervision will also review its internal registration system to eliminate redundancies in reporting.

The Hungarian Financial Supervisory Authority had promised that the review of the new supervisory reporting requirements enacted as of January 2002 would be finalised in November 2001, in order to allow banks enough time for the necessary preparations. However, we received the draft decree for review as late as the middle of December. In our submitted opinion, based on member banks' comments, we expressed our objections to the shortened deadline for quarterly reports and to the requirement of providing data in HUF thousand rather than HUF million. Banks submitted proposals for certain modifications related to building societies and some excessive money laundering, as well as VAT data requirements that would put excessive burdens on banks. Most of these proposals were accepted; however, the reporting requirements on money laundering and VAT were still being discussed at the beginning of 2002. We forwarded our comments to the State Secretary of the Finance Ministry and the Government Commissioner on Money Laundering. It is expected that our objections concerning VAT data requirements will be accepted.

2.5.3. Interbank data supply

The new Interbank Database was launched at the end of last year.

Given that for joining the old data supply system (launched in 1992), a properly signed joining statement had to be presented, we felt it appropriate to obtain the agreement of all members before the old system is terminated. Accordingly, we requested the opinion of the banks' IS officers as to whether the new database operated by the Bankers Training Center was suitable for replacing the old interbank data supply system and asked for their approval for terminating the old system.

All responding banks approved the termination of the old system. Based on this, we advised all credit institutions that the old system has been terminated and that in the future all inputs and outputs will exclusively be managed by the Database operated by the Bankers Training Center.

2.5.4. Building loans reporting requirements of the Central Statistical Office, 2002

Banks drew attention to some interpretation problems regarding the tables used for reporting home loan data to the Central Statistical Office (CSO) from 2001. Upon our inquiry, the Central Statistical Office advised that the data supply requirements for 2001 are provided by law and cannot be changed (these data requirements had not been coordinated with banks previously). However, the tables and completion guides to be issued in the near future will be sent to us for review.

Based on the comments received from credit institutions involved in home loan schemes, we informed the Central Statistical Office about some basic problems with the data requirements: the Office has built all statistics on the data banks they thought banks would request and assess, whereas a significant part of the home loans disbursed is granted at market interest rates. In such cases the data banks normally ask for are those that are required for credit approval and may vary between banks. Consequently, in these cases the information requested by the authority is not available. Answering the CSO's subsequent question whether banks could obtain the required information, banks quoted the opinion of the data protection ombudsman: banks may only ask for data required for their credit decisions. Accordingly, we requested the CSO to modify the data supply requirements in line with this principle.

Another problem banks encountered was that the CSO requested data inconsistently in various breakdowns such as loans approved, loans disbursed or total stock of loans, broken down according to various criteria within the same table. The problem for the banks' statistics staff was that different databases were to be managed simultaneously and there were no table correlations provided in this respect. The data required could not be 100% managed by IT systems and, therefore, some manual processing would also be required. We forwarded the banks' comments to the CSO, asking that the table structures be revised, with special regard to the risks involved in manual data processing.

In addition, we indicated that the data supply requirement did not reflect properly the stipulations of the agreement between commercial banks and FHB Land Credit and Mortgage Bank and this might also cause problems with the completion of the tables.

In our letter to the CSO we offered our assistance in arranging a consultation between it and the banks.

2.6 Refund of VAT on financial services provided to foreign clients

Tax and legal specialists from PricewaterhouseCoopers and tax specialists from our member banks proposed that the Association initiate amendments to certain tax deduction rules provided by Act LXXIV of 1992 on Value Added Tax.

Under the current act, financial services (except for safe-keeping and financial leasing) are exempt from tax (activity-based tax exemption). According to the provisions of the same act, VAT is not deductible if the product or service in question is directly used for the sale of products or services exempt from tax. Due to this provision, banks must account for VAT

incurred in connection with their tax-exempt services as costs (irrespective of whether the client is Hungarian or foreigner).

According to Paragraph (3) c) of Section 17 of EU Directive 77/388 EEC 6 on VAT, the service provider is entitled to deduct the VAT paid on the tax-exempt financial services specified in the directive if the addressee of such services is a national of a non-EU-member country or if the service in question is directly related to exports to a non-EU-member country. If the services are addressed at the same time to a domestic and a foreign client, then the VAT is deductible in proportion to the services provided to the foreign client (by proportioning).

Before initiating this amendment, aimed at making the Hungarian legislation EU-conforming, we held a discussion with the involvement of tax and legal specialists from PricewaterhouseCoopers and tax specialists from member banks. Following this we wrote a letter to the Administrative State Secretary of the Ministry of Finance, initiating an amendment to the act in conformity with the relevant EU legislation, stressing that the current VAT deduction rules in the relevant Hungarian legislation caused a competitive disadvantage to Hungarian financial service providers.

III. PAYMENTS

1. New regulation on payments

The drafts of the proposed decrees on payments (a decree on payments and a central bank ordinance) specified the reasons for the proposed amendments as follows:

- due to foreign exchange liberalisation, the status of forint and foreign currency accounts and transactions had to be redefined;
- definition of the foreign currency account and IBAN structures (based on a preliminary agreement between banks and the National Bank of Hungary);
- due to legal approximation to the EU legislation, bank card liability rules have changed (the liability of banks has been extended to the period before reporting the incident); a regulation on international transfers in accordance with the relevant EU regulations has been adopted (but will only enter into force on accession);
- the equal treatment of electronic account instructions with written instructions has now been declared;
- making the structure to the two decrees more transparent.

Although the National Bank of Hungary said the changes were not significant, having reviewed the drafts banks concluded that the proposed decrees constituted major changes to the current regulations and interfered with the entire payments system and its consistency. The following main comments were submitted:

- the definition of bank accounts, as a basic category in the payments system, is not clear-cut enough; its types (payments, retail) and their use as well as the requirements related to international payments are unclear;
- the adoption of EU rules in the Hungarian legislation is premature; it would be inequitable to encumber banks with extra liabilities and it might give rise to fraud; the EU regulation on international transfers is inapplicable to Hungarian banks;
- the consumer protection measures stipulated in the proposed decrees are exaggerated and would put extra financial burdens on banks (excessive customer information, increased indemnification liabilities);
- banks objected to curbing their rights in enforcing claims against their account holders.

The written review was followed by a discussion with the involvement of all banks. Remaining open issues were then reviewed again with the National Bank of Hungary, with the involvement of a limited circle of banking specialists. Progress was made on the interpretation of liabilities related to bank cards, the rate of penalty for late payment by banks and in making the performance rules more clear-cut. No final agreement was reached on the exact definition of bank accounts, the regulation of international payments and a more specific formulation of banks' rights to enforce claims against their account holders.

2. New contractual system to regulate payment relations between banks and the Hungarian Post Office.

The Hungarian Post Office requested the Association's opinion on a proposed new contractual framework to be introduced from the following year with the objective of modifying the current transfer procedures between banks and the Post Office (which the latter found too complicated).

The Post Office said the current system of agreeing in details on each individual issue separately was slow and difficult. Instead, the Post Office would like to conclude a general agreement with banks based on its Standard Terms and Conditions, with the proviso that issues not regulated therein should be agreed upon separately with the banks.

Based on the comments received from our member banks, we informed the Post Office that banks basically agreed with the proposal; however, they had some concerns that given its monopolistic situation in payment intermediation, it would be rather easy for the Post Office to enforce any changes in the future. This issue is particularly sensitive in respect of charges and invoicing. Based on our earlier verbal agreement we requested that the Post Office hold a consultation with banks before finalising these items.

