REPORT

on Activities of the Hungarian Banking Association

2002

CONTENTS

I. ASSOCIATION LIFE, CONFERENCES

Tasks related to promoting bank's preparations for Hungary's accession to the European Union were a priority in the Association's activities in 2002. Conferences addressing the key issues of capital adequacy requirements (Basel II), accounting standards and money and capital market regulation were organised with the participation of international experts, with consultation opportunities for specialists from our member banks. With the Association's help, bank specialists attended the retail banking seminar organised by ATTF Luxembourg, with presentations held by recognised experts of the profession.

Main conferences and seminars organised by the Association:

1. BASEL ACCORD II.

A one-day seminar on Basel Accord II was organised by the Association in February. Presenters at the seminar reviewed the main elements of the Basel proposal (approximation of regulatory capital to economic capital, consistent use of the three pillars, computation of capital requirements for credit risk under the standard and IRB approaches, capital requirements for operational risk, the principle of supervisory reviews, market discipline); typical market actor opinions were outlined and preparations by Hungarian banks were also presented. Presenters included professionals from the National Bank of Hungary, the Hungarian Financial Supervisory Authority, the Hungarian Banking Association, CA IB, CIB Bank, Hungarian Foreign Trade Bank and Raiffeisen Bank. Banks showed keen interest in the seminar; transcripts of the lectures were published in Volume 2 of the Association's Credit Institutions Review (Hitelintézeti Szemle).

2. SEMINAR ON EU FINANCIAL LEGISLATION

A seminar for bankers and legal counsels on EU financial legislation was organised by TAIEX (Technical Assistance Information Exchange Office) and ISDA (International Swaps and Derivatives Association) in cooperation with the Hungarian Banking Association on September 26. The objective of the seminar was to present legislative work and law application in the EU and to review the related preparations and specificities in Hungary.

3. SEMINAR ON MONEY AND CAPITAL MARKET LEGISLATION AND DECISION MAKING SYSTEM IN THE EUROPEAN UNION

A seminar titled "Money and Capital Market Regulation and Decision Making Process in the European Union" was held in December 2002 by the Hungarian Banking Association with the professional support of the Brussels and Budapest offices of the international law office White & Case. The seminar was attended by legal counsels from member banks, colleagues from other areas (compliance,

treasury, risk management), as well as representatives from the Ministry of Finance, the National Bank of Hungary and the Hungarian Financial Supervisory Authority.
At the seminar it was emphasised that with the approach of the country's accession to the European Union, financial legislation in Hungary is facing a special situation: a significant part of the legislation can be considered as harmonised with EU legislation; however, EU legislation is undergoing significant and continuous changes and these changes have to be continuously followed up; through its involvement in the work of the various professional committees of the European Banking Federation, the Hungarian Banking Association is doing its best to acquire first-hand information and follow the relevant EU legislation. Lectures was offered on the EU decision making mechanism, its main bodies, the need to speed up the legislative process, proposed reforms for a single supervision of financial institutions, cross-border financial services and new regulations taking effect in Hungary upon accession.

4. CHANGING ACCOUNTING STANDARDS - IAS 2005

The Hungarian Banking Association, with the professional support of PricewaterhouseCoopers, organised in December an all day professional seminar with the title „Changing Accounting Standards - IAS 2005". The program of this seminar, followed with keen interest, included lectures on the planned harmonisation of Hungarian accounting standards, comparison of various accounting standards, practical experience in the introduction of IAS 39, advantages and problems related to fair value accounting, the connection between IAS and Basel II as well as practical issues related to the application of Hungarian accounting standards. The lectures were held by professionals from the Ministry of Finance, PricewaterhouseCoopers and WestLB. The lectures were published in the first 2003 volume of Credit Institutions Review.

5. VISIT OF MR ERNST WELTEKE, PRESIDENT OF BUNDESBANK

During his visit to Budapest at the invitation of the National Bank of Hungary and the European Studies Institute, Mr Ernst Welteke, President of Bundesbank, paid a visit to the Hungarian Banking Association on June 18, 2002. The President of Bundesbank met members of the Association's Board and representatives of the Association's member banks.

In his lecture Mr Welteke expressed appreciation for Hungary's economic and political achievements whereby this country is now regarded as the best among the pre-accession countries to meet the EU requirements; however, he also pointed out that there was still work to be done in meeting the convergence criteria by increasing the intermediation role of the financial sector and by further strengthening the operation of money and capital markets. The President of Bundesbank also spoke about the possible ways of reconciling budget needs with central bank independence. He also addressed the issue of how the EU integration and accession to the EMU would impact the structure and profitability of the financial sector.

After his lecture Mr Welteke answered questions by the participants.

6. VISITS BY INTERNATIONAL FINANCIAL ORGANISATIONS

An IMF delegation visited the Association at the beginning of March, followed by an FATF delegation in May, to assess activities related to the prevention of money laundering. Visits included on-site discussions with banks, aimed at assessing practical measures implemented in Hungary in the fight against terrorism and money laundering.

Hungary was removed from the list of non-cooperative countries in June 2002. The decision was made by the FATF based on on-site investigations and the new legislation and action plans developed by the authorities. This, at the same time, means that the relevant legislation and the development projects and educational and training programs undertaken will continue to be monitored through on and off-site inspections.

Action plans were developed and implemented by the authorities within the framework of a special inter-ministerial committee. The Hungarian Banking Association undertook in its programme to hold regular consultations, coordinate the developing of best practices and organise regular sessions on the available IT tools for bank managers responsible for the areas concerned.

7. CONFERENCE AIMED AT PRESENTING THE POLISH DEBTORS DATABASE

A one-day conference aimed at presenting the recently set up Polish Debtors' Database was organised by the Association in cooperation with GIRO Ltd. in August. The organisers' objective was to familiarise professionals, involved in the preparation of legal settings for the debtors' positive list database, with a similar system in operation before submission of the draft law to Parliament in the autumn.

Professionals from member banks, the Hungarian Financial Supervisory Authority and the National Bank of Hungary received an overview of the initial experiences, the legal framework and the expected impacts of integration with the EU in this particular area.

8. ACTIVITIES OF THE ANTI-MONEY LAUNDERING AND ANTI-TERRORISM WORKING GROUP

In 2002, the Anti-Money Laundering and Anti-Terrorism Working Committee, a sub-committee of the Association's Bank Security Committee, started developing a best practice model to promote banks' activities in this area. The Association requested professionals from large and foreign-owned banks (OTP, KH, CITIBANK, CIB, Raiffeisen Bank, MKB, BB) to be involved in the practical work, to ensure, drawing on the parent banks' experience, that the relevant standards are in line with international practice and the relevant Hungarian regulations. It was agreed with the competent authorities (the Government Commissioner and the National Police

Headquarters) that the Best Practices to be issued will be reviewed with them and, once finalised, will be deemed by them as governing.

The Committee also considers it its task to ensure a continuous exchange of experience between bank professionals on the issue. Also, the Association was given the chance to submit proposals to the FATF, the FBE and the Hungarian Financial Supervisory for the forty FATF recommendations that constitute the basis for the requirements currently in force. The task of drafting the relevant proposal was given to the new Committee.

9. CONSULTATION ON ISSUES RELATED TO GENERAL PRACTITIONER FINANCING

At the request of member banks, a round-table conference on issues related to general practitioner financing was held by the Association in February. The conference was attended by representatives of the Ministry of Economic Affairs, the Ministry of Healthcare, the Ministry of Finance, the National Health Insurance Fund, the Hungarian Medical Chamber and specialists from member banks. A number of practical issues were answered, and banks were briefed on the main directions of the proposed modifications to the relevant Government Decree. Banks found the conference very useful and asked the Association to continue to organise similar consultations on any practical issues that may arise.

