General Meeting
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Agenda Item 2/a

REPORT

ON 2005 ACTIVITIES OF THE HUNGARIAN BANKING ASSOCIATION

BUDAPEST, MARCH 2006

INTRODUCTION

In 2005 the Hungarian economy was characterised by a relatively rapid growth, low inflation, an unemployment level tolerable by EU comparison, associated with high deficits in general government and the current account.

The economy is struggling with some serious disequilibrium problems. The Hungarian economy has deviated from a sustainable (fundable) growth path since the beginning of the new century. This was due to the fact that fiscal policy started to aggressively boost demand. The increasing role of the state was also indicated by a rapid expansion of tax allowances and exemptions. Increasing redistribution is not a cause for but partly an antecedent and partly a consequence of the upset of equilibrium and increasing vulnerability of the system. Another factor undermining equilibrium was the weakening of the capacity to invest and the decline in the savings rate (in particular, of households). The reason why the current path is not sustainable is that while the economy is growing, the deficit of general government and in relation to it the current account deficit are unacceptably high. Indebtedness is a major constraint due to rolling interest charges. Foreign investors have financed this growth path with surprising consistency in a still favourable international capital market environment; however, investor confidence is fragile.

Taking note of the inevitability of the adjustment (not least under pressure from the EU), the government decided to reduce the disequilibrium cautiously, in small steps. Accordingly, the date for joining the Euro-zone was postponed from 2008 to 2010, the annual deficit reduction rate was set at 0.5% of GDP (0.7% recently). The programme included a modest narrowing of state redistribution.

What is the most worrying, beyond the increasing debt burden, which is constantly narrowing the government's room for manoeuvre, is the weakening of credibility in both fiscal and monetary policies. Contributing to the weakening of credibility were the regular year-end adjustments to the deficit forecast each year, with overstated revenue appropriation, multiple adjustments to the convergence program, the shifting of the exchange rate band and speculative attacks on the forint.

In summary*:* drawing the balance of budget policy, it may be established that, with great efforts, the increase in demand had to some degree been brought under control and an investment and export-driven growth restored by 2005. However, there was no turnaround in stabilising the economy and restoring credibility.

With profitability high by international standards and with all prudential criteria met, the Hungarian banking sector closed a successful year in 2005. The depth of financial intermediation increased, although the loans to GDP ratio has not yet reached the optimal level. Retail loans grew faster than corporate loans. Within retail loans, consumer loans increased faster than the high volume of home loans. Within corporate loans, loans to SMEs grew at a fast pace.

Alongside the increase in lending, the main factor contributing to banks' profitability results was the decrease in operating costs relative to assets. In the last months of 2005, profitability in the Hungarian banking industry started moving into the mature phase. The growth of profit after tax slowed down; accordingly, ROE decreased slightly in 2005.

Banks' continued preparations for implementation of the new EU Capital Requirements Directive, adoption of international accounting standards and tasks related to creating a single financial market in Europe. The Association's delegates were involved in the work of the various committees and working groups of European Banking Federation, providing banks with regular information on ongoing activities and current tasks.

At the invitation of the Hungarian Banking Association, several of the FBE's committees and working groups held their meetings in Budapest in 2005.

I. MEETINGS AND EVENTS

1. FBE Committee meetings in Budapest

At the invitation of the Association, associate members of the FBE and the FBE Executive Committee held their scheduled meetings on May 12 and May 13 in Budapest. The two meetings were attended by the Secretaries General of 29 full and associate member associations. At the Associate Members' Meeting, Erika Marsi, Director General of the Hungarian Financial Supervisory Authority offered a presentation on preparations made by the Supervisory Authority for the implementation of the new Capital Requirements Directive. The presentation was received with great interest.

At the FBE Executive Committee Meeting, rulemaking related to the Financial Services Action Plan, various EU directives, the future framework for European banking supervision, international accounting standards and issues related to the European payments system were reviewed, in addition to administrative issues of the FBE.

At the invitation of the Association, the FBE Social Affairs Committee held its 21st meeting in Budapest. The Committee reviewed ongoing projects, including latest developments in the CSR social dialogue project and the European Commission's Green Paper on demographic change.

Also at the invitation of the Association, the FBE Physical Security Working Group and the Anti-Fraud and Money-Laundering Committee held their meetings in Budapest on June 13 and 14, with 30 delegates from 23 countries.

Participants expressed their appreciation for the good organisation of the meetings and for the hospitality extended to them by the Association.

2. Inter-bank database on operational risk

Specialists in operational risks in banking have conducted consultations for quite some time on setting up a common database on losses from operational risks. The proposal was presented to the Association's Board in May. With the Board's approval, a preliminary survey was conducted among banks on whether they were interested in setting up an inter-bank database on operational risk. 20 banks indicated their intention to participate (subject to the concrete conditions), 7 said they did not wish to participate and 10 banks did not answer the enquiry. Based on the survey and the feasibility study prepared the Association's Board at its October 10 meeting endorsed the setting up of the database and authorised the Association's Secretary-General to contribute a defined amount from the Association's accumulated assets for the creation of the database. Further funding may acquired under the Hungarian Financial Supervisory Authority's application scheme for funds from supervisory fines.

The next steps will include the creation of the legal framework for the database, the development of the data model and the drafting of the tender documentation, the user's guide and the application for supervisory funds.

3. Bank's tasks related to the prohibition of insider dealing and market manipulation

With the enactment of Act LXII of 2005, the relevant provisions in Act CXX of 2001 have changed significantly. A presentation and consultation on these changes was held at the Association by officers of the Hungarian Financial Supervisory Authority with regard to banks' tasks related to the prohibition of insider dealing and market manipulation and the related new reporting requirements.

4. Hungarian Financial Supervisory Authority presentation on the EU Third Directive on money laundering

A presentation and consultation on Hungarian anti-money laundering and anti-terrorism measures and the EU Third Directive on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing was held at the Association by officers of the Hungarian Financial Supervisory Authority. After adoption of amendments to the relevant Hungarian legislation, the Directive will have to be applied by banks effective from 2008. The implementation of the Directive will entail substantial work and extra costs in the area of anti-money laundering and terrorist financing operations and it is doubtful whether the banks will be able to properly prepare themselves for implementation of the Directive.

5. National Police Headquarters presentation

Based on an agreement made with the National Police Headquarters, leaders from the Police Headquarters gave a presentation to banks' physical security officers on bank robberies committed in 2005 and the conclusions to be drawn from those incidents. At the meeting, an in-principle agreement was reached on potential preventive measures and tasks.

6. Bank Security Working Committee

The Committee's **IT Working Group** conducted consultations with the head of the IT Supervision Department of the Hungarian Financial Supervisory Authority, aimed at specifying the requirements provided in Section 13/B of the Credit Institutions Act. The working group drafted a wording proposal to make the provisions of the Act more specific. The objective was for banks to prepare themselves and to meet the Supervisory Authority's requirements, while continuously enhancing the security of their systems.

The working group heard presentations from András Gerencsér and Ferenc Suba from the Ministry of Informatics and Communications on the role and activities of the European Network and Information Security Agency (ENISA). Ferenc Suba, Vice-President of ENISA, offered their cooperation with CERT Hungary, the Hungarian member of CERT[1].

Senior IT security officers from GIRO Ltd. offered a presentation on security issues related to the clearing system. The purpose of the presentation was for the presenters to familiarise themselves with the views and requirements of officers in charge of IT security at banks.

The Committee's **Physical Security Working Group** held two joints meetings with the National Police Headquarters with a view to the prevention of assaults on bank branches and customers.

[1]CERT: Computer Emergency Response Teams (a group providing assistance in computer emergency situations)

The September meeting was initiated by the Police Headquarters with the objective to provide information on bank robberies committed in 2005, the conclusions to be drawn from those incidents and on the Police's proposals for prevention.

At the November meeting, bank security tasks related to the usual, increased volume of cash transactions anticipated at year-end, including measures aimed at protecting customers after leaving the branch were reviewed.

7. Hungarian Bank Card Forum

A survey on interchange fees related to the various payment instruments was launched by the EU Commission's DG Competition with the participation of 300 banks in 25 member states. In Hungary, the inquiry is focused on bank card payments. The selected banks have been requested to provide information retrospectively for several years in the specified format. The Commission approached the banks' leaders directly, requesting their cooperation to ensure the success of the exercise and to meet the deadline for information supply.

Members of the Bank Card Forum continued their coordinating discussions on setting up the VISA and Mastercard Forums to replace the Bank Card Forum. The Forum was to select the banks to be involved in the Cost Study proposed by VISA at its meeting of September 14. A working group, including 6 banks (Inter-Európa Bank, Raiffeisen Bank, Citibank, Erste Bank, K&H Bank and OTP Bank) was set up to develop the VISA Forum.

8. Payment System Forum

The European Payments Council (EPC) has set the objective to create a Single Euro Payments Area (SEPA) by 2010. Working groups of the Payment System Forum, the EPC's mirror organisation in Hungary, continued to work actively in the first quarter of 2005. The Forum presented a report on activities of the working groups and the Legal Committee to the managing body of the Payment System Forum, the Payment System Council, in March. The Council decided on the next tasks for the working groups.

The Payment System Council adopted the report of the Hungarian representative of the EPC; however, no decision was made on the creation of a national SEPA unit. Decision was made on the method of cooperation between the Payment System Forum and the EPC's Hungarian representative. Accordingly, activities of the EPC representatives and members of the EPC's working groups and information flows between the Forum and its organisational units are coordinated by the Secretary of the Payment System Forum.

The Payment System Council held its second ordinary meeting in November. The expectations of the founders, the MNB and the Banking Association, in setting up this body as the managing body of the Payment System Forum have been fully met: the range of issues addressed by the Council at this meeting virtually covered all areas of cooperation, including domestic regulations on payments, market players' plans for intensifying cooperation and preparations for the implementation of changes related to EU integration.

9. Communications Working Committee

Pursuant to the relevant resolution of the Association's Board, the Association set up a Communications Working Committee. The Committee is tasked to discuss and issue briefing papers on issues of public interest and to relay the industry' views and positions on laws and regulations affecting banks' operations. János Müller (Director, MKB) was elected as Head and Spokesman of the Working Committee. The Working Committee developed a position paper on the proposed introduction of interest tax. Members of the Committee compiled a study entitled *Economic Policy in 2005*. First presented by the Board at a press meeting with financial and business journalists, the study was sent to the Government, the Ministry of Finance, the Hungarian Financial Supervisory Authority and the Parliamentary parties. The paper was also published on the Association's website.