In addition to the above, we forwarded the following observations to the Post Office.

- Many of the money transfer and liability conditions are unequal and prejudicial to the banks.

- The communication and information obligations of the Post Office are vague in terms of both form and content. For example, the draft does not provide for the obligation of the Post Office to notify the banks about any major operational disturbance at the Post Office and about the expected steps. We proposed that a multi-channel information system be established (fax, phone, e-mail) to ensure safe information flow.

- We indicated that some credit institutions found the conditions on bank card and money supply-related issues so prejudicial that they did not wish to sign the amendment to the agreement for the time being.

Because of the large number of comments and proposals presented in our review, and the conflicting opinions of banks on certain essential issues, and in view of the fact that only a limited circle of banks could be involved in the written review, we proposed that the Post Office hold another consultation with the participation of all banks, where all the issues raised could be discussed in detail.

The Post Office agreed to the proposal. All member banks were invited and the Post Office committed a number of specialists to the discussion.

Although, initially, the Director of the Post Office announced that the new agreement contained only formal changes and, therefore, professional issues would not be discussed, all essential issues were reviewed and discussed in detail during the meeting. Representatives of the Post Office admitted that the new contractual system still needed substantial "polishing" and also

took note of the banks' comments concerning unilateral conditions in the agreement. They promised to review the issues raised with their colleagues and management and to try to develop payment and liability conditions that would also suit the banks' requirements.

Progress was made concerning the Post Office's information policies, with the banks' proposals being accepted both in respect of emergency situations and information flow. Existing misunderstandings concerning bank card transactions were clarified.

The Post Office committed itself to consulting with banks in advance about any essential changes in the Standard Terms and Conditions and to giving banks the chance to initiate such changes (maybe through the Association). Regarding service charges, a key issue, the Post Office said it would be prepared to review the charges for 2002 at a later date.

3. Authorisation of the Post Office to perform clearing operations

GIRO Rt. requested the Association to ask for the opinion of its member banks about the idea of authorising the Hungarian Post Office to perform clearing operations, as contained, rather ambiguously, in the proposed Telecommunications Act.

The Association reviewed the issue with the involvement of the National Bank of Hungary (as the licensor and regulator of this activity), the Ministry of Finance, the Hungarian Post Office and the IT Government Commissioner's Office. The discussions revealed that under its long-term plans the Hungarian Post Office would like to perform the clearing functions provided under the Credit Institutions Act. However, neither the National Bank of Hungary nor the Finance Ministry support the idea. The IT Government Commissioner's Office also confirmed that the "exclusivity" in the draft law only refers to the organisations falling under the scope of the proposed act; in other words, of all organisations performing postal services, only the universal service provider, that is the Hungarian Post Office, will be authorised to perform clearing functions.

After further consultation and in full agreement with our member banks' comments, we turned to the authority drafting the legislation (the IT Government Commissioner's Office at the Prime Minister's Office), requesting a proper and unambiguous regulation. We proposed that the clearing operations to be performed by the Post Office should either be referred to and controlled by the relevant provisions of the Credit Institutions Act (in which case this activity should be performed as a core activity, in accordance with the relevant provision of the Credit Institutions Act), or, alternatively, the problematic sentence should be deleted (if it refers to the current clearing services performed by the Post Office).

This latter proposal was accepted and the reference to clearing operations was deleted from the act passed by parliament.

4. Obligation to report bank account numbers to the Court of Registration

In October 2001, the Association initiated with the Justice Ministry modifying motions to the proposed amendment to the Company Registration Act presented to parliament. The Association’s representatives were involved in the meeting held on this subject and submitted to the Justice Ministry the draft text for the requested amendments. Act XCIII of 2001 on the

abolition of foreign exchange restrictions and on amendments to certain related acts amended the Company Registration Act in such a way that, from 1 June 2001, banks would be obliged to report company bank account numbers to the Court of Registration electronically. In parallel with this, the simultaneous reporting obligation to the Tax Office will be abolished.

The issue of how reporting should be done in the interim period was raised at the reviews held with the Justice Ministry and Registration Courts. The Registration Courts' practice of requiring hard copy reports to be submitted separately for each company under a properly signed separate cover with reference to the Registration Number caused banks extreme difficulties. Also, e-mail reports were required to be sent exclusively through Microsec Kft., the Courts' IT provider.

Recognising that the confusion around reporting may lead to an impossible situation, the Justice Ministry initiated an amendment to the decree on company registration to the effect that financial institutions meeting their bank account reporting obligations electronically, shall only pay 10% of the company information fee. This highly advantageous amendment was issued under Justice Ministry Decree No. 22/2001. (XII.13.) The incentive, primarily aimed at promoting the changeover to electronic data supply, is also expected to make the data supply smoother.

5. Regulations on foreign exchange activities

The legal framework of foreign exchange activities has changed under the new anti-money laundering measures. Following a short interim period, from mid-2002 only credit institutions and their agents may operate in that market. During the review of the implementation decree, we requested that the issue be reviewed again with the central bank, as the current supervisory organisation, before the legislation is finalised. Since the drafters of the regulation rejected this request for lack of time, several issues remained unregulated in the relevant Finance Ministry Decree. As a result of the review, the decree now provides in a clear-cut manner that exchange agents may only contract with banks, under stringent material and security requirements. However, we failed to achieve a situation whereby the Supervisory authority would draft and issue, within a reasonable time, a guide about the personal and material conditions required for performing currency exchange services. It also remained unclear who the authorities will take action against in the case of any misdemeanour – the exchange agency or the bank.

Although by the time the consultation with the National Bank of Hungary was arranged the decree had been finalised, banks still acquired a lot of useful information on the types and number of exchange agencies and their turnovers, typical frauds in the market and the possible control methods. Banks also requested a consultation with the Hungarian Financial Supervisory Authority, as the new supervisor of this activity.

6. Introduction of International Bank Account Numbers (IBAN)

Representatives of the Association and the National Bank of Hungary reviewed the possible ways of utilising the information we gather as a member of the European Committee for Banking Standards. It was agreed that the possibilities of introducing to Hungary the International Bank Account Number (IBAN) and the International Payment Instruction (IPI), as the most common

payment standards adopted by this organisation, should be investigated. The decision was all the more timely in view of the general use of IBAN by all EU banks from January 2002.

The relevant working paper compiled by the National Bank of Hungary was discussed with the involvement of bank specialists in May. All specialists agreed that with the general introduction of the IBAN in the EU, clients will sooner or later push banks in Hungary to use the IBAN as a standard. Accordingly, the taking of joint preparatory actions would be desirable.

Although the usefulness of IPI is obvious, in view of the fact that it is not yet compulsory in the EU and there are still some debates concerning its hard-copy and electronic versions, it was agreed that it was untimely to decide about the introduction of this standard at this time.

The participants were of the opinion that banks should first become prepared for initiating transfers with IBANs (i.e. they should be able to check the correctness of the IBAN number) and only thereafter should they receive transfers for clients (that is, generate IBANs for clients).

Banks specialists pointed out that the implementation of a new account structure will involve substantial time and money. Therefore, the introduction should be gradual and well-planned. Banks rejected the National Bank of Hungary's proposal to use the IBAN in domestic payment transactions (as some EU countries do). However, they agreed that the current unregulated and varied structures of foreign currency accounts should be standardised and the IBAN standards should be introduced and applied on a compulsory basis.

