Institute of International Bankers

Global Survey 2005

Regulatory and Market Developments

Banking - Securities - Insurance
Covering 38 Countries and the EU

September 2005

OVERVIEW

The Institute of International Bankers represents internationally headquartered banking/financial institutions from over 30 countries that engage in banking, securities, insurance and other financial activities in the United States. The combined banking and non-banking assets of the U.S. operations of international banks total over $4 trillion. This 18th annual *Global Survey of Regulatory and Market Developments in Banking, Securities and Insurance* is part of the Institute's efforts to contribute to the understanding of the trends toward globalization of financial markets and convergence of regulatory systems around the world. This year's Global Survey covers developments during the period from July 1, 2004 to June 30, 2005 in 38 countries and the European Union (EU). We are very grateful to the banking associations and financial services supervisory authorities from those countries and the EU that have contributed to this year's Survey and without whose participation this publication would not be possible. We are also grateful to Connie M. Friesen, Partner at the law firm of Sidley Austin Brown & Wood LLP, and her colleagues in New York for assisting the Institute in the preparation of this year's Survey.

As discussed in a number of the individual country chapters, the period under review saw continued developments in such areas as implementation of Basel II, corporate governance and efforts to combat money laundering and the financing of terrorism.

In the United States, the federal banking agencies concluded their fourth Quantitative Impact Study ("QIS4") in the spring of 2005. In a statement issued on April 29th, the banking agencies indicated that the minimum regulatory capital charges resulting from QIS4 were more variable across financial institutions and these capital charges dropped more, in the aggregate, than the federal banking agencies had expected. This was the impetus for their decision to delay issuance of a next round of proposals for Basel II while they review the QIS4 results. At the same time, the federal banking agencies have emphasized that they remain committed to moving forward with the implementation of Basel II. The delay in issuing a notice of proposed rule making is intended to ensure that any proposed changes to the risk-based capital framework to be implemented in the United States are consistent with safety and soundness, good risk management practices, and the continued competitive strength of the U.S. banking system. It was anticipated that representatives of the U.S. federal banking agencies would meet in the early fall of 2005 to prepare for presentations on Basel II implementation at the quarterly meeting of the Basel Committee on Banking Supervision in October 2005.

Meanwhile, the European Commission published in July 2004 the Capital Requirements Directive which will implement Basel II in the EU member states. The Directive will apply to all banks and investment firms in the EU and will become effective on January 1, 2007, although banks following the Advanced Approaches will have an additional year. The complexity of the Directive (which is nearly 500 pages long), and the lack of certainty have resulted in delays for European banks and investment firms in their implementation processes.

In the wake of the Sarbanes-Oxley Act in 2002, corporate governance issues continued to be a major focus of attention during the period under review. In Germany, for example, the summer of 2005 saw the passage of the Act on Corporate Integrity and Modernization of the Right of Rescission, which will become effective in November 2005. The Act implements a catalogue of measures presented by the German government in early 2003 to strengthen investor confidence in the integrity, stability and transparency of the financial markets, particularly by reforming the system of corporate governance. Meanwhile, the Basel Committee on July 29, 2005 issued a revised guidance, entitled Enhancing Corporate Governance for Banking Organizations (the "Bank Corporate Governance Document"), to help promote the adoption of sound corporate governance practices by banking organizations. In its current form, the Bank Corporate Governance Document is a draft and public comment has been invited prior to October 31, 2005. The draft highlights (a) the importance of effective management of conflicts of interest; (b) the role of internal and external auditors and other control functions; (c) the important role of boards of directors in promoting transparency in corporate governance; and (d) the role of bank supervisory agencies in promoting sound corporate governance. The Bank Corporate Governance Document has been cited in several speeches of various Governors of the U.S. Federal Reserve Board and is likely to influence directly both bank regulations and "sound practices" in the United States.

As indicated above, many of the chapters deal with ongoing efforts to combat money laundering and terrorist financing. In the European Union, the EU Council of Ministers approved a third Anti-Money Laundering Directive, which is to be implemented in member states by early 2007. The new directive aims to ensure consistent application in all member states of FATF's revised 40 Recommendations. In a long-awaited development in the U.S., the federal banking agencies and the U.S. Treasury Department's Financial Crimes Enforcement Network (FinCEN) published on June 30, 2005 a comprehensive Bank Secrecy Act/Anti-Money Laundering Examination Manual designed to promote greater consistency and clarity in the application of the BSA to banking organizations. In Bermuda, the introduction of a new Anti-Terrorism Act provides a framework for dealing with any terrorist financing concerns, consistent with the requirements of the standards agreed by the Financial Action Task Force (FATF). At the same time, the Bermuda Monetary Authority continued to work closely with the National Anti-Money Laundering Committee in an ongoing review of current provisions of Bermuda's anti-money laundering arrangements, with a view to ensuring full consistency with the revised recommendations adopted by the FATF in late 2003. Elsewhere, Australia is consulting broadly on the implementation of the FATF's revised 40 Recommendations, which the Government accepted in December 2003. The Philippines, meanwhile, was removed from the list of Non-Cooperative Countries and Territories (NCCTs) during a meeting of FATF on February 11, 2005.

In other notable developments during the period under review, Bank of America agreed to invest $2.5 billion in China Construction Bank. The deal, finalized on June 17, 2005, marked the largest single investment to date by an overseas firm in a Chinese company. And in another development that gained widespread attention, Japan's Financial Services Agency announced an administrative judgment relating to Citibank, N.A. in Japan on September 17, 2004. The decision was based on findings of material legal violations, improper transactions and other incidents, particularly with respect to private banking operations. Operational licenses for all four Citibank offices in Japan involved in private banking activities will be revoked on September 30th.

As in past years, the Survey includes an updated table on permissible securities, insurance and real estate activities of banking organizations in various countries. In addition, this year's Survey includes updated tables on the approach countries take to funding the activities of their bank supervisory authorities, implementation of Basel II, market risk capital requirements, consolidated supervision, host country supervision of branches of non-domestic banks, applicability of host country endowment/dotational capital requirements for branches of non-domestic banking organizations, the applicability of asset pledge requirements to branches of non-domestic banking organizations, availability of central bank "daylight overdraft" credit for both domestic and non-domestic banking organizations, and permissibility of merchant banking activities.

Lawrence R. Uhlick
Executive Director and
General Counsel

For further information contact:

Institute of International Bankers
299 Park Avenue
New York, New York 10171
Tel: (212) 421-1611
Fax: (212) 421-1119
E-Mail: IIB@IIB.org

TABLE OF CONTENTS

THE APPROACH COUNTRIES TAKE TO FUNDING THE ACTIVITIES OF THEIR BANK SUPERVISORY AUTHORITIES

Country	Funded Through Assessments Paid by the Regulated Institutions and Independent of the Government's General Budget Process	Funded Through Assessments Paid by the Regulated Institutions but Subject to the Government Budget Process, Including any Freezes	Funded Through the Central Bank's Budget Process	Funded Through Deposit Insurance Assessments	Funded Through the Government's General Budget Process
Argentina			Central Bank of Argentina		
Australia		Australian Prudential Regulation Authority[1]			
Austria	Austrian Financial Market Authority[2]		Oesterreichische Nationalbank		Ministry of Finance
Bahrain			Bahrain Monetary Agency		
Belgium	Banking, Finance and Insurance Commission		National Bank of Belgium		
Brazil			Banco Central do Brasil		

[1] Not subject to government freezes
[2] The Federal Act on the Institution and Organization of the Financial Market Authority stipulates that the Austrian federal government contributes a fixed sum each financial year.

Country	Funded Through Assessments Paid by the Regulated Institutions and Independent of the Government's General Budget Process	Funded Through Assessments Paid by the Regulated Institutions but Subject to the Government Budget Process, Including any Freezes	Funded Through the Central Bank's Budget Process	Funded Through Deposit Insurance Assessments	Funded Through the Government's General Budget Process
Canada	Financial Consumer Agency of Canada/ Office of the Superintendent of Financial Institutions			Canada Deposit Insurance Corporation	
Czech Republic			Czech National Bank	Deposit Protection Insurance System	Securities Commission/Office for Supervision of Credit Cooperatives
Denmark	Danish Financial Supervisory Authority				
Egypt			Central Bank of Egypt		
Finland	Financial Supervision Authority				
Germany	Federal Financial Supervisory Authority		Deutsche Bundesbank	Deposit Insurance Systems of Private Banks	

Country	Funded Through Assessments Paid by the Regulated Institutions and Independent of the Government's General Budget Process	Funded Through Assessments Paid by the Regulated Institutions but Subject to the Government Budget Process, Including any Freezes	Funded Through the Central Bank's Budget Process	Funded Through Deposit Insurance Assessments	Funded Through the Government's General Budget Process
Hong Kong			Hong Kong Monetary Authority		
Ireland	Irish Financial Services Regulatory Authority – 50%		Irish Financial Services Regulatory Authority – 50%		
Israel			The Bank of Israel		
Japan					Financial Services Agency
Korea	Financial Supervisory Service		Financial Supervisory Service		
Latvia	The Financial and Capital Market Commission[3]				

[3] From July 1, 2001 to December 31, 2006, activities of the Financial and Capital Market Commission are financed from payments made by financial and capital market participants, the State budget and the Bank of Latvia. As from 2007, the activities of the Commission shall be fully financed from payments by financial and capital market participants.

Country	Funded Through Assessments Paid by the Regulated Institutions and Independent of the Government's General Budget Process	Funded Through Assessments Paid by the Regulated Institutions but Subject to the Government Budget Process, Including any Freezes	Funded Through the Central Bank's Budget Process	Funded Through Deposit Insurance Assessments	Funded Through the Government's General Budget Process
Luxembourg	Commission de Surveillance du Secteur Financier		Banque Centrale du Luxembourg		
Norway		Kredittilsynet	Norges Bank	Guarantee Schemes for Banks	
Philippines	Bangko Sentral ng Pilipinas				
Portugal	Securities Market Commission		Banco de Portugal	Deposit Protection Scheme	
Romania			National Bank of Romania		
Singapore			Monetary Authority of Singapore		
Spain			Bank of Spain		
Sweden		Financial Supervisory Authority	Sveriges Riksbank	Deposit Guarantee Board	

Country	Funded Through Assessments Paid by the Regulated Institutions and Independent of the Government's General Budget Process	Funded Through Assessments Paid by the Regulated Institutions but Subject to the Government Budget Process, Including any Freezes	Funded Through the Central Bank's Budget Process	Funded Through Deposit Insurance Assessments	Funded Through the Government's General Budget Process
Switzerland	Swiss Federal Banking Commission				
Turkey	Banking Regulation and Supervisory Agency			Saving Deposit Insurance Fund	
United States	Office of the Comptroller of the Currency (OCC) as well as a number of states	A number of states, including the New York State Banking Department	Federal Reserve System	Federal Deposit Insurance Corporation	
United Kingdom	Financial Services Authority				

THE APPROACH COUNTRIES ARE EXPECTED TO TAKE TO IMPLEMENTATION OF BASEL II[1]

Basel II is Expected to be Implemented on a Limited Basis for Large Complex Banking Institutions	Basel II is Expected to be Implemented for all Banking Institutions Without Exemptions for Less Complex Institutions
United States[2]	Argentina[3] Australia[4] Austria Bahrain Belgium Bermuda Canada Chile Czech Republic Denmark Finland France Germany Hong Kong[5] Ireland Israel Italy Latvia Luxembourg The Netherlands Norway The Philippines[6] Portugal Romania[7] Singapore[8] Spain Sweden Switzerland Turkey[9] United Kingdom

[1] This chart describes the approach countries are expected to take in the application of Basel II to incorporated banking entities; it does not cover the extent to which a host country will assess the capital of a non-domestic bank operating a branch in the host country.

[2] U.S. supervisory authorities intend to use only the most sophisticated approaches of Basel II, which will be required for only about the 9 largest U.S. banks (other large U.S. banks are expected to adopt them on a voluntary basis).

[3] Argentine regulatory authorities may allow banks a transitional period during which they would remain subject to Basel I.

[4] Australia has announced that it intends to adopt Basel II for all authorized deposit taking institutions. At least initially, it is expected that organizationally and operationally less complex institutions will adopt the simpler Basel approaches

[5] The HKMA will make available a "Basic Approach" for smaller institutions with simple and straightforward operations (i.e. mainly the restricted licensed banks and the deposit-taking companies). The Basic Approach builds on the existing framework for calculating capital charge for credit risk, with certain changes to align it with the Basel II revised framework. Institutions adopting the Basic Approach are also required to calculate an operational risk capital charge and be subject to Pillar Two and Pillar Three requirements.

[6] Universal/commercial banks (UBs/KBs) are expected to comply with the standardized approach for credit risk and the basic indicator or standardized approaches for operational risk by 2007. By 2010, these banks may move to the foundation internal ratings based (IRB) or advanced IRB approaches for credit risk, and advanced measurement approaches for operational risk. Thrift banks (TBs) are generally expected to be subject to an enhanced Basel I-type approach by 2007. However, TBs affiliated with UBs/KBs should use the same approach used by their "parent" UBs/KBs. Rural/cooperative banks, meanwhile, are expected to be subject to an enhanced Basel I-type approach also by 2007.

[7] In Romania, the central bank, as banking supervisory authority, intends to adopt all elements of Basel II.

[8] In Singapore, there are only three local banking groups of broadly similar complexity.

[9] Turkey's regulatory authorities may allow banks a transitional period during which they would remain subject to Basel I.

MARKET RISK CAPITAL REQUIREMENTS

Banks subject to Risk-based capital Requirements for market risk	Nonbank financial institutions (such as securities or insurance firms) subject to risk-based capital requirements for market risk	Banks permitted to use Internal models to Measure market risk for risk-based capital adequacy requirements
Argentina	Australia (securities and insurance firms)	Australia
Austria	Austria (securities firms)	Austria
Australia	Belgium (securities firms)	Bahrain
Bahrain	Bermuda (securities and insurance firms)	Belgium
Belgium	Brazil (securities firms)	Canada
Bermuda	Czech Republic (securities and insurance firms)	Cayman Islands
Brazil	Denmark (securities firms)	China
Canada	European Union (securities firms)	Colombia
Cayman Islands	Finland (securities firms)	Czech Republic
China	France (securities firms)	Denmark
Colombia	Germany (securities firms)	Estonia[3]
Czech Republic	Greece (securities firms)	European Union[4]
Denmark	Ireland (securities firms)	Finland
Estonia	Italy (securities firms)	France
European Union	Korea (securities firms)	Germany
Finland	Latvia (securities firms)	Hong Kong
France	Luxembourg (securities firms)	Indonesia
Germany	Mexico (securities firms)	Ireland
Greece	Norway (securities firms)	Israel
Hong Kong	Poland (securities firms)	Italy
Indonesia	Portugal (securities firms)	Japan
Ireland	Singapore (securities firms; futures brokers)	Korea
Israel	South Africa (securities firms)	Latvia[5]
Italy	Spain (securities firms)	Luxembourg
Japan	Sweden (securities firms)	Netherlands
Korea	Switzerland (securities firms)	Norway
Latvia[1]	United Kingdom (securities firms)	Pakistan
Luxembourg	Venezuela (securities firms)	Philippines[6]
Mexico		Poland
Netherlands		Singapore
Norway		South Africa[7]
Peru		Spain
Philippines		Sweden
Poland		Switzerland
Portugal		Turkey
Romania[2]		United Kingdom
Singapore		United States
South Africa		
Spain		
Sweden		
Switzerland		
Turkey		
United Kingdom		
United States		
Venezuela		

See the text of the footnotes on the next page for additional explanatory information.

[1] In Latvia, the capital requirement for fx risk applies from July 1, 2000, while for other market risks it applies from January 1, 2000.

[2] In Romania, market risk capital requirements have been imposed by the NBR Rules No.5/2004, in force starting with January 1, 2005. The actual provisions shall be updated in order to bring them in line with the provisions of Basel II, as transposed in the Re-casting Directive 2000/12/EC of the European Parliament and of the Council of the 20 March 2000 relating to the taking up and pursuit of the business of credit institutions and Council Directive 93/6/EEC of 15 March 1993 on the capital adequacy of investment firms and credit institutions.

[3] In Estonia, internal models can be used, provided the resulting capital requirement is <u>not</u> lower than that required under the EU Directives.

[4] EU-based banks will be able to use internal models to the extent permitted by the Basel Committee "Amendment on Capital Requirements for Market Risk" upon implementation of CAD II.

[5] Use of VAR models is not allowed in Latvia. Delta-plus method for options can be used with the consent of the Financial and Capital Market Commission.

[6] Subject to prior BSP approval.

[7] Subject to prior written approval by the Registrar and a prescribed monitoring period.

THE APPROACH COUNTRIES TAKE TO CONSOLIDATED SUPERVISION OF THE OPERATIONS OF DOMESTIC AND NON-DOMESTIC FINANCIAL GROUPS

Consolidated Supervision Applied to Bank Subsidiaries and Affiliates of Domestic and Non-Domestic Financial Groups <u>and</u> to Unincorporated Branches/Agencies and Affiliates of Non-Domestic Financial Groups	Consolidated Supervision Applied to Bank Subsidiaries and Affiliates of Domestic and Non-Domestic Financial Groups <u>But Not</u> to Unincorporated Branches/Agencies and Affiliates of Non-Domestic Financial Groups	Consolidated Supervision Applied to Bank Subsidiaries and Affiliates of Domestic Financial Groups <u>But Not</u> to Bank Subsidiaries and Affiliates or Unincorporated Branches/Agencies and Affiliates of Non-Domestic Financial Groups	Consolidated Supervision is <u>Not</u> Applied to Either Domestic or Non-Domestic Financial Groups
Argentina Brazil Canada[1] China France Indonesia Ireland Italy Japan Luxembourg The Netherlands Philippines Spain[2] Sweden[3] Switzerland[4] United States[5]	Australia Austria[6] Bahrain Belgium Bermuda[7] Finland Hong Kong[8] Korea[9] Latvia Poland Romania[10] Singapore[11] United Kingdom	Czech Republic Denmark[12] Germany Norway Turkey	Israel

[1] While the Office of the Superintendent of Financial Institutions oversees the operations at the federal level, certain entities within a financial group (e.g. securities and insurance companies) may also be subject to supervision by provincial agencies, such as the Ontario Securities Commission.

[2] As far as subsidiaries, affiliates or branches of non-domestic banks are concerned, consolidated supervision refers to their respective "Spanish sub-groups."

[3] Regarding affiliates of banks within the EEA, the Swedish Financial Supervisory Authority has a shared responsibility with the home country supervisor. After notification to the Swedish supervisor a home country supervisor may conduct an on-site exam at an affiliate location in Sweden.

[4] Swiss Banking law requires the Swiss Federal Banking Commission (SFBC) to exercise consolidated supervision over bank subsidiaries and affiliates of domestic financial groups. Bank subsidiaries and affiliates of non-domestic

financial groups and unincorporated branches/agencies of non-domestic financial groups are only allowed in Switzerland if they are subject to consolidated supervision by their home country banking authority.

[5] Under the Gramm-Leach-Bliley Act of 1999 as well as the International Banking Act of 1978 the U.S. Federal Reserve Board does make determinations regarding the capital strength of the non-domestic banking organization that seeks to become a "financial holding company" or engage in other nonbanking activities permissible for bank holding companies.

[6] Within the European Union (EEA countries) reliance is placed on home country control; non-EU countries: The Austrian Banking Act stipulates that a non-EU non-domestic branch is treated in principle in the same way as an independent credit institution is treated. Thus, the Austrian branch is obliged to fulfill the Austrian regulatory and supervisory provisions independently. The situation of the entire bank will not be taken into account. However, legally the branch is not deemed to be independent.

[7] Bermuda does not license branches of overseas banks. Consolidated supervision is applied to the licensed entity and to any subsidiaries or affiliates.

[8] The Hong Kong Monetary Authority (HKMA) supervises locally incorporated authorized institutions on a consolidated basis, covering their subsidiaries as well as local and overseas branches. The prudential requirements and supervisory approach applicable to foreign bank branches are broadly the same as those for authorized institutions incorporated in Hong Kong. The HKMA will also require that branches of foreign incorporated banks are under adequate consolidated supervision in their home country. This is one of the minimum authorization criteria that will be assessed at the time of authorization and on an on-going basis thereafter.

[9] As far as subsidiaries, affiliates or branches of non-domestic banks are concerned, consolidated supervision refers to their respective Korean sub-groups.

[10] The National Bank of Romania supervises locally incorporated authorized institutions on a consolidated basis, covering their subsidiaries as well as local and overseas branches. The NBR will also require that branches of foreign incorporated banks are under adequate consolidated supervision in their home country. This is one of the minimum authorization criteria that will be assessed at the time of authorization and on an on-going basis thereafter. After the accession date, within the EU, reliance will be placed on home country control.

[11] The Monetary Authority of Singapore (MAS) supervises Singapore-incorporated banks on a consolidated basis, taking into account the operations of their domestic and overseas branches and subsidiaries. MAS does not supervise on a consolidated basis unincorporated branches, agencies and affiliates of non-domestic financial groups but takes into account, among other things, the adequacy of consolidated supervision exercised by parent supervisors for the foreign banks' operations in Singapore and overseas in considering applications made under our licensing and regulatory processes.

[12] If the parent company is located abroad only the subgroup is encompassed by the consolidated supervision.

HOST COUNTRY SUPERVISION OF BRANCHES OF NON-DOMESTIC BANKS[1]

Host Country Generally Relies on Global Supervision by the Home Country[2]	Host Country Applies Its Supervisory Standards Apart from the Home Country[4]		
Cayman Islands	Argentina	France	Peru
Panama[3]	Australia	Germany	Philippines
	Austria	Greece	Poland
	Bahrain	Hong Kong	Portugal
	Belgium	Indonesia	Romania
	Bolivia	Ireland	Singapore[7]
	Brazil	Israel	South Africa
	Canada	Italy	Spain
	Chile	Japan[6]	Sweden
	China	Korea	Switzerland
	Colombia	Latvia	Turkey
	Czech Republic	Luxembourg	United States[8]
	Denmark	Netherlands	United Kingdom
	Estonia[5]	Nigeria	Uruguay
	Finland	Norway	Venezuela

1 Host country supervisory practices may be subject to cooperative agreements with the banking authority in a home country.

2 The host country may impose special limitations on branches of non-domestic banks that are not subject to global supervision by the home country.

3 Branches of non-domestic banks in Panama are subject to host counting supervision under Panamanian law, but home country requirements for liquidity, capital adequacy and other conditions apply. Home country supervisors may request information from the Superintendency of Bank only for supervisory purposes.

4 Member States of the European Union (EU) are listed on the basis of their supervisory practices with respect to non-domestic banks from outside the EU. Within the EU, relationships among bank supervisors are governed by the Second Banking Directive, which establishes a "home country" supervisory system for banks incorporated in a Member State. Under these arrangements, (i) the banking license of a bank from a Member State permits the bank to branch throughout the EU without obtaining approval of the host country, and (ii) the supervisory authority of the Member State where a bank is incorporated (i.e., the home country) has primary responsibility for the operations of the bank throughout the EU. An EU Member State also can apply the home country principle applied to EU banks in whole or in part to banks from non-EU countries if there is reciprocity, close cooperation between the supervisory authorities of both countries, and a high standard of home country supervision. Otherwise, the EU Member State makes its own assessment of banks from non-EU countries and applies capital standards consistent with EU standards. By agreement, these arrangements have been extended throughout the European Economic Area to include, in addition to the 15 EU Member States, Iceland, Lichtenstein and Norway.

5 Estonia applies the EU's "home country" supervisory system to banks from EU Member States, although it is not itself an EU Member State.

6 In Japan, the supervision of the capital adequacy of non-domestic banks relies on consolidated supervision by the home country, but Japanese standards are applied to the other aspects of the branches of non-domestic banks.

7 The Monetary Authority of Singapore requires bank branches to be subject to consolidated supervision by the home country regulator.

8 The Office of the Comptroller of the Currency is the primary regulator for federal branches and agencies and the states are the primary regulator for branches and agencies licensed under their laws. The Federal Reserve has examination authority over the combined U.S. operations of international banks, including their branches and agencies. U.S. branches and agencies of international banks are subject to supervisory standards regarding risk management, asset quality, operational controls and compliance with laws and regulations.

APPLICABILITY OF HOST COUNTRY ENDOWMENT/DOTATIONAL CAPITAL REQUIREMENTS FOR BRANCHES OF NON-DOMESTIC BANKING ORGANIZATIONS[1]

Host Country Applies Such A Capital Requirement[2]	Host Country Does Not Apply Such A Capital Requirement
Argentina	Australia
Austria	Bahrain[9]
Belgium	Canada[10]
Czech Republic	Cayman Islands
Denmark[3]	Finland
France	Hong Kong
Germany[4]	Ireland
Indonesia[5]	Japan
Italy	Latvia[11]
Korea	Norway
Luxembourg	Philippines
The Netherlands	Sweden
Panama	Switzerland
Portugal[6]	United Kingdom
Romania	United States[12]
Singapore[7]	Turkey
South Africa[8]	
Spain	

[1] Banks from Member States of the European Union (EU) may branch freely into other Member States under the EU "passport" system. Accordingly, responses for these countries are limited to requirements applicable to branches of banks from outside the EU.

[2] Except as otherwise noted, the host country does not impose any restrictions on how a branch may use its endowment/dotational capital, which is freely available to a branch to make loans and investments as it sees fit (other than with respect to transactions with other members of the bank group). In this regard, endowment capital requirements are fundamentally different from "asset pledge" requirements, which restrict eligible assets to highly liquid but low yielding instruments.