10. ISDA conference

At this conference, organised by the Association, Dr. Zoltán Lengyel lawyer and his associates (Hegedűs Law Office in cooperation with Allen & Overy LLP-vel) reviewed documentations of the International Swaps and Derivatives Association (ISDA) and practical issues related to their use in Hungary. Practical examples on how to fill in the documents were also presented.

11. Cooperation agreement with the National Association of Financial Enterprises

The Association concluded a cooperation agreement with the National Association of Financial Enterprises in November 2005. By signing the cooperation agreement the signatories expressed their interest in continuing cooperation in an organised form by holding regular consultations and taking joint actions in issues affecting both organisations.

12. Cooperation Agreement with the Budapest Chamber of Commerce and Industry

To ensure the mutual coordination and common expression of opinions and to perform professional interest representation and public tasks related to economic legislation and the enforcement of general economic interest, the Hungarian Banking Association concluded a cooperation agreement with the Budapest Chamber of Commerce and Industry.

13. Joining the Budapest Public Work Council Strategy Development Centre Foundation

At the initiative of the Budapest Chamber of Commerce and Industry, the Hungarian Banking Association participated, as a founder, in the forming of the Budapest Public Work Council Strategy Development Centre Foundation to set the professional grounds for the establishment of the Budapest Public Work Council. Tasks of the foundation include the improvement of the competitiveness of Budapest, the assessment of infrastructural investment needs and the planning and implementation of strategic projects.

II. PROFESSIONAL ACTIVITIES, INTEREST REPRESENTATION

In cooperation with specialists from member banks, the Hungarian Banking Association continued to actively participate in the review of draft laws and regulations affecting the banking sector. In developing its positions the Association worked closely with the Ministry of Justice, the Ministry of Finance, the Ministry of Agriculture and Rural Development, the National Bank of Hungary and the Hungarian Financial Supervisory Authority. The following main topics were addressed:

1. Amendments to the Credit Institutions Act

As requested by the Ministry of Justice, in the first half of 2005 we continued our work aimed at developing a proposal for legal amendments to the credit information system. During the consultations, several conceptual issues were clarified:

- although this could improve market security, the system should not register "interbank" loans granted to those financial institutions providing data for the system,
- customers deliberately misleading creditors and causing damages to creditors should be registered (there is now a precedent for this legal practice in the case of mobile phone providers),
- to ensure more information, banks insist on retaining negative data on the customer for five years and do not support the Justice Ministry's proposal for a differentiated retention time.
- banks do not require any credit rating services from the operator of the BAR system.
- the fairness of the registration is increased by the fact that the sale of the loan does not affect the debtor's status in the BAR system and the purchaser of the loan is obliged to take over the seller's commitments registered in the BAR system.

The proposed regulation was also reviewed at a government level. Participants in the review (the Ministry of Justice, the Hungarian Financial Supervisory Authority and the Data Protection Ombudsman) were supportive of the Association's proposals.

After the consultation, the Ministry of Finance took over the task of drafting the law amendment.

The Ministry of Finance sent us for review a draft amendment to the Credit Institutions Act aimed at amending the provisions on the National Deposit Insurance Fund and the central credit information system. Conceptually, the proposal departed from the Association's proposals in several points. In our comments we pointed out that the way the proposal intended to liberalise the operation of the central credit information system was ill-considered and risky. We gave a detailed presentation of the credit information system models used internationally and the related experience and proposed that the draft be fundamentally revised. In addition, we provided wording proposals for adjustments to the draft text and the Appendix regulating the data to be registered in the system.

After consultations, the draft was revised most of our proposals were adopted.

In certain issues requiring further adjustments, we proposed amendment motions to be submitted by MPs and the competent Parliamentary Committee.

After more than a year of preparations, an amendment to the Credit Institutions Act, amending the rules for debtor registration was passed by Parliament at the end of December. The amendment is in line with the expectations of those who were involved in the drafting of the regulation in that it has improved the customer protection status of those registered in the system and by extending the scope of information that can be entered and retrieved from the system it allows banks to make their customer ratings more modulated and more profound.

The provisions on regulatory capital in the Credit Institutions Act were modified upon an independent MP motion at the end of 2005. Under this amendment, the definitions of core loan capital and additional loan capital were added to the core capital and additional capital elements. Under the new regulation, the amount of core loan capital recognised in regulatory capital may not exceed 15% of the sum of all core capital elements. The reason for the amendment was to promote the expansion of Hungarian-based banks in Central and Eastern Europe and to ensure a level playing field. A consultation to review tasks related to the implementation of the new regulation was organised with the participation of Ministry of Finance, the Hungarian Supervisory Authority, Interbank Informatics Service Ltd. (BISZ Rt) and member banks at the beginning of 2006.

2. Amendments to the Capital Market Act

The Capital Market Act was amended twice in 2005 within the framework of legal harmonisation with EU laws.

The first amendment, enacted as of June 1, 2005, was related to new EU legislation on insider dealing and market manipulation and on provision of information. The definitions for insider dealing, insider and market manipulation have changed. Another important new provision is the obligation to keep a register on those persons with access to inside information and to make available such registers to the Hungarian Financial Supervisory Authority upon such request.

With a view to creating a single European market, the provisions on the prospectus to be published on securities issue or introduction to the market were also amended. The new legislation allows for the use of a new prospectus format for securities and mortgage bond programmes and for a new registration document system. Electronic communications means have been given more emphasis in the publication of prospectuses. Another improvement is the possibility to include in the prospectus links to documents containing information already submitted to the competent authority.

Issuers registered on the regulated market have a continuous disclosure obligation; however, the regular disclosure of updated information is not obligatory. In cross-border issues, the host or home country may only require that the summary of the prospectus is issued in the official language, if the prospectus is in a language commonly used in the international financial sphere.

Restrictions on the size and maturity of investment loans have been repealed and investor funds can now be invested in stock exchange products within the framework of portfolio management, in addition to investment instruments.

The second amendment, taking effect in 2006, is related to the EU rules on public acquisition bids and revisions to the laws on venture capital and on clearing house and central depository activities.

In relation to public acquisition bids, the definition of the supervisor acting in the process with the powers of approval and control and the reporting and disclosure obligations has changed. An important change is that a squeeze-out may be exercised even at a 90% control (previously could only be done at a control exceeding 90%). The squeeze-out may be exercised within three months as from the date of the bid made by the acquirer of control or the date of the public acquisition bid, provided the control acquired during this period exceeds 90%. The rules for determining the bid price have been fine-tuned. The time-window for acceptance of the public acquisition bid has changed to between 30 and 65 days. During this period, the powers of the managing body of the target company are restricted; for example, the legitimacy of protective measures that may disturb the bid is subject to prior approval by the general meeting.

Break-through rules, applicable to acquisition of a control in excess of 75% have been introduced to the legislation. Accordingly, restrictions on the sale and purchase of shares and extra voting rights may not be exercised and the right of sale will open up for the shareholders of the target company.

Act XXXIV of 1998 on venture capital companies and venture capital funds has been repealed, the relevant rules have been incorporated in the Capital Market Act. Apart from this formal change, an important change is that, in contrast to former regulations, the capital is not required to be paid up on creation of the fund. Investors will have a maximum period of 6 years to pay up the capital and the schedule within this period will depend on the venture capital investment opportunities arising. Venture capital funds may only be formed as private funds; thus, through determining the management rules of the fund, investors can exercise proper control over the operations of the fund and the fund manager.

In view of the warning from the European Central Bank that the risks that are concentrated in KELER, performing both clearing house and central depository operations as one entity, involve threats from the point of stability, it was necessary to separate the two functions. This was also done under the amendment to the Capital Market Act.

Amendments to the provisions of the Credit Institutions Act related to credit information system have been updated to the Capital Market Act.

3. Capital adequacy of financial conglomerates

EU Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate was adopted in Hungary in 2004. In connection with this, the Ministry of Finance drafted a decree on the calculation of capital adequacy. Banks provided comments and a number of proposals concerning the draft, primarily aimed at EU law harmonisation.

Alongside the rules for the capital adequacy of conglomerates, Ministry of Finance Decree No. 13/2001 (III 9) on the computation of capital adequacy ratio was also adjusted.

4. Amendments to the Act on the Hungarian Financial Supervisory Authority

In our comments on the latest version of the proposed amendment to the Act on the Hungarian Financial Supervisory Authority we indicated, inter alia, that there was a disproportion between

the rights of the Supervisory Authority and those of the clients, primarily in terms of long deadlines for the Authority and short deadlines for the clients.

We proposed that once a Supervisory Authority decision is published, then the fact that an appeal has been filed against the decision and the results of such appeal should also be made public.

In agreement with the Supervisory Authority, in relation to government Decree No. 205/1996 on mandatory contents of the Business Rules of organisations providing investment services we proposed an amendment to provide that in the case of standards adopted by professional associations the Supervisory Authority may dispense with an individual licensing procedure and approve such standards under a framework agreement

We welcomed the proposal for a uniform treatment of supervisory fees and proposed to provide clear rules regarding fees for custodian activities.

5. Calculation of supervisory fees

To ensure a uniform calculation of supervisory fees, the Hungarian Financial Supervisory Authority issued a circular concerning supervisory fees on custody services. In this context we requested that the Supervisory Authority should resolve the issue of double fee payments due to delivery repo trading deals, as neither the publication "Information for the calculation of supervisory fees for institutions and persons subject to supervision", nor the decree on supervisory reporting provided a solution for avoiding double fee payments. In the meantime the Supervisory Authority invited a consultation to review the regulation on supervisory revenues. During the consultation we managed to convince the regulators to develop a more consistent fee system.