Finally, the National Bank of Hungary proposed that banks should become prepared for IBAN initiations from January 2002 and for IBAN receipts from the middle of 2002. The Association informed its member banks about the discussions and forwarded them the NBH working paper.

7. Draft law on e-commerce and other information society services

The IT Government Commissioner of the Prime Minister's Office submitted the above draft law and the relevant government proposal for review in August. The relevant EU Directive that forms the basis of this legislation (Directive No. 2000/31/EK) specifies the requirements related to the provision of information society services. Certain provisions of this directive have already been incorporated in the relevant Hungarian laws under Act XXXV of 2001 on Electronic Signatures. Further requirements are provided by this draft law in relation to private law relations established through electronic communication devices and the setting of legal conditions for information society services. The draft law also contains provisions on data supply; contracts concluded electronically, the provider's responsibility and the rules of reporting illegal services.

Banks pointed out that the draft law did not define which media and which e-commerce services fall within the scope of the act; services provided through mobile communication devices or through telephone customer service cannot be unequivocally classified as information society services, and the requirements set by the proposed law for certain media would be very difficult to meet.

Banks also pointed out that the law failed to clearly specify the relationship between the provider and the client, and the related liability relations; also, it failed to provide for the protection of personal data and secrecy. We submitted several comments to make the provisions

of the law more specific and submitted additional definitions to be included in the draft law. We also raised the question whether the client would continue to be bound by the bid even if the bank fails to send a confirmation within 48 hours (in the case of account transaction requests submitted electronically this was not an unequivocal requirement). We also indicated that a grace period of at least 120 days should be granted before entry into force of the law, so that the organisations affected could become prepared.

8. Regulation on electronic signatures

The Act on Electronic Signatures entered into force in September. The related implementation decrees were issued in advance. Of these, one of the most important was the decree on services related to electronic signatures and on the related service providers. In our comments sent to the IT Government Commissioner, the officer coordinating the drafting process, we submitted a number of complementary proposals to make the provisions of the regulation more specific. We requested clarification of the legal relations concerning the provider certifying the electronic signature and the so-called registration centres. Namely, in international practice, tasks related to the issue of the certificate and those related to the identification of applicants requesting electronic signatory rights and to the generation and issue of the required keys are performed by separate organisations; and this is the practice banks in Hungary also follow today. Bank specialists were unable to determine whether this practice could be continued under the new regulation in the future.

In our comments we requested the legislators to nominate until the regulation is enacted at least one provider, who would provide date stamping services (indispensable for meeting certain legal provisions), and to provide regulatory assistance in creating at least one insurance product that would serve as a liability insurance for the provider authenticating the signatures (such liability insurance is required by law, as well). In relation to major loans, we challenged the fact that the liability insurance amount set in the proposal was lower than required.

After the regulation was enacted banks raised the issue of establishing a standard authentication system within the banking sector to avoid the current diversity in the various electronic signatures in use.

In accordance with this request, the Association held a meeting with the involvement of major potential market players. It was agreed that a specialist team would be appointed to develop a common authentication standard acceptable for all banks.

9. Standard bank certificates to promote telebanking

The working group set up to develop a common electronic signature certificate submitted to the Association's relevant committee a proposal based on international experience and the operations of GIRO Rt. The proposal defined the responsibilities and relations of the two authentication organisations – the CA, doing the certification, and the organisations doing the actual customer identification and issuing the certificates (i.e. banks); it also specified the contents of the certificate and the related main regulatory procedures (registration, mutual acceptance of certificates, cancellation, etc.).

The committee accepted the working group's proposal and stressed that for this programme to succeed, the commitment of all banks will be required; the role of GIRO Rt. should be clarified and the related legal issues (banking secrets, data protection) should be identified and resolved. The committee requested the Association's Presidium to review the proposal and to give its position on the issues raised.

10. Banking tasks related to the introduction of Euro coins and banknotes

In view of our member banks' questions and the National Bank of Hungary's request for consultations regarding the introduction of Euro coins and banknotes, a meeting was organised in April to review the issue. At the meeting, the National Bank of Hungary's specialists presented the proposed schedule for the introduction of Euro coins and banknotes. The National Bank of Hungary (NBH) would like to ensure that the money swap is managed smoothly; it is also prepared to take a leading role in informing the general public and in familiarising specialists with the new coins and banknotes.

Banks requested the NBH's assistance in coordinating the joint purchase of the required initial cash stocks and the joint sale of foreign currencies to be phased out. The also asked the NBH to take action for an early enactment of the regulatory changes required.

The meeting was followed by further consultations on the proposal.

As result of these consultations

- it was agreed that the campaign should be focused on the withdrawal of the respective foreign currencies in circulation (possibly before the end of 2001) to avoid a stormy exchange campaign at the beginning of 2002, to reduce the initial Euro coin and banknote stock requirement and to manage the sale of withdrawn currencies in a planned manner. While the campaign will be focused on encouraging people to deposit the outgoing currencies on their forint or foreign currency accounts as soon as possible, it will also offer conversion facilities into forint or into other foreign currencies (USD, GBP and CHF).
- A two-month "dual-currency" period will be allowed at the beginning of 2002. During this period banks will still accept the national currencies to be abolished and payments in Euro will also be available.
- the National Bank of Hungary rejected the proposal that it take part in the joint purchase of initial Euro cash stocks and in the joint sale of withdrawn currencies.
- the National Bank of Hungary confirmed it will not regulate exchange rates (i.e. banks will be able to control the exchange demand through their own exchange rates) and will not impose any mandatory acceptance of coins (which is good for banks but may cause problems for clients in using the outgoing coins).

The National Bank of Hungary informed banks and the general public about the practice it proposed to follow in converting national currencies into Euro in the form of a recommendation. At the end of the second quarter, the National Bank of Hungary asked the Association to give its opinion on the recommendation. The respective review took rather long due to the diversity and interests of individual member banks. Banks agreed with the basic objective of the proposal (namely, to convert customer accounts in national currencies to Euro as early as possible in 2001). However, one question was whether this could be done without a specific authorisation by the customer. Based on a majority opinion, the Association asked the

National Bank of Hungary to enact a regulation that would guarantee that the banks' conversion measures are legally incontestable. The National Bank of Hungary rejected this request. However, it cancelled the provision to convert all accounts by September.

The National Bank of Hungary and the Association had formerly agreed to devise a joint campaign; accordingly, our member banks' specialists were invited to the NBH working group preparing the Euro campaign. In the campaign plan, which envisaged the Association as a co-financer, our member banks' proposals were almost completely disregarded and the costs involved were highly excessive.

Based upon the relevant decision of the Presidium, we requested our member banks' opinion about our participation in the campaign. Although the National Bank of Hungary had in the meantime reduced the costs by half, banks said they did not wish to scatter their resources and would rather concentrate on informing their own customers. We advised the National Bank of Hungary about the banks' decision and expressed our hope that given its importance, this issue will receive close and continuous media coverage.

National Bank of Hungary Ordinance No. 6/2001 regulates the acceptance of legal tenders of the Euro-zone countries and the quoting of exchange rates by businesses performing currency exchange.

The draft of the proposed ordinance was sent to member banks for review. The following main comments were received:

- banks proposed that the ordinance provide a list of all national currencies to be withdrawn from 1 January 2002;
- the ordinance did not address the conversion of the respective national currencies to non-Euro-zone currencies;
- banks proposed to change the last trading day for the respective national currencies from 1 January 2002 to 15 February 2002 to bridge any Euro supply problems in the initial period;
- banks proposed that the ordinance pronounce that the obligation to accept the respective national currencies only applies to banknotes;
- banks found it necessary to determine the final acceptance dates for the respective banknotes separately, by country, depending on the final date on which the respective national currency is to be withdrawn in the country in question.