10. AD HOC COMMITTEE ON REPORTING

To keep the reporting requirements of NBH and the Hungarian Financial Supervisory Authority within reasonable limits, a **Reporting Ad Hoc Committee** was set up based on the relevant decision of the Association’s Board. Following the Committee's first meeting in June, the Association initiated a consultation with the National Bank of Hungary on problems related to the use of title codes.

The adjustment of reporting requirements in connection with Hungary's EU accession is a major (although not unexpected) task for banks. The Association attaches great importance to representing banks' interests with special regard to the continuously changing EU requirements, in order to ensure that the changes required are implemented as smoothly as possible.

11. MONEY AND CAPITAL MARKET ARBITRATION COURT

The new capital market law in force from 2002 has extended the scope of competence of the Arbitration Court of the Budapest Stock Exchange and the Budapest Commodity Exchange and allowed for the setting up of a Money and Capital Market Arbitration Court from July 1, 2002. Based on the decision of the Association's General Meeting of April 3, 2002, the Association took part in setting up the Court. The Association also decided to provide financial contribution to the operation of the Arbitration Court for a period of 3 years. In addition to the existing stock and commodity exchange chambers, a new Credit Institutions Chamber will be set up within the Court. Members of the new chamber, the new arbitrators, were appointed

by the Association's General Meeting. The Arbitration Court's Statutes were signed by three founders; thus, the Court can be considered formed. At its June meeting, the Association's Board elected Dr Imre Vörös and Dr János Bánáti to members of the Presidium of the Court and dr Adrienne Kraudi to President of the Court.

12. PRESS MEETING

The Association's Board gave a brief summary of the Association's assessment of economic and financial processes in the first half of 2002. The Secretary General pointed out that economic growth in the first half of the year could not be considered low in the face of a weak international economy; however, the economy failed to return to an investment and export-driven path and growth mainly resulted from an expansion of consumption. The deficit of general government was the highest in 10 years. Macro-economic tensions were further aggravated by monetary policy not only not signalling the need for a tightened fiscal policy (which has been of an expansive character for nearly three years) but rather supporting – up until May – a demand-stimulating economic policy which manifested in a deterioration of competitiveness. The central bank attempted to rein in inflation by a significant real appreciation of the Hungarian currency, which can be maintained in the short-term but may have adverse consequences in the long-term. The Secretary General expressed hope that fiscal and monetary policy-makers will soon find a common way to set the economy on an investment and export-driven path again.

An important element in the Association's comments on the proposed comprehensive amendment to financial laws was the proposal for setting up a Private Debtors Positive List Database. Given that this proposal raised a number of data protection issues, a consultation was initiated with the Data Protection Ombudsman. The Ombudsman presented a negative opinion in writing.

Journalists asked several questions about the proposed Private Debtors Positive List Database and inquired on the expected position of banks on the issue. Questions were answered by Mr.Tamás Erdei, President of the Hungarian Banking Association.

13. HOME PAGE

The Association is continuously publishing new information on its home page, renewed in 2002. From this web side, banks, inter alia, can obtain information on conferences and training opportunities abroad. Publications, quarterly and annual reports and opinions of the Association on specific issues are also made public on the home page.

The Association's home page is regarded by banks as a useful source providing up-to-date information on important conferences, workshops and training courses.

II. PROFESSIONAL ACTIVITIES

1. ACT LXIV OF 2002 ON AMENDMENTS TO CERTAIN FINANCIAL ACTS

The draft of a comprehensive amendment to the Credit Institutions Act and the Securities Act was passed by Parliament on December 23, 2002. The amendment was aimed at abolishing formerly necessary but now superfluous legal restrictions, law harmonisation with the EU and, in respect of the Credit Institutions Act, meeting a regulatory obligation resulting from a ruling by the Constitutional Court.

Part of the amendments entered into force as of January 1, 2003, some rules will become effective on Hungary's accession to the European Union.

1.1 Amendment to the Act on Credit Institutions and Financial Enterprises (Act CXII of 1996)

The amended Act contains significant changes in respect of a number of issues. The following are the most important changes:

The regulation on consolidated supervision has changed significantly. The amendment to the regulation on the consolidated supervision of businesses in ownership relationship or other controlling relationship is aimed at ensuring a transparent and controllable risk management between associate enterprises.

Restrictions on the acquisition of ownership in credit institutions have been abolished. Currently, the ownership share of a single owner in a credit institution's subscribed capital – with the exception of acquisition of ownership by other credit institutions, financial enterprises or investment companies – may not exceed 15%. With the implementation of a group level supervision, this restriction will become irrelevant. With reference to international regulations and practice, the higher education requirement for senior bank officers has been abolished; the new requirement is ten years experience at a similar institution.

The requirements for the foundation of co-operative credit institutions have been tightened, existing credit institutions have been given an interim deadline to comply with the new requirements.

The provision on mandatory bi-annual on-site inspections has been replaced by mandatory bi-annual comprehensive supervisory inspections. The provisions on consumer protection have been expanded, the scope of competence of reconciliatory bodies of the Consumer Protection Supervisory Authority has been extended to financial services, as well.

The Association entered the drafting process in June, when the Ministry of Finance asked professional interest representation organisations to provide their proposals for amendments to the Act.

Based on banks' proposals, a detailed concept document, including specific wording proposals was compiled and submitted to the Ministry. Proposals were submitted concerning the scope of activities of credit institutions to include electronic signature services. We recommended that provisions on outsourcing be annulled, given that the Ministry has failed to issue the relevant implementation decree, and therefore, there was a general legal uncertainty over the types of activities that can be outsourced. We submitted a proposal for making the regulations on banking secrecy more specific in order to simplify the execution procedure of shared accounts and to allow the developing of positive list credit reference services. We also proposed for debtors' (or their owners') shares listed on the stock exchange to be allowed to be accepted as collateral. Further, we proposed that short-term interbank deposits should not considered as a risk exposure.

Regarding the imposition of supervisory fines we proposed setting a 100-day maximum limit on default. Also, we submitted proposals in relations to advertisements, electronic contracts, the publication of business rules and certain definitions of the Act.

1.2 Amendment to the Capital Market Act

In addition to amendments to the Credit Institutions Act, Act LXIV of 2002 also includes amendments to the Capital Market Act (Act XX of 2001), the Act on Building Societies (Act CXIII of 2001), the Act on Insurance Institutions and Insurance Activities (Act CXVI of 1995) and the Act on Consumer Protection (Act CLV of 1997).

At the request of the Ministry of Finance, in July 2002 the Association compiled a summary of banks' proposals for amendments to the Capital Market Act. As a general note we pointed out the fact that transactions performed between investment service providers were not regulated separately; also, we emphasised that in our opinion, it is the client who should be protected from potential risks, given that the investment service providers have their own risk management procedures.

Accordingly, we proposed that transactions performed by using investment instruments between two credit institutions or between a credit institution and a financial enterprise or between a credit institution and the National Bank of Hungary as well as sale and purchase and swap transactions performed by credit institutions by using their own issued bonds be excluded from the definition of services.

Comments were also submitted in relation to the conversion of print securities into dematerialised securities, the offering of collective investment securities through continuous issue, rules on company signature, client risk rating, mandatory information, keeping the share book, securities lending, portfolio transfer, conflict of interest on the stock exchange, payment of supervisory authority fees and reporting requirements.