6. Tax laws and the government programme aimed at reducing bureaucracy

The Association initiated several amendments and adjustments to current laws and regulations in the first quarter. Within this framework, we also submitted proposals in relation to the proposed "Streamlining Act" on taxation and the government programme aimed at reducing bureaucracy. Our proposals were focused on the following key issues:

6.1 VAT on credit rating

The Association has long challenged the classification of credit rating as an activity subject to VAT, arguing that credit rating is an ancillary activity related to tax exempt financial services (lending). In view of the contradictory regulations, the Association requested the Ministry of Finance several times to make the classifications clear-cut and proposed that credit rating be classified as a tax-exempt activity. Credit rating is an ancillary activity closely associated with lending. Banks do not perform credit rating as an independent service. The Credit Institutions Act clearly provides that credit rating is part of the lending service; accordingly, is warranted for credit rating to be classified in the VAT Act as a tax-exempt activity.

Our long and persistent efforts finally succeeded. To the satisfaction of banks, the Tax Authority in its Communication of December 2005 took the clear position that if, alongside credit rating, the taxpayer also performs lending, then credit rating shall not be deemed as an

independent activity but as part of the lending activity, and shall therefore be considered as a tax-exempt activity.

6.2 Discretion in the imposition of default fines related to the special bank tax

The rules of procedure in the *Act on special tax for credit institutions and financial enterprises*, enacted in 2005, provide that the institutions affected should top up their tax payments to 100% of the tax liability latest by the 20th day of the last month of the tax year. Taxpayers defaulting on this obligation are subject to an up to 20% fine (Subsection 5(4) of Act CII of 2004). The topping up deadline is identical with that provided in the Corporate Tax Act; however, the 100% rate for topping up is unusual. For topping up tax liabilities to 100%, a number of unknown components should be pre-calculated. Interest rate changes, possible exchange rate changes, write-offs and provisions for qualified portfolios, changes in market conditions in the case of those applying full fair value accounting (all significantly affecting results), can only be estimated, and therefore, the topping up will either be excessive or less than what would have been required. The Association informed the Minister of Finance on these uncertain and changeable components and requested that the Tax Authority consider all factors affecting final liabilities and, in case of minor differences, dispense with imposing a fine. In his response letter the Minister of Finance informed banks that the Tax Authority has been requested to **exercise discretion** in evaluating compliance with the topping up obligation and, in consideration of the size of tax payments made, will not impose a fine.

Here, it is worth mentioning that the Association's initiative to allow banks to choose the tax base has proved correct: pre-tax profit is the right alternative to net interest income.

6.3 EU reporting on interest income received by foreign nationals in Hungary

Pursuant to the Act on Taxation, banks are required to collect data on interest income paid to EU citizens in line with the relevant EU Directive, effective from July 1, 2005. The interpretation of the relevant Hungarian regulation raised a number of questions. The Association invited a consultation with the participation of banks and authorities involved in interest income reporting.

At the consultation the Association emphasised that banks would like to comply with their EU reporting obligations correctly and in time; to achieve this, a number of issues related to practical implementation should be addressed and answered. It is our common interest and an important aspect - and not only for banks - to implement customer-friendly procedures and to avoid an outflow of savings due to any excessively stringent procedures or any wrong interpretation of the laws, and overall, to ensure that the Hungarian procedures are received favourably in the international markets. Furthermore, it is important to avoid competition between banks: for example, similar types of savings placed with different custodians should be reported according to the same rules. Clear rules and implementation instructions, allowing a uniform interpretation by both authorities and banks are needed to avoid legal disputes and tax fines. The harmonisation of rules and requirements would also be important in view of the interest tax to be introduced from January 1, 2007.

Following the discussion, a working group was set up and, as a result of continuous consultations, a guide to help implementation was issued at the beginning of 2006.

Obviously, the process is not over: the relevant EU regulation is not detailed enough; additional wording adjustments will probably be needed; there is no implementation experience yet: even in other EU countries, the process only started in the second half of 2005.

6.4 Interest tax to be imposed from 2007

Under the proposed tax laws for 2006, the government submitted provisions on interest tax to be imposed from 2007. While not opposing the proposed interest tax, we submitted amendment proposals regarding certain provisions of the proposed legislation, including the tax exemption of home savings deposits and some wording proposals, and, in view of the complexity of banking products, we proposed that the technical details of implementation be specified in an implementation decree. The Ministry of Finance was receptive to the proposals, and we were given the opportunity to draft the relevant implementation decree. During subsequent working group consultations, the most important professional aspect and technical implementation points were clarified and the draft text was submitted to the Ministry of Finance at the beginning of 2006. The decree is expected to be finalised in March.

6.5 2006 tax laws

In its proposals and comments on proposed amendments to the Acts on taxes, contributions and other fiscal dues the Association expressed its support for the government's tax policy objectives aimed at a more transparent and more fair taxation system and a more equitable general and proportionate sharing of taxation.

We once again pointed out that despite the 2004 amendments, the rules for determining the local trade tax base are still inappropriate. We expressed our hope that any new tax to replace local trade tax in the future will be imposed on a more fair, and plannable, profitability basis, rather than on a revenue basis.

We also proposed that publicly offered securities should remain duty-exempt, as was the case before 2005.

At our initiative, the undercapitalisation rules in the 2006 tax legislation were changed after promulgation but still before entry into force of the new legislation. The original text of the legislation would have imposed substantial and unwarranted tax burdens on banks due to the inclusion of all interest-bearing liabilities in the undercapitalisation rule. Based on the technical discussions on this issue, a more manageable proposal was developed. Accordingly, interest-bearing liabilities related to financial services in the balance sheet will be treated as exceptions to the undercapitalisation rule.

Banks indicated some content and technical problems regarding the new tax returns and reporting requirements introduced as of 2006. The Association initiated a review of the reporting requirements and submitted a proposal for modifications, with special regard to the reporting requirements for securities dealers and investment companies. We pointed out that our proposal was also important from the point of view of meeting the objective of the relevant Government Resolution to develop, in respect of all reports related to fiscal dues and contributions, solutions that put the least reporting burden on the customer.

We requested that, for foreign nationals, in cases where, under an agreement on the avoidance of double taxation with the state in question, the income is not taxable in Hungary (the source

country may not withhold tax from the income) the requirement of obtaining of the customer's tax ID number be repealed. We also requested that incomes included in the consolidated tax base and incomes subject to special taxation be reported separately due to difficulties in the aggregation of data. Regarding the former issue the Ministry advised us that in case of foreign nationals, the obtaining of personal tax ID number would not be required if the income is not taxable in Hungary. The issue of reporting of incomes included in the consolidated tax base separately from those subject to special taxation affects several professional areas; the issue of reporting requirements is now being investigated by the Ministry.

6.6 Proposals related to the government programme for reducing bureaucracy

The Association indicated to the Ministry of Finance that with complex and ever changing regulations, the requirements related to interest subsidies are hard to follow and manage: there are no standard documentation packages; due to the lack of sufficient IT processing facilities, manual work is substantial and there are no statutory deadlines for disbursement in the relevant regulations. We also indicated that it would be expedient for organisations involved in the management of government supports (the Ministry of Economy, the Ministry of Finance, the Ministry of Agriculture, Hungarian Development Bank and the Tax Authority) to appoint contact persons with whom banks can liaise in these matters.

The administration rules related to environmental product fees are rather complicated, the data required for meeting the regulation are often hard to obtain. We provided proposals to reduced administrative burdens.

The rules provided by the Act on Personal Income Tax for documenting fringe benefits also impose substantial administrative burdens on banks. We proposed that the previously applied simplified taxation rules be restored.

There are no standard tax returns forms for local taxes: every municipality has its own forms and the forms may be filled in exclusively by typing machines. The calculation and division of the tax base is complicated and, in the case of major branch networks, rather time-consuming. We proposed that for the purpose of proportioning, it should suffice to give the division rather than filing separate tax returns.

The Association proposed that the reporting requirements of the Hungarian Financial Supervisory Authority and the National Bank of Hungary be harmonised, rationalised and redundancies in information flows eliminated.

7. Companies Act, Company Registration Act

The Ministry of Finance submitted for review the proposed amendments to the Act on Companies and the Act on the Publicity of Company Documents, Company Registration and Final Accounting. The concepts for both Acts were reviewed and commented on by the Association earlier.

Based on member banks' comments we provided a number of proposals for adjustments to the texts of the draft laws. We proposed that the right of creditors to demand collateral be regulated in more details among the provisions for recognised company groups and transformation. Further, we proposed the reconciliation of certain provisions of the Companies Act with the rules for liquidation and final accounting.

We repeated our concerns over the proposed change in the name rules for joint stock companies. In relation to Section 229 of the Companies Act we proposed that deals concluded by banks or financial institutions in their normal course of business be exempted from the provision prohibiting the granting of loans for the purchase of shares issued by them.

We proposed that signatory rights and the right of disposal of the bank account of the company be separated and a one-man disposal right be granted for the bank account. We offered comments on the proposed rules for the re-conversion of dematerialised securities into printed securities and the withdrawal of shares on the cessation of joint stock companies without legal successor. After the review of the Companies Act, we turned in a letter to the Prime Minister's Office in the matter of the indication of the form of operation (public or private) in the names of joint stock companies and proposed that the form of operation should not be required to be indicated in both cases. Our proposal was rejected, the issue may only be revisited after the amendment to the EU Company Directive has been passed.

8. Amendments to the Bankruptcy Act, drafting of a new bankruptcy law

Act VI of 2006, amending Act XLIX of 1991 on bankruptcy, liquidation and final accounting procedures was passed by Parliament on December 19, 2005. A comprehensive amendment to the bankruptcy law is also on the agenda, according to the government's decision its draft is to be produced in the autumn of 2006. Some of the provisions of the Bankruptcy Act will be amended now, in parallel with the adoption of the Companies Act and the Company Registration Act. Parliament will discuss the three draft laws together because their provisions are interrelated. Thus, for instance, the provisions on final settlement procedure will be transferred from the Bankruptcy Act to the Company Registration Act.

The Association participated in the review of the draft law and provided detailed proposals on it. Furthermore, we initiated some amendments in the parliamentary stage. There was active lobbying on behalf of professional organisations concerning the creditor protection provisions of the draft law. The Association was actively involved in the debates in the various Parliamentary Committees; we organised a press meeting and participated in the reviews of the draft law at the Ministry of Justice. With its active involvement, the Association largely contributed to achieving that the provisions on lien (very favourable for creditors) were passed with unchanged contents (to take effect at a later date, though).