The above comments were accepted by the National Bank of Hungary and the final draft was revised accordingly. Due to its discriminative nature, the National Bank of Hungary, however, turned down the bank' proposal to limit the amount of foreign currency to be converted to Euro. At the same time, in protection of banks it provided that while the acceptance of the respective national currencies from domestic clients will be mandatory up to the deadline, acceptance from foreigners will be optional and may be determined by the banks at their discretion.

IV. LOAN FACILITIES

1. Student loans

The Association's Presidium reviewed the proposed student loan facilities several times during 2001. Following its meeting on 3 September 2001, the Association's Presidium sent a letter to the Finance Minister, drawing attention to problems related to student loans. Upon the government's decision of 9 August 2001, the Student Loan Centre, the organisation assigned to organise and disburse student loans went into the ownership of Postbank and Savings Bank Ltd. The Student Loan Centre was privatised by the state in such a way that the new owner, legally deemed as a private entity, was given a monopolistic position, without any tendering process. Based on an assessment prepared by legal counsels from member banks, the Presidium concluded that this system was against the principle of equal competition. The system is unclear, the regulation does not specify clearly how the Centre will be funded and how operating costs (for two academic years) and risk premiums assumed by the government will be recovered.

The Association was of the opinion that the regulation was prejudicial to the interests of commercial banks, as it gave one bank a monopoly in a particular customer segment. In its letter to the Minister of Finance, the Association proposed that the regulation be changed such that the original ownership relations of the Student Loan Centre would be restored and beneficiaries could freely decide which bank account they would like to have the loan disbursed to. We proposed allowing banks, under the rules of fair competition, to conclude an agreement with the Student Loan Centre to provide lending and related services as the Centre's agents. We also proposed that banks be allowed to extend loans from their own resources, in addition to the normative support granted by the government, thereby reducing the costs encumbering the state.

In his reply dated 17 October, the Minister turned down most of our proposals, except for one, which he said he considered as settled in the meantime. The Presidium reviewed the Minister's answer at its November meeting and decided to initiate a procedure with the Competition Office on the grounds that the procedures instituted by the Student Loan Centre violated the provisions of the competition law.

The note filed with the Competition Office was drafted with the involvement of legal experts from member banks. It was submitted on the grounds that the exclusive right of Postbank to manage student loan accounts violated the Act on Fair Competition and constituted an abuse of dominant position. Fourteen member banks jointly signed the complaint. On 28 November 2001, the Competition Office notified the Association to the effect that a procedure had been instituted to investigate the matter.

2. Applications for SME subsidies

Despite our detailed comments and counter-proposals submitted in 2001, the Ministry of Economic Affairs submitted, after months of silence, the Procedures for the management of SME development schemes under the Széchenyi Plan, in an unchanged form, for signature by banks. It turned out that the ministry's proposal had in the meantime become untimely, given that the scope of organisations involved in managing the scheme had been changed by a related

government decree. At the next meeting of the Enterprise Development Council (coordinated by the Ministry of Economic Affairs) we expressed our objections and drew attention to the issues to be resolved. We once again offered our assistance in drafting the proposed Procedures. Accordingly, we were given the chance to review the draft invitations for applications for 2002. Despite the short notice, we submitted a number of essential and detailed proposals. Many of those proposals were incorporated in the final document (higher interest rates, consistency between the invitation for applications and the relevant implementation guides) and some were ignored (e.g. reducing the appraisal time, a more accurate formulation of the objectives and techniques related to general practitioner loans; standard guarantee forms). We will continue to seek resolutions to the relevant issues.

3. Loan facility for compensating export losses due the appreciation of the Hungarian currency

The appreciation of the forint as a result of foreign exchange liberalisation and the widening of the intervention band caused exporters serious losses. The government decided to take measures to maintain interest in exporting. The relevant proposals, developed by the Hungarian Export-Import Bank (Eximbank) and Hungarian Export Credit Insurance Ltd. (MEHIB), were forwarded to our member banks. While appreciating the government's efforts, banks raised a number of problems concerning some elements of the proposed facilities.

In our observations we communicated the banks' comments and requested the Ministry of Economic Affairs and the Ministry of Finance to initiate a consultation on the proposals. Subsequently, Eximbank advised that they had developed a new proposal based on the comments received and requested a meeting to review the new scheme with our member banks. At the meeting organised by the Association it was advised that the government would grant through Eximbank a significant interest subsidy (50% to 75%) to businesses with revenues under HUF 10 billion.

Based on the discussion, Eximbank developed the details of the proposed facility in the form of a Cooperation Agreement. The draft agreement was sent to banks for review. Some banks indicated that contrary to what was said during the discussion, commercial banks would have to assume the exchange rate risks involved in loans provided in foreign currency and the narrow margins and low charges allowed for did not provide adequate cover for such risks. We communicated this point to Eximbank.

4. Evolution loans

In autumn 1999, parliament passed a resolution allocating HUF 65 billion in subsidies to improve the liquidity of private agricultural businesses. Based on the proposal of the Ministry of Agriculture, the government issued a decree on the utilisation of these subsidies through the provision of various loan facilities in April 2000. The highest portion (HUF 25 million) of the subsidies was allocated for evolution loans.

Evolution loans were made available under an application system for enterprises with long-term loans as of 31 December 1999. Applicants could apply with their banks for the conversion of 70% of their loans (for businesses with a maximum of HUF 50 million in revenue)

or 50% (for businesses with over HUF 50 million in revenue) into evolution loans with a maturity of three years.

Applications had to be accompanied by a three-year evolution plan. Applications passed by banks were appraised by a technical jury set up at the Ministry of Agriculture (in which the Association was also represented) and submitted for final approval by authorised executives in the ministry.

Converting existing long-term loans into evolution loans was in the interests of both applicants and banks. One advantage was that the **government has assumed a guarantee up to 80% of the loan amount**. Another, even more important advantage was that those having met the commitments made in the evolution plan and accomplished the tasks set in the ministry's approval, were eligible to receiving **government subsidies covering their loan instalments due over three years**. The subsidies are disbursed by the Tax Office and the applicants can pay their loan instalments from these disbursements.

More than 2,800 applications had been submitted by **30 June 2000**. Most applications were endorsed and forwarded by banks to the Agriculture Ministry within one month.

Final decisions and notifications to applicants suffered substantial delays and were concluded as late as **April 2001.** Finally, more than 2,700 applications were approved, with an approximately equal number of loan agreements concluded with banks, to a total value of HUF 40 billion. (In some cases, applicants or banks opted out due to unforeseen reasons, for example, liquidation.)

Pursuant to the relevant Government Decree, agricultural businesses with evolution loan contracts must prepare each year a self-evaluation on the accomplishment of their contractual commitments and tasks defined by the ministry. The deadline for the submission of these reports in 2001 was 30 June.

Some 2,600 businesses submitted accomplishment reports on the year 2000. Most were approved by banks and passed on to the Agriculture Ministry.

Based on banks' opinions, the technical jury recommended the approval of most reports and, accordingly, the disbursement of government subsidies for due instalments.

Less than 100 reports were rejected. The main reasons for rejection included a significant missing of the deadline, loss not attributable to any drought or other natural disasters such as flooding, inland water, etc.