The first version of the draft amendment was received from the Ministry of Finance for review in September. In the summary compiled based on our member banks' comments we submitted proposals in relation to the rules for converting print securities into dematerialised securities, the definition of continuous issue, narrowing the scope of extraordinary information and retaining existing professional qualification requirements. We also proposed having a more flexible regulation on outsourcing.

We submitted proposals for complementing the provisions on the Money and Capital Market Arbitration Court. We also proposed setting a maximum limit on turnover-related supervisory fees. Our summarised proposal was copied to member banks.

Upon the Association's proposal, amendments were incorporated to Section 337 on the scope of activities of organisations performing clearing house services and Section 202 on insider trading

The Act has complemented the provisions taking effect on Hungary's accession to the EU and has made them more specific.

1.3 Amendment to the Act on Building Societies

Pursuant to the amendment to the Act on Building Societies, state support provided for preliminary home savings contracts has been doubled, to HUF 72,000. The amendment, however, does not affect existing contracts. The extent of state support for housing co-operatives and condominiums will increase in a differentiated way, depending on the size of the building.

In the amendment to the Act on Consumer Protection, the authorisation of the Supervisory Authority to file a suit in public interest appears as a new instrument to enforce investor claims, when the illegal activity of the service provider affects a wide range of consumers or causes a significant disadvantage.

1.4 Private Debtors' Positive List Database

At the request of the National Bank of Hungary and member banks, the Association has assumed the task of drafting the provisions for a Private Debtors Positive List Database for the proposed amendment to the Credit Institutions Act to be enacted in the autumn.

While clients in default are recorded in the current negative list database, the proposed positive list would contain all loan debts of a client. The new database would enable potential creditors to check on clients' creditworthiness more thoroughly. With rapidly increasing household borrowings, it is in the best interest of the central bank as well as of commercial banks to set up the proposed database as soon as possible. The new database would provide more accurate information on the borrowing potential of households.

Two working groups were set up to manage the drafting work: a the technical working group, to define the scope of information to be managed in the database and a legal working group, to draft the legislation and develop the data protection aspects. After two months of intensive work, the draft law was completed at the beginning of September, with the following main points:

- All financial institutions engaged in lending should join the system on a mandatory basis. The client's agreement will not be required for sending its data into the database.
- The proposal envisaged the database to be operational from 2004 (this would not be specified as a requirement in the Act, but the system owner would like to ensure that the technical documentation required for implementation is made available to banks as soon as possible).
- Rather than setting up a new system, the database would be implemented within the framework of the current corporate register by adding a positive list component to the existing private debtors negative list database.
- Client identification and registration would be easier if the use of "personal numbers" was allowed, to replace the current name and address data.
- Although most of those involved in the drafting process agreed that existing loans should also be included in the database, some serious legal concerns were raised in relation to the retrospective effect of the regulation; accordingly, an alternative proposal for entry into force was included in the draft.
- A separate section was included to address client data protection issues.

Following a detailed discussion with member banks and review by the Association's Board, the draft law was submitted to the Ministry of Finance. Given that the regulation will affect the wider public, the Association also solicited the opinion of the Data Protection Ombudsman.

The conclusion of the consultation with the Data Protection Ombudsman was that the draft law should be revised due to constitutional queries; given the short time, this could be done within the framework of another planned amendment to the Credit Institutions Act in 2003.

2. COMMON PROJECT FOR DEVELOPING ELECTRONIC SIGNATURE CERTIFICATES FOR TELEBANKING

The Association's working committee responsible for developing a program to promote telebanking with the use of electronic signatures closed the first, information technology, phase of its work at the beginning of 2002. Banks involved in the working committee decided to ask for the opinion of the Association's Board on the next phases in the process (selecting the contractor to implement the project, the role GIRO would play in the next phases and certain legal issues to be clarified).

The Board decided that in addition to GIRO, other potential service providers should also be contacted and asked about their scope and terms and conditions of services.

Based on this decision, Banks on the committee decided to set up a new working

group to draft an invitation for bids, including all the relevant IT, business and legal requirements.

2.1 Activities of the Working Group on Electronic Signatures

After identifying the IT requirements, the working group started working on the related business and legal issues. From business points of view the group focused on identifying client authorisations to be associated with the common certificate. On the legal side, the group looked at the practicability of certification within the prevailing legal framework; since legal experts involved in the working group raised some serious queries concerning this issue, the Association assigned a law office specialising in IT laws to clarify the questions raised.

The summary report was reviewed at a special meeting of the working group. The followings were concluded:

- Pursuant to the Act on Electronic Signatures, certification services may be provided by separate organisations. In other words, credit institutions may provide partial services on behalf of the licensed service provider.
- Experts were divided with regard to the law office's opinion that the exchange of client data between banks based on proper authorisations should not be a problem. (Some banks challenged this statement based on the opinion of the Data Protection Ombudsman),
- The working group was of the opinion that the implementation of the project would require amendments to the Credit Institutions Act and the Money Laundering Act. The group requested the Association's assistance in this respect.
- No final position was reached on the question whether the fact that all banks would assign the same certification service provider to issue the required certificates would violate the competition law.

2.2 Status of the common electronic signature certificate

By elaborating the standard containing the requirements of banks, the working group has completed its work. The result of this work, however, has not been made public for the banks, as an essential element – the inter-bank acceptability of the common certificate – could not be settled from the legal side in a reassuring manner.

An important element of making the standard functioning is that, clients with a common bank certificate could establish from their computers a business relationship with any domestic bank by using their electronic signature. However, the Act on the Prevention and Impeding of Money Laundering stipulates a client-identification procedure according to which the client must appear in person and present his/her ID documents at the bank.

Drafting of the proposed law amendment was assisted a law office specialising in IT-technology issues. After a review by bank experts, the proposal was submitted to the Ministry of Finance and the Government Commissioner on Money Laundering. Pursuant to the proposal, the financial institution would not be obliged to apply the

strict provisions of the Money Laundering Act when checking on a new client identifying himself electronically by using the common bank certificate, but could rely on the identification of the financial institution that has issued the certificate. For this purpose, the proposal suggests introducing the notion of "primary identification". This would of course require the client's consent and the credit institution to obtain client's data and ID documents from the bank performing the primary identification.

In addition to our wording proposal, we have attached a substantial justification section in which international practice was also outlined in detail. According to this, the initiative of the Banking Association does not contradict the relevant EU directive and gives due consideration to the Guide issued by the Basel Committee for Banking Supervision as well as the relevant Recommendation of the Financial Action Task Force (FATF) of the OECD.

According to preliminary information obtained from the Ministry of Finance and the Hungarian Financial Supervisory Authority, these two authorities in principle agree with the Association's proposal. However, in view of the fact that Hungary was just recently deleted from the black list of the FATF, for the time being, any proposal resulting in loosening the rules would be received with reservations.

3. MEASURES FOR THE PREVENTION AND IMPEDING OF MONEY LAUNDERING

According to some opinions, current regulations on money laundering contain a number of elements that cannot be to implement in practice. The competent regulatory and supervisory authorities have realised the reality of the issues we have raised and the Ministry of Finance has expressed its willingness to address the issues in question, pointing out, however, that given that the draft law has already been presented to Parliament, any modification to it could only be effected through a motion by a Member of Parliament.