Certain provisions of the Act are particularly important from the point of view of banks. One of these is the amendment of the rules related to lien. The draft law repeals the provision currently in force according to which the provision concerning the separate satisfaction of the holder of the lien can only be applied when the lien was established a year prior to the date of commencement of liquidation. Every lien created prior to the date of commencement of liquidation will enjoy privileged satisfaction. The amendment will also repeal the current 50% limit on satisfaction and stipulates that the liquidator may only deduct the costs of the safekeeping of the pledged property (including preserving its condition) and the cost of its sales and the liquidator's fees specified in separate legislation from the proceeds of the sale of the pledged property and shall put the remaining amount to the satisfaction of claims secured by the lien on the sold pledged property.

The provisions repealing the 50% limit on lien will enter into force on January1, 2007; the provision shall be applied in procedures initiated after entry into force so that in liquidation

procedures commenced by July 1, 2007 the costs of settling environmental damage incurred in relation to the pledged property may also be deducted from the proceeds of the sale of the pledged property. Yet the deductible costs and the liquidator's fee may not together exceed 50% of the purchase price. In the event that 50% of the purchase price does not cover costs, it shall be put first to the costs of safeguarding and preserving the condition of the pledged property, the costs of sale and the fees of the liquidator, and secondly to the costs of settling damage to the environment. This provision is extremely important from the viewpoint of applying the Basle II capital directive.

To protect the assets of the business organisation subject to liquidation, the amendment widens the powers of the temporary receiver. The law amendment tightens the rules related to the exclusion and conflict of interest of the liquidator as well as the requirements concerning qualifications and other personal conditions applicable to the liquidator.

The rule governing the liability of the managers of the organisation subject to liquidation will also be tightened according to the new provisions. The creditor or the liquidator may request the court to establish that the managers of the business organisation did not perform their management tasks on the basis of the primacy of the creditor's interests after the onset of the situation threatening with insolvency, in the three years preceding the commencement of liquidation, and because of that the company's net assets decreased. When the Court establishes the liability of the managers of the organisation subject to liquidation, the creditor may request the court to obligate the former manager of the debtor company to satisfy his claims based on the liability established in the earlier litigation within 90 days following the final closure of the liquidation procedure.

The law amendment tightens the rules governing the liability of the owners of the business organisation subject to liquidation, wishing to prevent the exemption of male fide shareholders emptying the business organisation from liability.

The law amendment will enter into force together with the amendments to the Companies Act and the Act on Registration Court Procedures on July 1, 2006 with the exception of the provisions on lien described above.

The Association is involved with a small group of economists and legal specialists from the work-out area in the work of the Codification Committee drafting the new bankruptcy legislation.

A comprehensive concept for the new bankruptcy legislation was adopted by the government in August 2005 under Government Resolution No.1094/2005 (IX 19.). We provided comments on the concept in relation to improving the status of creditors with collateral, the recognition of other creditor protection instruments, the enforcement of liabilities of owners and officers and the prevention of the withdrawal of assets. We continue to actively participate in the Committee meetings.

9. Accounting standards

In connection with a proposed amendment to Government Decree No. 250/2000 (XII 24) on the book-keeping of credit institutions, banks initiated with the Ministry of Finance an amendment to the rules for accounting for delivery repo and securities transactions, given that the current Hungarian accounting rules are different from those in the IFRS.

Due to this difference between Hungarian accounting rules and the IFRS, Hungarian banks have to constantly adjust the data between their international and Hungarian financial reports; this is a significant burden for them. Also, the current rules restrain market operations and, as far as we know, cause problems in other sectors of the economy. During earlier talks with the Hungarian Financial Supervisory Authority it was raised that it would be important that prudential reports are prepared in accordance with the IFRS. Professional organisations of the European banking community (the European Banking Federation - FBE; the Committee of European Banking Supervisors - CEBS) would also like to achieve that banking reports are compiled according to uniform rules and are based on the IRFS, rather than on national rules.

Banks say the Hungarian rules may also distort the Profit and Loss Account and the accounting profit. The banking community thinks the market has developed a lot since the relevant Hungarian rules were introduced more than five years ago; a lot of experience has been gained and, in general, Europe is moving towards the IFRS. We initiated personal consultations on this issue with the Ministry of Finance and asked the central bank (MNB), the Hungarian Financial Supervisory Authority and the Money and Capital Market Section of the Chamber of Hungarian Auditors to support our proposal. The MNB and the Money and Capital Market Section of the Chamber of Hungarian Auditors reassured us of their support and the Hungarian Financial Supervisory Authority said it is now looking into the European practice and expects to take position in February 2006. The Ministry of Finance will address the issue after February 2006 and has not ruled out that, following a broader review, covering several other areas and regulations, the current accounting rules could be changed.

In the context of the review of 2006 regulatory changes we indicated that the proposed amendments did not address issues related to differences between international and Hungarian accounting laws, for example: the reporting of negative valuation difference of available-for-sale securities and more detailed and accurate provisions on the accrual of fees and commissions.

10. Baby bonds

The baby bonds scheme is aimed at supporting young people starting their lives by making them available the savings and subsidies contributed from government and private resources (along with the relevant interest) when they reach the age of 18. The funds granted by the state can be augmented in bank and investment accounts through additional savings and investments.

At the meeting held between the Association's President and the Minister of Finance on the issue, it was promised that the Ministry will endorse the transferring of the accounts to banks and investment companies and the Hungarian State Treasury will only manage customer accounts as "safety reserves". The Association had several rounds of consultation with the Ministry of Finance and the Hungarian State Treasury. As a result - and despite the short deadlines - a viable scheme was created.

At the consultations it was achieved that

- the funds are invested in safe securities,
- the mode of investment of the funds received in the account (state support, contributions by relatives, free funds, other donations) can be agreed with the customer in advance (the bank does not have to make decisions for the customer).

- entities other than individuals may also make contributions to the account (municipalities).

Issues where we could not enforce our position:

- the HUF 120,000 annual deposit limit of the START account was not lifted (excess contributions must be refunded to the originator)
- contrary to our explicit request, the official certificates required for government support will have to be collected, checked and forwarded by the banks,
- we failed to achieve a fee rate meeting the level desired by banks.

From banking points of view, a complicated product with high administrative burdens and a moderate price was created; however, given that the funds cannot be withdrawn for 18 years, this product provides a long-term resource for the service provider and will hopefully contribute to the acquisition of new customers. Most banks active in the retail market will participate in the scheme.

11. Central bank and supervisory reporting requirements

In determining the 2006 reporting requirements, the central bank and the Hungarian Financial Supervisory Authority made concrete steps aimed at reducing reporting burdens. In this context we pointed out that this positive process could be further improved if the most important information requirements of the two institutions could be further harmonised. We welcomed the results of the process completed to reduce bank's reporting burdens: the elimination of redundant information, the reduction of the number of tables and the wording amendments aimed to make the various definitions more straightforward.

In relation to the new Decree we made some additional content and practical proposals with a view to further reducing the reporting burdens. We drew attention to problems in automating the reports due to differences between the structures of common reports; questions difficult or impossible to answer in the narrative reports and excessive formal requirements (the requirement to sign each page of the report). We pointed out that when introducing changes, care should be taken not to upset the current, efficient, risk limit monitoring system: restructuring the tables and reducing the number of cells does not in all cases make reporting easier; therefore we requested that in some specific cases the old system be reinstated. Our comments and proposals were accepted and the final text of the decree was adjusted accordingly.

Reporting officers from some major member banks requested the Association to make steps for improving the quality of central bank reporting and for constructive cooperation with the central bank.

Banks do not see the MNB's sanctioning principles properly reflected in the annual evaluations, especially as regards transparency and normativity. Banks would like to understand the central bank's evaluation criteria. It was also proposed that the central bank issue a more specific reporting guide and furnish banks with the program it uses for correlation checks. Keeping up and improving the quality of reports is just as important for the banks. The Association forwarded the banks' comments to the competent Vice-President of MNB and offered the assistance and cooperation of experienced professionals from the banks.

In his response letter the competent Vice-President of MNB expressed their thanks for the cooperation proposed and indicated that they would use such assistance in their quality assurance enhancement program. In his letter the Vice-President pointed out that although reporting discipline has improved a lot in recent years, further efforts are need on both the central bank's and the reporting organisations' part to further improve quality. According to the MNB's plans, from 2006, reports will be received through a new IT system. It was promised that banks' reporting officers will be consulted with during the design of the system and will be involved in the testing of the program.

12. Ombudsman's criticism regarding prompt collections

The Deputy Ombudsman for Citizen Rights compiled a report on constitutional queries regarding prompt collections. The report, copied in advance to the Association, expressed criticism over a number of legal provisions and practical measures that, according to the Deputy Ombudsman, prejudiced fundamental rights.

The press release issued on the report only held banks partly responsible; however, media comments that followed based on this press release held banks fully responsible for what according to them was an illegal collection practice.

The Association issued a press statement in which it rejected all these groundless charges. We emphasised that banks do observe all the relevant statutory regulations, a fact that has not been questioned by the Ombudsman's report at all. We pointed out that the Report was not critical of banks but rather of the regulations banks have to implement. We also stressed that participation in execution procedures is a delicate issue for banks, who in these cases must take action against their own customers. We proposed a fair discussion of the issue with the Deputy Ombudsman.

Prior to the meeting we solicited our member banks' position on the issue. Banks' were of the opinion that however delicate the issue, effective execution is of fundamental interest for banks and prompt collection is an important element of this procedure. These arguments were presented at the discussion organised by the Deputy Ombudsman with the National Bank of Hungary, the Ministry of Justice and member banks. The Deputy Ombudsman acknowledged that a number of issues have been put in a different perspective. At the same time, he found that some other issues were still problematic from a constitutional point of view and turned to the Ministry of Justice for answers.

At the press conference held after the meeting, all parties presented their views. These views were reflected in the media in a fair and correct manner.

13. Ombudsman's recommendation regarding home subsidies

The Ombudsman for Citizen Rights sent us his report addressing customer complaints related to home loan subsidies and making recommendation for amendments to the relevant laws.