Evolution loans have another two years to go. Accomplishment reports on 2001 are due in 2002 and on 2002 in 2003. It should be noted that businesses whose reports were not approved in 2001 still have the chance to receive subsidies in the following years (i.e. they just did not qualify for the disbursement for their 2000 instalments). Businesses that have paid their instalments from their own resources may still be eligible for subsidies for their instalments in the following years. For business that have failed to pay their instalments, the creditor bank may call the government guarantee, the evolution loan agreement becomes null and void and the ministry disqualifies the business as an applicant.

Sixteen banks and several savings banks are directly involved in evolution loan facilities. They had participated in drafting the relevant regulations (government decree, ministry decree, invitation for application) and although many of their good proposals were rejected, they still managed to avert a number of poor regulations.

5. Government investigation on government guarantees granted for agricultural loans

The Ministry of Finance informed us and requested our opinion about a Government Control Office report compiled on the calling of government guarantees granted for agricultural loans. Banks found the sections criticising the banking practice in calling the guarantees unjustified and stressed that bank branches follow internal banking procedures, drawn up and based on legal regulations. It is more likely that the problems were mainly due to the inadequate formulation of the relevant laws and the different practices the Tax Office follows in the different areas. We drew attention to the fact that the regulations on the government guarantees in question are inconsistent, sometimes too liberal, sometimes too stringent and impossible to comply with.

6. Cooperation with the Association of Hungarian Insurance Companies (MABISZ) on insurance provided as collateral for building loans

Last year the Association of Hungarian Insurance Companies (MABISZ) proposed that banks and insurance companies introduce common practices in administering home insurance used as collateral for building loans. After an interruption due to the flooding in the spring, the discussions resumed in May and brought some very positive results.

Insurance companies have undertaken to notify the financing bank 30 days in advance in each case where the insurance contract is to be terminated by the insurance company (to enable banks to manage the risks of collateral withdrawal).

Further, the following understanding was reached:

- the insurance request form will be initiated by banks (to ensure proper data contents);
- the request forms may be forwarded by the client (no postal delivery required - although slower but safer);
- banks will not be notified about damages under HUF 300,000 (these relatively small damages do not jeopardise the collateral; also, banks would almost always relinquish these damages in favour of their clients to enable them to restore their homes).

It still remained open whether banks should have the right to act on behalf of their clients in the case of disputes over damages established by the insurance companies (insurance companies are against it). Another open question is what ways, other than the insurance collateral for building loan, can be ensured for banks to become aware of any insurance collateral instituted by another bank on a particular real estate. Agreement should also be reached regarding a uniform approach to such cases where the debtor and the person providing the insurance collateral on the real estate are different persons.

V. INTERNATIONAL COOPERATION

1. European Banking Federation

1.1 Banking Supervision Committee - New Capital Accord

Representatives of the Hungarian Banking Association attended the meetings of the European Banking Federation's Basel Working Group and the Association's Secretary General attended the 18 May meeting of the Banking Supervision Committee. The issue covered at both meetings was the Basel Committee's Consultative Package 2 (CP2) on capital adequacy requirements.

The first version of this document (Consultative Package 1) was compiled by the Committee in June 1999. The CP2, prepared on the basis of comments and proposals received, was presented in January 2001 with the request for money and capital market actors and supervisory authorities to give their views, comments and proposals by the end of May 2001.

The new regulation on capital adequacy requirements, aimed to replace the requirements introduced in 1988, is basically different from the old regulation. The new regulation rests on three pillars:

- minimum capital requirement (development and application of new methodologies to ensure a more accurate, comprehensive, sensitive and flexible measurement of risk through various approaches);
- improving the efficiency of the supervisory review process, developing and implementing the rules of consolidated supervision;
- strengthening market discipline to mitigate risks.

The mutual use of these three pillars is intended to contribute to market security and to overall safety and soundness in the financial system.

The working group and committee meetings were focused on the first pillar, i.e. the new regulation on minimal capital requirement.

According to the Basel Committee's working paper, the minimum capital requirement would remain 8%. The definition and calculation of regulatory capital would also be maintained. However, the risk types to be covered by regulatory capital and the methods for determining and measuring risks within the various asset categories will change substantially. Under the proposed new regulation, the regulatory capital should cover three main types of risks:

- credit risk;
- market risk (risks in the trading book);
- operational risk - a new category of risk (the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events (such as legal risk).

Various approaches to these risk categories would be allowed. These are:

- the standardised approach, or
- internal rating-based methods (basic and advanced), subject to meeting certain criteria and requirements and audited by the supervisory authority.

In summary: while the minimum capital requirement (8%) and the definition of regulatory capital remain unchanged, the risks to be covered and the methods of risk measurement will change fundamentally in the new regulation.

Following the second consultative document issued in January, the Basel Committee issued new working papers in the summer and autumn of 2001. The proposals provide specific rules to determine capital requirements for the various banking activities. New proposals were developed for taking into account expected loss and future margin income, operational risk, securitisation, specialised lending and equity exposures in the banking book. Some of these proposals and initial results of the industry impact studies were reviewed at the 12th Meeting of the Basel Working Group of the EBF Banking Supervision Committee.

Industry simplified impact study - According to the findings of the first quantitative impact study based on the parameters and risk curves of the January proposal, the capital adequacy requirements computed by the standardised and IRB approaches were both higher than the current requirements. (Furthermore, the IRB requirement was higher than the standardised). Based on the results, certain elements were recalibrated to reduce the capital requirement.

Operational risk - In view of the fact that the handling of operational risk is undeveloped, the working group found the proposal for the computation of capital requirement for operational risk premature, too prospective and too credit-risk focused. The working group found it unacceptable for standardisation to control industry development; this would be a misdirection and would generate costs. Regulation should be simple and open for any future development. The Basel Committee should focus on developing the standardised approach, while remaining flexible for the Advanced Measurement Approach, without any close commitment to either method. (The working group welcomed the fact that the new working paper on operational risk provided ample room for various AMAs). The participants challenged the ability of the business lines specified in the standardised approach to cover all banking activities and were of the opinion that more flexibility was needed, while safeguarding a level playing field. They found it important that external elements (such as insurance) mitigating risk are taken into account. As for disclosure of information related to operational risk, the group supports the disclosure of capital requirements by business lines but strongly opposes the disclosure of operational losses.

Retail lending - The developing of a specialised retail lending approach has become indispensable, as the corporate lending approach cannot be applied to retail loans. In its letter to the Basel Committee, the working group initiated the developing of a working paper for capital requirement for retail lending.

Securitisation - The Committee's securitisation working paper ignores the EBF’s former opinion and the industry practices.

Specialised lending - The group found the proposal on specialised lending inadequate. The group questioned whether the correlation between probability of default (PD) and loss given default (LGD) was indeed that close and the LGD so high as described in the committee’s proposal. As a solution, they proposed that (except project financing) specialised lending be re-classified to corporate lending, while developing an adequate collateral management system.

Although the new working papers represent significant progress compared to the consultative package of January 2001, the EBF expressed further reservations, apart from those mentioned above.

- The EBF believes the new accord is too complex and detailed and thus the positive pressure to further develop risk management standards and flexibility in application would be lost, while implementation costs would be very high.[1] Bankers would like to see a more flexible system and are concerned that technical specialists would be given excessive autonomy. The proposal is too far-reaching, which was not the objective of the Basel Committee. The principle of "all or nothing" should be applied flexibly, but authorities should not open the way for cherry-picking certain portfolio elements.