[3] The Danish Financial Supervisory Authority may grant exemption from the capital requirement.

[4] Under a 1994 regulation of the German Federal Ministry of Finance, the dotational capital requirement for German branches of U.S. banks that are supervised by the Board of Governors of the Federal Reserve System or the Office of the Comptroller of the Currency has been capped at the legal minimum amount of 5 m euros.

[5] Use of funds is subject to the approval of the Bank of Indonesia.

[6] Funds must be invested in Portugal.

[7] The branch must maintain net head office funds of not less than S$10 million in Singapore, of which $5 million must be in the form of assets approved by the Monetary Authority of Singapore; viz "immovable" properties in Singapore, Singapore Treasury bills and Singapore government securities.

[8] Funds must be invested in assets denominated in South African rand.

[9] Branches of non-domestic banks holding a full commercial bank license (which allows the holder to undertake retail as well as wholesale banking business in any currency, with both residents and non-residents) are subject to such requirements.

[10] Branches of non-domestic banking organizations are instead subject to host country asset pledge requirements.

[11] A foreign bank that opens a branch in Latvia shall invest, within one year after the receipt of a license, at least EUR 1 million in assets in Latvia and shall maintain such an investment level throughout the entire time of its operations.

[12] Branches of non-domestic banking organizations may instead be subject to host country asset pledge (i.e., collateral) requirements as, for example, New York that requires 1% of third party liabilities of the branch.

APPLICABILITY OF ASSET PLEDGE REQUIREMENTS TO BRANCHES OF NON-DOMESTIC BANKING ORGANIZATIONS OPERATING IN A HOST COUNTRY[1]

Branches Are Subject to Asset Pledge Requirements	Branches Are Not Subject to Asset Pledge Requirements	
Canada	Argentina	Korea
United States[2]	Australia	Latvia
	Bahrain	Luxembourg
	Belgium	Netherlands
	Cayman Islands	Norway
	Czech Republic	Panama
	Denmark	Philippines
	Finland	Poland
	France	Portugal
	Germany	Romania
	Hong Kong	Singapore
	India	Spain
	Ireland	Sweden
	Italy	Turkey
	Japan	United Kingdom

1 Asset pledge requirements refer to any host country law or regulation that as a general matter requires branches of non-domestic banking organizations to maintain on deposit with local custodian banks a specified minimum amount (determined, for example, as a percentage of the branch's total liabilities to third parties) of liquid assets such as domestic government securities that would be available to the appropriate host country authority in connection with the liquidation of the branch. Such requirements are distinguished from (i) minimum "endowment capital" requirements, pursuant to which a branch must be established with a minimum amount of freely available funds as prescribed by the host country, and (ii) "asset maintenance" requirements, pursuant to which a host country regulator may require branches of non-domestic banking organizations to maintain in the host country a certain level of assets in relation to third-party liabilities. Among the surveyed countries, Bermuda and Colombia do not permit non-domestic banking organizations to operate through branches, and therefore the issue does not arise.

2 U.S. branches and agencies of international banks are subject to asset pledge requirements under applicable federal and state law. At the federal level, the International Banking Act of 1978 provides that branches and agencies licensed by the Office of the Comptroller of the Currency must maintain a "capital equivalency deposit" equal to at least 5% of their third-party liabilities. Requirements under state laws vary. For example, branches and agencies licensed by the State of Illinois are not required as a general matter to pledge assets, although the Commissioner retains the discretion to impose an asset pledge requirement when deemed "necessary and appropriate". In December 2002, the New York State Banking Department lowered its asset pledge requirement to 1% of third-party liabilities from 5%.

AVAILABILITY OF CENTRAL BANK "DAYLIGHT OVERDRAFT" CREDIT

Central Bank Daylight Overdraft Credit Is Not Available to Domestic and Non-Domestic Banks	Central Bank Daylight Overdraft Credit Is Available Equally to Domestic and Non-Domestic Banks But Only on a Fully Collateralized Basis	Central Bank Daylight Overdraft Credit Is Available to Domestic and Non-Domestic Banks on an Uncollateralized Basis But Stricter Limits Apply to Non-Domestic Banks
Australia[1] Bahrain Hong Kong[1] Philippines[1] Romania Switzerland[1]	Argentina Austria Belgium Czech Republic Denmark Finland Germany Ireland Israel Italy Japan Korea Latvia Luxembourg Netherlands Norway Portugal Singapore[2] Spain Sweden Turkey United Kingdom	United States[3]

[1] Intra-day liquidity is provided through repurchase agreements with the central bank.

[2] Only for banks which are Primary Dealers in Singapore government securities.

[3] Effective May 30, 2001, the Federal Reserve Board modified its payments system risk policy on an interim basis to permit qualifying institutions, including branches and agencies of international banks, to gain access to daylight overdraft credit in excess of the limits otherwise applicable to them by collateralizing the amount of any such excess.

PERMISSIBILITY OF MERCHANT BANKING ACTIVITIES[1]

Banking Organizations Are Prohibited from Conducting Merchant Banking[2]	Merchant Banking Is Permissible for Banks Pursuant To Their General Authority To Invest in Non-Financial Companies		Merchant Banking Is Permissible for Nonbank Affiliates of Banks or Specially Licensed Entities
Chile	Argentina[3]	Italy	Canada
China	Australia	Latvia	Egypt
Colombia	Austria	Luxembourg	Indonesia
Poland	Bahrain	Netherlands	Israel[8]
Uruguay	Belgium	Norway	Japan[9]
	Bermuda	Panama[5]	Korea
	Brazil	Philippines[6]	Nigeria[10]
	Cayman Islands	Portugal	United States[11]
	Canada	Romania	
	Czech Republic	Singapore[7]	
	Denmark	South Africa	
	Finland	Spain	
	France	Sweden	
	Germany	Switzerland	
	Hong Kong[4]	United Kingdom	
	Ireland	Venezuela	

[1] As used in this table, "merchant banking" is the business of investing for one's own account, either directly or indirectly through an affiliate, in the shares or other ownership interests of non-financial companies for the purpose of capital appreciation and ultimate resale or disposition and is understood to be different from making permanent investments in non-financial companies to diversify the investor's business activities.

[2] Merchant banking is either expressly prohibited by law or is not otherwise permissible under applicable statutory and regulatory provisions.

[3] Up to 12.5% of bank capital for non-complementary activities.

[4] The holding of shares by Hong Kong banks is subject to a 25% restriction based on the capital of the bank.

[5] Although the law in Panama does not contemplate a special "merchant banking" license, a bank may obtain a banking license for the sole purpose of conducting such business.

[6] Philippine banks may invest in both financial and non-financial allied undertakings subject to prior approval of the Central Bank (BSP) and certain limitations. A universal bank may further invest in non-allied undertakings subject to prior approval of the BSP and certain limitations.

[7] Generally, in Singapore banks are prohibited, without regulatory approval from acquiring a stake in excess of 10% or that gives it significant influence over the management of a company. Exceptions are given for venture capital/private equity investments.

[8] Merchant banking is permissible for separately licensed "banks for business promotion".

[9] In Japan, merchant banking is permissible for securities subsidiaries of banks.

[10] Merchant banking is permissible for separately licensed "merchant banks".

[11] The Glass-Steagall Act generally prohibits U.S. banks from owning equity interests in other companies, but they may conduct limited merchant banking activities outside the United States through Edge Act subsidiaries. Under the Gramm-Leach-Bliley Act, financial holding companies that have securities affiliates may engage in merchant banking activities (including the acquisition of controlling interests in non-financial companies) subject to certain regulatory restrictions prescribed by the Federal Reserve Board (e.g., limits on aggregate amounts of merchant banking investments and restricted holding periods). Bank holding companies that do not satisfy the criteria for becoming a financial holding company are subject to strict limitations on their investments in non-financial companies, including the following: (i) the bank holding company may not own in the aggregate more than 5 percent of any class of the voting shares of a non-financial company and 25 percent or more of any such company's total equity (voting and non-voting) and (ii) such investments must be held on a passive, noncontrolling basis.

PERMISSIBLE ACTIVITIES[1] FOR BANKING ORGANIZATIONS IN VARIOUS FINANCIAL CENTERS

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Argentina	Permitted	Permitted, but only with regard to pension fund affiliates	Limited; based on bank capital and investment	Limited	Permitted but subject to prior approval of authorities
Australia	Permitted	Permitted through subsidiaries or sister companies, subject to controls under the insurance laws	Limited	Permitted; a bank (and its consolidated banking group) is required to deduct equity investments in non-subsidiary entities that are not operating in the field of finance in excess of 0.25% of consolidated Tier 1 capital for an individual investment of 5% of consolidated Tier 1 capital in aggregate, from the bank's (and the group's) Tier 1 capital.	Shareholdings of more than 15% in a bank need the approval of the Treasurer. The Treasurer has signaled a willingness to consider an association between a bank and a non-financial company where a sound case can be presented. This policy will be applied conservatively.
Austria	Permitted	Permitted through subsidiaries	Permitted	Permitted, subject to capital deduction rules relating to equity investments in non-financial entities.	Permitted, but subject to notification and prohibition under certain circumstances

[1] With respect to the activities described, the chart indicates which types of financial activities are permitted. The chart is not intended to summarize the complete range of prudential restrictions which may apply to any such activities.
[2] Securities activities include underwriting, dealing and brokering all kinds of securities and all aspects of the mutual fund business.
[3] Insurance activities include underwriting and selling insurance as principal and as agent.
[4] Real estate activities include real estate investment, development and management.
[5] Including investments through holding company structures, where applicable.

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Bahrain	Permitted, but limited to banks	Selling as agent is permitted	Generally limited to own premises. Management or development on behalf of customers is permitted.	Subject to large exposure limits (15% of capital) and generally limited to holdings of marketable securities	No legal restriction, but subject to "fit and proper" regulations of the Bahrain Monetary Agency
Belgium	Permitted	Permitted through subsidiaries	Generally limited to holding bank premises	Single qualifying holding may not exceed 15% of bank's own funds and such holdings on an aggregate basis may not exceed 45% of own funds	Permitted, but subject to prior approval of authorities
Bermuda	Permitted	Permitted through subsidiaries	Permitted through subsidiaries	Permitted, subject to regulatory consent	Permitted, subject to regulatory vetting of business
Bolivia	Permitted	Permitted through subsidiaries	Not permitted	Not permitted	No legal restriction, but subject to approval of banking authorities
Brazil	Permitted through subsidiaries	Permitted through subsidiaries	Generally limited to holding bank premises	Limited to suppliers to the bank	Permitted

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Canada	Permitted through subsidiaries	Permitted through subsidiaries	Permitted	Permitted up to 10% interest in industrial firm	Permitted up to the following limits: a 20% voting share limit in banks with equity of $5 billion or more; a 65% voting share limit in banks with equity of $1 billion to $5 billion; and a 100% voting share limit in banks with equity of up to $1 billion.
Cayman Islands	Permitted	Permitted upon issuance of an insurance license	Permitted	Not restricted by law	Permitted, but subject to consultations with authorities
Chile	Permitted	Insurance brokerage permitted	Not permitted	Not permitted	Permitted up to 10% of a bank's shares, after which the Superintendent's prior approval is required
China	Not permitted	Not permitted	Not permitted	Not permitted	Permitted; acquisitions of 5% or more require approval of the banking regulatory authority

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Columbia	Permitted through subsidiaries	Not permitted	Permitted through subsidiaries	Not permitted, except in connection with the resolution of debts previously contracted in good faith	Permitted
Czech Republic	Subject to authorization by the Securities Commission	Selling of insurance policies as an agent is permitted; other activities permitted through independent subsidiaries with the approval of the Ministry of Finance	Permitted	Controlling interests (i.e., in excess of 50%) are prohibited. "Qualified" interests (i.e., in excess of 10% but not controlling) are permitted but may not exceed (i) individually, 15% and (ii) in the aggregate, 60% of the investing bank's capital	Subject to regulatory approval for acquisitions of voting shares equal to or in excess of 10, 20, 33 and 50%
Denmark	Permitted	Permitted through subsidiaries	Permitted up to 20% of the bank's capital	Permitted with restrictions; permanent controlling holdings in industrial companies are prohibited	Not prohibited
Egypt	Permitted through subsidiaries	Permitted through subsidiaries	Generally limited to holding bank premises	Limited to 40% of the capital of the company and in the aggregate may not exceed the bank's capital	Consent of the Central Bank of Egypt is a pre-requisite for the ownership of more than 10% of a bank's issued capital; ownership through heritage is exempted

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Estonia	Permitted	Permitted through affiliates	Permitted, but as of July 1, 1998 total investments in fixed assets may not exceed 60% of own funds	Permitted, but each shareholding may not exceed 15% of the bank's own funds and such holdings in the aggregate may not exceed 60% of own funds	Permitted
European Union[6]	Not applicable; permissibility is subject to home country authorization and limited to host country regulation	Not applicable; permissibility is subject to home country and host country regulation	Not applicable; permissibility is subject to home country and host country regulation	Each 10% or more share-holding may not exceed 15% of the bank's own funds and such shareholdings on an aggregate basis may not exceed 60% of own funds	No general restrictions; does not allow investments of 10% or more if home country supervisor is not satisfied with the suitability of the shareholder
Finland	Permitted	Only selling of insurance policies as an agent is permitted	Permitted to hold real estate and shares in real estate companies up to 13% of the bank's total assets	Permitted, subject to the EU directive on qualified companies	Permitted

[6] The Second Banking Directive contains a long list of securities and commercial banking activities that EU "credit institutions" (i.e., entities engaged in deposit-taking and lending) may conduct directly or through branches throughout the EU so long as their home countries authorize the activities. Subsidiaries of credit institutions governed by the law of the same member state may also conduct activities on the list throughout the EU, subject to conditions which include 90% ownership and a guarantee of commitments by the parent credit institutions. Insurance and real estate activities are not on the list and are therefore determined by home country and host country regulations.

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
France	Permitted	Permitted; usually through subsidiaries	Permitted	Permitted, but limited to 15% of the bank's capital; in the aggregate limited to 60% of the bank's capital	Not prohibited
Germany	Permitted	Permitted, but only through insurance subsidiaries	Permitted	Permitted, but limited to 15% of the bank's capital; in the aggregate limited to 60% of the bank's capital	Permitted, subject to regulatory consent based on the suitability of the shareholder
Greece	Underwriting permitted with consent of Bank of Greece; dealing and brokerage permitted through subsidiaries	Permitted to hold shares in insurance companies subject to limits based on the bank's capital and insurance company's capital	Generally permitted	Permitted, subject to the EU Directive on qualified holdings	Permitted, subject to the EU Directive on qualified holdings
Hong Kong	Permitted, through registration with the Securities and Futures Commission and subject to limits based on the capital of the bank	Agency permitted, subject to regulatory requirements. Underwriting permitted through subsidiaries.	Permitted, subject to limits based on the capital of the bank	Permitted, subject to limits based on the capital of the bank	Permitted, subject to regulatory consent based on suitability of the shareholder with a 10% or more controlling interest.

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
India	Underwriting permitted; trading activities through subsidiaries	Not permitted	Generally limited to holding bank premises	Limited to 30% of the capital funds of the bank	Permitted up to 30% of the capital and reserve of the investing company subject to approval of RBI of the transfer of 1% or more of the bank's capital
Indonesia	Permitted through subsidiaries	Permitted through subsidiaries	Not permitted	Not permitted	Permitted
Ireland	Permitted; usually conducted through a subsidiary	Permitted to engage in agency and certain life assurance activities through a subsidiary, which must be separate and independent	Permitted	Acquisition of more than 10% of voting rights of a firm requires Central Bank approval	Permitted, but subject to prior notification to the Central Bank for acquisition of more than 5% of total bank shares
Israel	Permitted; brokerage and investment advice by banks directly, other activities through subsidiaries	Not permitted	Permitted on a limited basis	Permitted on a limited basis	Permitted, but subject to prior approval of the Bank of Israel

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Italy	Permitted	Limited to 10% of own funds for each insurance company and 20% aggregate investment in insurance companies	Generally limited to holding bank premises	Permitted, up to 15% of the bank's capital, subject to approval of the Bank of Italy	Permitted, up to 5% of shares of the bank, subject to the approval of the Bank of Italy
Japan	Some services (e.g., selling of government bonds and investment trusts) permitted to banks, others permitted through subsidiaries.	Some services (selling insurance policies in connection with housing loans and others) permitted to banks, others permitted through subsidiaries	Generally limited to holding bank premises	Limited to holding 5% interest*	Permitted, provided total investment does not exceed investing firm's capital or net assets. Acquisitions of shares in excess of 5% must be filed and shares equal or in excess of 20% subject to regulatory approval

* Bank holding companies and their subsidiaries are allowed to hold in the aggregate up to 15% of the total shares of non-financial companies.

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Korea	Permitted through affiliates	Permitted through affiliates	Generally limited to holding bank premises and to 60% of bank capital	Permitted, but limited to 15% of the total shares of non-financial companies	Permitted, up to 10% of the bank's capital, but subject to prior approval based on suitability of the shareholder
Latvia	Permitted	Permitted through subsidiaries	Permitted; together with the investments in industrial firms must not be more than full amount of the bank's capital	Permitted, but limited to 15% of bank's capital; in the aggregate limited to 60% of the bank's capital	Subject to regulatory approval for acquisitions of voting shares equal to or in excess of 10, 20, 33 and 50%
Luxembourg	Permitted	Permitted through subsidiaries	Permitted	Permitted, but limited according to EU Directives	Permitted, but majority shareholdings are very restricted
Mexico	Permitted through affiliates	Permitted through affiliates	Generally limited to holding bank premises	Not permitted	Permitted up to 20% of the shares with approval
The Netherlands	Permitted	Permitted through subsidiaries	Permitted	Subject to regulatory approval for voting shares in excess of 10%	Subject to regulatory approval for voting shares in excess of 5%
New Zealand	Permitted; usually conducted through a subsidiary	Permitted; usually through subsidiaries	Permitted; usually through subsidiaries	Permitted	Permitted, but subject to approval of authorities

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Nigeria	Permitted	Permitted through subsidiaries	Mortgage finance permitted through subsidiaries	Limited to certain types of agricultural, industrial and venture capital companies. May not acquire more than 40% of a company's share capital. Each investment limited to 10% of the bank's capital; limited in the aggregate to 20% of capital for commercial banks and 50% of capital for merchant banks	Permitted
Norway	Permitted; the activities need no longer be conducted in separate subsidiaries; mutual fund management permitted through dedicated subsidiaries	Permitted through subsidiaries	Permitted, subject to restrictions based on total assets of the bank	Investments of up to 49% in single companies permitted; only 4% of total bank assets permitted to be invested in shares	Any person who intends to acquire a “qualified holding” (10% or more) in a financial institution must notify the authorities and get prior authorization

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Pakistan	Permitted, except for some specifically disallowed securities	Not permitted	Generally limited to holding bank premises	Permitted as a form of financing, subject to the Central Bank's prudential guidelines	Permitted
Panama	Permitted through subsidiaries	Not permitted	Not permitted	Permitted up to 25% of the bank's capital	Permitted
Peru	Permitted; dealing usually conducted through subsidiaries	Not permitted	Generally limited to holding bank premises	Generally not permitted	Permitted, subject to approval of Superintendent of Banks if investment exceeds 15% of bank's capital
Philippines	Permitted; universal banks may engage in securities activities directly or through a subsidiary with limitations; regular commercial banks may engage in securities activities only through the investment house where they have a minority interest	Insurance companies/ insurance agency and brokerage permitted for universal banks through subsidiaries with limitations; insurance agency and brokerage permitted for regular commercial banks through subsidiaries with limitations	Permitted for universal banks through subsidiaries with limitations	Permitted for universal banks through subsidiaries with limitations	Permitted with limitations on foreign and/or corporate ownership

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Poland	Permitted; dealing in publicly traded securities through subsidiaries	Permitted	Permitted	Permitted up to 25% of the bank's capital	Permitted
Portugal	Permitted; mutual funds only through subsidiaries	Permitted through subsidiaries	Generally limited to holding bank premises	Permitted up to 15% of bank's own funds (but not to exceed 25% of the voting rights of the company) and such investments may not in the aggregate exceed 60% of the bank's own funds	Subject to regulatory approval for acquisitions of voting shares equal to or in excess of 20, 33 and 50%
Romania	Banks allowed to engage in underwriting, dealing and brokering; with regard to mutual fund business, only carrying on the function of depositary institution is permitted	Not permitted; however investments in insurance companies are not limited, but are subject to notification to the NBR or in certain circumstances, to prior approval	Permitted only for carrying out banking activity in compliance with the Banking Law, for employees' use, and the enforced collection of claims	Permitted up to 15% of the bank's own funds and 20% of a company's share capital; such investments in the aggregate may not exceed 60% of the bank's own funds.	Permitted, but acquisition of 10% or more requires prior notification of the National Bank of Romania
Russia	Permitted	Not permitted	Not permitted	Permitted, but not more than in one financial-industrial group	Permitted, but acquisition of more than 25% of a bank's shares requires the Central Bank of Russia's prior approval

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Singapore	Banks may engage in the full range of underwriting, dealing, brokering and mutual fund activities	Banks can act as a distributor but not as a manufacturer of insurance products unless they possess a separate insurance license to conduct insurance business, which is governed under the Insurance Act administered by MAS	Investment in real estate is limited in the aggregate to 20% of bank's capital funds. Banks are generally not allowed to engage in property development or management	Interests in excess of 10%, or that give the bank significant influence over the management of a company, require regulatory approval. In addition, a bank may not invest more than 2% of its capital funds in any individual firm.	Acquisitions of 5%, 12% and 20% or more by any single shareholder require regulatory approval
South Africa	Generally permitted, but subject to financial reporting requirements	Banks may not hold more than 49% of a registered insurer	Bank may not hold more than 10% of their total liabilities in fixed assets, loans and advances to certain subsidiaries and investments in, and loans and advances to, certain associates	Banks require prior permission from the Registrar to establish subsidiaries within South Africa or to acquire an interest in companies outside of South Africa	Permission is required from the Registrar for holdings in excess of 15% and from the Minister of Finance for holdings in excess of 49%
Spain	Permitted; banks themselves allowed to become members of the stock exchange; mutual funds managed through separate affiliate	Marketing permitted directly and through subsidiaries	Permitted	Permitted, subject to capital-based limits under EU Directives	Acquisitions of 5% or more require the approval of the Bank of Spain

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Sweden	Permitted	Permitted	Generally limited to holding banking premises	Limited	Not prohibited, but such investments are generally not made
Switzerland	Permitted through specific license as securities dealer	Permitted through subsidiaries	Permitted	Permitted	Not prohibited
Turkey	Permitted	Permitted to act as agent but not permitted to act as principal	Not permitted unless specifically authorized by bank's charter	Limited to 15% of bank's own funds and in the aggregate limited to 60% of bank's own funds	Not prohibited
United Kingdom	Permitted; usually conducted through subsidiaries	Permitted through subsidiaries	Permitted	Permitted, subject to supervisory consultations	No statutory prohibition
United States	Permitted, but underwriting and dealing in corporate securities must be done through (1) a nonbank subsidiary of a bank holding company (subject to revenue limits), (2) a nonbank subsidiary of a financial holding company (no revenue limits) or (3) a financial sub of a national bank (no revenue limits)	Insurance underwriting and sales are permissible for nonbank subsidiaries of financial holding companies. National banks and their subsidiaries are generally restricted to agency sales activities.	Generally limited to holding bank premises	Permitted to hold up to 5% of voting shares through a BHC (bank holding company), but a BHC that is designated as a financial holding company and has a securities affiliate may exercise merchant banking powers to make controlling investments, subject to certain regulatory restrictions	Permitted to make noncontrolling investments up to 25% of the voting shares

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Uruguay	Underwriting and brokering permitted; dealing limited to public debt; mutual funds permitted with Central Bank approval	Permitted through affiliates	Generally limited to holding bank premises	Not permitted	Permitted; subject to Central Bank approval
Venezuela	Permitted without restriction for universal banks; other types of banks limited to 20% of capital	Permitted through subsidiaries, subject to controls under the insurance laws	Limited	Limited to 20% of capital	Acquisitions of more than 10% of a bank's voting stock requires approval from the Superintendent

ARGENTINA

Restructuring of Debt

In the first quarter of 2005, the Government formally proposed a plan to restructure Argentina's foreign debt of 81.8 billion US Dollars, on which Argentina has been in default since the end of 2001. The debt comprises 152 different types of bonds, and up to 178 financial products, due to the coupon stripping. Bonds included in the restructuring proposal will bear 12/31/2003 as the issue date and will be amortized semiannually during the last 10 years of maturity of each bond. Approximately 76% of the creditors have accepted the government's proposal. This new public sector obligations program places public debt in a regular payment situation. The program improves Argentina's debt profile, and provides more certainty with respect to the medium-term tax situation.

Capital Inflows

The Government established by Decree 616/2005 a minimum period of 365 days before capital inflows (with some exceptions) into the local exchange market may be transferred abroad. In addition, approximately 30% of such capital inflows will have to be deposited in a financial institution for a period of 365 days.

Changes in Minimum Capital Requirements

The Central Bank modified minimum capital requirements based on location, type of institution and the extent of operations to increase the supply of banking services in certain areas. The Central Bank divided jurisdictions into four zones, based on location, where the minimum capital requirement is a decreasing amount from 25 to 10 million pesos for banks and from 10 to 5 million pesos for non-banking financial institutions. The classification of the four zones was based on a technical analysis taking into account the concentration of loans and deposits, loans and deposits per capita, ATMs, and branches.