The report sharply criticises the fact that it is basically the banks who decide whether or not a citizen may have access to state subsidies and there is no government forum to appeal to. We gave our comments to the Ombudsman based on consultations with member banks. In our letter we explained that banks have several times communicated to the Ministry of Finance their complaint over having to perform a number of non-banking administrative tasks in

relation to home lending (for example, verifying the presence of conditions required by law); at the same time banks do admit that the current practice is more favourable for the customers, who, thus, do not have to go with the various certificates to a second administrative forum. In our letter we also pointed out that banks dedicate considerable staff resources to be able to responsibly verify the various certificates. (Otherwise, in disputed cases they always approach the law drafter for decision).

We expressed our full support for the Ombudsman's recommendation that a flat temporarily held for technical reasons (and practically sold) should not prohibit someone from purchasing a new flat and receiving the relevant subsidies. We also expressed our support for the recommendation for banks to provide customers with detailed information on the terms and conditions for state subsidies. However, we noted that it should be the organisation representing the state who should provide for the contents of such customer information (perhaps in the subsidy management contract to be concluded with the banks).

14. Amendments to the Act on Land Registration and its implementation decrees

The Association was involved in the review of proposed amendments to Act CXLI of 1997 on Land Registration and the relevant implementation decrees. The amendments were primarily aimed at making the legislation more specific and reconciling the provisions of the Land Registration Act with those of other laws, such as the Act on Administrative Procedure. The amendment also created the legal framework for the issue of proprietorship registers in the form of an electronic deed.

The implementation of the new rules, applicable from January 2005, was not problem-free at the Land Offices, neither at the banks.

The most important changes affecting customers, and thus, banks, are related to the following:

- Mandatory legal representation, which has remained for a narrower scope in registration procedures launched based on request**,**
- Standard application form,
- Introduction of an administrative service fee.

The creation, change or cessation of a title or fact related to a real estate shall be recorded in the land register based on an application submitted in an application form specified by law. The application form is also available on the Internet.

According to the new regulation, the administrative service fee cannot be paid by revenue stamps. The payment must be made on submission of the application in cash at the cash-desk or by transfer via a postal payment voucher or bank transfer order to the appropriation budget account of the County Land Office.

Alongside the conditional sale of the title, the regulation has reinstated the solution provided by Law Decree No. 31 of 1972 and now again gives the parties the freedom to agree in the sale and purchase agreement that the seller will provide his/her consent to the registration at a later date.

In relation to the application of the new regulation, we organised a consultation with the Ministry. We also consulted with the Budapest Bar Association and asked for Ministry rulings on certain implementation issues.

Several banks indicated to the Association that they had problems with the services provided by the Land Office. Some complained about the radical increase in the TAKARNET electronic service, others challenged the unacceptably high rate of errors in the classic Land Office service of issuing proprietorship registers (one bank mentioned an error rate of 12%).

In our letter to the competent Deputy State Secretary we expressed our objection to the fact that the Decree on increasing the fees for the TAKARNET electronic services had been issued by the Ministry without consulting banks, one of their largest customer groups and informed him on the errors mentioned by banks. We received a detailed response at the beginning of 2006. The response was distributed to our member banks.

15. Pension savings (Pillar 4)

The Association supported the concept developed by the Budapest Stock Exchange for a pension savings facility (also mentioned as Pillar 4). The savings facility was launched in 2006.

16. Ministry of Finance proposal for the standardisation of employer's certificates

The Minister of Finance conducted a survey with employer associations on possibilities to reduce administrative burdens on businesses. One of these organisations, the Confederation of Hungarian Employers and Industrialists (MGYOSZ) criticised banks for using different employer's certificate forms and for their practice of checking on the validity of the certificates. Completing the different forms and answering inquiries by mail or phone is a substantial burden on businesses. The Ministry of Finance requested the Association to check with the banks on the possibility to standardise the employer's certificate forms.

After consulting with a number of banks affected, we rejected the proposal. Banks emphasised that employer's certificates are key elements in assessing the customer's creditworthiness and in some areas, such as consumer lending, are the only source for a lender to make a responsible decision within the short time given. In our written response to the Ministry of Finance we pointed out that it is the banks' freedom to determine the criteria they use for assessing a customer's creditworthiness; accordingly the information requirements may vary by bank; on the other hand, the amount of information a bank requires for credit rating purposes is also a competitive factor.

17. European Master Agreement

In accordance with the request of the Hungarian Financial Supervisory Authority, the Association coordinated the European Master Agreement (based on the framework agreement published by the European Banking Federation) and the licensing of sample contacts for re-purchase transactions and security lending transactions for the eight banks involved. The sample contracts are displayed on the Supervisory Authority's website (in the meantime, measures have been taken to update them).

III. INTERNATIONAL COOPERATION

1. International banking regulations

The most important legislative steps in 2005 were the agreement on the Trading Book Review and the adoption of the EU Capital Requirements Directive. Meanwhile, work aimed at the development of conditions for a uniform implementation was in full gear, primarily within the CEBS[2].

1.1 Capital Requirements Directive (CRD)

Following the adoption of the Basel II Accord in June 2004, the European Commission published its proposal for a new Capital Requirements Directive (formally through amendments to two former directives). The new directive (Capital Requirements Directive) is basically a reflection of the Basel II capital Accord, with the difference that it shall be applied by all credit institutions and financial enterprises registered in Europe, irrespective of size or territories of activity. Within the framework of the co-decision process, the Commission's CRD proposal was submitted to the Council. The Council decided on the necessary amendments based on the compromises reached between member states at the end of December.

European Central Bank report on the Capital Requirements Directive

At the request of the Council, the ECB made a report on the Capital Requirements Directive. The report was published in the EU official journal in February. In its report, the ECB stressed that the Directive, once properly transposed by the member states, will considerably strengthen the soundness and stability of the European banking system through the application of more sophisticated, risk sensitive capital standards. In its report the ECB emphasised the importance of ensuring a level playing field through sufficient flexibility in regulation, reducing national discretions and reinforcing convergent implementation. The ECB addressed in details the role of the supervisor on a consolidated basis, stressing that the model envisaged in the Directive will contribute to increasing efficiency and reducing the overall cost of supervision and will strengthen the stability of the financial sector. The ECB agreed with the timing of the introduction of the new capital requirements and supported the introduction of transitional requirements to limit the impact on credit institutions' minimum capital requirements over the first three years after transposition of the directive. The ECB stressed the importance of ex-post monitoring of the structural and possible procyclical impacts of the Directive.

Report of the EP Rapporteur (Radwan Report)

The EP rapporteur, Alexander Radwan's draft report was published at the beginning of April. The draft report contained nearly 300 proposals on more than one hundred pages regarding the Draft Directive submitted by the European Commission in July 2004. Some of the proposals meant the adoption of amendatory and corrective motions passed by the Council in December 2004 but the rapporteur made a number of new initiative and there were several points, where he did not support the Council's proposals.

The most important amendment proposals concerning the recitals of the Directive were related to the need to revise the rules for own capital and data protection, to the role of external rating

[2]Committee of European Banking Supervisors

agencies, increased recognition of customary banking collaterals, the recognition of insurance, annual reporting by the CEBS with regard to the convergence on supervisory practices and ensuring the Parliamentary scrutiny of the Commission's and the CEBS's work. The most important proposals concerning the various articles of the Directive related to the mandatory application of the exemption from individual compliance within a member state, amending the conditions for solo consolidation and the extension of the favourable weighting of intra-group lending to groups belonging to the same institution protection system. The Rapporteur also proposed that technical adaptations and implementing measures may enter into force only if the European Parliament or the Council has raised no objections within six months. He also presented amendment proposals (such as those related to the SME sector and retail portfolios) aimed at ensuring that smaller institutions are not disadvantaged to their larger competitors when the directive is applied.

Amendment proposals by MEPs

MEPs had until mid-May to make amendment proposals to the Draft Directive. According to the document published on May 27, 2005, a total of 887 amendment proposals were submitted (including those 288 contained in the Radwan Report). The most important proposals related to the levels of application (individual or only consolidated), the criteria for the zero weighting of internal group lending (particularly with regard to integrations of savings co-operatives), the predominance of consolidated supervision, fine-tuning of the wording of the rules for cooperation between home and host country supervisors, extension of the retail portfolio, the more favourable weighting of the SME sector under the standardised approach, and relaxing the rules related to risk mitigation.

Compromise proposals of the Presidency and the EP Rapporteur - the ECON's meeting of July 13

In consideration of the amendment proposals submitted by MEPs, the Luxembourg Presidency drafted a compromise proposal for the CRD in June. The proposal included the adoption of some 200 proposals and provided compromise wording for more than 100 proposals. Based on the proposals submitted by MEPs and the compromise proposal of the Presidency, additional compromise proposals were developed by the Rapporteur for the Economic and Monetary Committee's meeting of July 13. All of these proposals as well as those orally submitted by the Rapporteur were adopted by the ECON without any changes, thus increasing the chance for the CRD to be passed at first reading.

The compromise adopted by the ECON suspended the provisions on comitology, allowed the option of exemption from an individual application and relaxed the criteria regarding the degree of diversification for the classification of loans in the retail portfolio; loans secured by real estate collateral were taken out of the EUR 1 million floor and the treatment of the retail portfolio under the IRB and standardised approaches was harmonised, the option of zero weighting of intra-group lending was extended to participants in those interest protection schemes as per Directive 94/19 EC meeting the prudential requirements set for them by the Directive (in a new Article); the minimum data requirements for the application of the IRB approach were relaxed and the alternative treatment of exposures to Collective Investment Undertakings (CIUs) was allowed; the disclosure of rating decisions comprehensibly in writing to corporate and SME loan applicants was made mandatory; the definition of default may be increased from 90 to 180 days under national discretion, if the circumstances so require, etc.

Trading Book Review (TBR) [3]

The Basel Committee and concurrently, the European Commission in April published a consultation paper on proposed modifications to the rules for trading books. Comments were invited to be submitted until May 27. The modifications were related to the following:

- the treatment of counterparty credit risk (for OTC derivatives, repo and reverse repo transactions, securities lending and borrowing transactions, lending against variable deposits, long settlement positions) and the treatment of cross-product netting arrangements (four methods of different complexity!);
- the treatment of double-default effects for trading and banking book exposures;
- the short-term maturity adjustment in the internal ratings-based approach;
- improvements to the current trading book regime, especially with respect to the treatment of specific risk, and
- the capital requirement for settlement risks (failed transactions).