With the cooperation of members of the committee and with the support of the Ministry of Finance, our most important proposals were presented to Parliament in the form of MP motions. The following proposals were submitted:

- The scope of persons subject to identification should be narrowed. Contracts between organisations licensed and thus, adequately controlled, by the Hungarian Financial Supervisory Authority are exempt from the obligation of identification. Data of such organisations are available for the investigation authority in databases kept by authorities pursuant to other laws and regulations.

- Service providers suspending transactions for reasons specified in the Act should not be held accountable for such action. However, the exclusion of liability would only apply if the service provider has followed the procedure specified by the Act. Thus, service providers could be relieved from serious liability and financial consequences of suspending transactions.

- A proposal was drafted to specify those instances where it would be the service provider's responsibility to perform identification and those where it would be the client's to provide the data required.

- A proposal was submitted for a deadline in respect of transactions requiring identification. Accordingly, service providers would be allowed, until the end of December 2003, to perform transaction orders from clients with whom the service provider has had business relations prior to the enactment of the Act and the client's identification data are not fully available and the client has not appeared for the purpose of identification despite a respective written notice by the service provider. Effective from January 1, 2004, any order from a client whose identification data were not obtainable during this interim period should be rejected.

4. BANK SECURITY

The **Mór bank robbery**, which claimed 8 fatalities, put bank security in the forefront of public opinion and focused attention on bank security issues, including regulations, infrastructure, responsibility, etc.

To ensure common action by the profession, the Bank Security Committee held a special meeting to determine the measures required. A meeting was also invited by the Ministry of Finance and the Hungarian Financial Supervisory Authority to provide a quick regulatory response.

From early summer to the end of September 2002 the Association explained the banking sector's position at all review forums of the Ministry of Finance. An important achievement was that the regulation would not entail any substantial extra costs for banks. As a result of the reviews, a manageable bank security regulation draft was complied.

However, certain concessions made due to the limited cost-bearing capacity of savings co-operatives and the Hungarian Post Office were so strongly opposed by representatives of the Interior Ministry attending the review that finally, in the absence of agreement and despite the September deadline, the last version of the draft decree was not submitted to the Government.

The **Bank Security Committee** discussed the following issues:

- Concept for cooperation in receiving and processing signals coming from security installations of bank branches and related actions by the police. Under the concept, the National Police Headquarters (ORFK) and organisations of the Defence Ministry, operating on a contracting basis, presented the Association a proposal for a faster and more efficient alarm system. The Committee requested the National Police Headquarters to have further consultations on the details of cooperation and the costs involved.

- Presentation by Kereskedelmi és Hitelbank Rt on the detecting bank frauds by electronic means. The method presented is suitable for preventing frauds and other account or payment-related internal crimes committed by bank employees. According to K&H Bank's Compliance Officer, practical experience shows that the method is also suitable for detecting suspicious money movements that may be related to money laundering.

5. REPORTING REQUIREMENTS

Banks' activities in 2002 were significantly affected by the modified **reporting requirements** of the Hungarian Financial Supervisory Authority and the National Bank of Hungary and by the process of coordination of banks' opinions regarding the new requirements. The Supervisory Authority made preparations for the implementation of a consolidated reporting system and introduced certain changes to the reporting requirements for banks providing investment services.

The Association's Board decided to set up a **technical committee on reporting** to assist banks in preparing themselves for the new reporting requirements and in representing banks' opinion on the proposed changes.

The Association held a meeting to resolve issues related to **reporting new bank account numbers** introduced for banking technology reasons **to the Tax and Financial Control Administration (APEH)**. The banks' problem was that while previously all bank account numbers had to be reported to one authority (the Registration Court), based on a law amendment enacted in 2001 the Tax Office also indicated its requirement to have information on the new bank account numbers (special numbers introduced by the banks within their own scope of competence).

The meeting was attended by representatives from the Tax and Financial Control Administration, banks, the Ministry of Finance, the Justice Ministry, the National Bank of Hungary and the IT company managing Registration Court reporting. The IT company proposed that the data requested by APEH be sent together with the Registration Court reports, in the same format, and the IT company will then select the required information and send it to the Tax Office.

The president of the Tax and Financial Control Administration requested in a letter the Association's assistance to resolve **problems encountered in the use of tax identification numbers when extending credit**, namely: several banks rejected loan applications in cases where the client's birth date and the date of birth retrieved from the tax identification number differed. In particular, the tax authority objected to the practice that such tax identification numbers, after having been confirmed by an official certificate issued by the tax authority specifically for this purpose were still not accepted by some credit institutions.

The Association informed member banks on the letter of the tax authority and requested their opinion. The issue was analysed with experts of the affected banks. During this analysis it became clear that incorrect tax identifiers may be generated by fault of the clients as well as by that of APEH (e.g. wrong data entry), but this number has been probably in use for years for various other official proceedings, so for tax returns as well. A correction of erroneous tax identifiers would not be practicable, as this would lead to the need to revise all affairs handled based on these numbers. Ultimately bank experts considered it acceptable to recognise tax identifiers that in legal terms are „faulty" but are confirmed by an APEH certificate.

The National Bank of Hungary held a consultation for banks on the **modification of interest statistics reporting requirements** in 2002. At the discussion, the issue of the applicability of the Indicator of Total Charges on Credit (THM) to certain banking

products was raised again. Citing international examples, the NBH did not agree with the view that the reporting requirement was unwarranted. However, some banks disagreed with this. As no solution was reached at the meeting, the Association suggested having a second consultation, in a more limited circle.

The second consultation brought tangible results:

- It was agreed that the Indicator of Total Charges on Credit will not be applied to overdraft facilities or credit cards functioning as overdraft,
- For corporate loans, the Indicator will be only apply to SME loans not related to the borrower's business (in NBH's interpretation: loans basically taken for private purposes).
- For mortgage loans, the NBH will consider the Association's proposal for banks to develop an economically correct and easily verifiable estimating method instead of providing a mandatory computation method which would be hard to implement,
- it was agreed that a separate consultation will be held on two reporting philosophy questions, namely: how international reporting requirements can be incorporated in the central bank reporting requirements and what indicators the authorities may require from reporting organisations.

The NBH reporting requirements for 2002 were duly modified in accordance with the above agreements.

6. MOTION TO THE CONSTITUTIONAL COURT ON ACT CXVI ON THE NATIONAL LAND FUND AND ACT CXVII AMENDING ACT LV OF 1994 ON ARABLE LAND

A report prepared based on consultations with member banks involved in agricultural lending was presented to the Association's Board on the expected adverse impacts of the above laws. Constitutional queries raised during these consultations were also confirmed by legal counsels from member banks.

Based on a resolution adopted on January 23, 2002, the Board requested prominent legal experts in constitutional and agricultural laws to investigate the constitutional queries raised and to draft a relevant motion to the Constitutional Court. After review by the Association's Board, the motion was submitted to the Constitutional Court. The motion asked for abolishing certain provisions of the Act on the National Land Fund and Act CXVII of 2001 amending the Act on Arable Land; further, it requested the Court to annul Government Decree No. 16/2002 (II 18) on detailed rules for excising pre-emption and pre-emptive leasing rights related to arable land, the provision of Government Decree No. 17/2002./II.8./ on detailed rules for the registration and management of assets of the National Land Fund and Government Resolution No. 1010/2002./II.1./ on the Principles of Land Property Policy.

The provisions requested to be annulled violate several provisions of the Constitution, make agricultural lending difficult and risky and reduce the value of arable land as collateral. Based on these latter arguments, agricultural interest representation

organisations and the Association filed independent motions with the Constitutional Court.