Measures to Facilitate Access to Credit by Small- and Medium-Sized Companies

The Central Bank adopted measures to facilitate companies' access to credit, particularly small- and medium-sized companies. The key measures were:

- The discount margin for debt instruments issued by companies whose credit rating meets certain standards was increased from 85% to 100%.

- The term of loans covered by self-liquidating guarantees, implying a minimum risk for the similar evolution of the *value* of loans and guarantees was extended to one year.

- Requirements for discount of diversified credit instrument portfolios were made more flexible, eliminating internal thresholds when the aggregate amount of the transaction is not higher than 15% of the institution's regulatory capital and none of the issuers represents more than 10% of the discounted portfolio.

A series of measures, effective until December 2005, was adopted. The rules require a debtor's credit rating to be based on its future repayment capacity, in addition to its past performance. These measures include:

- The possibility of classifying debtors compliant with the conditions set forth by the Central Bank (among others, having a high payment capacity, not registering delays of more than 30 days, etc.) in a regular situation, even though they had to refinance their debt.

- Improvements in the repayment capacity of a debtor who attempts to refinance will be factored in. This measure will reduce bureaucracy and improve the debtor's credit rating.

- Limited assistance to debtors who have good credit history and liquidity may be granted.

Federal Uniform Compensation

In November 2004, Bankers Associations and the Central Bank entered into an agreement to implement the Uniform Federal Compensation. This agreement implements the following provisions:

- As of January 14, 2005, the term for domestic retail electronic transfers was reduced to 24 hours, from 48 hours;

- The amount of checks maintained by the deposit institution has been increased. The institutions will only send electronic information, which significantly reduces the transfer of physical documents. This amount was increased from $2,000 to $3,000 starting on January 7, 2005, and it will be increased to $5,000 as of July 7, 2005.

The adoption of this system throughout Argentina requires significant investment in communication networks, information equipment, and advanced technology, based on state-of-the-art techniques used in developed countries.

Amendments to Central Bank's Information Regulations

In August 2004, the Central Bank implemented new rules on transparency, the so-called Transparency Regime. The rules implement a single system for financial institutions to present information on products and services to customers. This initiative is intended to increase competition in the financial system, allowing customers to make more informed decisions. The information published fosters a general understanding of products offered by financial institutions, as it covers a wide range of data, including maintenance costs and checking and savings account use, interest rates, mortgage and personal loans terms and conditions, and information on credit cards, both for consumers and business.

This initiative was supported by the collaborative effort of financial institutions.

At the end of December, the Central Bank initiated some measures intended to simplify information requirements, facilitate the transfer of information, prevent unnecessary duplication of orders, and provide multiple order and reception lines, which will lower administrative costs for financial institutions.

Credit Unions

Provisions of the Financial Institutions Act that relate to credit unions were amended. Credit unions will be required to operate at a single location and conduct business exclusively with their members, who must subscribe a minimum corporate stock of $200 and must be residents of the credit union district. The Act states that credit unions may grant loans and other short- and medium-term financing mainly to urban and rural small- and medium-sized companies. The Central Bank reduced the basic capital requirements, which currently amount to between $100,000 and $1 million, depending on the population of the credit union district. Requirements necessary to grant financing have also been significantly reduced, together with the determination of maximum amounts and terms applicable.

Financial System Developments

The recovery of the Argentine financial system has continued during 2004 and the first half of 2005. This has resulted in the growth of private sector credit, the improvement of portfolio quality, the recovery of the income structure and the progressive reduction of balance sheet currency gaps. Capitalizations carried out after 2001, mainly from private banks, illustrate the commitment of these institutions to the development of Argentina's financial system. Even though there remain issues to be solved, these indicators are positive signs for the banking sector and for the economy.

AUSTRALIA

Authorized Deposit-taking Institution ("ADI") Developments

In May 2005, the Australian Prudential Regulation Authority ("APRA") released authorization guidelines and a draft prudential standard for providers of purchased payment facilities ("PPFs"). PPFs include payment instruments such as stored-value cards and internet-based payment systems or "electronic purses." The draft proposals require PPF providers to obtain a conditional authorization under the Banking Act limited to providing PPF services. They must meet ADI prudential standards on governance, fitness and propriety, outsourcing, business continuity, management and auditing requirements. If the PPF also has stored value at risk, it must meet the requirements of a simplified capital adequacy framework.

For developments in relation to ADI business continuity management, governance and lenders mortgage insurance see below.

General Insurance

In November 2003, APRA released a discussion paper entitled *Prudential Supervision of General Insurance – Stage 2 Reforms* outlining proposals to revise prudential standards covering governance, capital, risk management, reinsurance management, audit and actuarial arrangements and outsourcing. During the first half of 2005, APRA released a series of further discussion papers relating to the prudential supervision of general insurers covering these proposals. These papers were accompanied by draft prudential standards issued for comment with prospective release from January 2006.

In the area of risk management, APRA has clarified its expectations for the annual submission of business plans and risk management strategies to generate improvements in capital and risk planning. The proposals also include a requirement that the CEO and CFO of an insurer attest to certain financial information. This requirement is expected to improve the quality and accuracy of financial data supplied to APRA. The proposals for reinsurance follow global regulatory trends by requiring insurers to seek APRA's approval to treat limited risk transfer arrangements as reinsurance for the purposes of regulatory capital requirements. On audit and actuarial arrangements, APRA proposes to introduce the requirement for Approved Actuaries to complete an annual Financial Condition Report for each insurer. The Liability Valuation Report will also be required to be peer-reviewed, to assist in maintaining and improving the quality and consistency of the work undertaken by the Approved Actuary. Proposals for outsourcing include the introduction of an APRA approval requirement for offshore outsourcing arrangements and the provision of notice to APRA with respect to all material outsourced business activities.

Life Insurance

In December 2004, APRA released a discussion paper, *Compliance Committee Requirements for Eligible Foreign Life Insurance Companies*. The paper is a consequence of amendments to the *Life Insurance Act 1995* (the "Life Act") required by the Free Trade Agreement negotiated in 2004 between Australia and the United States. The paper proposes a new prudential standard for branches registered under the Life Act. It will require eligible foreign life insurance companies to establish a compliance committee for their Australian (branch) life insurance business. The purpose of the proposed Committee is to provide greater assurance that branches will comply with the prudential requirements placed upon entities registered to conduct life insurance business in Australia.

APRA recognizes that legacy products represent a growing issue for regulated industries and is at an early stage of considering options internally.

Superannuation

Much of APRA's work in 2004/2005 has focused on the implementation of the comprehensive Superannuation Safety reforms. These came into effect on 1 July 2004 with a two-year transitional period and apply to trustees of all APRA-regulated superannuation entities. The reforms include universal licensing, compulsory fund registration, development of effective risk management frameworks and operating standards in the key areas of fitness and propriety, outsourcing and adequacy of resources. An extensive range of guidance material was produced for licence applicants, and intensive trustee training and other assistance was provided throughout the year.

Major changes were made during the year to APRA's statistical data collections relating to the superannuation industry. New quarterly and annual statistical publications were released in May 2005. The Government finalized the Choice of Superannuation Fund legislation which, from 1 July 2005, enables many employees to choose the fund into which their compulsory contributions are paid (discussed further below). The Government has proposed legislation to remove the surcharge tax on contributions of high income earners, also from 1 July 2005. The Government also introduced changes to its retirement income policy to enable people who have reached retirement age but continue in employment to commence receiving superannuation benefits in the form of a non-commutable income stream.

Fit and Proper

APRA has formalized its expectations that regulated institutions ensure the fitness and propriety of their responsible persons. Following an industry consultation exercise in March 2004, APRA released a second public consultation package in mid-2005 that included revised draft prudential standards applicable on a cross-industry basis.

Under the proposed standards, regulated institutions must adopt and implement a "Fit and Proper Policy" aimed at reducing the risk of failure arising from incompetent or dishonest management. The draft standards also propose criteria for fitness and propriety that APRA will apply when considering exercising its powers to remove or disqualify a responsible person.

Lenders Mortgage Insurance

Proposed reforms to the capital and reporting framework for Lenders Mortgage Insurers (LMIs) were released in February 2005. In response to trends in product innovations ('low-doc' loans) APRA also tightened the criteria for ADIs to qualify for the concessional risk-weighting of residential mortgage lending for capital adequacy purposes. Implementation of the requirements will commence on 1 October 2005.

Insurance Conglomerates

In May 2005, APRA issued a discussion paper outlining its proposed supervision of corporate groups for general insurers. This framework aims to close a gap in the prudential supervision of these regulated institutions to better protect the interests of policyholders. It allows APRA to supervise Australian insurers and their corporate group on a consolidated basis, and address "contagion risk" posed to the insurer(s) in the group from group activities and inter-relationships.

The framework includes proposed prudential measures on group structures and management, group capital adequacy, reinsurance and risk concentrations at group level and intra-group exposures.

Following the initial consultation on the proposed consolidated supervision framework, the next step will be to develop new prudential standards and an amended consolidated reporting framework for public consultation. Subject to the outcome of this process, APRA intends to implement the regime in 2007.

Business Continuity Management ("BCM")

In April 2005, APRA released new prudential standards governing BCM for ADIs and general insurers. Similar standards for life companies will be released in 2006. The BCM standards aim to ensure that regulated institutions are able to adequately manage business disruptions arising from internal and external events. They place the burden on Boards of Directors and senior managers to manage BCM from a "whole of business" approach.

Among the requirements is that a Business Continuity Plan must be developed and reviewed annually. Further, APRA is to be notified within 24 hours of a major disruption that has the potential to materially affect policyholders or depositors. While the standards were effective upon release, transitional arrangements permit institutions to demonstrate compliance with the new requirements over a reasonable time period.

Governance

In May 2005, APRA released draft prudential standards and a discussion paper outlining its proposed governance requirements. These set out broad principles that regulated institutions must refer to in establishing and maintaining their governance frameworks, as well as specific requirements concerning Board size and composition, auditor independence, Board renewal and assessing Board and senior management performance. It is anticipated that the new prudential requirements concerning governance will come into effect in January 2006.

International Financial Reporting Standards ("IFRS")

Australia adopted IFRS for reporting periods beginning on or after 1 January 2005. APRA's objective in its approach to IFRS is to align its prudential and reporting standards with Australian accounting standards and principles where practicable. Under some circumstances APRA's prudential framework departs from the accounting standards because APRA has a forward-looking and risk-based approach to an institution's ability to meet its financial promises to beneficiaries, while accounting standards focus on reporting of past events.

In November 2004, APRA released an Overview Paper on the adoption of IFRS followed by a Discussion Paper in February 2005 on the prudential implications of a number of specific IFRS-related changes. Submissions and comments on the discussion paper were received from industry and representative organizations and are being considered by APRA. The intention is that, subject to further consultation with interested parties, the proposals outlined in the discussion paper will take effect in 2006. Appropriate transition arrangements will be allowed where the changes would have a material impact on individual institutions.

APRA intends to issue a second discussion paper for consultation in 2005. This discussion paper will deal with the treatment of eligible Tier 1 capital instruments and securitization. The two papers will be followed by consultation on changes to APRA's prudential and reporting standards.

Basel II Implementation

In April 2005, APRA released the first of its draft Basel II prudential standards, the standardized approach to credit risk, and its national discretions for the IRB approach to credit risk. In May 2005, APRA provided detailed accreditation guidelines to those Australian-owned ADIs that had indicated their intention to seek accreditation for the internal ratings-based approach to credit risk and the advanced measurement approaches to operational risk.

APRA is working closely with the Reserve Bank of New Zealand ("RBNZ") on implementation to promote closer-co-ordination and harmonization of supervisory arrangements.

APRA and the RBNZ have agreed on Terms of Engagement which establish high-level principles for the cross border implementation of the Basel II Framework in Australia and New Zealand.

Funding of Bank Supervisory Authority

APRA is funded primarily through fees paid by the industries it regulates. The amounts are set periodically based on a four-year rolling average of the cost of supervision of each industry, with the levy for each firm based on asset size but subject to a cap or floor. The fees raised are transferred to APRA via a special appropriation of Government after some amounts are retained in the Government's Consolidated Revenue Fund to fund consumer protection, market integrity and certain other initiatives not undertaken by APRA. For some of APRA's activities not related to its supervision functions, there can be a Government budget appropriation; however, these amounts are usually small relative to fee-based funds. Changes in funding will be implemented beginning 1 July 2005. There will be two fee-based components: the first relates to the cost of supervision and is subject to a maximum and minimum amount; the second relates to the potential systemic impact of that institution without regard to a maximum or minimum. The changes are aimed at being more equitable so that the amount paid by an institution better reflects the relative risk it poses to the system.

For further information on any aspects of prudential regulation discussed above please visit APRA's website, **www.apra.gov.au**.

Financial System Guarantees

The Government commissioned a technical study into the merits of a limited explicit guarantee scheme for the Australian financial system. The study was published in May 2004 and the Government has since been seeking the views of interested parties. At this stage, the Government has not decided whether any form of guarantee scheme should be introduced in Australia. Comments received through the public consultation process will assist the Government in making a decision on whether to implement a financial system guarantee scheme and, if so, to determine appropriate design parameters.

For further information please visit the Department of Treasury's website, www.treasury.gov.au.

Regulation of the Financial Services Industry

The Australian Government issued a consultation package in May 2005 proposing a number of amendments to the provisions of the *Corporations Act 2001* that relate to regulation of financial services. The proposals seek to clarify the law and to reduce the industry's compliance costs, while ensuring that consumers receive the disclosure they need. Under the proposals, a shortened form of disclosure to consumers about regulated financial products will be permitted, with further information on request. For basic deposit products provided by ADIs and general insurance products, consumer disclosure requirements will be tailored to consumer need for those products and this will help reduce compliance burdens. The jurisdictional reach of Australian regulation is to be clarified to ensure that consumer protection and licensing obligations do not apply inappropriately to offers made to persons outside Australia or where the Australian client has sought out the service. Licensing requirements are not intended to apply to foreign persons engaged in derivatives transactions with Australian professional investors.

The Government's Choice of Superannuation Fund legislation (discussed briefly above) has increased competition for retirement savings. Accordingly, increased regulation applicable to those who provide advice about superannuation choice has been planned to coincide with this. Further specific product disclosure requirements to help consumers compare fees and charges on superannuation products will apply, including requirements for disclosure of amounts in dollars to aid consumer understanding. Further, the legislation contemplates the use of prescribed tabular disclosure formats and warnings to help consumers compare superannuation products.

The Australian Securities and Investments Commission ("ASIC") issued a number of statements explaining how it would administer the financial service provisions in the Corporations Act. Policy Statement 181 "Licensing: Managing Conflicts of Interest," explains how financial services providers can ensure they meet their obligation to avoid conflicts with their duties as an Australian financial services licensee. ASIC issued updates to its Policy Statement 176, "Licensing: Discretionary Powers – Wholesale Financial Services Providers." The updates cited decisions to extend relief from Australian financial services licensing to wholesale financial services providers regulated by the German BaFin or the US CFTC, and also streamlined reporting obligations.

ASIC reported on a number of surveillance campaigns it has undertaken in several areas. This includes surveillance targeted to verify claims of compliance that were the basis for the granting of Australian financial services licenses. ASIC's surveillance campaign found that most licensees had the arrangements and systems they claimed, but a small number had significant deficiencies. Surveillance was also conducted for foreign insurers whose products were offered to Australians but which were not regulated as insurers under the *Insurance Act 1973*. Appropriate enforcement actions were taken in some cases.

For further information please visit ASIC's website, www.asic.gov.au.

Payment Systems, Electronic Commerce and Banking

In recent years, the Reserve Bank of Australia ("RBA") has introduced a number of reforms to credit card schemes. Access to the Bankcard, MasterCard and Visa schemes has been broadened to allow specialist credit-card institutions (SCCIs), authorized and supervised by APRA, to apply to participate in the schemes. The RBA has also reached a preliminary view that a new access regime for the Visa Debit system is required to ensure SCCIs can issue and/or acquire both Visa credit and Visa debit cards. Accordingly the RBA has initiated a consultation process around a new draft access regime for the Visa Debit system. Merchants are now permitted to impose a surcharge on customers who pay with MasterCard or Visa branded credit cards (Bankcard did not have such a restriction). American Express and Diners Club have also permitted merchants accepting their cards to impose a surcharge for use of the card and American Express has agreed to amend its contracts with merchants to allow them to encourage their customers to pay with another card or payment method.

Interchange fees for each of the Bankcard, MasterCard and Visa schemes must now comply with a standard that requires them to be no higher, on a weighted-average basis, than a cost-based benchmark. The benchmark is calculated using a set of eligible costs set out in the standard. The RBA is currently considering amending this standard to apply a common benchmark to all schemes and has published a draft revised standard and a consultation document setting out the reasoning behind the proposed standard.

In February 2004, the RBA designated the Visa Debit scheme in Australia under the *Payment Systems (Regulation) Act 1998* and in September 2004 it designated the EFTPOS debit card payment system. Designation is the first step in the possible establishment of standards and/or an access regime for a payment system. In February 2005, the RBA released draft standards for these systems for public comment

The Australian Payments Clearing Association ("APCA") is currently developing an access code for the EFTPOS system. The RBA has been working with APCA to finalise some aspects of the proposed regime and a new regime should be introduced early in 2006.

In March 2003, an ATM Industry Steering Group released for public comment a proposal that interchange fees paid to ATM owners/acquirers be replaced by a regime where each ATM owner can levy charges directly on consumers. Progress has been slow and in 2004, the RBA considered designating the ATM system but many participants in the ATM industry expressed a desire to pursue voluntary reform so the RBA decided not to designate. The group is yet to come to any decision on the way forward.

The RBA implemented financial stability standards for central counterparties and securities settlement facilities in March 2004. The standards seek to ensure that clearing and settlement facilities identify and properly control risks associated with their operations, thereby promoting the stability of the Australian financial system. The standard for securities settlement facilities was amended in June 2005 to limit its application to facilities that settle obligations in excess of $100 million in a financial year. This was done to ensure that the standard applies only to securities settlement facilities that could potentially pose a risk to the stability of the financial system, exempting small systems from unnecessary regulation.

For further information please visit the RBA's website www.rba.gov.au.

Anti-Money Laundering

As a member of the Financial Action Task Force on Money Laundering ("FATF"), Australia is consulting broadly on the implementation of the FATF's revised 40 Recommendations to combat money laundering, which the Government accepted in December 2003. This consultation is being run by the Australian Government's Attorney-General's Department. The Government is also undertaking a fundamental overhaul of Australian legislation, including the *Financial Transaction Reports Act 1988* (FTR Act), which will balance effective regulation and a sensible approach to the impact of new laws on industry and small business.

The Attorney-General's Department is coordinating an extensive consultation process which has included the release of industry specific issues papers, a policy principles paper and direct consultation with industry sectors. In consultation with other Government agencies, the

Attorney-General's Department has conducted consultative forums with industry representatives and members of the public.

The Australian Government has also established a Ministerial Advisory Group to assist with the development of anti-money laundering measures. The Advisory Group provides a forum for high level discussion of implementation options for Australian industry as a whole and for each of the affected industry sectors. Participants within this group include a wide range of industry associations, as well as the Attorney-General's Department and Australian Transaction Reports and Analysis Centre (AUSTRAC).

AUSTRAC has developed an internet based anti-money laundering E-learning application as part of its ongoing regulatory program. The application was launched 13 April 2005 and contains 15 modules ranging from "An Introduction to Money Laundering", "Terrorist Financing", "Best Practice Risk Management" and individual modules on the specific reporting obligations within Australia. It is designed to assist cash dealers, particularly small and medium-sized cash dealers, in understanding the various reporting and "Know Your Customer" obligations under the FTR Act. Industry associations, solicitors, members of the public and other interested parties will also benefit from this initiative.

During 2004-2005, AUSTRAC established a Technical Assistance and Training Team to support and deliver multilateral training programs, technical workshops and other anti-money laundering and counter terrorist financing assistance to international counterparts. Assistance programs are being provided to a range of South East Asian and Pacific countries in the form of in-country mentoring, IT advice and development, training programs and assistance with the development of typologies to detect money laundering and the financing of terrorism.

These programs are vital in developing the region's capacity to detect and counter money laundering, terrorist financing and other major crime. The ability to develop and share intelligence internationally is vital in taking a global approach to the prevention of serious organized crime and the financing of terrorism.

For further information please visit www.austrac.gov.au and www.ag.gov.au/aml.

AUSTRIA

Amendment to the Stock Exchange Act (Börsegesetz) and the Wertpapieraufsichtsgesetz Securities Supervision Act (Wertpapieraufsichtsgesetz) to implement the Market Abuse Directive of the European Union

The above-captioned amendment has transposed Directive 2003/6/EC on insider trading and market manipulation (market abuse), and the related directives implementing it, into Austrian law. The legal framework for efficiently combating market abuse was amended with the aim of ensuring that securities markets function smoothly and that the public has confidence in these markets. The offense of price manipulation was replaced by the more broadly defined offense of market manipulation and the offense of misuse of insider information has been overhauled. Legal consequences for market manipulation and misuse of insider information were increased. As regards insider proceedings, the amendment stipulates new provisions on procedural law: insider trading falls within the jurisdiction of the Vienna Regional Court for Criminal Matters (“Landesgericht für Strafsachen”) and the Austrian Financial Market Authority (“FMA”) is permitted to join the proceedings as a private party (Privatbeteiligter). The provisions on ad hoc reports (disclosure of insider information) and on reports of transactions in own shares (so-called director’s trading) in particular were also fundamentally amended. For the first time, the Stock Exchange Act now includes regulations on the fair presentation of investment advice.

Misuse of inside information

Pursuant to former section 48a Stock Exchange Act (until December 31, 2004, now section 48), persons who have insider information of a company are not permitted to use this knowledge – either themselves or via third parties – for trading in securities in that company with the intent to make a profit for themselves or a third party. The law defines insider information as knowledge of a fact that is not publicly known and which, if made public, might significantly influence the price of a security. It is not only punishable to make an illegal profit, but also to avoid or mitigate any impending loss (for example, by selling shares prematurely). In the reported period, insider trading was punishable by up to two years imprisonment or a fine of up to 360 daily rates, depending on the person of the perpetrator. On January 1, 2005, possible punishment was increased to up to five years’ imprisonment.

Amendments to the Austrian Banking Act

Last year, the Federal Ministry of Finance (“BMF”) submitted proposals for revising liability provisions for public authorities in response to a 2003 Supreme Court ruling. In August 2004, the BMF proposed a draft amendment to the Austrian Banking Act (“BWG”). The objective of this amendment to BWG is the clarification of the role of bank auditors. A bank auditor is retained by the audited institution and will assume banking supervisory functions in clearly defined cases. An amendment to the Financial Market Authority Act (“FMABG”) specifies that the federal government − as the legal entity responsible for the FMA − is liable for losses caused by FMA bodies and employees. The federal government’s liability is not limited to intent and gross negligence, as was originally proposed.

Insurance Brokerage

Federal Law Gazette I no. 131/2004 has implemented Directive 20027927EC on insurance brokerage. The Gewerbeordnung (“Trade Law”) has introduced insurance brokerage as a trade. Insurance brokerage may be offered by insurance agents, insurance brokers or insurance consultants. The amendment sets forth requirements for professional qualifications for insurance intermediaries. In addition, it regulates the principles of trade. The credit institutions’ license to broker insurance contracts based on the statutory provisions of § 1(3) Austrian Banking Act was cancelled. In future, insurance brokerage conducted by credit institutions will be subject to the FMA’s (Austrian Financial Market Authority) supervision. In addition, the decentralized business register lists insurance brokerage activities of credit institutions.

BAHRAIN

Bahrain Monetary Agency Developments

The period under review continued to see the Bahrain Monetary Agency (the "BMA"), the Kingdom's central bank and single regulator for the financial services sector, extremely active across a wide range of areas. These efforts continued to be directed at further enhancing the effectiveness and efficiency of the country's regulatory system, in the wake of the decision in 2002 to move all financial sector regulation to the BMA. They were also intended to promote awareness of Bahrain as the Middle East region's leading international financial center, in keeping with one of the Agency's statutory objectives of contributing to the development of the country's financial sector.

At present, the BMA continues to operate under the powers contained in existing sector-specific laws, notably the 1973 BMA Law (which establishes the regulatory framework for the banking sector as well as the operating framework of the BMA) and the 1987 Insurance Law. The new, integrated financial services draft law to replace existing sector-based legislation, reported in last years' survey, has now been finalized by government and is currently awaiting enactment by the Kingdom's parliament.

Since the last survey, the BMA has embarked on a major program to enhance resources dedicated to its supervisory functions. The increase in resources reflects the continued growth in licensee numbers, as well as the growing complexity and volume of regulation, notably as a result of Basel II. To ensure consistent and effective implementation of supervision, and to assist in the training of new staff, the BMA has embarked on a project to develop internal procedures manuals for each of its supervisory directorates. The first of these manuals will be implemented by the end of the third quarter of 2005.

Rulebook Developments

In the meantime, significant progress has been made on the project to redraft all of BMA's regulations in the form of a structured Rulebook, so as to move away from the Agency's traditional approach of issuing individual circulars on an ad-hoc basis. Volume I of the Rulebook, covering regulations for banks operating under conventional principles was issued in October 2004. Volumes 2 and 3 (covering Islamic banks and the Insurance sector respectively) were published in April 2005. The final two volumes (covering investment firms and other specialized activities such as leasing) will be issued during 2006. The Rulebooks have proved highly helpful to the financial sector in interpreting and implementing rules and regulations. The Rulebooks are available on the BMA's website and on CD-ROM, as well as in hard copy. Whereas for most volumes of the Rulebook the work has been limited to reviewing and redrafting existing regulations, work for the Insurance Volume has extended to creating a completely new regulatory framework, aimed at significantly enhancing the previous regime inherited by the BMA in 2002.