The new rules for trading books were adopted by the Basel Committee on July 12. After that, the proposed text of the European Commission, reflecting the agreements made was disclosed, thus allowing the TBR results to be enacted under the new capital regulation.

Adoption of the CRD in first reading

At the beginning of September, representatives of the Commission, the Council and the European Parliament agreed on compromise text proposals for an additional six items. The amendments to the treatment of trading book items were endorsed by the ECON on September 14 and the proposal submitted by Alexander Radwan for an amended European Capital Requirements Directive based on the new Basel recommendations was unanimously passed by the European Parliament on September 28. A main difficulty was caused by the non-adoption of the European Constitution, in the absence of which the comitology procedure did not take effect. According to the original idea, the Directive would have fallen under the Lámfalussy process; thus, the technical details (Annex I -XII) could have been modified by the committees at the various levels, under the Parliament's call back right. The call back right is currently replaced by a sunset clause providing that any technical amendments may only be implemented before April 1, 2008; by then, the Parliament, Council and Commission will decide on the procedure to be followed in the future.

The ECOFIN reviewed the Parliamentary amendments to the Directive on October 11. The integral text of the Directive had been drafted by October 18. The text was unanimously endorsed by the European Council. Significant changes were made to the text even in the last moments: the TBR amendments made by the BIS and IOSCO were updated to the text and some lobbies also used the last moments to achieve some amendments to the text. Accordingly, the savings co-operatives lobby (despite contrary intentions) managed to achieve that groups belonging to the same institution protection scheme may apply the zero weighting of IGEs under more *relaxed* conditions than those originally provided in the text.

The new (formally modified) Directive will be implemented in two stages: after promulgation of the Directive on January 1, 2006, member states will have 12 months to implement it, by

[3] The Application of Basel II to Trading Activities and the Treatment of Double Default Effects

December 31, 2006; thereafter, member states *may* apply the new Directive from January 1, 2007 and *will have to* apply it from January 1, 2008.

European Commission CRD Transposition Group

The CRD Transpositions Group was formed on December 9, 2005. Each national supervisor is represented by one member in the group. The objective of the group is to facilitate correct and coherent transposition of the CRD in members states' legislation and to provide all interested parties with interpretations on the CRD and to make them available on the website of the Commission. Interpretation of the CRD, however, does not mean the re-opening of the discussion of the Directive.

1.2 U.S. developments related to Basel II

The results of the Fourth Quantitative Impact Study (QIS4) undertaken by U.S. banks suggested that the new regulatory framework may result in an unacceptable drop in capital. According to the joint statement issued by the four U.S. regulatory agencies[4] on April 29, additional time will be needed to establish why the new capital framework leads to material reductions in the aggregate minimum required capital. This may cause a delay in drafting the Notice of Proposed Rulemaking (NPR), originally planned to be published by the end of June. In their joint statement of September 30, the four U.S. regulatory agencies announced that they have revised the timeline for the implementation of Basel II. The regulators intend to publish the NPR ensuring the Basel II implementation; however, they want further prudential safeguards to be included, based on the results of QIS4. The NPR is expected to be completed in the first quarter of 2006.

According to the modified implementation plan, banks may start the parallel application of the old and the new capital requirements as of January 1, 2008. A three-year transition period will be provided: the floor capital requirement calculated under the new rules may not be less than 95% of the Basel I capital requirement in 2009, 90% in 2010 and 85% in 2011. An institution's primary Federal supervisor would assess that institution's readiness to operate under Basel II-based capital rules consistent with the above schedule and will make decisions on a bank-by-bank basis about termination of the floors after 2011. The regulatory agencies also expect to make further revisions to U.S. Basel II-based rules if necessary during the transition period before the system-wide floors terminate in 2011 and intend to retain the Prompt Corrective Action (PCA) and leverage capital requirements in the proposed domestic implementation of Basel II.

The proposal for capital requirements for banks not adopting Basel II was published on October 20 (Basel IA); the profession and the public may provide their comments within the same timeframe as that provided for the NPR.

The postponement of the implementation of the Basel II accord in the United States will entail serious consequences for international banks that are active in both Europe and the United States. The European Commission is conducting consultations with U.S. regulators on the provisions that should be applied in the transition period (when the CRD is already in force in Europe versus Basel I in the U.S.). The U.S. regulatory agencies said they will seek solutions through bilateral negotiations with European regulators for all banks affected by the

[4] Federal Deposit Insurance Corporation, Federal Reserve, Office of the Comptroller of the Currency and Office of the Thrift Supervision.

postponement. However, this procedure is not transparent and may prejudice the principle of level playing field.

Apart from the difference in implementation dates, for a consistent implementation of Basel II a number of other details should be clarified in relation to the scopes of application, validation, operational risk, securitisation, trading book and the treatment of collateral. A lot will depend on the results of the Fifth Quantitative Impact Study to be completed in the second half of 2005. This study was more comprehensive than the previous ones and also addressed the impacts of changes in the rules for trading books. If the results of this study reveal a drop in capital requirements similar to that in the U.S, significant adjustments to the Basel II Accord may become necessary.

1.3 Committee of European Banking Supervisors (CEBS)

Founded in January 2004, the Committee of European Banking Supervisors, in line with its objectives, conducted intensive consultations with market players and other stakeholders in 2005 and issued, revised and finalised a number of important documents taking into account the comments received. The following documents[5] were published by the CEBS in 2005:

- Revised consultation paper on a supervisory review process (New CP03)
- Consultation on a common framework for reporting solvency ratio (CP04)[6]
- Consultation paper on a common European framework for supervisory disclosure (CP05) (finalised)
- Consultation paper on a standardised consolidated financial reporting framework (CP06)[7]
- Consultation paper on the recognition of External Credit Assessment Institutions (ECAIs)[8] (CP07)
- Consultation paper on the role and tasks of CEBS (CP08)
- Consultation paper on an enhanced framework for cooperation between consolidating supervisors and host supervisors (CP09)
- Consultation paper on the validation and assessment of the risk management and risk measurement systems (CP10)

In addition to preparing consultation papers aimed at promoting the uniform interpretation and implementation of the Capital Requirements Directive, another important task of the CEBS is to provide the European Commission advise on banking regulatory matters. Within this framework, in December 2005, the European Commission asked the CEBS to carry out a review of the current rules for the treatment of large exposures. A stock-take on the implementation and national application of the current rules is to be completed by the end of March and a report on the results of the industry consultation on current industry practices and risk mitigation techniques is to be presented to the Commission by the end of June. The European Commission called for the CEBS's assistance in the review of the definition of own funds; market participants were requested to provide input on six questions by February 10, 2006.

[5] For more on these documents see our quarterly reports.
[6] Common Reporting Framework (COREP)
[7] Financial Reporting (FINREP)
[8] External Credit Assessment Institutions

Priorities in the CEBS' Work Programme for 2006 include the European Commission's calls for advise, the fostering of convergence and supervisory cooperation and the finalisation of guidelines and standards, taking into account the results of the consultations.

1.4 White Paper on Financial Services Policy (2005-2010)

Following its Green Paper issued in March, the European Commission published its White Paper on its financial strategy for the next 5 years. Although the objectives set by the Commission remained the same, as a result of the consultations the document and its annexes were significantly revised. After successful completion of the Financial Services Action Plan (1995-2005), the Commission's objective is to consolidate and ensure sound implementation of existing rules in the medium term (2005-2010). For better regulation,

- further open and transparent consultation,
- impact assessments, ex-post evaluations,
- coherent implementation,
- timely implementation and enforcement,
- simplified and coherent legislation
- consumer education,
- reconciliation of the legislation with other policy areas are required.

Ensuring the right EU regulatory and supervisory structures and within this, greater clarity in roles and responsibilities of home and host supervisors and improving the efficiency of supervision are priorities. Ongoing and future legislation activities in the period in question include the release of a White Paper on mortgage credit, a proposal for a Directive on consumer credit and a proposal for a Payments Services Directive. A Solvency II Directive will be developed to improve regulation and supervision in the insurance area. Legislation Measures will be introduced to eliminate barriers to cross-border consolidation. An evaluation of experiences regarding the e-Money Directive is underway. The Commission will decide whether to propose new legislation in the area of deposit guarantee schemes and will make initiatives in respect of investment funds, bank accounts and credit intermediaries.

1.5 European Commission consultation and report on Deposit Guarantee Schemes

On July 14, 2005, the European Commission issued a discussion paper in relation to the review of the Deposit Guarantee Schemes Directive (94/19/EC) due in 2005. Comments were invited by October 14, 2005. The review is to primarily assess whether the EUR 20,000 minimum coverage level of deposit guarantee schemes needs to be adjusted. However, the objectives of supervisory convergence raise the question whether or not the divergence of insurance practices is a barrier to convergence and the levelling of competitive conditions, and whether or not the differences in conditions and costs are an incentive to the decisions of market participants to change the location of their company seat within Europe.

The Consultation Paper provided a summary of existing deposit guarantee schemes, based on earlier studies, analysing the similarities and differences between deposit guarantee schemes in the various member states, and raised questions for consultation.

Following its July discussion paper, the European Commission in December published a report on the minimum guarantee level of Deposit Guarantee Schemes.[9] The report provides a thorough review of the current situation and the Commission intends to issue policy recommendations on possible changes to the deposits' guarantee level in mid-2006. The purpose of the review of the Directive is primarily to assess whether the EUR 20,000 minimum guarantee level is still appropriate. The report establishes that it is very difficult to obtain reliable information on deposits and their distribution; therefore, it is important to improve the quality of data. Without adequate information it is very difficult to decide whether the ratio of insured deposits versus insurable deposits meets the European Commission's dual requirement of not leaving too great a proportion of deposits without protection and not encouraging the unsound management of credit institutions (moral hazard). Currently there are great differences between the ratios of insured deposits in the various member states.