7. OTHER PROFESSIONAL ISSUES

In addition to the above activities, the Association coordinated reviews of the new **Insolvency Act** and the **concept of the new Civil Code,** this latter intended to create the legal conditions for a market economy with social elements. The concept is based on the principles of private property, private autonomy, the liberty of contract and the freedom of enterprise. The new Civil Code will be extended in scope and will contain regulations on family rights and general regulations on employment contracts and the use of intellectual property. The concept is primarily aimed at creating the legal framework and conditions for pecuniary transactions between equal parties.

In their comments, banks basically agreed with the concept and their observations were mostly focused on banking laws not addressed in depth in the concept, including banking relations, securities laws and securities relations.

Banks questioned the idea of providing employment contract regulations under the Civil Code. Further, they proposed that regulations on co-operatives be added to the Code, especially if business organisations were to be covered by the law. Most comments were related to contract law, proposals were submitted in relation to collateral obligations guaranteeing the contract, the repayment of financial debts, certain types of contract and the termination of contracts. The Association also addressed the proposed Ministry of Finance Decree to regulate administrative activities eligible for outsourcing; key issues raised in this area included the definition of outsourcing, as the basic category of the regulation; issues related to the protection of banking secrecy, outsourcing of activities to entities outside Hungary, allowing an interim period, etc.

The Association reviewed issues related to the **out of court sale of pledges,** as a new regulatory tool in hypothecary law. In respect of claims secured by lien, credit institutions now fall under the same regulations as those applied to secured lenders. In addition, auctioneers, insolvency practitioners and independent bailiffs may also be commissioned to sell pledges. Banks submitted several comments on the draft, mainly aimed at balancing the advantageous position of the mortgagor and allowing the mortgagee to initiate sanctions in the event of default by the mortgagor.

Following a review with the involvement of the Hungarian Banking Association, the Chamber of Hungarian Notaries, the Chamber of Bailiffs, the Hungarian Association of Insolvency Practitioners and the competent Ministries, the Ministry of Justice revised the draft; a number of our comments were accepted.

The Association of Hungarian Insurance Companies and the Hungarian Banking Association wish to conclude an agreement for managing insurance policies serving as collateral for home loans by using uniform printed forms. The elaboration of details of a cooperation to provide more efficient services to common clients of banks and insurance companies have commenced. Preparations have been sped up due to the need to acquire the consent of the Competition Authority.

III. LOAN SCHEMES

1. AGRICULTURAL EVOLUTION LOANS

The evolution loan scheme was introduced for businesses in the agricultural sector by a Government Decree in the fall of 1999. Under this scheme, private entrepreneurs and companies in the agricultural sector were invited to submit applications to the Ministry of Agriculture for the government to assume part of their long-term loan instalments as a government support. In their applications the applicants had to undertake commitments for technology development, restructuring and improved management.

The agricultural evolution loan scheme commenced in 2002 and will be concluded in 2003. 2,800 applications were accepted. Applicants' self-assessment reports were evaluated based on their commitments for 2001. The deadline for the submission of self-assessment reports was May 31. Banks had to complete the evaluations and send their opinions to the Ministry by June 30, 2002.

As of the end of September, two thirds of the reports were reviewed by the technical appraisal committee at the Ministry of Agriculture. Only a small percentage of the reports was rejected.

The review of self-assessment reports was due to be completed by the end of October. Accordingly, it is expected that loan instalments to a value of approx. HUF 13 billion, due in 2002, will be settled through the utilisation of government support.

2. SETTLEMENT OF SHORT-TERM AGRICULTURAL LOAN DEBTS

2. 1. Legal framework

On passing the Act on the Closing Account for the year 2001 the Hungarian Parliament approved a state support of HUF 60 billion for agricultural entrepreneurs to help them repay their short-term loans. Out of the HUF 60 billion allocation, HUF 45 billion was allocated for the general settlement of short-term agricultural loan debts and HUF 15 billion for agricultural businesses for mitigating damages caused by drought and the Danube flooding. The relevant implementation decree was approved by the Government on October 17 and then modified on November 16.

To promote implementation, the Ministry of Agriculture issued a Guide for practical purposes.

2. 2. Preparations by banks

In accordance with the resolution of the Board, the Association set up a working group with the involvement of all interested banks, to discuss the tasks and actions

required. About 200 questions, comments and proposals were submitted by the banks in relation to the draft decree.

The government decree and its amendment failed to clarify numerous, from the aspect of implementation, important, practical questions. Therefore, a Guide was issued by the Ministry of Agriculture. Banks made several proposals in relation to the guide. These were primarily aimed at clarifying the tasks for banks and the relationship between the client and the banks during debt settlement.

2. 3. Implementation

The first phase of implementation ended on November 29. By that date agricultural entrepreneurs (applicants) had to announce their request for state subsidy to the County Offices of the Ministry of Agriculture. For this, the applicant had to obtain data from the banks with whom he had short-term loans with interest subsidy standing on May 31 2000/2001/2002 or term deposits fixed for more than one month, or debt securities on his securities account or bank deposits and securities deposited in connection with interest-subsidised loans.

Pursuant to the government decree, the applicant had to simultaneously conclude an agreement with the bank(s) about how and for the repayment of which loans he would use the state subsidy. The amendment of the government decree provides for the following order of priority:

- loans with government guarantee with a maturity under one year,
- other loans with government guarantee with a maturity under one year,
- loans with government guarantee with a maturity over one year,
- other loans with a maturity over one year.

The repayment subsidy could exclusively be used for interest-subsidised loans funded from the budget chapter of the Ministry of Agriculture. In case of loans with several banks, the repayment was to be split between banks proportionally.

Based on the agreement with the tax authority, the client could open a technical account at his bank (at one bank only, even where several credit institutions involved) and ask for the support to be disbursed to this account.

Due to the inexactness of the relevant government decrees and with most clients being unprepared, combined with a very short deadline, bank clerks had a very difficult task to resolve. Therefore, the Association emphasised that banks would provide data at the client's request from their records, but composing the application was the task and responsibility of the applicant.

The second phase of implementation ended on December 31. Applications received until November 29 by County Offices of the Ministry of Agriculture were summarised by the Ministry. Based on this and pursuant to its authorisation under the relevant government decree, the Ministry on December 3 published the adjustment rates by which the amount of subsidy applied for had to be reduced to 87.5%.

Accordingly, the applicants finalised the amount of state subsidy requested and submitted their applications to the tax authority between December 6 and 13. The tax authority disbursed the state subsidy without any check up to the bank account specified by the applicant.

Applicants then could dispose of the loan instalments in accordance with the relevant agreements. To ensure smooth implementation, we requested to provide in the Guide that state subsidy disbursements should be transferred to the client's account still in 2002 and the applicant should dispose, until December 22, of the state subsidy to be transferred to the banks as loan repayment.

2. 4. Results of the scheme

Combined with integrators, nearly 50 thousand applications for support to a total value of HUF 68.5 billion were submitted to the tax authority. (According to the Ministry of Agriculture, integrated applicants represent another 50 thousand participants). The amount disbursed was HUF 59.9 billion, 87.5 % of the total amount applied for.

Despite the extremely short timeframe, the scheme was successfully accomplished without any major disturbances. This was largely contributed to by the continued active and client-centred attitude of the banks.

3. INTERVENTION PURCHASES OF WHEAT AND CORN

The Ministry of Agriculture announced intervention purchases, initially for wheat and subsequently, for corn. The produce had to be stored in a public warehouse. The Ministry requested banks to extend loans to entrepreneurs against warehouse receipt as collateral.