Regulatory Developments

The BMA's new insurance regulatory framework provides a comprehensive set of regulations for insurers, and is compliant with the Core Principles of the International Association of Insurance Supervisors. The framework covers all key areas, in particular capital and solvency, governance and high level controls, risk management, conduct of business, reporting and public disclosures and group risks. Banking regulations continue to be kept under review and a number of new requirements were introduced during the period 2004-05. These included revised Anti-Money Laundering regulations (which have been revised in the light of the FATF's revised 40+9 Recommendations) and revised consumer finance regulations along with enhanced security requirements for banks. In addition, the BMA has completed the first stage of a major overhaul of its regulations relating to banks' governance and high-level controls. The new high-level controls requirements are to be implemented with effect from October 2005. Discussions with banks on Basel II have continued. For the most part, banks intend to follow the standardized approach to credit risk. The BMA has appointed consultants to assist it in developing new regulations, with the target of implementing Pillars 2 and 3 in 2007 and Pillar 1 in 2008/09. In the area of capital markets, the BMA has issued new regulations covering disclosure standards; the issuing, offering and listing of debt securities; and the prevention of money laundering by users of the Bahrain Stock Exchange. A major consultation on a comprehensive Securities and Exchange Regulation is also under way.

Performance of Financial Sector

The performance of the financial sector since the last survey has remained strong. The risk-adjusted rate of return remains healthy in all the Kingdom's banking sectors. The contribution of financial corporations to Bahrain's GDP increased from 21.2% in 2003 to 24.6% in 2004. Total assets of full commercial banks stood at US$15.5 billion in June 2005, compared to US$13.3 billion in the corresponding period of the previous year, a growth of almost 17%. Of these assets, US$2.1 billion were in Islamic banks in June 2005, up 31% from a year earlier. Total assets of the offshore banking units rose to US$100.1 billion in June 2005 from $89.1 billion in June 2004, an increase of 12%. Islamic banks accounted for US$1.2 billion of these assets in June 2005. Total investment bank assets stood at US$6.5 billion in June 2005, recording a 20% growth over the corresponding figures of US$5.4 billion a year earlier. Islamic banks were the fastest growing part of this sector, their assets increased over the year by 54% to US$3.4 billion in June 2005. The number of insurance companies operating in Bahrain increased to 21. There was a continuing growth in gross insurance premiums in 2003 by 16% to reach BD79 million (approximately US$210 million).

Meanwhile, Bahrain's financial sector continued to grow and attract new entrants during the period. In calendar year 2004, 23 new licenses were issued. At the end of the year there were a total of 367 banks, insurance companies, securities brokers and other financial institutions that were licensed by the Agency. During the year, 17 new licenses were issued to the banking and financial sector and six new licenses were issued in the insurance sector. This growth has continued into 2005, with 18 new licenses issued in the first half of the year.

The BMA continues to take a leadership position in encouraging transparency with respect to key statistical and other data. It currently publishes the Quarterly Statistical Bulletin, the Main Economic Indicators, and includes a comprehensive overview of recent economic and financial developments in the BMA Annual Report. These publications are available on-line on the BMA website www.bma.gov.bh.

BELGIUM

Regulation and Supervision of Banks

Capital Adequacy Requirements

No important changes have occurred. Efforts have focused on the preparation of the national regulation which will apply the Basel framework (Accord Implementation Group), the E.U.-regulation (mainly the Committee of European Banking Supervisors) and the relevant European directive (Capital Requirements Directive).

Reporting and Disclosure Requirements for Banks

Commencing 2005, several provisions on reporting requirements have become effective or will become effective in the next three years. These provisions are applicable to banks, investment banks, insurance companies, financial conglomerates, Undertakings for Collective Investments in Transferable Securities ("UCITS") and management firms for UCITS. The description set forth below relates only to the reporting requirements for banks. Banks listed on a European exchange will, commencing January 1, 2005, draw up their consolidated accounts following the International Financial Reporting Standards (IFRS). Belgian banks which are not listed, will be required to do so commencing January 1, 2006. Following the Transparency Directive the procedure for disclosing regulated information (which is more conclusive than the consolidated accounts) will change commencing January 1, 2007.

Following Directive 2003/51 of 18/6/2003, a level playing field is sought between local gaap and IFRS. This Directive modernizes the 4th and 7th Accounting Directives as well as the specific Accounting Directives for banks and insurance companies. It became effective on January 1, 2005. As Belgian banks apply IFRS on a consolidated level, its use is limited to the statutory accounts. Commencing January 1, 2006 the new detailed prudential reporting requirements based on IFRS will enter into force for all Belgian consolidating banks. The reporting will be used on consolidated level only. The introduction will take place in two stages: the first stage will start on January 1, 2006, the second on January 1, 2007, after a final agreement is reached on the FINREP-model which is discussed on European level. In order to reconcile differences in fair value, the European Central Bank ("ECB") has anticipated fair value corrections on deposit liabilities and loans. As the ECB-statistics are not gathered on a consolidated level, this Regulation is currently not applied. However, once the IFRS become applicable on a statutory level, this will change. An environmental annex to the annual accounts is under discussion in the Belgium Parliament. This annex will need to be reported by all companies, including banks. It was tentatively scheduled to be applicable from January 1, 2005 but as the project is still under discussion, the first application remains unclear.

The first application of the CRD-reporting is scheduled to start on January 1, 2007 or January 1, 2008 (the latter only for the more complicated methods). Parallel run starts on January 1, 2006. The prudential IFRS-filters are scheduled to apply starting January 1, 2006. There are IFRS-filters for banks as well as for insurance companies. On the latter no information is available about the likely first application. The statistical reporting for the payment balance will change starting December 31, 2005. Commencing May 1, 2007, a new securities reporting framework will have to be developed by, *inter alia*, banks following the Markets in Financial Instruments Directive (MIFID). Commencing January 1, 2008 a new securities accounting framework will have to be developed by institutions (including banks) which act as account managers for book-entry securities. In case those institutions develop services of asset management or investment advice they also need to fulfill an asset management reporting requirement. The first application however is not clear yet.

Anti-Money Laundering Developments

In accordance with the competence it has been given by the Law of January 12, 2004 modifying the Law of January 11, 1993 on preventing the financial system from being used for the purposes of money laundering and the financing of terrorism, the Banking, Finance and Insurance Commission (supervisory authority), has issued a regulation as well as a circular explaining the way in which the law must be applied by the companies under its supervision.

The regulation has been laid down by Royal Decree and has force of law. The circular also provides a number of additional recommendations. The 40 FATF recommendations and the Basel Committee documents on the required vigilance towards customers have all been fully integrated into these texts.

These texts provide detailed rules with respect to the following requirements:

- identification of customers and the checking of their identity (natural persons, legal persons, proxy holders, economic parties entitled and the required proofs);
- third parties taking care of identifying the customers and the economic parties entitled;
- customer acceptance policy (all institutions must lay down this kind of policy and establish criteria for the acceptance of risky customers (additional information and acceptance at the appropriate hierarchical level). A number of obligatory risk criteria have been laid down (e.g. PEPs : politically exposed persons);
- specific rules for establishing business relations with remote identification customers and for executing transactions on their behalf;
- the duty of vigilance;
- specific obligations in the field of money transmission and funds transfers;
- data storage, training, appointing a person in charge of prevention (there are no new provisions vis-à-vis these aspects).

Market Developments

Developments Relating to Payment Systems
Electronic Commerce and Banking

The implementation of the Single European Payments Area (SEPA) is a major challenge for the European banking sector. The Belgian banking sector has created a structure needed for developing a migration plan for the different kinds of payment instruments involved (credit transfers, direct debits and cards) as well as clearing systems which should evolve into one or several Pan-European Automated Clearing Houses (PEACH).

There has been a considerable increase in the use of e-banking, PC-banking and Internet banking in the past few months. The consultation body on payments set up by the Central Bank, which regroups the banking sector, the consumer organization, the merchants and the public authorities, has pursued activities in two directions:

- an in-depth study of the social cost of the different payment systems, more particularly cash money;
- a study of the modernization of payments made by the public authorities.

BERMUDA

During the period July 1, 2004 to June 30, 2005, the Bermuda Monetary Authority (the "BMA") maintained its pivotal and active role in implementing policy developments and legislative changes for Bermuda's financial services sector, in consultation with government and industry.

The BMA has progressively implemented a range of significant legislative initiatives as part of its ongoing project to enhance Bermuda's suite of financial services legislation and regulatory framework. These developments reinforce Bermuda's firm and demonstrated commitment to upholding international standards and are part of an ongoing process of regulatory enhancement for the jurisdiction.

Insurance

The introduction of the Insurance Amendment Act 2004 (the "Insurance Amendment Act") was probably the most significant development for the insurance sector during the period. The Insurance Amendment Act represents part of a series of ongoing enhancements to Bermuda's insurance regulatory regime. The legislation provides enhanced statutory support for a number of reporting and disclosure requirements and standards that the BMA had, in part, already applied to the sector.

In particular, the Insurance Amendment Act provides the basis for a series of specific Guidance Notes on numerous key aspects of the insurance regulatory regime, such as the role of auditors, insurance managers and principal representatives. There are also provisions that reduce the time period by which an insurer is required to notify the BMA of certain changes in information and stipulate that the BMA must approve an insurer's loss reserve specialist. In addition, the Insurance Amendment Act clarifies rules for appointing and removing auditors, sets a new standard for auditor independence and imposes new obligations on approved auditors to communicate certain matters to the BMA. Another amendment requires Class 1 insurers to file statutory financial statements on an annual basis while all insurers must file statutory financial returns simultaneously with the filing of financial statements.

During this period the BMA also introduced a new risk-based framework for its routine supervision of insurance firms. The Supervisory Model provides a more structured framework for assessing the risk profile of insurers, helping the BMA to identify higher risk firms more effectively, to focus at an early stage on areas of developing concern and to bring supervisory resources to bear accordingly. The BMA is applying the Supervisory Model progressively during 2005, together with the roll-out of a more substantive on-site work program in higher risk institutions aimed at developing a more complete assessment of the systems and controls which management uses to monitor and control the risks to which a business is exposed.

Further enhancements to the insurance regulations are currently being considered, based on an in-depth self-assessment of the Bermuda insurance regime compared with the new International Association of Insurance Supervisors (IAIS) Insurance Core Principles, which Bermuda, in common with other IAIS members, was invited to complete and provide to the IAIS early in 2005. The key component of the next phase will be a set of additional detailed technical amendments to the Insurance Act. Such amendments are necessary in situations where the legal powers currently available to the BMA need further development in order to ensure full compliance with the new Core Principles.

Banking

The effectiveness of Bermuda's supervisory approach for the banking sector was recognized by the International Monetary Fund (the "IMF") in its review of the jurisdiction's financial services regulatory framework, published in early 2005. The review assessed Bermuda's approach to supervision of the sector in terms of compliance with the Basel Core Principles. The IMF assessment was extremely positive, concluding that the powers available to the BMA are strong and that the supervisory process is effective, with Bermuda rated as compliant or largely compliant with all of the Basel Core Principles.

The IMF assessors identified a few matters on which they felt that some enhancements should be considered to aspects of on-site and off-site supervision. These are being considered as part of the wider development of the current framework on which the BMA is already consulting industry in the context of Bermuda's preparations for the implementation of the new Basel II regulatory requirements.

Investment

The smooth transition to, and implementation of, the new provisions of the Investment Business Act 2003 (the "Investment Business Act") continued through the period under review. The Investment Business Act clarified and updated the provisions for regulating investment business and protecting clients and the public included in the predecessor legislation, the 1998 Act. While the provisions of the new Act differ in many respects from those of the repealed 1998 Act, the BMA's general supervisory approach underwent relatively little change.

During the course of the year, the remaining sections of the Investment Business Act were introduced – specifically sections dealing with cold calling and with the regulation of investment exchanges and clearing houses. A recognition order was made under the Investment Business Act in respect of the Bermuda Stock Exchange.

The BMA also worked closely with the Ministry of Finance in consulting industry on a number of remaining pieces of secondary legislation under the Act. Subsequently, the Investment Business Appeal Tribunal Regulations 2004 came into effect on November 5, 2004, and the Client

Money Regulations were finalized early in 2005 and brought into effect on March 1, 2005. Consultations on Unsolicited Calls Regulations and on a draft Order defining circumstances in which persons not otherwise caught by the prohibition in the Investment Business Act may be deemed to be carrying on investment business in Bermuda remained underway at the end of the year. It is anticipated that both items will be finalized and introduced late in 2005.

At the same time preparatory work for a proposed new Collective Investment Schemes Act continued, and it is anticipated that the new legislation will be placed before Parliament by the end of 2005. This is intended to expand the definition of collective investment schemes beyond mutual funds and unit trusts to include certain other corporate vehicles and limited partnerships used for investing funds on a pooled basis, to introduce a licensing regime for fund administrators, and to provide the BMA with enhanced information, intervention and enforcement powers.

In addition, provisions were added to the Criminal Code during the year prohibiting insider dealing and price manipulation in securities markets. The amendments provide for a $10,000 fine or six months in prison for people summarily convicted of market manipulation, and a $100,000 fine or a prison sentence of up to five years upon indictment. The penalties for insider trading are a $25,000 fine on summary conviction or two years in prison, and a fine of $175,000 or seven years in prison upon indictment.

Proceeds of Crime Legislation

The introduction of the Anti-Terrorism (Financial and Other Measures) Act 2004 (the “Anti-Terrorism Act”) provided Bermuda with a robust framework for dealing with any terrorist financing concerns, consistent with the requirements of the standards agreed by the Financial Action Task Force (FATF). The new Anti-Terrorism Act makes it an offense to raise funds for terrorism and use or possess money or other property for the purposes of terrorism. The Anti-Terrorism Act also has provisions making it illegal to launder terrorist property or to participate in activities where money or other property is made available for terrorism. There are also specific provisions in the Anti-Terrorism Act detailing reporting requirements with respect to any suspicions of such activity.

The BMA also continued to work closely with the National Anti-Money Laundering Committee in an ongoing review of current provisions of Bermuda’s anti-money laundering arrangements, with a view to ensuring full consistency with the revised recommendations adopted by the FATF in late 2003. Legislation on a number of detailed amendments to the Proceeds of Crime Act 1997 and the Proceeds of Crime (Money Laundering) Regulations 1998 are in preparation.

BRAZIL

The main institutional changes, between July 1st 2004 and June 30th 2005, were:

a) Law nº10,931 of August 2nd, 2004 on capital segregation for real estate;
b) Law nº11,076 of December 30th, 2004 on agricultural financial instruments;
c) Law nº11.079 of December 30th, 2004 on public-private partnerships; and
d) Law nº 11,101 of February 9th, 2005 on bankruptcy.

Capital segregation is important to avoid unanticipated losses to investors in real estate companies. Law nº10,931 of August 2nd, 2004 deals with capital segregation of real estate companies, real estate credit bills, credit real estate notes, bank credit short letters, and modifies decree-law nº 911 of October 1st, 1969 and Law nº 4,591 of December 16th, 1964, Law nº 4,728 of July 14th, 1965 and law nº 10,406 of January 10th, 2002. Its main objective was to increase the legal distinction between the business parts of real estate incorporations. It created safer and less onerous conditions for the concession of credit for banks, as well as created new representative securities for real estate credit, thus lowering the funding costs of construction.

Financing of agriculture is an important issue and Law nº11,076 of December 30th, 2004 was passed with the purpose of improving it, creating new financial instruments, such as the Agricultural Warrant, the certificate of agribusiness credit rights, and the certificate of agro business receivables.

The law also changed other laws: Law nº9,973 of May 29th, 2000 on storage; Law nº 8,427 of May 27th, 1992 on rural credit; Law nº 8.929 of August 22nd, 1994, on rural product sales; and Law nº 9,514 of November 20th, 1997 on real estate financing.

The new law updated the rules for issuing and dealing of securities related to agribusiness, thus promoting a better financing of agriculture and cattle raising. It will also facilitate the business carried through between the agricultural producers and suppliers and buyers.

Public-private partnerships are a priority for the government, and Law nº11.079 of December 30th, 2004 was passed to establish the legal framework.

Basically, it regulated an administrative contract of concession. Its main objective is to attract private investments for public infrastructure in Brazil. It was inspired by the experiences of England and Mexico.

Updating a bankruptcy law of 1945 was the reason for Law nº 11,101 of February 9th, 2005. It is called "the New Law of Bankruptcy " and modernizes treatment of enterprises experiencing financial distress.

After 60 years, the new law changed practices intended to preserve enterprises. Two procedures of recovery for companies experiencing difficulty were created, which will demand an ample and serious negotiation with the creditors, and diminish the power of judges. Similarly, the bankruptcy process was radically modified, altering the preference of credits. This was intended to reduce stress and financing costs.

CANADA

Executive Summary

The last twelve months have seen very few actual changes to the regulation or structure of the Canadian financial marketplace or system. However, the federal government has begun the process relating to the next revision of the Bank Act (scheduled for 2006). The consultation paper and public responses are posted on the website of Canada's Department of Finance. A consultation paper has also been released about possible changes to Canada's anti-money laundering legislation, and the banking regulator, the Office of the Superintendent of Financial Institutions, is finalizing the necessary measures to implement Basel II.

Bank Act Revision 2006

In the February 23, 2005 Federal Budget, the federal government formally announced the beginning of the Bank Act revision process. Specifically, the government released an Appendix ("Annex 6") to the Budget which outlined some proposed changes to the Bank Act and described the consultation, policy development and legislative process to be followed. Comments were requested by June 1, 2005 and since that time, over 40 submissions have been made to the federal government. During the summer of 2005, work will progress to complete the policy review, draft policy proposals and produce a white paper. The white paper is expected to be released in the fall of 2005, after which the House of Commons Standing Committee on Finance and the Standing Senate Committee on Banking, Trade and Commerce will have the opportunity to review it and provide comments. It is expected that the drafting of the bill will be completed during the winter of 2005–06, and legislation will be introduced in the House of Commons in early 2006, with a view to having it come into force by the deadline of October 2006

Overview of Annex Paper

The Annex Paper is only eight pages in length and contains 12 items on which the government is seeking comments. Further, it indicates that it is the government's intention to make "selective" (as opposed to comprehensive) changes to the legislation once the consultations are completed. The Paper also makes clear that the specified items do not constitute an exhaustive list of items that might be raised during the review, but rather have been included as a means to "stimulate debate, generate ideas, and provide a starting point for discussions". The three broad themes are set out in the Paper:

- Enhancing Interests of Consumers
- Increasing Legislative and Regulatory Efficiency, and
- Adapting the Framework to New Developments

Specific Issues in Annex Paper

The Paper asks for comments on such matters as the possibility of enhanced disclosure requirements, assigning responsibilities and liability in respect of debit card and other electronic transactions, and maximum check holding periods. The federal government has again sought comment on how to improve financial services legislation to help credit unions and caisses populaires.

The Paper also invites comments on how to streamline the "approval system" (broadly across the legislation and not limited to permitted investments). The government focuses its specific request for suggestions on removing approval requirements for routine approvals.

Foreign Banks in Canada

Recent legislative reforms relating to foreign banks in Canada have sought to encourage their entry into Canada as a means of fostering competition in the financial sector. Yet, in an effort to facilitate entry through various structures, the legislative framework has evolved into a complex set of rules that are broad in scope. The scope and complexity of the framework imposes a regulatory burden on foreign banks seeking entry and their activities in Canada and has implications for the resources required to administer it. On behalf of its foreign bank members, the Canadian Bankers Association made a number of recommendations for changes to decrease their operating costs and give them greater flexibility.

Anti-Money Laundering Initiatives

Canada's anti-money laundering measures are subject to a periodic five-year review and the Department of Finance released a Consultation Paper in July on possible changes and new initiatives.

Overall the purpose of the paper is to strengthen Canada's anti-money laundering (AML) and anti-terrorist financing (ATF) framework including:

- Meet Canada's international obligations as a member of the Financial Action Task Force (FATF) under its revised Forty Recommendations and Nine Special Recommendations to combat money laundering and terrorist financing;
- Address the recommendations of the Auditor General of Canada's 2004 Report;
- Address various stake holder's concerns, particularly those of law enforcement and intelligence agencies; and
- Review Canada's AML and ATF framework in preparation for the upcoming legislative review of the Proceeds of Crime (Money Laundering) and Terrorist Financing Act (PCMLTFA).

Auditor General Report

The Auditor General of Canada (AGC) concluded an audit in 2004 of the national initiatives to combat money laundering which assessed the production, dissemination and use of financial intelligence, current compliance requirements and systems and the extent to which performance is measured and reported. The AGC Report noted that restrictions on the type of information FINTRAC (the government agency that collects money laundering data, including various reports from financial institutions) may include in its disclosures to law enforcement and intelligence agencies can, at times, limit the usefulness of information provided. The Report recommended that communication and feedback between partners be improved and performance measurements for the overall initiative be improved.

Consultation Paper

In its Consultation Paper, the government has stated that it is committed to:

- Strengthening "Know Your Client" standards;
- Closing gaps in Canada's AML/AFT regimes;
- Increasing compliance, monitoring and enforcement;
- Strengthening Footrace's intelligence function; and
- Coordinating and assessing overall AML/AFT efforts.

To achieve these objectives, the Paper suggests a number of revisions to existing provisions or new measures, including the following:

- Expand the client identification and record keeping requirements for large cash transactions to accountants and accounting firms, and to real estate brokers and sales representatives.
- If there is suspicion of money laundering or terrorist financing and the identity of the client has not been previously been ascertained or there are doubts about the veracity or accuracy of previously received information, the reporting entity should identify and verify the customer's information.
- For transactions above a certain threshold, where there are reasonable grounds to suspect that a new or existing customer is a Politically Exposed Person (PEP), reporting entities would have additional responsibilities to determine whether a person actually is a PEP. Reporting entities would also be required to take additional steps to establish the source of the funds, monitor the business relationship, and ensure that senior management approves opening the account and approves transactions and allows the business relationship to continue.
- Enhanced due diligence measures for cross border correspondent banking.
- Consulting with reporting entities to establish appropriate non-face-to-face client identification requirements for financial institutions, securities dealers, money service businesses and foreign exchange dealers.
- In every situation where there are customer identification requirements, reporting entities should obtain third party and beneficial owner information and take reasonable measures to verify information.
- Reporting entities should monitor their business relationships with their customers, including transactions on an ongoing basis, and implement procedures to ensure customer information is up to date.
- Require financial entities, money service bureaus, foreign exchange dealers, securities dealers and casinos initiating an electronic funds transfer (domestic or international) at the request of the client, regardless of the amount, to ascertain the identity of the client and keep records.
- Require the reporting of "Suspicious Attempted Transactions".
- Establish a registration regime for Money Service Bureaus and Foreign Exchange Dealers.
- Create an Administrative and Monetary Regime for non-compliance.
- Expand the current list of designated information items that FINTRAC can disclose to law enforcement and intelligence agencies.
- Establish a formal advisory committee for the overall initiative that would bring representatives from government, industry and law enforcement together in a single forum.

Implementation of Basel II in Canada

The Office of the Superintendent of Financial Institutions ("OSFI") has stated that it will apply the new Basel framework to all banks incorporated in Canada and expects large internationally active domestic banks to implement the Advanced IRB approach for all "material" portfolios and credit businesses in Canada and in the U.S. beginning as at November 1, 2007 (for banks with a fiscal year that ends on October 31). OSFI is striving to develop informal, but effective, relationships with host supervisors.

OSFI intends to allow the IRB and Standardized approaches to be followed by all other banks incorporated in Canada, but anticipates that most will adopt the Standardized Approach for measuring credit risk. A Canadian subsidiary of a foreign bank will be permitted to use its parent's IRB methodology subject to OSFI approval. OSFI's approval will consider, among other things, the appropriateness for the Canadian marketplace of the data and experience used to calculate the subsidiary's IRB capital requirement.

To measure operational risk, OSFI will permit banks incorporated in Canada to implement any one of three approaches: the Basic Indicator Approach, the Standardized Approach or the AMA. OSFI anticipates that banks that plan to implement an IRB approach for credit risk will, over time, implement an AMA for operational risk as they improve their systems and processes to the point where they are able to meet the qualifying criteria.

CHILE

Modification to Law No. 19,1913, on Financial Analysis Unit

The Law No. 19,1913 created the Financial Analysis Unit and modified several regulations on the prevention of money laundering. It also established an administrative procedure that provides for the right to judicial defense.

Studies on Free Trade Agreement

A possible Free Trade Agreement between Chile and Japan, Chile and Peru, and Chile and Ecuador, in which Financial Services will be addressed in a separate chapter on Services, is being analyzed.

Entrance Of New Banks

Banco París purchased Santiago Express, division of Banco Santander Santiago.

Administración de Fondos de Pensiones- AFP

Banks have initiated talks with representatives of technology and of government authorities with the aim of increasing competition in the Pension Funds Management System (Administración de Fondos de Pensiones- AFP) and permitting banks to participate in this business.

Basel II

Transition in Chile

Chile has been developing rules related to a risk-based approach to management and supervision since the mid ‘80s. The groundwork has been completed. The remainder is in progress with precise objectives and timeline. The disadvantages of not pursuing efforts further will outweigh the benefits of aligning with the new global standards.