The report establishes that the original objectives of the Directive have not been fully met. Three future scenarios were analysed:

- 20,000 EUR guarantee level in all member states
- inflation adjusted guarantee levels
- constant guarantee level / per capita GDP

According to the initial conclusions of the Committee, fixing the 20,000 EUR level as a single guarantee level for all countries would just increase the dispersion in the way deposits are actually protected in the various member states, an adjustment on the basis of per capita GDP seems to be better in line with the spirit of the Directive. (One solution could be the definition of a common range for the insured / insurable deposits ratio). The report points out that the relationships that exist between deposit insurance and the other main regulatory measures that affect credit institutions should also be analysed when analysing the possible effect of changes to the deposit guarantee scheme.

1.6 Basel Committee documents related to the Capital Requirements Directive

Alongside the Trading Book Review[10], additional important documents were published by the Basel Committee in 2005, most of them providing guidance for the implementation of the new capital accord. The documents below are available on the Commission's website www.bis.org**:**

- Workbook for the third quantitative impact study
- Studies on the Validation of Internal Rating Systems
- Guidance on the estimation of LGD
- An Explanatory Note on the Basel II IRB Risk Weight Functions
- Guidance on the Estimation of Loss Given Default (Paragraph 468 of the Framework Document)
- Enhancing corporate governance for banking organisations
- Validation of low-default portfolios in the Basel II framework
- The treatment of expected losses by banks using the AMA under the Basel II framework
- Home-host information sharing for effective Basel II implementation
- Sound credit risk assessment and valuation for loans

[9] Report on the minimum guarantee level of Deposit Guarantee Schemes Directive 94/19/EC

[10] The Application of Basel II to Trading Activities and the Treatment of Double Default Effects. (See our 2nd Quarter Report)

1.7 FBE Banking Supervision Committee and Capital Adequacy Working Group

The FBE - and within it, the Banking Supervision Committee and the Capital Adequacy Working Group - continued to play a key role in global and European rulemaking in 2005 and had an important bearing on the contents and technical solutions of the Basel II Capital Accord and the CRD.[11] In the final stage of the adoption process of the CRD, the FBE conducted intense lobbying to achieve the professionally warranted changes in the proposed directive. The FBE played a major role in correcting some technical mistakes in the proposal and in rendering consistency within the Directive and between the CRD and the Basel Accord.

In the past period the CEBS has become a key negotiating counterpart for the FBE; the CEBS greatly relies on the opinions of the FBE in the open consultation process and its representatives have conducted discussions with FBE's professionals on a number of issues. In particular, the two organisations collaborated closely in the consultation on a common framework for reporting solvency ratio (COREP) and the consultation on the supervisory disclosure process. The FBE provided thorough and detailed comments on all consultation papers of the CEBS, stressing the importance of transparency of the consultation process. The FBE cooperates with the CEBS in the review of the regulations on own funds and large exposures.

The FBE gives special emphasis to cooperation with the competent bodies of the European Commission. It has been actively involved in drafting the White Paper, providing a mid-term vision for financial services, with special regard to taking up consolidated supervision as an objective to be achieved. It also played an active role in the European Commission's consultation on deposit guarantee schemes.

The FBE set up sub-working groups to develop common positions on the various professional issues, including the CAWG sub-working groups on the reduction of national discretions and on better banking supervision (including the harmonisation of deposit guarantee schemes). The review of the definition of own funds is addressed by a joint working group of the Banking Supervision Committee and the Accounts Committee.

2. Accounts Committee

Banking initiatives and proposals regarding IAS 39, a key regulation affecting the banking sector, are a priority on the FBE Accounts Committee's agenda and the Committee conducts intense lobbying on this matter with the International Accounting Standards Board.

After broad professional consultations, the IASB published a revised version of the Fair Value Option in IAS 39, supported by the financial sector as well as by the European Central Bank and the Basel Committee. Based on this revised and more advanced version, the European Commission drafted the regulation, which was adopted at the end of the year. The suspension regarding the Fair Value Option in IAS 39 was lifted. Application will be retrospective, which means that those European companies listed on the stock exchange that effective from January 1, 2005 have been required to compile their consolidated annual financial reports in accordance with the international accounting standards may apply the revised version in their year-end reports.

[11] For details see our 4th Quarter Report.

The debated chapter on hedge accounting in IAS 39 continued to be suspended as of the end of 2005. In the middle of 2005, in their joint decision the IASB and the FASB (Financial Accounting Standard Board of the U.S.) clearly stated that they do not wish to commit further resources to the investigation of the interest margin hedging (IMH) model proposed by the European banking industry and submitted by the FBE as an amendatory proposal to IAS 39. Most banks with large networks in Europe continue to support the proposal and propose further steps for the adoption of the IMH model (although some banks indicated strong reservations due to the complexity of the model). For further efficient measures, the FBE wishes to assess the interest in the IMH model, that is: how many banks in Europe would adopt the model. Hungarian banks also received the product description of the model. The ultimate objective is to achieve that the suspension of hedge accounting in the IAS is lifted as soon as possible and the management of risks is properly settled.

The European Union highly supports the cooperation launched in 2005 between the European Commission and the U.S. Securities and Stock Exchange Commission (SEC) aimed at developing a harmonised and high-quality global accounting framework. Convergence between the IFRS and the US GAAP is indispensable and it is a common interest of the two continents to remove market barriers and to reduce costs. Banks active both in Europe and in the U.S. need to address several methodology changes: in addition to the IFRS, the BASEL II and SOX (Sarbanes Oxley) rules should also be implemented; another reason why convergence of the various accounting standards is so for the banking sector.

3. Fiscal Committee

The Fiscal Committee continues to give special attention to issues and tasks related to the taxation of interest income in the EU and related reporting requirements. A report was compiled on the adoption of the European legislation on saving taxation and on related rulemaking in member states.

The FBE Fiscal Committee urges for a revision of ***the 6th VAT Directive***. Due to the activity-based exemption of banking from VAT, banks cannot deduct VAT. This is an enormous cost item in the banking sector. The current VAT legislation is a main barrier to the integration of financial markets in Europe. The FBE wrote a letter to László Kovács, EU Commissioner for Taxation, seeking an early remedy to this situation.

The FBE Fiscal Committee set up a working group on ***transfer pricing***. In banking, the documentation of transfer prices is particularly important in determining the lending rates applied between related parties and in accounting for the costs of outsourced services (especially, back office operations). In relation to the prices of services between related parties (controlled transactions), the fact that the price corresponds to the arm's length price applied in a comparable uncontrolled transaction must be documented in detail (if the price is not arm's length, the corporate tax base should be increased). For banks with large networks in Europe, it is difficult to comply due to the differences in the documentation requirements in the various countries and heavy tax fines are imposed on the grounds of deficient documentation. Taxpayers are squeezed between the two, competing, national tax authorities. The relevant OECD guidelines have not been adopted properly or at all in member states; national regulations are missing, outdated or non-existent in member states.

Further to this, the working group will address issues arising during the development of a Common Consolidated Corporate Tax Base. The objective of the proposal is to provide

common principles for the calculation of the corporate tax base, while maintaining the freedom of member states to determine the tax rates. Currently there are 25 different corporate tax systems in Europe, which, due to the lack of harmonisation, entails significant costs for companies with cross-European operations.

4. Financial Market Committee

In the FBE's opinion, the adoption of the Hague Convention would disadvantage European banks in their dealings with American customers in disputes related to securities in custody. The provision of the Convention, according to which the contractual parties may freely agree on the governing law for disputes related to securities in custody would clearly favour financially powerful non-European banks, investment firms and customers, as they could insist on stipulating, for example, the Law of the State of New York to be the governing law. Stipulating a non-European law as the governing law would entail undesirable consequences in terms of legal (lawyer) costs, litigation procedures, execution and potential liquidation procedures.

If the Hague Convention is signed, European-level legislation and national laws would have to be revised in several points. The professional community regarded the transposition of Directives 98/26/EC and 2002/47/EC into domestic legislation as a progressive move contributing to the stable development of the securities market, system risks involved in the adoption of the Hague Convention would be a significant step back from this progress.

5. Social Affairs Committee

The Social Affairs Committee launched an Enlargement Project. In the first phase of the project, bilateral dialogues were organised between new and old member states. Hungary was hosted by Austria. A report on the conclusions of the bilateral meetings will be prepared jointly with the European Trade Union Federation UNI-Europa.

The Committee also launched a Demography Project to analyse how the ageing of the society will affect the banking system. Within this, the situation in the individual member states, and the correlation of demography with the employability of the older generation, job opportunities for the younger generation and social security will be assessed.

Other issues addressed by the Committee include proposed amendments to the EU Working Time Directive. The debate is over whether or not the mandatory application of the provisions on maximum weekly working hours should be upheld and how on-call time should be treated. The Committee places special emphasis on the continuous exchange of views and information sharing.

6. Communications Committee

Research and experience on the image of banks is a central agenda item of the meetings of the Communications Committee.

The German experience was presented at the Committee's Rome meeting. The performance of the banking sector in Germany is low and falls behind that of other sectors in growth. Notwithstanding this poor performance, the general public has a different opinion and is dissatisfied with the information provided by banks. Changing the image of banks is a time-

consuming task (a situation caused by one bad news takes half a year to rectify); therefore, banks have decided to improve their communications with the society. Banks are primarily communicating the positive news, keeping regular contact with the press, and now start familiarising students with the economic conditions already in the school: regular information on the state of the economy is distributed by e-mail to teachers, who then forward this information to the students.

A successful program in Italy, PattiChiari, is aimed at high-quality customer information. Under this program, marketing is done not through the media but through bank branches. Customers are provided with maps showing the nearest ATMs, lists of low-risk bonds and information on the time and documents required for credit approval by loan amount at the various banks. Substantial funding (EUR 20 million) has been committed to the project and a special unit with a staff of 20 was set up in 2003 to manage the program. The program has been welcomed by the general public and has been running successfully ever since.

7. Legal Committee

The FBE Legal Committee held two meetings in 2005. Gérard Gardella was appointed as Chariman and Robert Priester as Head of Department to the Committee. By the definition, the Legal Committee addresses a wide range of issues. The most important of these are:

A new instrument for legal harmonisation (26th Regime)

This is a new and alternative tool to conventional legal harmonisation. The designation 26th Regime indicates that in addition to similar but unharmonised legal regimes in the 25 member states, the EU would introduce a 26th regime, which member states might choose to apply in parallel with their existing frameworks or to replace their existing frameworks with it. The idea is so new, that even its legal grounds are still debated, that is, whether the Council has the right to enact such a regulation or a unanimous vote is needed. If a unanimous vote is needed, then the question arises whether such an instrument is needed at all: if there is consensus between member states on a certain issue then it can be instituted through a respective directive or a regulation directly overriding the national rules. Anyway, the proposed method would be useful for standardising cross-border products and services (*products or services with a passport)* by eliminating the barriers posed by the requirements of mutual recognitions and the country of origin principle. The EU does not want member states to adopt new rules or adjust current ones, it would just offer a new instrument that could be applied in parallel with existing rules. Examples for this type of instrument are the European Company (SE) and the Community Trademark.