The Ministry of Agriculture signed an agreement with the banks interested, containing the loan conditions and guarantees for repayment of the loan. The Association coordinated the banks' views and proposals with the Ministry. 13 banks announced their interest and signed the agreement.

4. STUDENT LOANS

An informal consultation on the transformation of the student loan scheme was held by the Ministry of Finance with the involvement of banks on July 18, 2002. At the consultation, the Ministry announced its intention to allow other banks to be involved in the disbursement of the loan scheme, in addition to Postbank; in addition, the Ministry was studying the option of fundamentally revising the student loan scheme by placing it on a commercial basis; the Ministry was also investigating the possibility of replacing the current liabilities-side government guarantees by asset-side guarantees, to allow banks to participate in the lending scheme with their own resources.

Since no written proposal had been presented, banks present at the consultation did not take position on the issue; nevertheless, they expressed their interest in the scheme. Following the meeting, a brief description of the concept was compiled by the Ministry. The document was forwarded to the banks interested.

The concept outlined the future transformation of the student loan scheme (not affecting the 2002/2003 school-year). According to the concept, while the loan conditions would remain unchanged, banks would provide student loans from their own resources and the related government guarantee would be 100% attached to the loan. Upon redemption of the government guarantee, the debt would be collectible under the rules applied to the collection of tax liabilities. The maximum interest on the loan would be pegged to a reference yield on government securities. Instalments would be determined based on the debtor's previous year's income, certified by the Tax Office. The Student Loan Centre would operate with a small staff under the supervision of the Ministry of Finance as an organisation performing administrative functions.

Banks emphasised their intention to be involved in student loan account management as soon as possible. In relation to the transformation of the loan scheme, banks pointed out that involvement in the scheme would require adequate preparations and IT system modifications. They expressed their opinion that the type of surety associated with the loans was problematic: an absolute guarantee would make the facility more manageable. Banks' comments were forwarded to the Ministry.

Government decided that the conditions should be ensured for student loans to be disbursable at any commercial bank in Hungary. The decision is contained in Government Resolution No. 1169/2002/X.10./Korm. on additional tasks related to improving the conditions for developing competitive skills. Pursuant to the Resolution, conditions for the implementation of the Resolution were due to be developed by December 1, 2001.

5. ABOLITION OF THE LIQUIDATION LOAN FACILITY

The liquidation loan facility created in 1994 was abolished by Government Decree 310/2002 (XII. 28.). The essence of loan facility was that an interest subsidy could be applied for loans granted for purchasing assets of companies under liquidation. The Association was involved in developing this facility as, with the help of interest subsidies, clients became more creditworthy and businesses under liquidation gained access to additional resources, so there was a hope for stranded bank receivables to be – at least partially – recovered. The system was advantageous for the national economy as well as helped reinstall productive assets of businesses under liquidation and promoted new small and medium-sized enterprises.

During its 9 years of existence the loan facility was utilised by more than 1000 enterprises, the amount of interest subsidies disbursed was HUF 3.4 billion and banks made available liquidation loans to a value of HUF 20 billion. Almost all credit institutions engaged in the SME sector joined the liquidation loan scheme.

According to the review analysing the facility, the loan scheme affected all sectors of the economy and helped increase employment nationwide. Although the system was aimed at purchasing assets, the most successful transactions were those linked to supporting the purchase of plants under liquidation but still in operation (thus helping their prospective operation).

The Banking Association not only participated in shaping and further developing the facility but also took an active part in the work of the Inter-Ministerial Committee preparing the decision. During this activity – working closely with the banks - it put forward its arguments on numerous disputed issues, aiming at promoting the interests of banks and their clients.

The abolition of the facility was due to the fact that with the diminishing number of liquidations the number of cases brought to the Committee decreased as well, and the Ministry of Finance, the authority responsible for the issue, for plausible economic reasons decided not to allocate more funds for this purpose in the budget for the year 2003.

IV. INTERNATIONAL COOPERATION

1. EUROPEAN BANKING FEDERATION

As in previous years, the Associations representatives attended meetings of the committees and working groups of the European Banking Federation. This report gives an account of the most important issues addressed. Other specific issues are detailed in our quarterly reports.

1.1 Banking Supervision Committee

Capital Accord Basel II

In 2002 the FBE continued to give special attention to the new Basel Capital Accord. While steps in the process of developing the new accord were slightly behind schedule, the contents of the proposed accord improved on a number of issues. Here are the most important developments:

Joined by the Canadian and Japanese and U.S. Banking Associations, the FBE wrote a letter to the Secretary General of the Basel Committee in which they drew attention to the fact that the Basel proposal for applying the IRB approach for retail exposures was inconsistent with banks' risk management practices and requested that the proposal be modified.

Results of the Quantitative Impact Study QIS 2.5 were disclosed in July. Due to the relatively narrow circle of banks involved in the survey, the results cannot be considered as representative.

During its meeting of July 10, 2002, the Basel Committee reached agreement on a number of important issues related to the new Basel Capital Accord. The agreement

brought a breakthrough in the treatment of SME's, a key political issue in the EU. Agreement was also reached on a more favourable treatment of certain retail exposures (such as credit cards). The gap between capital requirements under the foundation and advanced IRB approaches was narrowed. The IRB capital requirement for credit risk and operational risk together may not fall below 90% of the capital requirement under the current Accord in the first year following implementation and 80% in the second year. To reduce procyclicality, banks adopting an IRB approach will be required to perform a meaningfully conservative credit risk stress test under Pillar Two to ensure that they hold sufficient buffer capital.

The FBE maintains its reservations concerning the treatment of the SME sector; maturities, specialised lending, the third retail risk curve, the measurement of operational risk, the introduction of floor capital and the mandatory application of stress tests.

The working paper titled „Revised Sound Practices for the Management and Supervision of Operational Risk" was published for discussion in June too. The FBE welcomed the modifications, with special regard to the adoption of the proposals it had made; however, it maintained its disagreement to the treatment of this portfolio element in the way proposed by the Committee.

The Third Quantitative Impact Survey (QIS 3) commenced in October. The required data had been collected by December 20, 2002. Results of this survey may have a significant impact on the contents and calibration of the third Consultative Package (CP3).

The FBE sent the Basel Committee its comments on the QIS3Technical Guidance . In these comments the FBE

- supported the convergence of supervisory practices, the objective of ensuring the transparency of practices referred to national discretion and the removal of national discretions over time;
- emphasised that banks should have an incentive to move towards the most risk-sensitive approaches, and thus, strengthen their risk management capabilities.
- proposed consultation on the requirements of the supervisory review process under Pillar 2 prior to publication of CP3 in May 2003.

The Basel Committee gives special attention to Pillar 3 (Market Discipline) to ensure that investors can obtain sufficient information that will help them understand a bank's risk profile, without imposing unnecessary disclosure requirements on the banks.

Representatives of the FBE met in November with the working group of the Basel Committee responsible for developing the disclosure requirements (Transparency Working Group). At the meeting it was agreed that Pillar 3 should be consistent with the updated IAS standards. (Unfortunately the relevant new standards will only be completed by the end of 2003 and so they do not provide real support for developing Pillar 3). Following the meeting the TWG sent the FBE the new working paper on Pillar 3 enabling it to review it before finalisation of CP3. During the revision of Pillar 3 – in the course of which the TWG worked closely with the standard-setters -

modifications to Pillar 1 as well as a part of the comments made by the banking sector were taken into account.