Previous regulations implementing provisions of Basel II

The quality of risk-based management has improved significantly in the last two decades. Supervision based on evaluation and classification has been in effect since 2001. Regulations on portfolio classification and other regulations required by Basel II were adopted in 2004. Basel II’s definition of operational risk was adopted in 2004. New legislation on liquidity risks, which include the option of using independent models was implemented in 2004. A regulation on the valuation of financial instruments will be issued shortly. Basel II requirements on Boards of Directors and Committees have been implemented for several years.

Principal criteria for the transition

The new regulations will be passed after consultation with and in cooperation with industry. Capital requirements will remain unchanged, whereas risk sensitive approach vis-à-vis management and supervision of the risks will be improved. The Bank Superintendencia will gradually be coordinated with the Central Bank. In a first stage, standards for credit and operational risks will be formulated. The transition towards the standardized approach is relatively simple. Subsequently, advanced approaches will be proposed.

The following initiatives have been taken:

- Simulation of/Studies on the quantitative impact (2003).
- Seminars and dialogue with the industry (2004, 2005)
- Subjecting the system to a stress test (2004)
- Issuance of routing sheets (2005).
- Coordination with bank supervisors from originating/contributing countries (2004, 2005).

Capital Markets II

It is expected that Congress will approve the Capital Markets II reform, which intends to reduce imbalances in the credit cards market and to create a single system of obligations and debt information. It will permit the extension of bank business and the creation of necessary capital conditions.

Consumer Protection

A system of dispute resolution was introduced through which clients and banks may resolve their disputes under the auspices of an independent authority.

Maximum Conventional Rate

The introduction of the bill on maximum conventional rates for products is under legislative consideration. This bill will address the characteristics of all products.

Standardized Record of Financial Information for Small and Medium Size Companies

Small and medium size companies will be permitted to simplify and standardize financial information provided to the market, as a way to reduce uncertainty of information and to harmonize financial systems for these companies. This rule permits access to credit and other sources of financing on equal terms for small and medium size companies. It will increase competition and transparency of the credit market.

New Procedure on Financial Instruments

Criteria will be established for the valuation and recognition of results for financial investments and for derivatives in general.

Fair Value of Financial Instruments

A regulation on fair value of financial instruments, that included a definition of fair value of financial instruments, was published. A key feature is the recognition of market risk and its effect on fair value.

Insurance

With the entry of banks in the insurance industry, banks have acquired many new accounts at low cost.

Market Risk

Regulators are completing the modernization of financial regulation in general, and market risk in particular.

The Boards of Directors of financial institutions determine policies on the management of market risk, liquidity and on payment periods. Banks that fulfill the requirements on liquidity may choose their own system of management vis-à-vis market risk or apply the standardized system.

CHINA

Significant Developments in Banking

- On August 4, 2004, the China Bank Regulatory Commission ("CBRC") issued a new regulation on the management of finance companies by enterprise groups. The new rule, effective September 1, 2004, will lower the threshold for the establishment of finance companies by enterprise groups in China. This will enable enterprises to open their own finance subsidiaries to enhance the efficiency of corporate fund management and financing services.

- On August 26, 2004, Bank of China was converted into Bank of China Limited (abbreviated to "Bank of China") with the Chinese government's approval. As a result of the restructuring, Bank of China became a joint stock commercial bank.

- On October 19, 2004, the People's Bank of China ("PBOC"), China's central bank, released new regulations on short-term financing for the country's securities firms. The new rules will allow eligible companies to issue short-term financing bonds to institutional investors through the interbank market.

- On December 1, 2004, CBRC, China's banking regulator, announced at a press conference sponsored by the information office of the State Council that it would take the following six measures to further open China's banking sector:

  1) As of December 1, 2004, foreign-invested financial institutions will be permitted to offer RMB services in five more cities in addition to the thirteen cities for which permission was previously granted;

  2) As of December 1, 2004, the branches of foreign banks in west and northeast China will see relaxation of the profit review criterion by the CBRC when applying for permission to offer RMB services;

  3) Foreign banks applying to set up operations or offer services in west and northeast China will go through separate expedited procedures and receive priority review under equal conditions;

  4) The review procedure will be further simplified;

  5) As of January 1, 2005, foreign-invested banks will be allowed to offer approved proxy insurance services to an eligible group of customers in accordance with relevant laws and regulations after registration with competent local representatives of the CBRC;

  6) The CBRC will cautiously speed up the review process for foreign-invested banks applying for branch operations in the same city and for offering RMB and derivative services so as to create an effective operating environment for foreign-invested banks in China.

- On December 2, 2004, PBOC, China's central bank, announced that it would allow travelers to take up to RMB20,000 out of the country. The last time China raised the limit on RMB's cross-border flow was in 1993, when the ceiling was set at 6000 yuan. The new rule came into effect in January 2005.

- In February 2005, China released a long-expected regulation to allow some pilot commercial banks to launch fund management companies, clearing the major policy obstacles to the reform. The regulation, issued jointly by the CBRC, PBOC and the China Securities Regulatory Commission (CSRC), will enable commercial banks to participate in the securities investment business.

- A national database for personal credit information is expected to be established at the end of 2005, according to PBOC. The database collects personal information including identity, profession and address, history of financial credit and other relevant data intended to demonstrate an individual's creditworthiness. A working group for credit standardization was established in June 29, 2005 in Beijing.

- In March 2005, China's central bank issued draft regulations on the management of the database for personal credit information. The document detailed how the banks will report and search for personal credit information, how individuals may apply to the administration to correct their information in the database, and how the database will be used in a way that the individuals' privacy is fully respected and protected.

- China's central bank and other related government agencies have formulated guideline(s) and measures to accelerate the development of the burgeoning bank card industry. Since 1985 when Bank of China issued the country's first bank card, China's bank card industry has experienced increasingly rapid growth. PBOC statistics showed that card issuance totaled 762 million at the end of 2004, more than 100 million up from a year earlier.

- On May 11, 2005, PBOC promulgated regulations governing bond issuance by financial institutions in the interbank market. The regulations, for the first time, allow financial companies affiliated with group firms to issue bonds in the interbank market to help meet the funding needs of the group. Replacing rules enacted in 1998 that governed bond issuance of the three policy banks, the new regulations took effect on June 1, 2005.

- Starting in May of 2005, China's central bank permitted eligible enterprises to sell short-term bonds to qualified institutional investors in the country's interbank market. This measure will assist enterprises in accessing new sources of financing, better implementing monetary policies, and preventing excessive growth of money supply. It will also promote the coordinated development of monetary and capital markets and safeguard the stability of the entire financial system.

- Bank of America is to invest $2.5 billion in shares of the China Construction Bank (CCB), according to an agreement finalized between the two banks in Beijing on June 17, 2005. The deal is so far the largest single investment by an overseas company in a Chinese company. As a strategic investor with CCB, Bank of America also has the option to increase its stake in CCB to 19.9%. CCB is one of the four major state-owned commercial banks and one of the two pilot banks in China's financial reform.

Significant Developments in Securities

- In November 2004, a new regulation to facilitate market access for securities firms was issued jointly by the PBOC, CBRC and the China Securities Regulatory Commission (CSRC). The new regulation allows more securities firms to acquire bank loans via the use of equity collateral.

- In May 2005, China issued long-awaited guidelines for the sale of non-tradable State shares in listed companies, according to CSRC. The rules, which took effect immediately, allow a small number of companies to take part in a trial program of State share sales. Under the new rules, future IPOs will no longer have a non-tradable share portion and individual listed companies will be able to decide how State shares are to be sold.

- On June 6, 2005, the CSRC announced that it has approved the application of Industrial and Commercial Bank of China (ICBC) to set up a fund management firm in cooperation with CreditSuisse First Boston.

- The CSRC has published regulations on increased possession of the public shares by holders with controlling shares of the same listed firms. The regulations, effective June 16, 2005, are designed to facilitate the ongoing experiments to make the non-tradable stocks tradable, to facilitate the reform of the split share structure in selected listed firms, and to safeguard the stability of the stock markets, the legitimate interests of investors and the firms.

- The CSRC regulator has published regulations on listed companies' buy-back of public shares, which became effective as of June 16, 2005. According to the regulations, new shares should not be issued in the buy-back period. Under the regulations, the listed companies should submit their buy-back records to the CSRC and should be obliged to make public any significant information.

- Two new rules, issued by the CSRC, to regulate sales and operations of securities investment funds, became effective on July 1, 2005. With detailed requirements for the qualification of fund managers, custodians and sales agents, and strict discipline for fund marketing and investment activities, the rules are an important supplement to China's Securities Investment Fund Law.

Significant Developments in Insurance

- The China Insurance Regulatory Commission (CIRC) has for the first time given approval to launch a mutual insurance company. The mutual insurance company will manage the insurance needs of agricultural businesses in the northeast Heilongjiang's grain growing area.

- China's insurance regulator has issued rules detailing the percentage of assets insurance companies will be allowed to invest in the stock market and the maximum stake they can hold in a listed company. The CIRC announced in a statement that insurers could invest all their assets derived from investment-connected insurance products and 80 percent of their assets derived from universal life insurance products into the stock market.

Significant Developments in Other Financial Sectors

- On July 15, 2004, the State Administration of Foreign Exchange (SAFE) issued new regulations on foreign exchange banking cards in a bid to enhance supervision of this business. Under the new rule, effective September 1, 2004, additional limitations are placed on overseas transactions using domestically issued cards, while other regulations are loosening controls on the use of overseas banking cards in mainland China. Restrictions are also placed on the use of domestically issued cards for trade deals and some specialized non-trade services. Use of such cards is prohibited in gambling, cross-bank transactions and transactions under the capital account. In the new rule, in addition to outlining relevant repayment procedures, SAFE has also provided detailed procedures for forex and RMB purchase and remittance by foreign currency cardholders.

- On August 19, 2004, China's foreign exchange regulator released a new regulation to clarify key forex procedures for the nation's growing ranks of individual traders. The rule has been seen as a step forward by the authorities in establishing the legal framework that is needed to implement a new Foreign Trade Law, that will allow individuals to conduct foreign trade.

- On May 18, 2005, China's interbank foreign exchange market started trading eight overseas currency pairs, opening a new platform for trade in of foreign currencies. The new trading platform, based in the China Foreign Exchange Trade System ("CFETS") in Shanghai, is an important step toward building a more mature foreign exchange market, and will help meet the growing needs for funding and risk hedging among Chinese enterprises.

- On May 18, 2005, SAFE declared that China's first anti-money laundering information system to monitor foreign exchange has been officially launched. The system, developed by the SAFE, will improve the efficiency of financial institutions and anti-money laundering supervision, facilitate data analysis to fight against money laundering, and detect irregularities or breaches of law precisely and promptly. It will help to prevent and crack down on various financial crimes, including money laundering.

- China's foreign exchange regulator has allowed Chinese companies to buy more foreign currency as they invest in overseas markets. It has raised the limit on foreign exchange purchases allowed for Chinese companies investing overseas to a combined US$5 billion nationwide, up from US$3.3 billion previously, according to the State Administration on Foreign Exchange.

- China's central bank announced on June 13, 2005 that non-financial institutions would be able to trade bonds in the nation's 4.4 trillion yuan (US$530 billion) interbank bond market. This liberalization is the latest in a series of measures by the Chinese authorities to accelerate the development of the bond market, which is expected to play a substantial role in funding economic growth and which will reduce the economy's over-reliance on the banking system.

DENMARK

New Regulation of Hedge Funds

On June 1, 2005 the Danish Parliament enacted new legislation regarding hedge funds. This legislation provides for a legal and supervisory framework as well as rules on taxation of hedge funds (*hedgeforeninger*) in Denmark. In this respect, Danish authorities are following a trend among OECD countries to enhance supervision of this fast growing segment in the financial industry. However, the situation in Denmark is somewhat different from that of countries such as Sweden and the UK, since a domestic hedge fund industry was almost absent until recently. Tax rules deterred direct investment in hedge funds by large investment groups. The new rules are, to a large extent, the result of demands from the Danish financial sector, which supported the new legislation because of the view that it would help the Danish financial sector to compete with foreign providers.

A hedge fund has to obtain a license from the Danish Financial Supervisory Authority (the "FSA") and is required to have a minimum capital of DKK 25 million. The rules permit the funds to invest in a wide variety of instruments as well as to use leverage and short selling, thereby permitting the funds to follow several different strategies, which is a characteristic for hedge funds. The amount of risk in each fund will be determined by the board of the fund. Investors will have access to information on investment strategy and philosophy set forth in the articles of the fund and in the prospectus. Potential excess in the determined risk level has to be reported to the FSA and the risk level will have to be reduced either immediately, or according to a plan specified by the FSA. The FSA can withdraw a fund's license if the fund exceeds its determined risk level too frequently. The new funds will be available for both professional investors and retail clients, subject to the conduct of business rules. Similarly, the rules for selling and marketing foreign hedge funds in Denmark were changed in 2003/04. Such funds are now required to obtain a license from the authorities before shares can be sold to the public.

The Introduction of a New Accounting Framework in the EU and the Implications for Regulatory Requirements in the Danish Financial Sector

International Financial Reporting Standards ("IFRS"), a key element of the European Financial Services Action Plan, were introduced as the official accounting framework for the annual consolidated financial statements of listed companies in the EU from January 1, 2005. At the same time, the FSA aligned Danish accounting rules with IFRS requirements, with few but fundamental exemptions. The transition to a new accounting framework was in general supported by the Danish financial sector, which saw some clear benefits in adopting an international accounting framework.

A number of FSA requirements have been implemented in Denmark, which significantly reduces the benefit of the transition to IFRS and the change of Danish accounting principles.

- Prudential returns to the FSA will be based on the new Danish GAAP. Under the new rules, the burden is on financial firms using IFRS to convert accounting data into Danish GAAP. Prudential returns will not necessarily reflect the company's financial data. For instance, some of the intention based principles in IAS 39 on financial instruments have not been included in the Danish GAAP. This will make it more cumbersome for the major banks, which more or less are forced to prepare their annual account both in national GAAP and IFRS.

- Companies must publish a statement highlighting the differences on profit and loss and on equity between applying IFRS and the information returned for prudential purposes.

- Individual capital requirements have been introduced commencing January 1, 2005, two years before the scheduled implementation of Basel II, pillar II requirements, because IFRS had envisaged a neutral information framework. Existing impairment rules on loans were very cautionary. A positive effect on the equity of Danish financial firms is to be expected from the transition to IFRS.

The individual capital requirements are expected, among other things, to eliminate the positive effect on equity from the change to IFRS. FSA has recently proposed new regulation, which would require reserves to be held for any positive effect on equity realized due to the transition to IFRS, which are not recognized under the new Danish GAAP.

Floating Charge

On June 17, 2005 the Danish Parliament adopted an Act introducing the floating charge for Danish companies. The Act introduces substantial changes to Danish commercial law where the floating charge as a general rule has not been available in financing business assets. So far, only farmers have had the option of using a kind of floating charge in animals, harvest etc. related to a charge on buildings.

The new rules on floating charge (*virksomhedspant*) will most likely become effective on January 1, 2006. The Act applies to companies but not to consumers. A floating charge may be applied to different kinds of debts, goods and intellectual property. The instrument is flexible in that companies may choose from different types of assets to charge and may choose to whom those charges apply. When a floating charge is created it has to be published in an official Danish register. This register will be public and so that a company's business partners can verify whether the company has made a floating charge on e.g. goods which are meant to be sold on credit to the company. The proposed framework will provide more flexibility compared to the existing rules. Under the incumbent rules, each item that is covered by a charge has to be identified. Hence, it is not practical to take a charge in goods. The new framework also simplifies charges on debt, as it will be permissible to charge debt without publishing the charge for each debt individually. The rules provide for a fair treatment of creditors without any special rights to the assets of a company vis-à-vis the holders of a floating charge. If the company does not repay its debt, the creditor (holder of a floating charge) may, under certain conditions, be in a better position than the bank in terms of coverage by the assets encompassed in the floating charge. This advantage will, however, be offset if the company is declared bankrupt within three months. In case of insolvency of a company which uses the floating charge, the holder of the floating charge is obliged to guarantee up to 50,000 DKR of the expenses related to the bankruptcy procedure.

Net-ID

In 2004, banks in Denmark launched net-ID. Net-ID is a new service for net bank customers that provides on-line proof of their identity and enables net bank customers to use digital signatures. Net-ID offers two services for financial institutions that conduct business on-line. Financial institutions previously were required to maintain and operate secure identification services. They may now outsource operation and maintenance of secure identification services.

The two services are: (1) Identification, which allows net bank customers to provide their identity easily and safely via their net bank access codes. Net-ID ensures that only authorized persons access relevant data; and (2) Digital signature, which permits, on-line bank customers to sign a document, e.g. an application form, a damage report or a purchase agreement on the bank's website using digital signature. Net-ID enables online bank customers to sign the document electronically. The customer verifies the document via the net bank security system, which identifies the customer. The document is stored for five years in a secure library in the bank and may be used in potential future disputes.

The benefits of net-ID include the following:

- Access to more than 2.3 million net bank customers;
- Customers only have to accept an extension to their net banking agreement to register;
- Customers are familiar with the access procedure as it is the same as for net banking; and
- Customers do not require additional software.

This is how net-ID works from a customer perspective:

- When the customer wants access to his own data or services, he or she clicks on the net-ID logo on the bank's website. The first time the customer uses Net-ID, he or she will be asked to choose his bank.
- The customer will be routed to his or her net bank, where a log-in window from the bank appears on the screen. The customer will use his or her usual net bank access code and click "approve".
- If the bank's security system recognizes the access code, the customer will return automatically to the bank's website, where the customer will be logged in. The bank now permits access and permits the customer to verify his or her data.
- Documents to be signed on a bank's website will be presented to the customer on the bank's website. The customer can prove his identity and sign the document by providing his or her access code to the on-line bank.
- A copy of the contract document is filed by the customer's bank in a secure library. Only authorized persons in the bank have access to the library, and data is only used in the event of a dispute.

Recommendations on the Handling of Conflicts of Interest within Investment Banks

The Danish Securities Dealers Association has published revised recommendations on the handling of conflicts of interest within investment banks. The term investment bank is defined as financial institutions, departments or divisions of such institutions, which trade in securities and provide financial advisory services and other related services, targeting primarily the institutional market. The recommendations replace the recommendations on regulation of corporate finance, equity research and staff trading, effective since July 1, 2002. The revision is intended to create a single set of guidelines matching international best practice. Substantial changes have been implemented in the US and the EU. The recommendations have been revised and adjusted to facilitate implementation by the banks. The recommendations can be viewed on: www.dbmf.dk under "Publikationer".

EGYPT

The fiscal year 2004/2005 has been a dynamic year for Egypt. Major political and macroeconomic challenges inspired a program of economic reform. This ambitious reform program aimed at addressing Egypt's most pressing economic challenges. The environment for economic policies in Egypt changed significantly in 2004 with the appointment of a pro-reform cabinet led by Prime Minister Nazif. The new economic team acted decisively on key structural reforms in the area of trade, taxation, and subsidies, and launched plans to restructure the financial system, privatize most state companies, modernize fiscal accounts, and strengthen monetary policy. Government reform process illustrates a top down approach with economic and banking sector reform occurring concurrently. The government has a new multi-year financial sector strategy that includes further consolidation among banks, reforming and recapitalizing state owned banks.

Major accomplishments have been achieved with respect to monetary policy, the financial and risk soundness of the banking sector as well as with respect to products and services offered on the market.

This paper attempts to summarize these accomplishments.

Economic Developments

- Presidential Decree No. 231/2004 requires the Ministry of Investment to take charge of developing and encouraging investment in Egypt.

- Key economic reform measures included lowering customs duties and simplifying customs procedures along with reducing income tax rates, improving tax collection, reducing tax evasion through increased penalties and introducing self assessment. Corporate income tax will fall to a flat rate of 20%, down from a current 42% levy on corporations in the service sector and the banking sector.

- Initiatives have been taken to reduce the deterioration of public finances, to improve coherence and transparency of fiscal and monetary policies and to reduce barriers to investment by creating GAFI – the investment promotion agency which can set up a company in three days versus four months.

- A number of regional and international agreements geared towards increasing Egyptian exports were concluded. These include the Agadir Declaration (comprising Egypt, Morocco, Tunisia and Jordan) which is a step towards Arab economic integration and the Euro-Med free trade area, in addition to the QIZ Protocol between Egypt, the USA and Israel which enables Egyptian exports, particularly textiles, to access the U.S. market duty free.

- Egypt has also signed and implemented a Free Trade Agreement with the European Union, which has resulted in increased trade between Egypt and its European neighbors.

- The issuance of treasury bonds with various maturities has been resumed and for the first time, bonds with a twenty year maturity have been issued.

- The Egyptian pound appreciated against the USD by 6.8% during the period from the December 23, 2004 to May 2005.

- CBE announced that Egypt's balance of payments during the first half of fiscal year 2004/2005 recorded a surplus of EGP 2.9 billion. Exports increased by 37.3% to USD 6.4 billion. Remittances increased by 37.9% to USD 2.5 billion.

- Foreign currency reserves reached USD 18.4 billion during May 2005. They are expected to reach USD 20 billion by the end of June 2005.

- With respect to privatization, the priority is to commence privatization of Egypt's oil and gas and transport sectors, the banking and insurance sectors and Telecom Egypt.

- Foreign investment in Egypt has increased, with USD 1 billion invested in recent months.

- The Mortgage Law was reactivated through the issuance of supplementary rules and regulations.

Banking Developments

The reform strategy is framed to address three key issues methodically and systematically: (i) strengthening the banking system through consolidation and privatization of smaller joint venture and public sector banks, (ii) restructuring of public sector banks, through recapitalization and other means, and (iii) resolution of the problem of NPLs.

- The government announced a comprehensive plan for reforming and developing the banking system. The plan is intended to decrease the number of banks operating in Egypt to 21 over five years through merging small and insolvent banks into viable banks so as to form banking institutions capable of competing domestically and internationally. In this context, Misr Exterior Bank was merged with Banque Misr and El Mohandes Bank is due to be merged with National Bank of Egypt. Moreover, mergers of the Housing and Development Bank and Egyptian Arab Land Bank are expected. In addition, the plan focuses on restructuring finance and management of public-sector banks, as well as selling their interests in joint banks and utilizing the sales proceeds to reinforce their capital base. The government has also declared its intention to privatize Bank of Alexandria in 2005, besides taking effective measures to overcome NPLs.

- A Bank Restructuring Unit staffed with professional bankers was established at CBE.

- Under sponsorship of the CBE, the banking community is creating the first Credit Bureau in the country which became necessary in view of the expansion of retail banking activities in the market. The Credit Bureau will have positive implications for the risk assessment and monitoring of retail and consumer lending.

- Pursuant to the law, issued and fully paid-up capital of banks should not be less than EGP 500 million, and capital of branches of foreign banks should not be less than USD 50 million or the equivalent in foreign currencies. Banks were obliged to increase their capital to reach the requirements within a stipulated time period; a bank that does not comply will be forced to either merge with another bank or to settle its position. Banks were given a grace period until June 2005 to comply. Consequently, a number of banks raised their capital following the former CBE rules: BNP, MIBank, NSG, Suez Canal Bank, SAIB, ABC, HSBC-Egypt, Egyptian Gulf Bank, National Bank of Abudhabi, Mashreq Bank, Arab Bank PLC and others.

- Total financial position of the banking system reached L.E. 714.4 billion by the end of April 2005.

- Article 133 of the Law No. 88/2003 on the CBE, Banking System and Currency was amended to allow reconciliation with insolvent debtors.

- Banks continue to implement plans to develop and upgrade IT infrastructure and to secure e-systems.

- Decision No. 506/2003 on requiring exporters to place 75% of their foreign-currency revenues with banks was abolished.

- A US$ interbank mechanism was introduced to maximize foreign-currency liquidity and consequently bring stability to the FX market.

- The minimum capital requirement for establishing FX companies was cut from L.E. 10 million to L.E. 5 million.

- Banque Misr and National Bank of Egypt are selling their shares in Misr International Bank and National Societe Generale, respectively, in compliance with the government regulations on privatization.

- In line with the government plan, there has been progress in settling non-performing loans and creating an arbitration committee affiliated with the CBE to take charge of co-arbitration disputes which may arise between banks and customers in addition to establishing a unit of monitoring non-performing loans. The CBE has set forth a strategy for collecting non-performing loans within two to three years without having to resort to litigation.

- In line with financial sector reforms that targeted financial risks and increased reliability and speed, CBE made extensive changes to payment systems. Hence, the payment system now can be categorized in two groups: RTGS (Real Time Gross Settlement) system and Deferred Settlement (or Netting) system. Most RTGS systems are owned by CBE and used for high value payments. They do not bear any credit risk as payments are settled in real time. The well designed queuing mechanisms and use of daylight overdraft facilities may resolve the liquidity risk problem that exists in such systems.

- In July 2004, a primary dealer system in the local debt market was initiated, whereby several of the major local banks would underwrite and resell debt issues. This led to slightly lower borrowing costs as well as greatly increased liquidity as primary dealers quoted two-way prices in all the new issues.

- With respect to retail banking, Egyptian banks have expanded their product range, ATMs, number of retail accounts, number of payment cards, and branch networks.

- With respect to the SME sector, a number of Egyptian banks have established a dedicated business line for SME activities and the CBE has issued related regulations and procedures.

Monetary Developments

- The FX market stabilized and the FX grey market almost vanished as a result of the increase in foreign-currency resources and the channeling of such resources, or at least the larger part thereof, to the banking system. This is in addition to activation of the exchange rate mechanism.