The EBF challenges the fact that the proposal is invariably based on expected and unexpected losses (EL-UL) in contrast to the industry practice, which is only looking at unexpected losses determining the capital requirement. This is particular significant in the case of retail portfolios, where expected losses are relatively high and stable and unexpected losses are low. According to the committee's proposal, the ensuing high capital requirement would be matched by the high future margin income. This approach would have far-reaching accounting and financial consequences (taxation, fiscal), which would probably hurt the level playing field and would be difficult to implement. Instead, the EBF proposes that retail expected loss be zero.

- The current capital requirements are not motivating banks to use the basic internal rating based approach instead of the standard approach. This is also valid for the basic and advanced IRB methods. The Basel Committee is of the opinion that to ensure a level playing field, there should be no high incentives; bankers, however, insist that incentives are needed, given the high costs of developing and managing internal rating based systems.

- The EBF finds it important that risk-mitigating collaterals are taken into account when applying the IRB approach in the case of real estate loans.

- In relation to the third pillar, the EBF has pointed out that the volume of information required constitutes a competitive disadvantage for the organisations affected. The FBE doubts the proposal would be able to render balance between reasonably disclosable information and owners' secrecy rights and emphasises the importance of disclosing qualitative characteristics.

According to the latest information, the next consultation document of the Basel Committee would not be issued at the beginning of 2002, as originally planned. The proposals will be finalised based on industry consultations. After that, the Committee will complete a comprehensive review of the consultative document and will submit it for formal consultations. The new capital requirements will be finalised at the end of the consultation period. The Committee still believes the new capital requirements can be introduced from 2005, but it is prepared to extend the deadline if necessary.

The Basel Committee has set up a working group to promote the implementation of the new capital requirements (Accord Implementation Group). This forum will enable supervisory authorities to share the various approaches and information related to the introduction of the new capital requirements.

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[1] *According to estimates, implementation costs of the new capital requirements would exceed those of Y2K.*

The proposed new capital adequacy requirements and the opinion of the EBF Basel Working Group also outline the expected Hungarian regulatory tasks in the process of legal approximation. The Association will follow closely the work of the Basel Committee and EBF's opinions and comments regarding the new regulation.

1.2. Accounts Committee

A representative of the Association attended the 45th Meeting of the EBF's Accounts Committee. The most important topics of the meeting included the introduction of international accounting standards, fair value accounting, the EC's proposal on transparency obligations, and the B.I.S. documents on the Basel pillar 3.

International Accounting Directives - The Accounts Committee agreed that all banks in member countries should apply the IAS from 2005.[2] Individual and consolidated reports should be compiled according to IAS in order to avoid double reporting procedures.

Revision of IAS39 (Financial Instruments: Recognition and Measurement) - With the mandatory introduction of IAS, the developing and improving of IAS39 will be inevitable. The work the Implementation Guidance Committee has done thus far leaves a lot to be desired. Experts are divided on the question whether simplifications would suffice or whether IAS39 should be changed more radically. The German member of the Accounts Committee said German banks were facing tremendous difficulties in introducing IAS39.[3] The European Banking Federation wrote a letter to the IASB, asking for the re-negotiation of the following issues: loan provisioning, originated loans, accounting hedge and internal contracts.

Fair Value Accounting (FVA) - According to the relevant IASB proposal, Fair Value Accounting should be applied to all financial instruments. (For marketable instruments this means applying actual prices; for non-marketable instruments, asset value should be determined by using the mark to model). The proposal has been criticised by the Basel Committee and the European Commission, and the ECB will probably also join this criticism. (About 300 comments were received on the proposal and the EBF would like IASB to make those comments public). It seems the IASB appreciates that the working committee's proposal needs to be revised and worked on further, and that there is no real chance for introducing full FVA within the next five years. (Priority should be given to the further developing and introduction of IAS). The Accounts Committee Secretariat is now drafting a "political" letter to draw politicians' attention to the economic impacts of full FVA.

B.I.S. working document on the third pillar (Market discipline) - Disclosure requirements were reduced in the September proposal compared to the January working document, a fact welcomed by all Committee members. However, Committee members expressed their reservations about the proposal for the Basel Committee to also issue accounting and disclosure standards, in addition to the IASB. They also feel the proposed information content is rather excessive. They believe the Basel Committee should influence the IASB's regulatory work, rather than developing its own measurement and disclosure requirements. The proposal for the third pillar should be reconciled with the revision of IAS30 (Disclosures in the

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[2] *As per the EC's proposal, EU companies quoted on the stock exchange will be obliged to apply IAS from 2005.*
[3] *The IASB requested the French standard setters to complete a survey on the introduction of IAS in 2005.*

Financial Statements of Banks). The Chairman announced that the Basel Committee has invited the representatives of the European Banking Federation for a consultation on the third pillar.[4]

The Basel Committee has also compiled a working paper on loan accounting and on the related disclosure requirements. Committee members highlighted the importance of reconciliation with the relevant IASB and B.I.S. requirements in this respect, as well.

According to the new directives, securities issuers operating in regulated markets are required to disclose their consolidated reports on a quarterly basis, not semi-annually, as was done formerly. The reports should be published within sixty days as from the end of the current period and should also be put on the Internet. Participants in the meeting challenged the scope of those subject to reporting, the contents of the reports, the quarterly frequency and the deadlines. The secretariat requested the Committee members to submit their views on the proposal.[5]

European Financial Reporting Advisory Group (EFRAG) - The European Financial Reporting Advisory Group (EFRAG) was set up based on a private sector initiative, to promote the adoption of IAS. Members of the advisory group include preparers and users of financial reports, standard setters and auditors. EFRAG provides experts' support in adopting IAS in the European legislation. The group is actively involved in the process of developing accounting and reporting standards. EFRAG maintains regular contact with the consultative forum of standard setters.

EFRAG has studied the proposal on full FVA. Based on the relevant comments, it is expected that the early introduction of the new standards will be rejected by a two-thirds vote.

2. European Committee for Banking Standards (ECBS)

A representative of the Hungarian Banking Federation attended the ECBS Technical Steering Committee Meeting. The objective of ECBS is to produce standards and to act as a catalyst and support for other organisations in creating technical banking standards. The Committee aims to build close working relations with third parties such as EMV (Europay, MasterCard, Visa) SWIFT and CEPS (Common Electronic Purse Specification). The ECBS's objective is to create awareness and increase knowledge through the publication of technical reports, implementation guidelines, position papers and recommendations.

Currently the ECBS has four Technical Committees:
TC1 Plastic Cards and Related Devices
TC2 Automated Cross-border Payments
TC4 Security
TC6 Electronic Services

Specialists from Hungarian commercial banks are also involved in the work of the Technical Committees. The actual work is performed by working groups including experts in the specific fields.

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[4] Basel Committee members attending the meeting rejected the Federation's proposals. The EBF plans to draft a detailed (table by table) proposal for the third pillar.
[5] The EBF' s answers to the EC's questions were submitted to the EC in February 2002.

The objectives of **TC1** are to increase the cross-border inter-operability of plastic card systems, enabling cardholders travelling in different European countries to access easily a wide range of card-based services; to increase the quality and profitability of the card-based system; to improve the quality and reduce the costs of card-related hardware and software products, to enable member banks to reduce the costs of cross-border card fraud in Europe and to build on and complement international and public domain standards and standards from the major international bank card schemes. TC1 has a working group for developing standard guidelines for the implementation of ISO 8583, the standard that specifies interchange between card issuers and card acquirers. Another working group has the task of producing standard technical specifications for a secure IC card reader, mindful of the results of the FINREAD project. A third working group addresses common protection profiles and methodology relating to integrated circuit cards and related devices. A fourth working group has recently completed an updated report on TR103 Banking Sector Requirements for an Electronic Purse.