According to current plans the timetable for introducing the new capital accord is as follows: The 3rd Consultative Package will be published in May 2003 to be reviewed by the industry by end July. The final new Basel Capital Accord will be published in October 2003. The proposal will be adopted by the European Commission as a new capital adequacy directive in March 2004, to be then be approved by the European Parliament in September 2005. This will be followed by adoption by member states. From January 2006, the new capital requirements may be applied simultaneously with the 1988 capital accord until December 31, 2006, which is the final date for the introduction of the new capital requirements.

The Third Capital Adequacy Directive (CAD3)

From the end of 2002, special attention has been given to the introduction of the new Basel Capital Accord in the EU. The European Commission published its working paper on the new EU capital adequacy framework in November. This working paper, not the full directive yet, and has two parts: the first part containing the fundamental principles and rules formulated in the various sections of the directive and the second part (an appendix), providing the detailed rules for application.

The FBE has set up a working group to develop a common position on the proposed directive. The working group held two meetings in 2002. The task of the group is to identify the points where CAD3 differs from Basel II and to indicate those areas where the two regulations should differ. Based on the findings of the working group, the FBE will develop a common position on CAD3. Representatives of the FBE attended the meeting held within the framework of structured dialogue[1] between the European Commission and representatives of the industry.

Financial stability, supervision, and regulation

The Economic and Financial Committee of the European Union (EFC) prepared a report on issues related to financial regulation, supervision and stability in July. The report proposes to extend the four-level securities market decision making process developed by the Lámfalussy Committee to the entire financial sector. To recognise sectoral specificities, three sector committees, for banking, insurance and securities, would be set up on levels 2 and 3. On the second level, a fourth committee would also be set up to address the issue of special rules for financial conglomerates[2].

The EBF has set up an ad hoc working group to form an opinion on the proposals made in the EFC report. In its response letter the FBE emphasised the importance of consultations with the industry and transparency of the legislation process on all levels. The new system of supervision and regulation should be adequately structured in size and should be able to keep pace with the rapid development of financial

[1] The discussion of CAD 3 is taking place on two levels: at the national level, the supervisions consult with representatives of the industry and report results to the European Commission. Simultaneously, the European Commission negotiates directly with the various interest-representation groups at the European level.

[2] For more details on the proposed decision making process see our 4th Quarter Report.

markets. The FBE supported the proposal for transforming FSPG[3] into a group with the task to address inter-sectoral issues (banking, insurance and investment) and to develop the financial sector's medium and long-term strategies. The FBE emphasised that in the new legislation process the role of the European Parliament must be safeguarded and therefor, Article of the European Agreement should be amended.

At its meeting of December 3, ECOFIN accepted the FBE's statements and the need to amend Article 202. The European Commission has initiated the setting up of the committees proposed. The committees are to start activities at the beginning of 2004.

Forum group on financial reporting

At the initiative of ECOFIN, a forum group has been set up with the participation of professionals from the financial sector, with the task of comparing financial reporting requirements in the EU, aiming at their convergence and streamlining. The forum group published its report in October. The report concluded that although the diversity of reporting requirements is not a main obstacle in the way of a single European market, compiling varied and inconsistent reports causes financial institutions substantial extra costs. The regulatory environments also differ by sector and country, members of financial groups must meet different reporting requirements. According to the forum group's proposal, reporting requirements should be harmonised at the European level. Within this, it should also be reviewed how data requested by the authorities are actually used. Also, the possibility of setting up a single European database with access by the competent authorities of member states should be looked into.

The European Commission reviewed the report with representatives of the financial sector. European credit institutions endorsed the report and urged the Commission to move forward with the issue.

Financial conglomerates

The European Parliament passed the directive on the additional supervision of financial conglomerates in November. It will be of fundamental importance for member states to apply this directive (to be introduced in a year and a half time) properly and consistently. The disclosure of supervisory practices and consultation mechanisms between supervisory authorities may largely contribute to the uniform introduction of the directive, ensuring level playing field.

1.2 Accounts Committee

Proposed modifications to IAS 39[4] and IAS 32[5] were in the focus of the Accounts Committee's activities in 2002. The FBE indicated towards the IAS Board that the strict restrictions on hedge accounting and the exclusion of internal contacts were against banks' risk management practices and hampered efficient assets-liabilities management.

[3] Financial Services Policy Group
[4] IAS 39 Financial Instruments: Recognition and Measurement
[5] IAS 32 Financial Instruments: Disclosure and Presentation

The working paper on the proposed modifications of IAS 39 and IAS 32 (Exposure Draft) contains a number of essential changes compared to the previous proposal but does not address the most important issues raised by the banking industry. In addition, it proposes without previous consultation loan valuation and provisioning approaches that are substantially different from the prevailing international standards and the US GAAP.

Critics of the working paper emphasise: the task of accounting is to provide a true and fair view of the business and financial operations of an entity, but it is not the task of accounting to change such activities. IAS 39, however, interferes with such operations and by restricting hedge accounting and excluding internal contracts, it results in inaccurate information in the financial reports.

In parallel with the FBE, CEO's of the largest European banks also indicated these problems in a joint letter to the IASB. Upon the comments and proposals received, on December 18 the IASB announced that it would hold two public round table conferences for the reviewing organisations to discuss the proposals made to improve IAS 39 and IAS 32.

The Accounts Committee's addressed a number of other important issues during its meetings in 2002. Key issues included the proposed standard on Full Fair Value Accounting (postponed for the time being); Pillar 3 of the new Basel Capital Accord, the European introduction of IAS in 2005; the modernization of European accounting directives; and the directive on disclosure requirements for securities issuers operating on the regulated market. The Committee reviewed the Sarbanas-Oxley Act, enacted in the US in protection of investors, and in its letter to the SEC challenged those provisions of the Act which are prejudicial to European banks. The Committee reviewed proposals for changes to the rules on provisioning; the consultation paper on the application of accounting standards in the EU, published by the Committee of European Securities Regulators (CESR) in October; the Winter report on company law and corporate governance; and the IASB working paper on share-based payments. The Committee has been following closely the activities of EFRAG[6], as well.

1.3 Fiscal Committee

Taxation of savings

In order to avoid tax competition between member states, the European Council, on December 11, 2002, adopted a Directive for the taxation of savings, aimed at applying uniform taxation rules for revenues from savings. The original proposal intended to introduce the uniform rules from January 1, 2004. Given that banks will need at least one year for developing and testing a system to comply with the new directives, the FBE supported the request that the date of introduction be modified to January 1, 2005.

[6] European Financial Reporting Advisory Group

Issues related to Value Added Tax

Investigations within the EU on a strategy for value added tax began in June 2000. Particular attention was given to particular aspects of the financial sector, given that some of these institutions are operating on a global level and are consequently faced with several problems. Most problems, such as costs allocation, cross-border services, relations between branch offices and parent institutions, the practice of refunding VAT, etc. stem from the fact that the relevant taxation rules vary in the member states and their financial impacts vary as well.

The FBE is of the opinion that banking professionals should dedicate more attention to the issue of VAT in the coming years. Accordingly, it proposes to set up a working group to develop VAT categories for the various financial services. The objective is to develop a setting that is in conformance with the relevant European directives, helps reduce operating expenses and does not hurt fair competition. Banks should agree on the internal distributions of costs. VAT consolidation should be implemented slowly, step-by-step.

Rules for banking secrecy

The Financial Committee of the FBE (FC) in co-operation with the Fraud Working Group (FWG) compiled in a table the regulations on banking secrecy in EU member countries and associate countries. Members of the Committee found this inventory very useful, as differences in the practices applied in the various countries are instantly apparent form the table. Legislators may also deduct useful conclusions from the comparison.