- The CBE created a new mechanism within the Monetary Policy which will permit the banks to borrow and make placements with the CBE on an overnight basis (Corridor System). This is considered an effective tool for interest rate management.

- The CBE initiated the Reverse Repo mechanism which represents another tool for implementing the Monetary Policy as well as providing another liquidity instrument for the banking community.

Financial Developments

- The customs system was developed and modernized with Customs Law No. 300/2004 on cutting the customs tariffs on industry inputs, fuel, finished goods, and some other products so as to decrease commodities' market price. Categories of customs tariffs were reduced from 27 to 6, with a minimum of 2% and a maximum of 40%. Subcategories of the customs tariffs decreased from 13,000 to less than 6,000. Following international tariff policy, the Law abolished all service fees on imports.

- Presidential Decree No. 410/2004 was published to address the shortcomings of the previous decision and to attain balance among the tariffs imposed on finished goods, intermediary goods and raw materials. This aims at reinforcing the domestic industry and sharpening its competitive edge.

- The new Tax Law was published with the intention of raising income standards, activating the market, encouraging investment, and creating a healthy environment for tax payers and the tax authority. The Law comprises an array of new tax cuts bringing the tax minimum to 10% and maximum to 20%, besides raising the limit for tax exemptions for all employees to L.E. 9,000.

- The intention was to attain a financial balance ensuring proper and effectual public spending and to increase resources.

Capital Market Developments

The stock market responded positively to the appointment of the new cabinet. With the new economic team aggressively addressing structural reforms, investors' confidence in the market soared with CASE30, the main exchange index depicting the performance of the most active thirty stocks, recording 200% increase in the past twelve months to June 2005. A survey in market activity cited the Egyptian market as the most profitable of the emerging markets.

The Capital Market Authority obtained approval of the Minster of Investment to amend the Capital Market Law and Depository Law to empower the Settlement Guarantee Fund (SGF) to impose penalties for failed trades. This has further decreased the number of failed trades and enhanced the timely settlement between direct market participants.

On October 31, 2004, the Prime Minister endorsed a decree to establish the Investor Protection Fund (IPF). The fund aims at partly indemnifying investors for the operational risk arising from dealing in the market through brokers, fund managers, and custodians. In November 2004, the Capital Market Authority decided to transfer the holdings of retail investors from the custody of the depository to local custodian banks. In January 2005, the online-link between the stock exchange and the depository was finalized. The second quarter of 2005 witnessed a revival of the role of the stock market as a primary market with the Initial Public Offering of a private sector company and the offering of a stake in a large state-owned petrochemicals company. The offers were the first in the primary market in five years. The conclusion of major privatization deals, such as that of Bank of Alexandria or Telecom Egypt, could also provide one-off stimulus over the coming months.

Legislative Developments

Law No. 3/2005 on Protection of Competition and Prevention of Monopolistic Practices was issued to ensure fair competition and to prevent monopolies and consequently enhance integration in the international market. It is expected that a number of laws will be issued over the coming period in line with the efforts to create a healthy legislative environment; most importantly, the Consumer Protection Law; the Account and Auditing Law; and the Cheque Law. Lastly, Fitch and S&P upgraded Egypt's credit rating, to stable from negative, in December 2004 and March 2005, respectively.

EUROPEAN UNION

Financial Markets

In financial markets, the second half of 2004 and the first half of 2005 were devoted to the preparation of the technical measures for the Markets in Financial Instruments Directive (the "MFI Directive"), which introduces a revised European passport for investment firms and new rules aimed at greater competition between venues for execution of securities transactions.

Adopted in April 2004, the MFI Directive requires a range of technical measures to be fully operative. Technical measures will determine key questions related to the scope and content of pre- and post-trade transparency obligations, best execution rule, reporting and information to clients, and conflicts of interest management, to name a few. At the end of April 2005, the Committee of European Securities Regulators (the "CESR") completed its technical work on these measures, which involved an intense consultation process in which the European Banking Federation (the "FBE") was actively engaged. This work is now being drafted. After consultation with industry and review by the CESR and the European Parliament, it is anticipated that the draft law will be formally adopted by early 2006.

Meanwhile, an industry campaign involving the FBE encouraged the European Commission to extend the MFI Directive compliance deadline by one year. The FBE had argued that firms needed substantial time to design, test and implement new IT-software, to adopt new internal procedures, reporting and recording mechanisms, and to train staff. Many of these preparations could start only once the final shape of the new rules was known, i.e. after national implementation. Under the original timetable, it would have been impossible for the firms to comply with the new requirements on time with the highest standard of quality and in line with the objectives of fostering global competitiveness and economic growth. These arguments were received well by the new European Commission, which in June 2005 proposed legislation to extend the transition schedule, granting national governments six months and the firms an additional six months for implementing the new regime. The FBE supports this decision.

The Transparency Directive

The Transparency Directive was finally agreed upon on December 15, 2004. The Directive was subsequently published in the Official Journal on December 31, 2004 and must come into force by December 31, 2006. The "Transparency Directive" refers to the Directive on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC.

The CESR has been asked to submit its package of Level 2 advice on implementing measures to the Commission by June 30, 2005 and has consulted with the industry over the past year in two stages. The first consultation set out CESR's proposed advice on the dissemination of regulated information. The second consultation brought together the remaining issues included in the mandate, covering notification of major holdings of voting rights; semiannual financial reports; equivalence of transparency requirements for third country issuers; and the procedural arrangements whereby an issuer may elect its home Member State competent authority for the purposes of the Transparency Directive.

CESR also received a request from the European Commission to develop ideas on how a single point of access to information for all EU corporate issuers might be realized. The FBE fully supports the creation of a central or centrally accessible storage mechanism for regulatory information from listed companies under the Transparency Directive in a manner that makes it accessible to the general public. The central storage mechanism should also include the list of approved prospectuses.

Implementation of the Basel Capital Accord in the European Union

In July 2004, shortly after the publication of the "Revised Framework for International Convergence of Capital Measurement and Capital Standards" by the Basel Committee, the European Commission published the Directive which will implement Basel II in the EU member states. The Capital Requirements Directive (the "Capital Requirements Directive"), will apply to all banks and investment firms in the EU and will become effective on January 1, 2007. The Capital Requirements Directive is optional for banks following the Advanced Approaches. On January 1, 2008, the Directive will become effective for the remaining banks on the Advanced Approaches. The Directive is a revision of two previous directives. The technical details of the Capital Requirements Directive are attached in separate annexes. The complexity of the Directive (which is nearly 500 pages long), and the lack of certainty have resulted in delays for European banks and investment firms in their implementation processes.

The main issues for European banks relate to the relationship between home and host supervisors in the EU. The Capital Requirements Directive calls for a progressive role for the home supervisor in coordinating and deciding on the validation of the advanced models. The Capital Requirements Directive is intended to mitigate the effects of the fragmented supervisory structure which creates problems of inconsistency across jurisdictions for European banks. In this context, the level of application of the rules became the single most political issue in the European debate. In particular, the FBE sought to have Pillar 2, the Supervisory Review Process, and Pillar 3, Market Discipline, applied at the group level. In addition, European banks sought to have a 0% risk weight applied to Intra-Group exposures at an EU level.

In December 2004, the Council of Member States completed a First Reading of the Capital Markets Directive. While few changes were made to the political aspects of the Capital Markets Directive, the Council, under the Dutch Presidency of the EU Council of Ministers, made a large number of technical amendments to the text. In March 2005 the European Parliament began its First Reading. Because the Council had moved so quickly to complete its Reading, Parliament was encouraged by industry representatives to consider technical amendments to streamline the Directive. A total of 887 amendments to the text were proposed by Members of the European Parliament (MEPs). Many amendments to the political aspects were proposed reflecting the views of industry. The institutions are currently negotiating a compromise aimed at adopting the Directive in a single reading by the end of 2005. While little change is expected on the political questions, the FBE has succeeded in having a full review clause included in the Directive which will require the institutions to revisit the level of application in a short to medium timeframe.

The European Commission has published a Paper on Financial Services Policy (2005-2010) which sets out its agenda regarding prudential supervision over the coming period. The FBE continues to push for fully consolidated supervision as the objective of this forward agenda. The Commission accepted it as a legitimate demand and has committed to reviewing and changing the safety nets in Europe, and to ensuring a high level of supervisory cooperation and convergence. Eventually, consolidated supervision will only be possible in Europe when it is clear which taxpayers will pay in the event of a banking crisis in a large cross-border institution. The Commission's forward agenda, therefore, promises to be challenging for all stakeholders.

Payments and Securities

The Single Euro Payments Area (SEPA) and the European Payments Council (EPC)

In December 2004 the EPC approved a Roadmap 2004-2010, which lays out concrete milestones and deliverables for the transformation of the European payments landscape. Building on past achievements in the area of wholesale and retail cross-border payments in Euro, and the introduction of the Euro, the banking community will create a range of SEPA payment solutions, which will find widespread adoption in the Euro zone and beyond.

Two new Pan-Euro Payment Schemes for electronic credit transfers and for direct debits will be delivered. A Cards Framework for a single market for bank cards will be designed by the end of 2005 and is expected to be in operation by January 2008. It is expected that a critical mass of transactions will be conducted with these payment instruments by 2010.

SEPA will be implemented by the European banking industry in close alliance with all stakeholder communities (consumers, SMEs, merchants, corporate and government bodies) and public authorities. The community of European banks is strongly committed to implementing SEPA, which is based on self-regulation and a full recognition of the role of market forces and competition.

The **pan-European automated clearing house ("PE-ACH")**, launched in 2003 by the Euro Banking Association ("EBA") has experienced continued increase in the number of banks participating in the system. In future STPE2, it will also process "domestic" payments. As soon as the pan-European payments schemes are in place, the distinction between "domestic" and "cross-border" payments is expected to gradually vanish.

Integration of the European Payments Clearing Infrastructure

In 2004 the Governing Council of the European Central Bank officially launched the TARGET2 project. The current system for high-value Euro payments across Europe TARGET1 interconnecting 15 European RTGS systems will be replaced by a centralized system operating on a Single Shared Platform ("SSP") with harmonized pricing and service levels. TARGET2 will be the core infrastructure of the envisaged Single Euro Payment Area ("SEPA") and is due for the second half of 2007.

The TARGET Working Group ("TWG") on behalf of the European banking industry is closely monitoring progress and regularly confers with the European System of Central Banks to determine the General Functional Specifications ("GFS") of the Single Shared Platform ("SSP"). Detailed functional specifications are being developed. The SSP will be proposed by three Central Banks (Bundesbank, Banque de France and Banca d'Italia).

The FBE TARGET Working Group will be closely involved in the next phases of the project i.e., the testing and training and the migration phases (together with the national banking communities).

A New Legal Framework for Payments in the Internal Market

The European Commission has continued its work on a Directive proposal for a "New Legal Framework on Payment in the Internal Market" in the last 12 months and is expected to publish a final proposal in fall of 2005. The FBE has closely followed the development of this Directive proposal and has provided feedback to the Commission. The payments framework will be an essential legal basis for the future pan-European payment schemes that are currently being developed by the European banking industry.

Legal and International Affairs

Third Anti-Money Laundering Directive

The European Commission presented in June 2004 a proposal for a third Anti-Money Laundering Directive due to replace the two existing directives. Besides the proposal for a new definition of money laundering, the new directive intends to ensure a consistent application in all Member States of the revised 40 Recommendations of the Financial Action Task Force on Money Laundering ("FATF"). On June 7, 2005, the Council approved in first reading the text of the directive by endorsing the amendments tabled by the European Parliament on May 26, 2005. EU Member States will have to implement the directive two years after its publication in the EU Official Journal.

The new directive introduces the principle of the risk-based approach (i.e. customer due diligence requirements shall be implemented proportionally to the concrete risks involved).

Social Affairs

The FBE, together with the European Savings Banks Group ("ESBG"), the European Association of Cooperative Banks ("EACB") and the trade unions UNI-Europa, was running a project on the Social and Employment Aspects of Corporate Social Responsibility ("CSR") throughout 2004. Five key themes were identified for examination:

1. Training, Learning and Development;
2. Core Labor Standards;
3. Work-Life Balance;
4. Internal Communication; and
5. Equal Opportunities.

On May 23, 2005 a joint statement on CSR was signed between the European social partners. While they agreed on the importance of a follow-up procedure in order to offer the possibility to the Sectoral Social Dialogue Committee to continue the process, the European Social Partners agreed that the use of such practices with respect to social and employment aspects of CSR is enhanced through voluntary means and in full respect of national/company practices.

Mortgage Credit

The FBE participated in a forum group (composed of representatives of the industry, consumers' organizations, etc) set up by the European Commission to identify the obstacles to the creation of an Internal Market for Mortgage Credit, to assess their impact and to propose policy recommendations to abolish them.

The report issued by the forum group in November 2004 includes 48 recommendations covering five subjects considered as key to assessing the state of integration of the EU mortgage credit markets: consumer confidence, legal issues, collateral issues, distribution issues and finance. The report constitutes the basis for a forthcoming Commission's Paper on the integration of mortgage credit due to be published by mid July 2005.

Consumer Credit Directive

Critical issues for banks are left open in the non-consolidated text of the revised proposal of the consumer credit directive released in October 2004 by the Commission. Overall, the proposed directive aims at increasing consumer protection in the field of consumer credit and at favoring cross-border transactions within the Single Market. In order to achieve its goal, the legal framework embodied in the proposed directive targets harmonization of the relevant rules.

Another revised version of the Commission's proposal is expected. The European banking sector expressed its willingness to have an impact assessment inserted in the forthcoming text, in line with the guidelines set forth by the Commission in its Green Paper on Financial Services Policy and in the Better Regulation Communication.

International Affairs

The FBE published in May 2004 a list of trade barriers in banking, securities and other related financial services in WTO member states. In order to achieve meaningful and substantive commitments in the round of trade negotiations in the WTO, the FBE believes that the financial services negotiations should reflect, *inter alia*, the following goals:

- Foreign investors should have the right to establish through a wholly owned presence or other form of business ownership, and to operate competitively through established vehicles available to national businesses.
- Foreign direct investors should have the same access to domestic and international markets as domestic companies.
- Unnecessary restrictions on cross-border financial services, business and consumption of services abroad should be removed.

Company Law and Corporate Governance

In September 2004 the FBE finalized answers to the Commission consultations on directors' independence, on the responsibility of boards of directors, and on improving financial and corporate governance information. Both consultations were part of the Commission Action Plan on modernizing company law and enhancing corporate governance in the EU. The FBE is presently drafting its reply to the Commission consultation on minimum standards that will apply to shareholders' rights (deadline of July 15, 2005).

The European Commission has set up an expert advisory group to provide detailed technical advice on preparing corporate governance and company law measures. The group comprises twenty non-governmental experts from various professional backgrounds with particular experience and knowledge of the subject. The FBE is represented in the advisory group.

European Contract Law

The European Commission has commenced a project on the harmonization of Contract Law in Europe. This project aims at becoming a Common Framework of Reference ("CFR"). In that respect, a network of stakeholder experts, called CFR-Net, has been set up in 2004 by the Commission to work on the project. The FBE is represented in the CFR-Net.

FINLAND

General economic activity in Finland was unexpectedly strong last year. This was also reflected in the banks' results, which, on average, were slightly better than in the previous year. The demand for housing loans in particular continued as strong, mainly supported by continued low interest rate levels. Continued strong consumer confidence also supported this development. Due to tight competition among the banks, interest rate margins remained extremely narrow. The growth in lending volumes largely compensated for the negative effect of the interest rate level and small interest rate margin on the net income from financial operations. Investment operations also picked up, and this was reflected in an increase in other income. The number of problem credits was low and only small credit losses were recorded during 2004. In terms of lending, public debate on the borrowers' and banks' ability to assign and bear risk continued, at times, intensely.

Focus on Service Fees

In early 2004 pensioner organizations focused on banks' high service fees and made them an issue for public discussion and debate. This led to a parliamentary bill, which introduced a ceiling for service fees charged for paying bills at the cash desk. The bill was widely supported. The Bankers' Association initiated discussions with the pensioner organizations, drafted a payment guide in co-operation with the organizations, and widely circulated alternative, less expensive payment options, which require no technical knowhow or use of technical equipment. In addition, the banks made a commitment to inform their customers of inexpensive payment alternatives. The overall aim was to find a solution that would not require legislative interference with pricing, which is foreign to a market economy. The outcome was satisfactory as the planned price ceiling was not imposed. However, through an amendment to the Financial Supervision Act, the Financial Supervision Authority is obliged to monitor the service fees and report on its findings to Parliament from time to time.

Debt Settlement Program

The debt settlement program launched in 2001 between the Bankers' Association and the government formally concluded at the end of 2004. By the end of 2004 a total of 3,500 debt settlements had been concluded with banks and all creditors combined totaled approximately 6,350. In addition, approximately one thousand applications were still being processed. All in all the number of settlements will probably amount to about 15% of the presumed number of debtors. This can be seen as an achievement, taking into account the manifold debt problems caused by the recession in early 1990s and previous experiences in reaching debtors. The banks have made significant concessions in the settlements that have been made. An average of 93% of debts and interest rates has been forgiven, i.e. over 260 million euro. The debt settlement program has been important in opening excessive indebtedness problems to public debate and in motivating debtors, creditors, officials and other parties to develop a cooperative approach to debt control issues. Even though the actual debt settlement program has ended, the banks are continuing to make voluntary arrangements with all willing debtors whose debt was incurred during the recession.

Siva Working Group

The so-called Siva working group that evaluated the competitiveness of savings, investment and life insurance products issued its final report in December 2003. The political decision in the matter was drawn out and only in late spring of 2004 did the Government decide that the Siva working group's suggestions to extend the tax deduction right to other savings forms would not be pursued. The Government limited its decision to certain transitional measures, including the transition to capital income taxation and enforcement of the age limit revision. The working group had proposed that tied long-term savings should be promoted by preserving the tax incentive associated with pension savings and extending the current tax deduction right for pension insurance policies to cover mutual fund shares, savings in bank accounts and direct savings in securities through investment service companies and deposit banks. The Bankers' Association favored the Siva working group proposals and felt they would provide a good framework for product development as well as promote market competitiveness.

Implementation of International Accounting Standards

The international legislation projects that have been under preparation for quite some time, the implementation of the international accounting standards and the revision of the capital adequacy legislation took a big step forward. The Government's proposal for a law on amending the Bookkeeping Act and certain related laws was given to the Parliament in June. This proposal brought into force the regulation of the European Parliament and the European Council (the so-called "IAS Regulation") on the application of international accounting standards, the fair-rule directive and the modernization directive. Based on the amendment, Finnish stock exchange-listed companies (including banks and other financial institutions) must apply IFRS standards approved at the EU level in their consolidated financial statements from January 1, 2005 onwards. Companies that only issue listed bonds, which are currently mainly banks, may postpone their IFRS transition to the year 2007. Finnish banks are well prepared to implement the new legislation.

Basel II Implementation

The time for the new Basel II capital adequacy regulations' entry into force was confirmed as January 1, 2007, so that a single bank may, at its discretion, make the transition from January 1, 2008 onwards. The proposed directive will be processed by the European Parliament in the spring of 2005. The Financial Supervision Authority circulated several interpretive drafts for comment in order to clarify national options for the directive and their implications for the Finnish market. The

Bankers' Association's statements emphasized the international comparability of the regulations and sufficiently clear restrictions in supervisory authority power.

The Ministry of Finance launched preparatory work related to capital adequacy reform in the autumn by appointing an unofficial working group consisting of, in addition to the Ministry, the Financial Supervision Authority and the Bankers' Association. The aim of the working group is to prepare a draft for a Government proposal during the spring of 2005 so that it would be circulated for comment during the summer of 2005.

Equipping international payment cards issued in Finland with chips started in full force last year. By the end of the year 68% of Visa Electron cards contained a chip, and 70% of Finnish ATMs were able to handle chip cards. Chip card certification for payment terminals used in Finland was initiated. However, by the end of the year, only a few certified payment terminals were in use. During 2004, a chip card implementation project for stores, banks and Luottokunta was launched. The study on developing Finnish bankcards to meet the technical requirements of the European payment area proved more difficult than expected. The current chip card specifications do not take combination card type solutions into account and a European debit card is so far only a target.

Bank Card and Payment Systems Developments

The banks are involved in developing a European payment area through the European Payments Council ("EPC"). During 2004, the EPC's work was reorganized and the European Committee for Banking Standards ("ECBS") was linked to it. EPC produced a plan on the transition to European payment traffic solutions. The focus areas were European giro transfer, direct debit and debit card. The European Commission prepared several proposals for European payment legislation during 2004. These regulate the relationship between the provider of payment services and the customer, and the requirement related to payment services. The Bankers' Association commented on the proposals during 2004. Harmonized payment services in the euro area will not necessarily improve the payment traffic services offered by Finnish banks, or make them more effective.

Special Projects of Bankers' Association

During 2004 the Bankers' Association provided approximately 80 answers to requests for statements received from domestic and EU authorities. In addition to four regular Bank Review issues, a special issue of the Bank Review was published in honor of the Bankers' Association's 90-year jubilee. The special issue reviewed developments relating to the banking sector and the Banker's Association throughout the decades. In addition, three papers and approximately 30 reports, studies, service descriptions and agreement terms were published on the web pages of the Bankers' Association. These included, e.g., a revision of the provisions of good banking practice.

At the end of the year the Bankers' Association joined the Confederation of Finnish Industries EK formed in the spring. No new members joined the association in 2004, so by the end of the year the association had 14 members representing 334 banks.

FRANCE

Major Changes in the Legal and Regulatory Frameworks of the French Banking and Financial Sector:

In 2004-2005, the French financial sector has pursued its efforts of rationalization and consolidation of the legal and regulatory frameworks. Major changes on the financial and banking scene have mainly proceeded from the implementation of both European standards (with the transposition of EU directives into national law) and domestic standards (notably the implementing legislation of the Financial Security Act of 1 August 2003).

1. Transposition of EU Directives into national law

- The Order 2004-1127 of 21 October 2004, transposing the EU directive 2001/24/EC on the **reorganization and winding-up of credit institutions**, has amended the French Financial and Monetary Code regarding the treatment of credit institutions in trouble. The order now guarantees mutual recognition of winding-up measures adopted by the Member States of the European Economic Area (EEA). In other words, the law of the country in which a company has its registered office will apply and be effective in all other Member States. The only areas in which the rule will not apply are securities, immovable property and transactions in financial instruments. The introduction of this single procedure should ensure a uniform cross-border approach to insolvency.

- The Order 2004-1201 of 12 November 2004, transposing EU Directive 2002/87/EC concerning the **additional supervision of credit institutions, insurance companies and investment firms belonging to a financial conglomerate**, introduces a common regime for the additional prudential supervision of the insurance, banking and investment services sector. The order defines a new category of supervised institutions, the financial conglomerates, and creates a special category of "mixed financial holding companies". Both categories will have to comply with similar requirements to those in effect for finance companies, and will be subject to supplementary oversight. A national authority appointed as a coordinator will carry out the additional supervision, with the possibility to sanction entities.

- The Order 2005-648 of 6 June 2005, transposing EU Directive 2002/65/EC concerning the **distance marketing of consumer financial services and amending**, lays down common rules for selling contracts of credit cards, investment funds, pension plans, etc. to consumers by phone, fax or internet. The main features of the directive are: (1) the prohibition of abusive marketing practices seeking to oblige consumers to buy a service they have not solicited; (2) rules to restrict practices such as unsolicited phone calls and e-mails ("spamming"); (3) an obligation to provide consumers with comprehensive information before a contract is concluded; (4) a consumer right to withdraw from the contract during a cool-off period.

2. New domestic regulation resulting from the implementation of the Financial Security Act (August 2003)

- **The Decree 2004-850 of 24 August 2004,** which implements Article 26 of the Financial Security Act (1 August 2003) deeply modified the structure of the French system of financial authorities. The Minister for the Economy and Finance still retains the power to issue regulations, but from now on the minister will be assisted by the Comité *Consultatif de la Législation et de la Réglementation Financières* (CCLRF). The CCLRF will deliver an opinion on any general legal text regarding banks, insurance companies and investments societies. It therefore replaces the CRBF (Banking and Financial Regulatory Committee) and the regulation commission of the CNA (National Council of Insurance companies).

- **The reform of the rules on *titres de créances négociables* (negotiable short-term debt instruments),** launched by the Financial Security Act, was implemented by Decree 2004-865 of 24 August 2004. The purpose of the new amendments is to make French commercial paper market more attractive to foreign issuers (for instance, issuance documentation can now be drafted in English and the breakdown of powers between the *Banque de France* and the *Autorité des Marchés Financiers* has been improved).

- In 2004-2005, the *Commission Bancaire* monitored **changes to the debt issuance regime** in accordance with the Order 2004-604 of 24 June 2004, which reforms the rules on securities issued by commercial companies. The order has introduced greater flexibility into the regime applicable to bond issuance by joint-stock companies: powers of issuance have notably been transferred from the general meeting of shareholders to the company's management bodies. It also unified the rules for the issuance of securities giving access to equity, by including convertible bonds and other complex debt securities.

3. Other important changes in financial legislation

- The Decree 2004-1255 of 24 November 2004 on **debt securitization funds ("*FCCs*")** improves the operating procedures of *FCCs*. By adopting an "extended" definition of credit derivatives, the decree makes it easier for them to engage in this type of transaction. It also improves the breakdown of responsibilities between transferors and custodians during the transfer and collection of receivables.

- The Parliament has adopted on 20 May 2005 a law which intends to prepare the French state-owned post office for liberalization of Europe's postal markets. The law includes a range of measures to help the former monopoly survive in a newly competitive market. Among those measures, it allows it **to create a postal bank**.