The objective of **TC2** is to facilitate and increase automation of cross-border means of payment; to enhance the business opportunities presented to banks consequent upon the development of the European single market and to increase the cost effectiveness, efficiency and reliability of cross-border means of payment. TC2 Working Group 1 addresses issues related to the International Bank Account Number, or IBAN (the group updated the IBAN implementation guidelines in December 2000). Another tool supporting the successful implementation of IBAN is the Register of European Account Numbers (Technical Report 201, TR201 V2.2.10), which includes domestic account number information and IBAN specifications for ECBS member countries. (This report is updated on a regular basis.) The TC2 working groups also address issues related to cross-border direct debits (facilitating remote access to domestic direct debit schemes); the updating of balance of payments regulatory reporting standards in close cooperation with Eurostat; the development and documentation of IPI standards (International Payment Instruction); and technical access to domestic clearing houses.

It is still a question whether the application of domestic charges on minor transfers (under 50,000 Euro) can be implemented parallel with introduction of Euro coins and banknotes from January 2002. The European Commission would definitely like to have this regulation adopted. At the same time, the challenge for banks is that the actual costs of cross-border transfers are not the same as those for domestic transfers. Part of the extra manual work will be reduced through the application of IBAN and BIC (Bank Identifier Code); however, the rest will be eliminated once the balance of payment reporting threshold is increased. (From January 2002, items under 12,500 Euro are exempt from reporting in the balance of payment statistics in the Euro-zone countries; this threshold will be increased to 50,000 Euro from January 2004.)

The objective of Technical Committee **TC4** is to establish the minimum requirements for information security in European banking, based on available international standards. The committee has five working groups, addressing issues related to electronic signature certification authorities; secure banking over the Internet; generic guidelines on algorithm usage and key management (key sizes, generation), audit trail management and the use of biometrics in personal identification.

Member countries decided on the adoption of the Technical Reports on certification authorities and audit trails in October (TR 408 Part 2 Secure E-mail for the Financial Sector Part 2: Banks and Certification Authorities for Secure E-mail; TR 409 The Use of Audit Trails in Security Systems: Guidelines for European Banks).

The objectives of Technical Committee **TC6** are to ensure that the new standards of electronic data transfer and related devices meet the needs of the European Community, strive for the convergence of standards to minimise the number of possible interfaces that banks may have to support in the development of electronic services, and to direct the IT industry in the new requirements for electronic services infrastructure. The working groups of TC6 address issues related to the standardisation of electronic banking services, mobile payments and EPI (Electronic Payment Initiator).

3. Conference on Banking and Finance in the Baltic States 2001

The Association represented itself through a delegate at the above conference, held on 19-21 September 2001 in Riga, Latvia. Presentations on the macroeconomic and financial situation, the role of central banks and the state of the banking sector in the three Baltic countries were offered by leading financial experts of the region. Issues related to the financial management of capital imports to the region, trends and opportunities in IT development and timely issues related to regulation and supervision in the financial sector were reviewed in three sections of the conference.

4. European Banking Congress 2001, Frankfurt

A representative of the Association attended the traditional Frankfurt Banking Congress in November, which in 2001 carried the title "The Euro Goes East". Presenters at the congress were not united in their opinions on whether EU enlargement should be carried out in one step or gradually, based on the individual performances of candidate states. Günter Verheugen stressed that there was no direct relation between the institutional reform of the EU and the accession of new members. The financial background for enlargement is secured until 2006. The basic principles for the structural reform (representation, rotation) have not been decided on yet and the reforms will not be completed until 2006.

The participants unequivocally agreed that the banking systems in the pre-accession countries are ready for accession. New members will only have to meet the Copenhagen criteria, the EU will not push them to meet the Maastricht criteria. Willem Duisenberg stressed that candidate states will have to develop their exchange rate policies with due consideration to common interests. For membership in the monetary union, pre-accession countries will have to first join ERM2. The EU will not accept a unilateral introduction of the Euro. The enlargement of the monetary union will require the reform of the European Central Bank. Small countries will probably be represented in the ECB decision-making bodies by rotation.

VI. EVENTS, ASSOCIATION LIFE

1. Estonia-Latvia bank security conference

At the initiative of the Estonian Banking Association, a bank security conference was organised by the Hungarian Banking Association on 25-29 April in Budapest for bank security specialists from Estonia, Latvia and Hungary. In addition to physical security, issues related to comprehensive defence, technology development and the prevention of money laundering were reviewed. Participants from Hungary offered presentations on the latest methods used by organised crime in white-collar crimes and bank card fraud. Participants agreed to develop channels for information exchange on organised crime.

2. Bankers' delegation from China

The Association received a high-level delegation from the Bank of China visiting Hungary in May. The delegation assessed the economic and money market rationale for developing their Representative Office in Hungary.

3. Iranian bankers' delegation

On Eximbank's initiative, the Association organised a contact-building conference for an Iranian bankers' delegation representing a full cross-section of the Iranian banking sector.

4. International vocational training

A training course on banking strategy in eastern and central Europe was held in Budapest, for the first time, in cooperation with Luxembourg Financial Technology Transfer Agency (ATTF). Presenters included Michel Doumont, EU Chief Financial Commissioner for Slovakia, Jean Grosjean, Director of ATTF and Roger Claessens, Professor at Brussels University. New and specific information on EU and regional strategic issues was provided to 20 bank specialists attending the training course.

5. Conference on land registration

In the autumn of 2000, the Association of German Mortgage Banks initiated a conference to be held jointly with the Hungarian Banking Association on current issues related to real estate registration. The conference, held on 14-15 February at the Budapest Bar Association, was financially sponsored by the two associations, with the Hungarian Banking Association also assisting in organising the event. An introductory presentation was offered by Dr. László Jójárt, former Deputy State Secretary of the Ministry of Agriculture (the chief officer who led the drafting of the new law on land registration at the Ministry of Agriculture). His presentation addressed questions related to the authenticity of land registers. Dr. Mihály Kurucz, first assistant at the Law Faculty of ELTE University offered a presentation on land registration issues related to mortgage lending, with special regard to ranking and to syndicated loans. The two Hungarian

mortgage banks were also represented at the conference. Dr. András Szikszai, CEO of HVB Mortgage Bank spoke about banking problems concerning land registration. Dr. József Baki, legal counsel of the Land Credit and Mortgage Bank gave a presentation on experience of the current practice of land registration in mortgage lending.

The conference was attended by participants from various areas. The Association of German Mortgage Banks was represented by 20 delegates, including legal counsels from banks; Hungarian delegates included legal counsels from banks, risk management experts, lawyers and representatives of ministries (Ministry of Agriculture, Ministry of Economic Affairs, Ministry of Justice, Finance Ministry), Land Offices, Courts, the Hungarian Financial Supervisory Authority and the Chamber of Hungarian Notaries. The total number of participants was close to 80.

6. MATRA EU Pre-Accession Project

A conference on legal approximation to EU laws was held by the Ministry of Justice within the framework of the Dutch-Hungarian MATRA EU Pre-Accession Project. Issues addressed at the conference included the regulation of ownership rights under the Civil Code, banking, securities and consumer protection laws. Company laws will be addressed in April. The Ministry of Justice also provided the opportunity for a limited number of banks to participate in the conference. Presenters at the conference reviewed the relevant EU and Dutch laws and expected trends in the further development of the EU legislation.