Implementation of intermediary agreements (QIA)

In the USA the Treasury and the Internal Revenue Services (IRS) drafted in 1997 a new regulation on withholding tax for non-American financial mediators. The Qualified Intermediary Agreement (QIA) is aimed at simplifying reporting and taxation obligations for account holders on revenues arising by way of foreign intermediaries. The QIA requires the engagement of external auditors. Directives on auditing were published in August 2002 and they contained temporary relieves up to the end of 2002. In this context the FBE, representing the banks, was of the opinion that more time would be needed for studying the directives and expressed its concern also that the requirement of engaging external auditors would charge significant costs to those financial intermediaries who operate with a low profit margin.

The FBE proposed to review the directives from the point of view of how costs could be reduced without hurting the taxation aspects. At the proposal of the FBE the final auditing directives significantly reduced the range in which the engagement of external auditors is required, as the amounts falling under the directives were changed. Although the FBE regards this as a positive step forward, its further concern is that European partners – due to infrastructure reasons – will not be able to comply with the IRS requirements; therefore, it requested that the transition period be extended.

Company taxation

The European Commission compiled a working paper with the title „Corporate Taxation in the European Market". Commission set the goal of developing a strategy by which the single market is not burdened with taxation problems. According to the Commission a consolidated tax base should be developed for activities pursued within the EU for companies, as this would be indispensable for making the EU one of the most competitive economies in the world, as formulated by the Council of Europe in March 2000 in Lisbon.

This topic requires a wide-ranging preparatory work and professional discussion. The key issue is that if a separate tax account is set up, how would this account be linked to the financial report. The issue will be further studied and discussed by accounting and taxation experts with the participation of the FBE.

1.4 Annual meeting of associate members of the European Banking Federation

At the annual meeting of associate members of the European Banking Federation, held in December, participants were briefed by EU officials on the schedule of enlargement and related tasks, contents of new EU financial regulations currently being drafted and related comments of the European Banking Federation.

The participants exchanged views on the enlargement of the European Banking Federation proposed to be carried out simultaneously with the EU enlargement: according to the proposal, current associate members would become full members of the Federation upon accession. This would open up the way for new members to participate in all organisations of the EBF and the system of paying membership fees would change as well. The latter would mean that the current associate members would then also pay the membership fee according to a factor established on the basis of the combined balance sheet total and staff numbers of the banks represented. In the case of Hungary, this factor is 1%, i.e. we would have to pay as membership fee 1% of the Federation's budget. (This would not be a significant increase compared to the current fee.)

Given that in the case of the smallest countries membership fees would grow substantially, associate members will conduct further consultations on a possible reduction of the membership fees or a gradual introduction of the calculated factors.

1.5 Payment Systems Steering Group

The Association's representative attends the **meetings of the Payment System Steering Group of ECBS** from time to time, depending on the topics addressed. Two major issues we addressed in 2002: efficient representation of European banks vis-á-vis the various authorities in the EU and the new EU regulation on banking charges on international transfers within the EU. The issue of charges on transfers within the EU became a focal issue because a radical regulatory measure of the European Commission has created a fundamentally new situation. Leading organs of the EU had long been asking, in vain, that banks harmonise their transfer charges by

the time the single European currency is introduced, as it would be difficult to explain why charges on domestic and cross-border transfers would significantly differ within an economically integrated area (the EMU). Banks in Europe made a significant progress in making transfers more accurate and less expensive by introducing various standards (e.g.: the IBAN, IPI) and by cutting administration (for example, by reducing statistical reporting requirements); however, due to the different giro systems and infrastructures and service charge policies, no breakthrough has been achieved. Given that the various EU member countries (and within that, the individual banks) apply different bank charge policies to domestic and international payments, the varied policies on domestic payments cannot be applied to the ever growing volume of international payments.

Despite protest by banks' interest representation organisations and arguments by the European Central Banks, EU decision-makers, simultaneously with the introduction of Euro cash, decided that bank charges on international payments should not differ from those on domestic payments. The relevant regulation has been effective for bank card payments since 2002 and will apply to international payments from mid-2003.

Not much time has been left for the banking community to resolve the issue. One thing is clear: a joint action is required. Problems around the payment systems have just highlighted the importance of co-operation between banks and banking associations in the EU. Leading European organisations (the European Commission, the European Parliament, the European Central Bank) have requested several times that the banking community appoint one representative organisation to be the counterpart for the various EU authorities in all issues. The FBE aims to play a leading organising role in this effort and has developed several proposals. The objective is to create a European banking organisation with a supreme body that would represent all main branches of the banking industry (national banking associations, European banking associations, major professional organisations, international banking groups, etc.) while remaining efficient and operative in performing its responsibilities of internal coordination, representing banks' interests externally and managing the various working committees.

The Association's representative is regularly invited to the meetings of **the European Committee for Banking Standards** (**ECBS)**.

The ECBS is also facing serious organisational challenges. Despite its relatively short history, the ECBS has had significant achievements (e.g., in developing and introducing IBAN worldwide). However, it is facing serious criticism for its scattered and unorganised „shop works" and consequently, the low interest shown in the resulting standards. Therefore, the ECBS intends to simplify its organisation and reform its management and operations by increasing the weight of senior bankers in its leading bodies (thus far dominated by leaders of interest representation organisations).

1.6 Bank Security Working Group

Fight against terrorism and money laundering

Most European countries criticised the general practice used in the fight against terrorism and money laundering. The main points: the number of regulations is increasing day-by-day, entailing constantly increasing costs; the rules are inefficient and fail to bring the desired results; banks are often forced to illegally check on their clients.

According to experts the current situation is unconstitutional from several points of view and should be discussed by the European Parliament. It would also be necessary to put pressure on the legislators to re-assess what the actual objective of the regulations should be. A new way of thinking would be required in relation to *risks, efficiency, costs, and lawfulness.*

2. SINGLE INTEREST REPRESENTATION ORGANISATION OF EUROPEAN PAYMENT INSTITUTIONS

Developing a new, single European interest representation organisation for payment institutions took considerable energy of the European Banking Federation, the federation of national banking associations. At the request of EU institutions (the Central Bank, the Commission, etc.), a new organisation has been set up to efficiently organise and represent the interests of the founding institutions (including different types of banks) at the EU level.

The supreme decision-making body of the new organisation is the European Payments Council (EPC). The Council has 52 members, including small and large banks, other financial institutions and national banking associations. Professional activities are performed within the framework of five working committees specialising in the areas of payment infrastructure, small international transfers, customer needs survey, bank cards and cash payments. Activities of the working committees are controlled by a coordinating committee which is also responsible for implementing the resolutions adopted by the Council.

Although no one questions the need for a single interest representation organisation, doubts have been expressed at several forums on the efficiency of management of affairs under the new organisation. What gives the issue special importance is that while EU authorities and the EU Parliament are making special efforts to create a Single European Payment Area (SEPA), given their own internal organisational problems interest representation organisations have limited energy left for this important EU-level regulation.

The European Committee on Banking Standards (ECBS) has followed the forming of the EPC with keen interest; with so many achievements and blunders in its own activities, the ECBS expects efficient and professional guidance from this forum. The EPC appears as an external control body in the transformation plans of the ECBS.

DRAFT RESOLUTION

The Board Meeting discussed and adopted the Report on 2002 Activities of Hungarian Banking Association.

Budapest, March 20, 2003

Dr. Rezső Nyers
Secretary General