- The Parliament has adopted on 8 July 2005 a **law proposal on business bankruptcy**. Inspired by the well-known US "chapter 11", this proposal enables a manager to open a case to a trade court before filing for bankruptcy. This saving procedure systematically (and temporarily) suspends any legal action that had been taken by a creditor against the manager. Two committees, respectively composed of the creditors and suppliers of the company, are then gathered to get the company's financial issues sorted out.

Banking Industry's Commitments in the Area of Customer Relations

In November 2004, during the first meeting of the new Consultative Committee for the Financial Services Sector (CCSF), the French banking industry made commitments to improve their relations with consumer customers.

These commitments are based on three principles: transparency, competition and equal access to essential banking services for everyone. It has been decided to bring these new measures simultaneously into effect within four distinct phases:

1. **Since January 2005**, consumers may close their current or passbook accounts free of charge. This highly symbolic measure makes it easier for people to change banks, and therefore increases competition.

2. **By March 2005**, all tariffs were made immediately accessible on the Internet or on advertising literature in branch offices, in order to enable consumers to compare prices. To make it easier for new customers to change banks, banks also began to provide them with an Account Closure & Transfer Guide. Furthermore, each customer now has free access to cash at his/her branch: this involves free withdrawal from the bank's ATMs for those customers with a bankcard, while other customers may withdraw cash free of charge either directly from their bank or using a debit card.

3. **During summer 2005, other measures have come into effect:**

   - **Alternative payment means** for customers who are denied cheque books will now be proposed by each bank network. These means will include a "systematic approval" type payment card with no credit facility, and a sufficient number of bank transfers, direct debits and interbank payment forms. They are currently being tested in the départements of Sarthe and Seine-Saint-Denis: they should be implemented throughout France as soon as possible.
   - **Fixed fee for cheque payment incidents:** customers will be better informed of the legal and financial consequences of bouncing a cheque, to encourage them to deposit sufficient funds into their accounts before a cheque is refused.
   - **A glossary of commonly-used banking terms** is also being prepared. This educational document contains 100 terms used for the most frequent banking transactions, explained in plain, easy-to-understand language.

4. **By the end of the year, two measures that require modification of banking information systems will be implemented:**

   First, the names of the most frequent transactions on bank statements will be standardized. Second, bank charges will be indicated using a visual code, to make them easier to identify.

Significant Market Developments in France for 2004-2005:

Rationalization of the French banking industry, initiated in the late 1980s in response to growing competition and the construction of the single European market, has resulted in a steady decline in the number of credit institutions. Finance companies, mutual and cooperative banks have been most affected, with commercial banks involved to a lesser degree. **In 2004, the number of credit institutions in France and Monaco fell by 48**: at end-2004, 911 credit institutions in France and Monaco were subject to Commission Bancaire supervision.

Most of the changes were related to new or ongoing large-scale tie-ups, which led to the authorization of new institutions, status changes, but especially mergers of institutions engaged in like areas of business.

Caisse d'Épargne group undertook a restructuring project (dubbed "Refondation") in 2004 that significantly increased its relative size. Caisse Nationale des Caisses d'Épargne (CNCE) took control of Eulia, a finance company that CNCE had owned jointly with Caisse des Dépôts et Consignations since 2001 and that held the competing businesses of the two groups. CNCE also obtained direct control of CDC Finance-CDC Ixis, a bank. In addition, CNCE reorganized the group's main business lines.

There was also some restructuring following Crédit Agricole's 2003 takeover of Crédit Lyonnais. Highlights included the merger of the finance and investment banking businesses within a new entity called Calyon. The consumer credit and leasing businesses were also brought together.

Banque du Développement des PME (BDPME) was also restructured as part of the government's creation of an agency to provide support to small and medium-sized enterprises (SMEs). Meanwhile, a number of foreign groups with a presence in France, including General Electric and several Benelux banking groups, reorganized their subsidiaries.

The number of investment firms increased by 38 overall. There was an 11-unit decline in the number of entities approved by the Credit Institutions and Investment Firms Committee (CECEI) and subject to Commission Bancaire supervision and a 48-unit increase in the number of entities approved by l'Autorité des Marchés Financiers (AMF).

GERMANY

EU Commission decisions and court rulings and their translation into German law have significantly eroded the competitive privileges enjoyed to date by Germany's public-sector banks. German company, accounting and capital market law have been further developed in order to strengthen investor protection and the accountability of both companies and auditors and improve framework conditions for modern financial products such as German covered bonds (Pfandbriefe). In addition, German banks are actively working on making online banking even more secure and supporting their successful fight against money laundering with IT-based concepts.

Decisions by the European Commission against State Aid to Public German Banks Distorting Competition in the Single European Market

In accordance with the understanding reached in 2001 between the European Commission and the German government on the phasing-out of *Anstaltslast* and *Gewährträgerhaftung*, the state guarantees for German public-sector savings banks (Sparkassen) and their central institutions (Landesbanken) were abolished in July of this year. This put an end to one of the most significant competitive privileges that German public sector banks enjoyed. As a consequence, ratings of public-sector banks will deteriorate, bringing their capital-market refinancing conditions more into line with those of their privately-owned competitors in Germany and worldwide.

Furthermore, state aid proceedings by the Commission against seven German Landesbanken for integrating state housing agency assets without paying proper remuneration were concluded in October 2004 by ordering them to repay 4.3 billion Euros to the owners of these assets. The Commission demonstrated that the remuneration for the transfer of these assets (about 1% p.a.) was well below the normal return on investment that a private investor would have required. The appropriate remuneration was calculated at 6-7%, except for one Landesbank, where it was found to be lower. The Commission therefore established that the low remuneration originally agreed constituted state aid within the meaning of the EU Treaty and ordered Germany to recover the difference between an appropriate return on investment and the originally paid return from the Landesbanken. The closing of the procedures was prepared by bilateral negotiations and the ensuing agreement reached in September 2004 between the Landesbanken, the Länder (German states) concerned and the Association of German Banks acting as the complainant. As of January 2005, the amounts due had been paid back by all banks concerned to the respective Länder. Currently, similar amounts are being re-transferred to the Landesbanken, with the Commission monitoring this process to ensure compliance with EU regulations on state aid.

In addition, the Commission is still examining whether the protection of the name "Sparkasse" provided under Section 40 of the German Banking Act is consistent with the freedom of establishment and the free movement of capital in the European Union. Under this provision, only public-sector savings banks are allowed to call themselves a "Sparkasse", whereas a private investor buying a savings bank would not be allowed to use this name, which is an important asset.

Level Playing Field for Banks Issuing German Covered Bonds (Pfandbriefe)

The Pfandbrief Act, reorganizing the legal basis for Pfandbrief business in Germany, entered into force on July 19, 2005. Pfandbriefe are bonds which are covered by property loans and loans to local, regional and central governments in Germany or other industrial countries' governments. They are a special type of investment, as (a) a bank may only use the funds obtained by means of Pfandbriefe for especially secure loans and (b) if the bank fails, the Pfandbriefe and the related covering loans constitute special assets which are separated from the failed bank's estate.

Only two groups of banks were previously allowed to issue Pfandbriefe in Germany. Under the German Mortgage Banks Act, private banks were only permitted to issue Pfandbriefe as specialist banks, i.e. they were only allowed to conduct other banking business besides Pfandbrief business within very narrow limits ("specialist bank principle"). Under the Public Pfandbrief Act, the public-sector Landesbanken and savings banks were also allowed to issue Pfandbriefe as universal (one-stop) banks, although the Public Pfandbrief Act delivered a lower quality standard than the Mortgage Banks Act. This privilege was justified by the existence of the state guarantees (*Anstaltslast* and *Gewährträgerhaftung*), which were, however, abolished on July 19, 2005 following state aid proceedings by the European Commission.

The abolition of the state guarantees meant that the unequal treatment of private universal banks and Landesbanken/savings banks could no longer be justified. German legislators responded by introducing the Pfandbrief Act, which is geared to – and actually surpasses in part – the high quality standard set by the Mortgage Banks Act but drops the specialist bank principle. Because of the continuously improved protection of Pfandbrief loans under insolvency law, the specialist bank principle had become less and less important in recent years. As a result, all banks in Germany can in the future fund their eligible lending business through Pfandbriefe. All they need is permission to issue Pfandbriefe from the Federal Financial Supervisory Authority, BaFin.

This solution, in which the private banks were closely involved, is strongly welcomed for both competitive and commercial reasons. The abandonment of the specialist bank principle finally puts an end to the unequal treatment of private and public universal banks and gives all banks access to Pfandbrief funding. At the same time, adhering to the previous quality standard and even tightening the requirements for Pfandbrief business help to preserve the good reputation of the German Pfandbrief, which is the international market leader in the field of covered bonds. The Pfandbrief has become very successful during the past decade and will thus be able to maintain its current position, particularly because various universal banks are presently planning to initiate Pfandbrief business.

New Developments in Company Law

German legislators have strengthened investor confidence in the integrity, stability and transparency of the financial markets, particularly by reforming the system of corporate governance. On February 25, 2003, the German government presented a “Catalogue of measures to strengthen corporate integrity and investor protection”, designed to give investors more rights and improve stock market transparency. This catalogue of measures, which is based on the so-called “10-point Program” presented during the last legislative period, takes up, among other things, some of the proposals for changes in the law made by the German Government Commission on Corporate Governance and in the Sarbanes-Oxley Act of 2002 to reform the U.S. corporate governance system.

To implement these measures, the Act on Corporate Integrity and Modernization of the Right of Rescission was passed in the summer of 2005. The key points of this Act, which will enter into force on November 1, 2005, are as follows:

- In the field of directors’ liability vis-à-vis a company, legal action by a minority of shareholders is made easier: The quorum required for the company to assert claims against directors in its own name is lowered significantly to only a 1 % shareholding in terms of registered capital or a nominal amount of 100,000 Euros. To prevent any abuse of the right to sue, a court procedure for admitting legal action will be introduced.
- A central forum will be set up on the Internet for small shareholders willing to sue so that they can look for the number of fellow-shareholders they need to meet statutory quorums.
- It is made clear that any liability of directors vis-à-vis a company for its performance is ruled out (“business judgment rule”).
- Resolutions passed at shareholders’ meetings that bring about changes in company structures and have to be entered in the Commercial Register are protected against improper actions for rescission.

- The requirement to deposit shares in advance of shareholders' meetings is abolished, bringing Germany into line with international standards applicable to shareholders' meetings. This requirement, which was repeatedly – but wrongly – seen abroad as an obstacle to the sale of shareholdings, will be replaced by a record date. Listed companies can thus stipulate in their articles in the future that shareholders wishing to attend a shareholders' meeting must demonstrate that they are entitled to do so by presenting a certificate from their bank with details of their shareholdings at the start of the 21st day before the meeting.
- Banks are required to enter their so-called "freier Meldebestand" (holdings for which neither the client nor the bank itself as trustee for its client are entered in the shareholders' register) in the shareholders' ledger of companies with registered shares if their clients refuse to allow themselves to be reported. The reason for this provision is the aim of companies with registered shares to reduce these holdings and increase presences at shareholders' meetings.

In addition, an Act passed in the summer of 2005 introduced model proceedings for actions by investors injured by false, misleading or withheld public capital market information in, for example, annual accounts or listing prospectuses. The introduction of model proceedings is designed to prevent complex, similar hearings of evidence in a large number of different actions. Unlike class actions under U.S. law, one of the plaintiffs is officially designated as the model plaintiff by an upper regional court (*Oberlandesgericht*); the other plaintiffs are invited to attend the model proceedings as well. The non-appealable model ruling is binding on the courts and, as far as the scope of its declaratory purpose is concerned, also on the other plaintiffs attending the proceedings and the model defendant.

The Act on the Disclosure of Executive Remuneration passed in July of 2005 introduces a requirement for listed companies to publish the earnings of individual executive directors, broken down into performance-related/non-performance-related components and components with a long-term incentive effect such as stock options, in the annex to the annual accounts or group accounts. However, the shareholders' meeting may decide by a qualified majority of three-quarters of the registered capital represented at the meeting to waive such disclosure for a period of not more than five years in each case. The new rules are to be applied for the first time to annual accounts and group accounts for financial years as of 1 January 2006.

At the beginning of June 2005, the Government Commission on the German Corporate Governance Code adopted a number of amendments to the Code. These are designed mainly to further improve the work of the supervisory board. The changes were triggered, first, by an analysis of recent international developments on corporate governance, particularly at European level, and implement large sections of the EU recommendation on the tasks of independent supervisory board members. They were prompted, secondly, by the recent comprehensive German legislation on corporate governance (e.g. in the Act to Reform Accounting Law, the Act on the Supervision of Accounting and the Act Enhancing Investor Protection – see below). These changes aim to make the dual board system operated by German stock corporations more transparent to foreign investors in particular.

New Developments in Accounting

The modernization of German accounting law launched in 2003 was continued. The individual measures envisaged under this reform are designed to establish high-quality, transparent accounting standards along with improved mechanisms for enforcing these standards and thus to maintain and enhance the quality of accounts.

In December 2004, the Act to Reform Accounting Law was passed. This Act contains national provisions on the regulation on the application of International Financial Reporting Standards (IFRS/IAS) adopted at the European level. Capital-market-oriented companies are already required under the IAS Regulation to prepare their group accounts in accordance with the IFRS from 2005 onwards. The national options contained in the IAS Regulation are used as far as possible in Germany. First, non-capital-market-oriented companies are permitted to prepare their group accounts in accordance with the IFRS. Second, both capital-market-oriented and non-capital-market-oriented companies may also draw up individual IFRS-compliant accounts, but only for disclosure purposes. For assessing tax and calculating dividend payments, accounts drawn up in accordance with the provisions of the German Commercial Code are still required. Third, bond-issuing firms without listed shares, as well as European firms listed on a U.S. stock exchange, and therefore applying U.S. GAAP, are allowed to implement IAS by 2007 instead of 2005.

Besides addressing the application of the IFRS, the Act also contains numerous amendments to German accounting law resulting from the translation of European accounting directives into national law. This means that German accounting law was brought into line with international standards, while the overall legal framework for accounting was optimized. In addition, the Act amends the Commercial Code to make auditors more independent. It prohibits auditors from auditing themselves, i.e. auditors are not allowed to get into a situation where they assess the results of earlier advisory activities of their own. Stricter auditing rules apply for capital-market-oriented companies, banks and insurance companies of a certain minimum size. Furthermore, the Act contains rules on the personal ties and financial dependence of auditors, as well as a requirement to disclose fees for auditing services and advisory services separately.

Furthermore, a bill to modernize accounting law is scheduled for the end of 2005. It will contain, in particular, provisions bringing German accounting rules further into line with international standards, including the introduction of fair-value accounting for certain financial instruments, valuation rules for pension provisions and changes to the rules on consolidation.

At the end of 2004, an Act on the Supervision of Accounting was passed by parliament. This Act created a two-step enforcement procedure in addition to the existing supervision of corporate accounting in Germany by the statutory auditors of the annual accounts and the courts of registration. As a first step, a private supervisory organization conducts checks, both in cases of suspicion and by way of random audits, on the orderly accounting of listed companies. As a second step, BaFin will take action as a sovereign supervisor whenever companies refuse to cooperate at the first-step level or do not correct the shortcomings detected there. The private supervisory organization started its work on July 1, 2005. The creation of a privately-run enforcement office under government supervision is firmly supported by the Association of German Banks and the other large trade associations in Germany.

New Developments in Securities Law

The Act Enhancing Investor Protection became effective on October 31, 2004. This Act was designed chiefly to translate the European Market Abuse Directive into German law. Germany is one of the first EU member states to transpose this directive more or less by the deadline set in it. Many of the changes concern the Securities Trading Act, specifically the prohibition of insider trading, ad hoc disclosure requirements, the ban on price manipulation and the rules on securities analyses. These statutory provisions have been fleshed out in the meantime by various ordinances issued by BaFin and the Federal Ministry of Finance. Currently under discussion are interpretative guides by BaFin to help market participants apply the new legislation in practice.

A further purpose of the Act Enhancing Investor Protection is the introduction of a prospectus requirement for non-certificated investments such as closed-end property funds or ship holdings. These new rules, which were laid down collectively in the Offering Prospectus Act, entered into force on 1 July 2005 and were fleshed out by a Federal Ministry of Finance ordinance specifying the requirements that an investment prospectus has to fulfill. This legislation was not triggered by a European initiative. It is intended to ensure further protection of investors by creating entry barriers for issuers on the so-called "grey capital market", requiring them to issue a prospectus in future for all public offerings of investment products. Although prospectuses were issued frequently in the past, they were neither uniformly designed nor examined by supervisors. In future, prospectuses will have to be approved by BaFin before their publication.

Parallel to the prospectus requirement for issuers of investment products, an act translating EU Prospectus Directive 2003/71/EC into German law became effective on July 1, 2005, largely abolishing the existing differentiation between prospectuses for admission to trading (listing prospectuses) and those for public offerings (offering prospectuses). Whereas offering prospectuses had previously been examined by BaFin and listing prospectuses by the stock exchange admission boards, prospectuses will be examined and approved centrally in future by BaFin. This means that issuers no longer have to apply to the different stock exchange admission boards but have a central contact. To make continued full use of the European passport for issuers (easier market access in another EU member country by using the prospectus approved in one member country) Germany decided that prospectuses may be presented for examination not only in German but also in English if a cross-border offering is involved. This makes things much easier for internationally operating issuers, particularly where financial information is concerned. It should also be noted in this context that Germany retained the important possibility for issuers who issue securities under an offering program to use a general listing. This allows an issuer to also list securities that do not yet exist so that the new securities issued under the offering program can be traded quickly without any further listing procedure as soon as the final terms of the respective security have been published by the issuer.

Following the effective date of January 1, 2004 of the Investment Act containing provisions on investment funds, a Federal Ministry of Finance consultation paper was published in April 2005, requesting market participants to comment in the light of their experience to date with the new legislation. This paper addressed, among other things, the issue of hedge funds, which – unlike in many other countries – had already been regulated in Germany. Thought is now being given to, for example, setting statutory requirements for prime brokers and carefully opening the marketing of single hedge funds to private individuals. So far only funds of hedge funds can be publicly marketed; single funds, on the other hand, may not be actively offered to clients.

New Developments in Banking Supervision

As of May 2005, the threshold triggering the requirement for banks to request disclosure of financial information from borrowers set out in Section 18 of the German Banking Act was raised from 250,000 Euros to 750,000 Euros or 10% of liable (tier 1) capital. Simultaneously, the extensive implementation regulations regarding the scope of financial information to be disclosed were abolished, thus assigning responsibility for the appropriate application of Section 18 to the individual bank.

Online Banking and Electronic Commerce

Thanks to the German direct banks, which are mainly subsidiaries of the big private banks, the private banks are the market leaders in this field, operating 40% of the 31 million online accounts (2003). In mid-2004, the Association of German Banks, in collaboration with the research group ipos, conducted another representative survey of online banking and e-commerce in Germany to follow up on the end-2003 survey. The number of Internet users has steadily increased over the last four years, almost doubling during this period. Whereas in 2000 less than one third of Germans (32%) used the Internet, 61% of adult Germans have access today to the Internet, representing an increase of four percentage points compared with the survey one year ago. The proportion of Germans conducting online banking has likewise risen steadily over the past few years, from just 11% in 2000 to 30 % today. This means that more than half (54 %) of all Internet users also use online banking facilities. The number of online banking customers has thus practically trebled since 2000. Another 13 % of Germans over 18 also intend to bank online in the future. The proportion of Germans who rate online banking as safe or very safe has virtually doubled since 1998, from 21% then to 41% today. At the same time, around a third (31 %) of respondents feel that online banking is “not so safe”, while another 15% actually regard it as “not safe at all”.

Internet technology is constantly undergoing technical innovation. Banks are responding to this trend by ensuring that their systems are always state-of-the-art. This naturally includes the further development of customer authentication systems as currently implemented by many banks in Germany. Besides systems which continue to give customers unrestricted mobility, such as the indexed TAN, the mobile TAN, the secure TAN or the TAN generator of the ZKA chip card (ZKA is the joint secretariat of the German banking associations), electronic signatures (bank signature cards) can also be used in online banking. When the indexed TAN (iTAN) is used, the bank server requests the customer to enter a particular TAN from the TAN list provided to the customer so that a password phisher has no way of knowing beforehand which TAN will be requested. The mobile TAN (mTAN) is sent to the customer’s mobile phone by SMS shortly before the transaction and is only valid for a short time. Details of the transaction itself are included in generation of a secure TAN so that a password phisher can only conduct this one particular transaction with the secure TAN. In combination with an offline card reader, an EMV chip card (ZKA chip card) is capable of generating a TAN on demand and can thus replace the paper-based TAN list. In addition to PIN/TAN systems, chip-card-based procedures, e.g. HBCI, have been in use for many years. The ZKA has set itself the target of further improving multibank use of the different authentication systems by creating common standards.

The Fight against Money Laundering and the Financing of Terrorism

At the national level, the focus of discussion in Germany is on IT measures to combat money laundering. The basis for the envisaged anti-money laundering concept is a risk analysis conducted by every bank in accordance with supervisory requirements, with, for example, anomalies pointing to money laundering then being identified by means of computer-based monitoring. BaFin has published circulars outlining the basic requirements for the risk analysis and the key points of the monitoring systems. The German banking associations are looking to develop a general concept for such a risk analysis that banks can subsequently adapt to their own individual needs, depending on their business policy.

The German Financial Intelligence Unit at the Federal Office of Criminal Investigation credits banks with having the "right feeling" when reporting suspicious activities. In more than 85% of the cases reported, the investigating authorities establish an initial suspicion of money laundering. At the same time, the quality of reports (over 8,000 in 2004, representing an increase of around 22% compared with the previous year) is seen to be continually improving.

Implementation of the Third EU Anti-Money Laundering Directive passed in June 2004 will be another major milestone in German legislation to fight money laundering. Besides its welcome endorsement of a risk-based approach and a number of appropriate provisions, the German banking sector feels, however, that the Directive also harbors the danger of a reversion to an unfocussed and bureaucratic anti-money laundering approach. It is therefore vital that German legislators make proper use of the scope granted by the Directive.

Tax Developments

The final phase of the Tax Relief Act introduced in 2000 became effective on January 1, 2005, gradually lowering the bottom income tax rate from 22.9% to 15% and the top tax rate from 51% to 42%. To facilitate restructuring measures by investment companies, companies based in the EU and the European Economic Area (EEA) were allowed to conduct mergers in Germany on a tax-neutral basis (i.e. no taxation of hidden reserves).

While the legislative proposals designed to ease the tax burden on companies, including in particular plans to cut corporation tax from 25% to 19% and to lower the succession duty to make it easier for family members to carry on businesses, were put on hold because of the early parliamentary elections, the need for action in this area was recognized in the tax-policy agendas of all the major political parties. Legislation is therefore likely after the elections in September 2005.

Initiative Finanzstandort Deutschland

The Initative Finanzstandort Deutschland (the "IFD") was established in mid-2003 and now counts among its members 16 banks, insurance companies, financial-sector associations, as well as the Bundesbank and the Federal Ministry of Finance. The IFD is an action group run by market practitioners whose main aim is to develop practical, market-driven solutions particularly at the product level and in this way to make the German financial marketplace more internationally competitive.

Since the IFD was set up, over 200 experts in numerous task forces have launched a wide range of projects, and initial successes have already been recorded. For example, the participating banks have agreed on a common rating scale with six uniform rating categories that will make the lending process more transparent for their customers. The IFD will also improve SME funding facilities by making mezzanine financial products available and providing direct investment capital through a "Hesse Fund" in cooperation with the State of Hesse. In addition to SMEs, the IFD has focused on the property sector and developed a concept for the introduction of real estate investment trusts ("REITs"). It is at the same time actively promoting the creation of the Single European Payments Area ("SEPA").

In the field of education, the IFD plans to set up an Internet portal with a wide range of information in order to promote the inclusion of economics and finance as subjects in school curricula. It will support newly introduced economics and finance courses with on-the-job training and further sponsor the establishment of finance research centers.

At the end of 2004, the IFD decided to continue its work and broaden the scope of its activities. Issues it will be dealing with in the future include public-private partnerships ("PPPs"), demographic change and capital-funded pension schemes, better regulation and less bureaucracy, and promotion of Germany as a location for holding companies.

HONG KONG

Banking (Amendment) Bill 2005

The main purpose of the Bill is to amend the Banking Ordinance to put in place a legislative framework to implement in Hong Kong the revised international capital adequacy standards promulgated by the Basel Committee on Banking Supervision in June 2004, commonly known as "Basel II". In particular, the Bill requires that the capital adequacy ratio (CAR) of locally incorporated authorized institutions shall be calculated, and information on their financial affairs including CAR shall be disclosed, in accordance with rules to be prescribed by the Hong Kong Monetary Authority (HKMA) under the Banking Ordinance. Another important change introduced in the Bill is to clarify the penal provisions of the Ordinance so that a manager only incurs liability for breach of the Ordinance where a breach is caused or contributed to by him or a person under his control. The HKMA is also to be allowed to publish details of disciplinary action taken by it in respect of the securities business of AIs. The Bill contains a few proposals to enhance the operation of individual provisions of the Banking Ordinance in the light of experience. The Legislative Council passed the Bill on 6 July 2005 and the HKMA will proceed with the development of capital and disclosure rules based on the Basel II requirements in consultation with the banking industry.