7. EBRD consultations

The EBRD requested a post-consultation with the Hungarian Banking Association on the experience of banks concerning the modification of lien laws within the framework of the programme aimed at modernising the relevant legislation. Two independent experts commissioned by the EBRD, Professor Dassesse and Jan Hoogmartens met with representatives of the Association and commercial banks on 26 March. The meeting was attended by Dr. András Nemes, Chief Counsellor of the Ministry of Justice, the officer responsible for Civil Code lien laws at the Civil Laws Codification Department of the Ministry of Justice. Main elements of the lien laws, issues related to the registration of pledges and floating charges and notaries' activities were covered. The two experts were especially interested in the regulations on execution associated with lien and the managing of claims secured by pledge under liquidation proceedings. A presentation was also offered on the latest EU Commission resolution on insolvency laws to be introduced as of 31 May 2002.

8. Bank Security Working Committee

Issues related to the amendment to the Act on the possession of firearms, the armed guarding and physical security of bank buildings and security in cash transport were reviewed by the Bank Security Committee at its meeting held on 10 January 2001. Several banks indicated that if prohibited from possessing firearms, then security guard firms may decide to terminate services. The participants agreed to study the situation further. Due to the different stances taken by the various parliamentary committees, the draft law has not been presented to parliament since.

Upon the proposal of bank security specialists, a Bank Card Fraud Sub-Committee was set up on 24 January. The sub-committee's first meeting was attended by bank specialists and

heads of the relevant police units. The sub-committee's working programme is under development.

9 International events

The Hungarian and Polish Banking Associations were invited for the first time, as observers, to attend the Brussels session of the Social Affairs Committee of the EBF and to participate in the discussion of the committee's working programme.

Nine subjects were reviewed during the meeting. Two major issues were examined in respect of social dialogue in the financial services sector. One was the job-creation effect of IT in the banking sector, which was assessed as overall positive (as an asset also contributing to social dialogue with UNI-Europe, the European trade union of banking employees). It was decided that a special working group will be set up to manage future efforts in this field. Another important issue was the definition of tasks related to establishing local forums of social dialogue in the pre-accession countries.

On behalf of the EBF, Fédéric de Brouwer evaluated the first social round-table conference in east and central European banking, held on 9-10 November in Budapest. He emphasised that through this conference, which he assessed as thorough and realistic, the Hungarian Banking Association, on the employers' side, has set the grounds for developing social dialogue with BBDSzSz (the Hungarian trade union of banking and insurance employees). The conference also revealed that the developing of social partnership will be a major task in the Hungarian banking sector in the long run. In this, the experience of EBF member associations will be indispensable. All those addressing the conference confirmed their commitment to continued co-operation in this field.

The meeting provided a wide review of issues related to social dialogue in the European banking industry.

10. Events organised and sponsored by the Association

A conference on ABS Asset-Backed Securitisation was organised by the Association and FHB Land Credit and Mortgage Bank on 6 June. Presentations were given by prominent financial experts (Elemér Terták, Deputy State Secretary of the Finance Ministry, on the theoretical background and significance of ABS; Júlia Király, Director General of the International Training Center for Bankers, on the role of ABS in international financial intermediation).

In cooperation with the Association, The International Training Centre for Bankers organised a conference on 19 November 2001 on ongoing preparations for the introduction of the Euro. On behalf of the Association Tamás Földi gave a presentation on banks' preparations for the changeover to Euro cash and banknotes.

11. Public Relations and information activities

The Association continued to organise press conferences in 2001. At the two such conferences held in 2001, the Presidium provided information about major issues affecting the banking sector and on the Association's positions on certain timely questions.

Issues reviewed at the June meeting included the following:

- Performance of the banking sector in 2000; prospects for 2001;
- Foreign exchange liberalisation - opinions;
- Preparations and banking tasks related to the introduction of Euro coins and banknotes.

The main issues covered at the second meeting on 26 November included the Association's position on the student loan scheme, preparations for new tasks arising from the new anti-money laundering laws and the possible impact of the recent global economic recession and the Association's views of the prospects.

The Presidium decided to renew the Association's publications, including its Bank Letter, published monthly in Hungarian and quarterly in English. It also decided that a bi-weekly electronic newsletter and a bi-monthly Banking Review will be issued to provide banks with regular, fast and up-to-date information. The first E-Newsletter was issued in October 2001, its editions are now also available on the Association's renewed home page. The first edition of the Banking Review, edited in cooperation with the National Bank of Hungary, was published in February 2002.

Annex

Date of Presidium Meeting	Agenda
15 January, 2001	1. Preliminary report on the financial management of the Hungarian Banking Association in 2000 2. Programme of the Presidium for the 1st Quarter of 2001; preparations for the next Board Meeting and election of Presidium 3. Observer status in the European Committee for Banking Standards 4. Miscellaneous
8 February 2001	1. Report on the 2000 Activities of the Hungarian Banking Association 2. Proposal: 2001 Training and media plans of the Hungarian Banking Association 3. Miscellaneous
12 March 2001	1. Report on the 2000 Activities of the Hungarian Banking Association 2. Main focuses in the programme of the Hungarian Baking Association for 2001 3. Report on the Financial Management of the Hungarian Banking Association in the year 2000 4. Proposal for the 2001 Budget of the Hungarian Banking Association 5. Report on results of the analyses on improving the membership fee system of the Hungarian Banking Association 6. Proposal for amendment to the Rules of the Hungarian Banking Association 7. Proposal for setting up a Nominating Committee 8. Miscellaneous
17 April 2001	1. Proposals for refining monetary regulations 2. Banking opinions on the monetary forecast made by Economic Research Company (Gazdaságkutató Rt.) 3. Managing accumulated financial assets of the Hungarian Banking Association 4. Miscellaneous

Date of Presidium Meeting	Agenda
21 May 2001	1. Transformation of the International Training Center for Bankers, proposed role of the Hungarian Banking Association as an owner 2. Sponsoring the proposed educational television series on banking secrets 3. Request from the Central Clearing House and Depository on joining the Bank Data System 4. Miscellaneous
2 July 2001	1. Report on the status of the proposed asset management contract 2. Report on issues related to the introduction of the Euro 3. Report on the financial management of the Hungarian Banking Association in January-May 2001 4. Report on cooperation with bank representative offices 5. Miscellaneous
3 September 2001	1. Proposal for improving the membership fee system of the Investor-Protection Fund (BEVA) 2. Student loans 3. Proposal for setting up a Money and Capital Market Arbitration Court 4. Miscellaneous
8 October 2001	1. Invitation for bids for managing the financial assets of the Hungarian Banking Association 2. Regular publications of the Hungarian Banking Association 3. Regulations on personnel and material conditions required for performing financial and investment services 4. Miscellaneous
12 November 2001	1. Report on the draft law on anti-terrorism measures, the tightening of anti-money laundering regulations and the introduction of certain restrictions 2. Report on the Finance Minister's letter on student loans 3. Report on communications with the Criminal Directorate of the Tax and Financial Control Administration 4. Miscellaneous

DRAFT RESOLUTION

The Board Meeting discussed and adopted the Report on the 2001 Activities of the Hungarian Banking Association.

Budapest, 20 March 2002

Dr. Rezső Nyers
Secretary General