European Bank Arrestment (EBA)

The European Commission's DG Justice proposes to introduce an institution that is similar to the current execution on domestic bank accounts, but would be enforceable at a pan-European level under a 26th Regime-type structure. Instead of an actual execution on the bank account, the proposal envisages to introduce a security measure, the arrestment of the debtor's bank account. In this context, a number of issues are yet to be clarified, and particularly the following:

- Should the EBA be issued before a Court decision is made or after it?
- Would it be necessary for the Court in the country of issue to declare the EBA as enforceable?
- Who should bear the costs of the enforcing bank?

Although at first glance, the institution of the EBA seems attractive for banks in conflicts with bad debtors, the issue needs a careful analysis and consideration of counter-arguments. At its 101st Meeting, the FBE's Legal Committee pointed out the following:

- banks do have the means to enforce their claims against bad foreign debtors; hence, the EBA does not necessarily improve the bank's position as a creditor, while the bank's obligation to enforce the EBA against the customer, who is an account holder of the bank, is a rather unpopular task;
- therefore, the word *Bank* should be omitted from the name of the instrument and the name should be *European Arrestment*;
- the question is how the creditor can get hold of the of debtor's account details.

In summary: an impact study and cost analysis will be needed for developing a final position on the EBA.

European Payment Order (EPO)

A proposal for a Directive on European Payment Order has been drafted. As a main rule, the European Payment Order would only be used for cross-border transactions, member states would be free to decide on its application at the national level. In this sense the EPO would be a 26th regime type instrument, which, in terms of contents, would be similar to a payment assessment.

International Regulatory Dialogues concerning the policies of DG MARKT

This EU dialogue with developed financial markets (the United States, Japan, Switzerland and Canada) is aimed at removing the barriers European banks are faced with due to divergent or redundant regulations, primarily through the mutual recognition of equivalence of standards and convergence of new or existing international standards.

There is a need for legal protection against the extra-territorial effect of Section 319 of the *US Patriot Act*, which provides for sanctions on business relationships with countries or persons that have been convicted in the United States (although not in Europe). Assets of European banks have been seized many times on these grounds in the United States.

The tight requirements for the separation of banking and securities trading operations within banks in Japan pose difficulties for European universal banks operating in Japan. European banks are faced with utterly discriminative regulations in China, India and Russia. Not one European bank branch has been licensed to be opened in the latter. In India, foreign bank branches are required to keep dotation capital, subsidiaries of foreign banks cannot yet be opened and bank acquisitions by European banks are largely restricted.

The Brasilian practice can be considered as liberal but the country is reluctant to formally commit itself to it in the WTO. DG TRADE should make steps regarding the challenged

practices during trade policy negotiations with the countries concerned and primarily, at the WTO Doha round.

8. Consumer Affairs Committee

The FBE Consumer Affairs Committee reviewed the proposed EU Consumer Credit Directive. After several years of consultations, the European Commission finalised the new draft legislation and submitted it to the European Council and the European Parliament. EU banks would like to develop a common position as soon as possible in order to ensure that the banking communities at both the EU and national levels can act, where possible, in a united manner in safeguarding their interests concerning the proposed, highly consumer-protection driven, legislation. The Association organised a consultation for banks on the issue. The position taken by banks was forwarded to the competent government committee for inclusion in the Hungarian position. Banks basically rejected those provisions of the proposed legislation that provided excessive consumer protection and were impossible to implement.

9. Payments Committee

Pursuant to the EPC's Road Map, a Hungarian SEPA organisation should be set up in preparation for joining the Single Euro Payment Area. The Hungarian organisation should develop its own schedule in accordance with the Road Map.
The Association has initiated the setting up of the Hungarian SEPA organisation. The task of the Hungarian SEPA organisation will be to familiarise the parties involved with the international SEPA programme and to review and coordinate domestic tasks related to its implementation. The Hungarian banking community is involved in the development of SEPA through the Payment System Forum, set up in 2003.

Despite continuous criticism, the EPC maintains its original objective and approach, trusting that the European banking profession will be able to implement SEPA in a self-regulated manner, without any authority regulations.

The Committee adopted the Hungarian proposal for a consultation to be organised for new member states on the assistance the EPC could provide in setting up the national SEPA organisations.

After approval by the organisation's supreme body, the proposed Rulebooks for the three payment schemes (credit transfers, direct debits and card payments) developed by the relevant Technical Committees were sent to the national banking communities for approval. Coordinated by the Banking Association and the Payment System Forum, the review of the Rulebooks was completed after several consultations at the end of 2005. The Hungarian position (in line with that of most member states) was supportive of the Credit Transfers Rulebook but was sharply critical of the Direct Debits Rulebook, as it would be a step back compared to the current domestic practice. The document is now being revised by the EPC.

10. Meeting of Banking Associations of the Visegrád countries, Warsaw

Poland initiated closer cooperation between the banking associations of the Visegrád countries, including a review from time to time of common issues of interest, the coordination of professional views and occasionally, acting jointly within the FBE according to the group's particular interests. Participants in the Warsaw meeting (the colleague from the Czech Republic

cancelled attendance at the last moment) gave brief presentations on their economies and banking sectors and outlines of the mains issues to be tackled. They addressed in details issues related to the implementation of the Basel II Capital Accord, supervisory cooperation and accountancy issues, with special regard to anomalies in the calculation of effective interest rates in the IFRS, mergers and acquisitions affecting the European banking industry, social dialogue, the single European payment area, data protection, credit information systems and corporate governance. Participants found the experience of the Polish credit information system very instructive.

Annex

Board Meeting Agendas 2005

Date	Agenda
January 17, 2005	1. Amendment to the Rules of the Hungarian Banking Association in relation to voting rights 2. Work programme of the Hungarian Banking Association for the first half of 2005 3. Briefing on the proposal of the National Development Office for setting up the Municipalities Guarantee Ltd. 4. Issues related to operations of the EPC 5. Briefing on the Association's 2004 financial management based on preliminary figures. 6. Miscellaneous
February 7, 2005	1. Economic and financial developments in 2004 from the perspective of the banking sector (Background document for the press meeting of February 14, 2005). 2. Proposal for the 2005 Budget of the Hungarian Banking Association 3. Briefing on consultations with the Ombudsman for Civil Rights on legal concerns related to collections. 4. Miscellaneous
March 7, 2005	1. Report on 2004 Activities of the Hungarian Banking Association (Document for the General Meeting) 2. Report on the financial management of the Hungarian Banking Association in 2004 (Document for the General Meeting) 3. Proposal for the 2005 budget of the Hungarian Banking Association (Document for the General Meeting) 4. Proposal for main tasks for the Hungarian Banking Association in 2005 (Document for the Board Meeting) 5. Miscellaneous
April 4, 2005	1. Preparations for the General Meeting 2. Bank finance for PPP projects 3. Customs Council 4. Cooperation agreement between the Hungarian Banking Association and the Budapest Chamber of Commerce and Industry 5. Miscellaneous

April 12, 2005. **(General Meeting)**	1. Briefing by Prime Minister Ferenc Gyurcsány on current economic policy issues 2. a). Report on 2004 Activities of the Hungarian Banking Association (in Hungarian and English) b). Proposal for main activities of the Hungarian Banking Association in 2005 (in Hungarian and English) 3. a). Report on the financial management of the Hungarian Banking Association in 2004. b). Proposal for the 2005 Budget of the Hungarian Banking Association 4. Election of the Board of the Hungarian Banking Association
May 2, 2005	1. National Development Office concept for the Municipalities Guarantee System (József Czimer, Councillor, National Development Office) 2. Cooperation with KPMG Hungary 3. GKI Economic Research Co. proposal for cooperation 4. Report on the financial management of the Hungarian Banking Association, January-March 2005. 5. Miscellaneous
June 6, 2005	1. Report on latest developments on the Capital Requirements Directive 2. Submission regarding the MNB's evaluation on the quality of annual reporting 3. Submission regarding the proposed cooperation between the Association and a consulting company in accounting and tax issues 4. Submission regarding the request received by the Board in connection with local trade tax. 5. Briefing on projected special bank tax payments in 2005 6. Proposal for amendments to security provisions for bank tills 7. Miscellaneous
October 10, 2005	1. Business plans of Creditguarantee Ltd. Presenter: György Radnai, CEO, Creditguarantee Ltd. 2. Creation of a Common Inter-Bank Database on Operational Risk 3. Proposal: joining the voluntary Code on pre-contract customer information on home loans 4. Banking Association position on interest tax 5. Open letter by the President of the Alliance of Free Democrats (SZDSZ) on the introduction of the euro in 2010 6. Miscellaneous

November 7, 2005	1. Economic policy in 2005 - Assessment and Proposals 2. Main issues for the meeting with the Minister of Finance on November 10, 2005 3. Decision on a request to be submitted to the Constitutional Court regarding the unconstitutionality of certain provisions in the Credit Institutions and Capital Market Acts. 4. Cooperation agreement with the National Association of Financial Enterprises 5. Miscellaneous: a) Decision on the application for membership of Fortis Bank SA/NV Hungary Branch b) Initiative of the A Chance for Disadvantaged Children Foundation c) Briefing on the financial management of the Hungarian Banking Association Q1-Q3 2005
December 5, 2005	1. Briefing on special bank tax payments in 2005 - Q1-Q3, 2005 2. Future role of domestic Automatic Clearing Houses in SEPA 3. Briefing on activities of the Hungarian Banking Association in the third quarter of 2005 4. Miscellaneous

DRAFT RESOLUTION

The General Meeting adopts the Report on 2005 Activities of the Hungarian Banking Association.

Budapest, April 14, 2006

Dr Rezső Nyers