Exemption Clauses in Contracts for Banking Services

At the request of the HKMA, all authorized institutions providing personal banking services have conducted a comprehensive review of the terms and conditions on which they provide banking services to ensure that they are consistent with the Code of Banking Practice and the relevant consumer protection legislation in Hong Kong. The review has been completed. The HKMA required the relevant authorized institutions to amend their terms and conditions of banking services by September 30, 2005.

Sharing Commercial Credit Data

Work is proceeding in relation to the extension of the Commercial Credit Reference Agency so that it includes data in respect of sole proprietorships and partnerships as well as data in respect of hire purchase.

Hong Kong/Shenzhen Joint Clearing for US Dollar Checks

The clearing and settlement facilities have now been extended to cover cross border clearing of US Dollar checks presented in Hong Kong and Shenzhen. This follows a model previously implemented in relation to the Hong Kong/Shenzhen Joint Clearing for Hong Kong Dollar checks.

Statutory Backing for the Listing Rules

The government has issued a consultation paper proposing that certain of the listing rules which are binding on listed companies by agreement should have statutory backing. The consultation paper also proposes that market misconduct and the criminal sanctions contained in the Securities and Futures Ordinance should be extended to cover breaches of the statutory listing rules so that breach of the statutory listing rules will become a new form of market misconduct. It is further proposed that the Market Misconduct Tribunal will be able to issue public reprimands and fines for breaches of the statutory listing rules and that the Securities and Futures Commission will be empowered to issue public reprimands, disqualification orders, disgorgement orders and civil fines for such breaches.

New Accounting Standards

Hong Kong decided to implement international financial reporting standards with effect from January 1, 2005. From this date, banks incorporated in Hong Kong need to ensure that their annual accounts are compliant with the new Hong Kong Accounting Standards (HKAS) which are modeled on International Accounting Standards. The accounting changes have an effect on the calculation of the components of capital and the regulatory reporting framework including financial disclosures. In addition, there is an important conceptual difference between the accounting and regulatory perspectives: HKMA's prudential framework and supervisory approach are primarily risk-based and forward-looking, while accounting standards primarily take a backward-looking "incurred loss" approach. It has thus been important to ensure that the integrity of the prudential framework is not undermined by these accounting changes. To this end, the HKMA has developed short-term solutions to neutralize the effect of the accounting changes on regulatory capital requirements for banks. A guidance note to guide AIs through the immediate impact of the accounting changes was issued in April 2005. In the longer term, the HKMA will review these policy conclusions as part of the broader review of capital adequacy requirements and regulatory reporting in the context of the Basel II implementation and in the light of further guidance from the Basel Committee.

Prevention of Money Laundering and Terrorist Financing

In June 2004, the HKMA issued a revised supplementary guideline on anti-money laundering (AML), together with a set of interpretive notes jointly developed with the industry to provide implementation guidance. These two documents have taken into account the requirements of the revised Forty Recommendations issued by the Financial Action Task Force (FATF) in June 2003 and the Basel Committee paper on "Customer Due Diligence for Banks". They have also incorporated the relevant FATF Special Recommendations (such as the recommendation on wire transfers) for countering terrorist financing (CFT) purposes. The banking sector was required to comply with the new requirements set out in the supplementary guideline by the end of 2004.

Following the issuance of the supplementary guideline, the HKMA rolled out a structured self-assessment framework, which was developed by the HKMA in consultation with the banking industry, at the end of June 2005 with a view to facilitating individual banks' ongoing assessment of their compliance with the AML/CFT requirements and supplementing supervisory monitoring. The HKMA will use the self-assessment results to analyze the compliance position of banks, with a view to identifying common issues within the banking industry and developing supervisory guidance over the longer term, and to ensure that the banks correct any weaknesses identified as early as possible.

INDIA

The Reserve Bank of India (RBI) is vested with regulatory and supervisory authority over commercial banks, urban co-operative banks (UCBs), development finance institutions (DFIs) and non-banking financial companies (NBFCs). As of March 31, 2005, there were 289 commercial banks, 1872 UCBs, 8 DFIs and 13,187 NBFCs. Insurance companies are regulated by the Insurance Regulatory and Development Authority (IRDA) and mutual funds and capital markets are regulated by the Securities and Exchange Board of India (SEBI).

The conduct of financial regulation and supervision by the RBI in 2004-2005 was guided by the need to ensure financial stability. Over the years, the RBI has progressively aligned the regulatory framework with international best practices and country-specific adaptation. In addition to fine-tuning the prudential guidelines, the RBI focused during the past year on encouraging market discipline and ensuring good governance with an emphasis on "fit and proper" owners and diversified ownership.

Corporate Governance

With a view to ensuring that the control of private sector banks is well diversified to minimize the risk of misuse or imprudent use of leveraged funds, the RBI had issued on February 28, 2005 important guidelines on Ownership and Governance in Private Sector Banks. The guidelines require that (a) important shareholders (i.e. with shareholdings of five per cent and above) be "fit and proper" in accordance with the Reserve Bank's guidelines on allotment and transfer of shares (b) the directors and the Chief Executive Officer who manage the affairs of the bank be "fit and proper" and observe sound corporate governance principles (c) banks have minimum capital/net worth for optimal operations and systemic stability (d) banks follow policies and procedures that are transparent and fair e) banks maintain a net worth of Rs. 300 crore at all times (f) shareholding or control in any bank in excess of 10 per cent of the paid-up capital by any single entity or group related entities requires the RBI's prior approval (g) banks (including foreign banks having branch presence in India) are not allowed to exceed an equity holding of five per cent of the equity capital of the bank in which the investment is made (h) large industrial firms are allowed to acquire shares not exceeding 10 per cent of the paid-up capital of a bank subject to the RBI's prior approval; and (i) the RBI may permit a higher level of shareholding on a case-by-case basis for restructuring of problem/weak, banks or when such shareholdings are determined to promote consolidation in the banking sector.

Strengthening the Prudential Norms

The RBI has accepted the adoption of the New Capital Adequacy Framework (Basel II) in principle. The timetable for approaching the various levels of sophistication under the Basel II standards would be decided by the Reserve Bank depending upon the preparedness of the banks. Accordingly, commercial banks in India (excluding RRBs) are required to adopt the Standardized Approach for credit risk and Basic Indicator Approach for operational risk as of March 31, 2007. However, parallel approaches following both Basel II and existing standards will be permitted as of April 1, 2006. After adequate skills are developed, some banks would be allowed to migrate to the Internal Rating Based (IRB) Approach. In terms of the New Capital Adequacy Framework, banks will be allowed to adopt/migrate to the advanced approaches only with the specific approval of the RBI.

A draft guidance note on management of operational risk was issued to banks on March 11, 2005 by the RBI.

Resolution of NPAs

Policy support together with prudent monitoring and recovery efforts made by individual banks has resulted in the reduction of NPAs in the Indian banking system. In this connection, some important policy announcements have included:

- Providing more options to banks for dealing with NPAs pursuant to guidelines issued the sale and purchase of NPAs on July 13, 2005.

- Amendment of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act in 2004 to dissuade borrowers from delaying the repayment of dues and to facilitate the speedy recovery of secured creditors from indebtedness.

- Improved performance of Debt Recovery Tribunals (DRTs) also helped in setting the cases with respect to NPAs. As of March 31, 2005 32,389 cases involving Rs.33 billion had been adjudicated with the amount recovered at Rs.10 billion .

- Lok Adalat which deals with smaller NPAs, the ceiling amount of which has been increased from Rs. 5 lakhs to Rs.20 lakhs; and

- the Corporate Debt Restructuring Mechanism (CDR) which was constantly reviewed and modified during 2004.

Road Map for Presence of Foreign Banks

As a part of the measured approach to further integration with the global financial system, the RBI set out a road map for the presence of foreign banks in India. In the first phase between March 2005 and March 2009, foreign banks satisfying the eligibility criteria prescribed by the RBI will be permitted to establish a presence by establishing a wholly-owned banking subsidiary (WOS) or converting existing branches into a single WOS. A WOS has a minimum capital of Rs. 3 billion and sound corporate governance principles are required. Permission for acquisition of shareholding in Indian private sector banks by eligible foreign banks will be limited to banks identified by the RBI for restructuring. The RBI would consider permitting an acquisition if it is satisfied that an investment by the foreign bank concerned will be in the long term interest of all the shareholders of the bank in which the investment is made. The second phase will commence in April 2009 after a review of the experience gained and after due consultation with all significant banking sector representatives.

Improving Customer Service

All public, private and selected foreign banks were advised by the RBI to establish Customer Service Committees of their boards with a view to strengthening the corporate governance structure in the banking system and improving the quality of customer service in banks. The core function of such committees includes the formulation of a comprehensive deposit policy, addressing issues such as the treatment of an account upon the holder's death, the product approval process, the annual survey of depositor satisfaction and the audit of such services once every three years were issues which were placed in the ambit of the functioning of these Committees. The Indian Banks' Association played a crucial role in the preparation of some guidelines on the Model Deposit Policy for adoption by banks. Banks were also advised to devise a comprehensive and transparent customer service policy taking into account technological capabilities, systems and processes and other internal arrangements for collection through correspondents. The policy framed in this regard was required to be consistent with the Indian Banks' Association Model Deposit Policy.

Anti-Money Laundering Measures

The RBI issued comprehensive measures in November 2004 which require banks to include four key elements in their KYC policies (1) customer acceptance policy; (2) customer identification procedures, (3) monitoring of transactions; and (4) risk management. The guidelines further specified that the following provisions must also be included:

- The identity of the customer and his address must be verified through documentary evidence.
- Customer accounts are to be classified according to perceived risk based on an assessment of the customer profile.
- Banks should be able to identify the underlying beneficial owners of each bank account;

- Banks must develop systems and procedures for the ongoing monitoring of customer accounts. Transactions that fall outside the regular pattern of customer activity and cash transactions of Rs. 10 lakh and above are to be reported to Head/Controlling office.

- The provisions of the Foreign Contribution and Regulation Act 197 must be adhered to strictly.

- Banks should apply revised KYC norms to existing customers on the basis of materiality and risk.

Major mergers

IDBI Bank Limited (a private sector bank) merged with Industrial Development Bank of India (a Development Financial Institutions) to form IDBI Ltd., which is classified as public sector bank.

Capital Adequacy

The aggregate capital adequacy ratio of the banks at end-March 2005 was marginally lower than that of the previous year owing to an increase in the total risk weighted assets relative to capital, for the first time since March 2000. Higher growth in the lending portfolios of banks and the higher risk weights made applicable to housing loans (the most rapidly increasing retail loans component) contributed to the increase in risk weighted assets.

Asset quality

The decline in gross and net NPAs for scheduled commercial banks that developed during 2002-03 continued during 2004-05 with the net NPA ratio going below two per cent for the first time. The fact that the provisioning for NPAs was much lower during 2004-05 indicates that the decline was due to increased recovery and overall reduction in asset slippage. An improved industrial climate also contributed to better recoveries.

Conclusions

The Indian financial sector now operates in a more competitive environment than previously and intermediates relatively large volumes of international financial flows. A review of macro prudential indicators indicates further consolidation of the financial system and a general improvement in key banking parameters.

IRELAND

Regulatory Developments

The Central Bank and Financial Services Authority of Ireland Act 2004 provided for the establishment of a statutory ombudsman scheme for customers, the establishment of industry and consumer consultative panels, the power to impose sanctions on financial services providers and the regulation of mortgage introducers and certain money transmission services. It also provided the Irish Financial Services Regulatory Authority ("Financial Regulator") with additional powers in relation to requiring regulated financial services entities and auditors to report to the Financial Regulator on compliance matters.

Policy Developments

Consultation Papers on Impairment Provisions for Credit Exposures and on Requirements for the Management of Liquidity Risk were published on August 12, 2004. A Consultation Paper on Corporate Governance was also issued. A final paper on Impairment Provisions is expected to be issued in August/September 2005. Regulatory notices and rules for banks and building societies were issued as follows in September 2004: Capital Instruments (Alternative Capital Instruments – Eligibility as Tier 1 Capital); Regulatory Treatment of Credit Derivatives Contracts; and Risk weighting of Asset Backed-Securities. A review of the Bank Licensing Policy as it relates to ownership of general insurance entities by credit institutions was undertaken in June 2005.

Money Laundering

The Criminal Justice (Terrorist Offenses) Act 2005 was signed by the President on March 8, 2005; its provisions were immediately effective with the exception of Section 32 (Training and Procedures) which came into effect on July 8, 2005. Guidance Notes in relation to Terrorist Financing were issued on March 8 with the approval of the Money Laundering Steering Committee. A letter was issued to all regulated entities on March 31, 2005 advising of these developments and other FATF and Anti Money Laundering developments. These Guidance Notes are available for viewing on the Financial Regulator website. Implementation of initiatives introduced following the events of September 11, 2001, continued during the period. These included the examination by institutions of their records for the existence of relationships with any individuals who were under investigation in connection with these events or other terrorist activities with the aim of reporting them to the Irish police authorities.

Auditing and Accounting Related Issues

The Financial Services Regulator established a Working Group in May 2004 on International Financial Reporting Standards (IFRS), with representatives of the financial industry (banks, insurance companies, security firms, funds, etc.) and accountancy bodies. The primary objective of the Working Group is to consider the implications for financial institutions, with particular reference to regulatory capital requirements, of the application of IFRS to certain entities as of January 2005. Progress was achieved during the year in finalizing the adjustments (i.e. so called "prudential filters") required to make IFRS based numbers suitable for regulatory reporting purposes.

Communication continued between the Financial Services Regulator, external auditors and the accountancy profession in relation to certain issues of common interest. The Financial Services Regulator continued to provide assistance to the auditing profession in the development of:

(i) Guidance on the audit of credit unions,

(ii) Auditors' reports on client money, and

(iii) Auditors' "statutory duty to report" under specified circumstances set out in legislation.

The Financial Services Regulator also participated in various EU groups and surveys on auditing and accounting related matters. The Financial Services Regulator has nominated a member to the interim Board of the Irish Auditing and Accounting Supervisory Authority (IAASA). This Oversight Board will supervise the regulation by the accountancy bodies of their members' professional standards.

The Financial Regulator is currently working on a Draft Consultation Document regarding Directors' Compliance Statements and external auditors reports thereon, whereby regulated financial service providers may be required to provide a Compliance Statement relating to "Relevant Obligations," e.g. legislation and codes of conduct. Similar legislation relating to certain types of companies under the Companies Acts has not yet been commenced and has been referred by the Taoiseach (Prime Minister) to the Company Law Review Group for review. The report from this group is due by July 31, 2005.

Basel II Update

The Capital Requirements Directive, which will implement the Basel II provisions in the EU, is in the latter stages of finalization. The Financial Regulator has been working to design an implementation infrastructure consistent with its mandate as a principles-based regulator. Industry preparation for Basel II is at an advanced stage. Ireland is actively engaged at the Committee of European Banking Supervisors (CEBS) level in efforts to ensure consistent application of provisions in the EU.

Client Money Rules

Revised Client Money Requirements (including requirements in relation to client investment instruments) were issued in February 2004. These rules are applicable to firms authorized under the Investment Intermediaries Act, 1995 and the Stock Exchange Act, 1995.

Conduct of Business

A draft 'Consumer Protection Code' was issued for consultation purposes in February 2005. This draft code is a single code covering all financial service providers. It consists of a set of general principles, rules common to all regulated entities, rules on different types of financial services and rules relating to advertising. Once the consultation process has been completed, comments will be considered and a unified code is expected to be issued in early 2006.

A voluntary code on switching bank accounts, which has been developed by the Irish Bankers Federation, became effective on January 31, 2005. The Consumer Protection Code consultation process invited views on whether the voluntary code should be incorporated into the statutory Code. A decision as to whether the voluntary switching code will be incorporated into the Consumer Protection Code will be made as part of the final decision on this Code towards the end of 2005.

In response to the Financial Regulator's request to all Credit Institution who have notified charges under S149 of the Consumer Credit Act 1995 (as amended) to carry out a review of their systems and charges in May 2004, a total of 37 credit institutions and bureaux de change submitted reports on their systems and charges. The Financial Services Regulator has been reviewing these reports and is in the process of responding to each Credit Institution and bureaux de change.

Developments in the Banking Sector

A banking license was issued to each of Bank of Ireland Mortgage Bank and Barclays Bank Ireland Plc. One banking license was revoked, that of Bankgesellschaft Berlin (Ireland) plc at the request of the license holder. At end of June 2005, the number of credit institutions supervised by the Financial Services Regulator was fifty.

Credit Institutions reported unprecedented demand for housing credit in June. Residential mortgage lending increased by almost 2.1 billion Euros during June, outpacing the previous highest monthly increase (1.7 billion Euros in July 2004) by some distance. 82.2 billion Euros was the outstanding level of residential mortgage debt as of June 30, 2005. As a result, the underlying annual growth rate of residential mortgage lending rose by 26.6 per cent from 25.9 per cent in May 2005, which brings the rate back up to a level similar to that of December 2004. This occurred despite house price inflation moderating considerably recently; the average price of a house increased by just 1.8 per cent in the five months to May 2005 – half the growth experienced during the same period in 2004.

Supervision of Non-Bank Financial Institutions

The Financial Regulator is now responsible for supervising financial institutions, which were previously regulated by the Central Bank of Ireland, the Department of Enterprise Trade and Employment, the Office of the Director of Consumer Affairs and the Registrar of Friendly Societies. Three separate departments of the prudential directorate carry out the supervision of non-bank financial institutions: Securities and Exchanges Supervision, IFSC and Funds Supervision, Insurance Supervision, and the Consumer Directorate.

Responsibility for the supervision of these non-bank financial institutions is derived from various pieces of legislation including the Investment Intermediaries, 1995, as amended, which provides for the authorization and supervision of investment business firms; the Stock Exchange Act, 1995, as amended by the Investor Compensation Act, 1998 which provides for the approval of stock exchanges and the authorization of their member firms and the ongoing supervision of such exchanges and member firms. (The Financial Regulator does not currently have a role in relation to listing requirements or insider dealing; the Irish Stock Exchange undertakes these functions.) Both these pieces of legislation transpose the obligations of the EU Investment Services Directive.

The Financial Regulator is responsible for the authorization and supervision of both life and non-life insurance companies in accordance with the Insurance Acts and Regulations 1909-2000.

The Financial Regulator is also responsible for the authorization and supervision of collective investment schemes established under the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2003 (UCITS Regulations), the Unit Trust Act, 1990, Part XIII of the Companies Act, 1990 and the Investment Limited Partnerships Act, 1994. It is also responsible for the authorization and ongoing supervision of fund service providers (i.e. managers, administrators and trustee firms).

Two amending Directives to the 1985 UCITS Directive entered into force in 2002 and were transposed and implemented into Irish law during 2003. The amending Directives are commonly referred to as the Product Directive and the Management Company Directive.

Statutory Instrument 212 of 2003 implemented the Product Directive on 29 May 2003. This Directive extends the range of instruments in which a UCITS can invest i.e. money market instruments, other collective investment schemes, bank deposits and financial derivative instruments. It also provides for the introduction of index tracking UCITS. Revised UCITS Notices and Guidance Notes issued in November 2004.

Statutory Instrument 497 of 2003 implemented the Management Company Directive on 21 October 2003. The Management Company Directive provides for the authorization of management companies in their own right, and broadens the scope of activity, which they are permitted to undertake. This Directive also provides for the publication of a simplified prospectus. Following consultation with the Funds Industry a revised UCITS Notice together with a guidance note on the publication of a simplified prospectus was issued in March 2005.

The Investment Funds, Companies and Miscellaneous Provisions Act 2005 was enacted into Irish law on 30 June 2005. The main provisions of the Act are as follows:

- The introduction of a new type of investment fund vehicle - the non-UCITS Common Contractual Fund (CCF);
- The introduction of cross investment and segregated liability for investment companies which are organized as umbrella funds. Cross investment facilitates investment by sub-funds within an umbrella investment company into other sub-funds of the umbrella. Where segregated liability applies, any liabilities of a sub-fund will be discharged solely from the assets of that sub-fund;
- The enactment of provisions in primary law to ensure the smooth and effective transposition of the EU Market Abuse Directive which covers insider dealing and market manipulation;
- Amendments to the Companies Acts relating to offers of securities to the public and prospectuses for listed securities. This is in anticipation of the transposition of the EU Directive dealing with Prospectuses.

In addition to the legal requirements imposed under the various pieces of legislation, the scope of the detailed supervisory requirements imposed on individual firms depends on the Financial Regulator's assessment of, among other things, the prudential and the consumer risk involved, the nature of the activities of the firm, the status of the owners and the experience and expertise of the management.

Under the Insurance Act, 2000, the Financial Regulator assumed responsibility for the supervision and regulation of insurance intermediaries (both life and non-life). Insurance intermediaries are now regulated under the Investment Intermediaries Act, 1995.

ISRAEL

During the period covered by this survey, the trend of developments in the Israeli economy was generally favorable: the rate of economic growth was between 3.5% and 4%, inflation was low (one to two percent) and the rate of exchange relatively stable. The favorable economic developments and a relatively stable geopolitical environment have benefited the financial sector: the profits of banks and insurance companies have grown substantially and the securities markets, both stocks and bonds, have generally produced healthy returns to investors, despite a decline in the markets in June 2005. The upward trend in the stock exchange has benefited the primary markets: many firms raised equity capital, but the more significant development has been the steep increase in the amounts raised in the corporate bond market; the less developed segment of the Israeli bond market is still dominated by government paper.

The process of privatization of the banking system has moved one step forward with the sale of a controlling stake in the Israel Discount Bank, Israel's third largest bank, to an American investor. The government declared its intention to complete the process by selling its controlling stake in Bank Leumi, Israel's second largest bank, by the end of this year.

The most important regulatory event of the past year was the submission of the Report on the Reform of the Capital Markets, prepared by a committee (the "Committee") headed by the Director General of the Ministry of Finance. The report of the Committee, whose members were the heads of the major regulatory agencies, was approved by the government and the enabling legislation was recently approved by the Knesset (parliament). The basic premises of the Committee were:

- The banking system is too concentrated with two banks accounting for close to two thirds of both banking business and the management of mutual funds and provident funds;

- The distribution of the self managed mutual and provident funds by the banks creates conflicts of interest situations and hinders competition in the asset management market and in the financial system as a whole.

The Committee recommended, accordingly, that the banks (all of them, not just the big two) be compelled to sell their asset management companies and be limited to an advisory capacity in offering to their customers mutual funds and provident funds managed by others. To compensate for the loss of their asset management business, the banks would be allowed to offer insurance and pension products, also in an advisory capacity i.e. their fees would be paid by the customer and not by the originator of the instruments purchased by him.

Prior to its approval by the Knesset, banks opposed the legislation on constitutional and practical grounds. They claimed that compelling them to sell assets amounted to a breach of the basic law on the Freedom of Enterprise. They also argued that conflicts of interest issues in the sale of their own products could be resolved by allowing them to impose distribution fees on the originators of competing financial products, a practice common in other countries that is not allowed under the existing law. The smaller banks had claimed that applying the same treatment to the giants of the system and to much smaller institutions would not contribute to a reduction in the level of concentration in the banking system. Another objection to the recently adopted legislation was that it ignored conflicts of interest in competing financial organizations, such as insurance companies and brokerage firms. It was argued that the seriousness of this problem would increase if insurance companies that already own pension funds and asset management companies were allowed to buy assets that the banks were compelled to sell.

Since the government strongly supported the recommended legislation, its approval by the Knesset was not unanticipated. Of course, it is still possible that banks will bring to the High Court of Justice their objections to the legislation.

It should also be mentioned that, contrary to expectations, the Committee has not discussed or made recommendations on the regulatory structure and on a possible consolidation of the existing agencies (Supervisor of Banks in the Bank of Israel, Supervisor of Insurance and of the Capital Market in the Ministry of Finance and the Securities Authority).

In the course of the past 12 months the Supervisor of Banks (the "Supervisor") has issued several directives relating to the management of banking institutions:

- To safeguard the independence of bank auditors, circumstances under which conflicts of interest may compromise auditor independence of the auditor have been defined;

- Banks have been required to report to the Supervisor on the nomination of senior officers and to supply answers to a detailed Questionnaire;

- Another directive has stated that the procedures for communication between an auditor and those responsible for the bank's internal controls will be governed by U.S. accounting standards SAS 60 and SAS 61.

- Banks have been required to discipline borrowers in overdraft accounts by insisting on strict adherence to the authorized limit;

- Banks have been required to refrain from dividend distribution when the value of buildings, equipment and other tangible assets exceeds their equity capital;

- Banks have been required to introduce various measures to upgrade the effectiveness of their anti money laundering efforts;

- Credit card companies have been subjected to a long list of the Supervisor's directives relating to the proper conduct of bank management.

One of the proposals in the legislation currently under consideration in the Knesset is intended to establish clearly the Supervisor's authority to issue directives relating to proper bank management.

A substantial number of legislative initiatives of the Securities Authority have been implemented in the past 12 months:

- The procedures for selling securities to investors were modified in ways that will facilitate the underwriting of offerings. The amendment distinguishes between offer and sale. The company and its underwriters will be allowed to offer securities to prospective buyers by a draft prospectus that was not approved by the Securities Authority (similar to the "Red Herring" in the U.S.A.).The sale will be consummated only after the final approval. This change will shorten the time elapsing from the approval of the prospectus to the sale of the securities. Other amendments in the Securities Law are also intended to improve the capital raising process and the procedures of underwriting securities;

- Another amendment to the Securities Law enables companies to use a "Shelf Prospectus" i.e. a prospectus that may be used to raise capital within 24 month from its approval by the Securities Authority. It is updated by current reports and may be used only by seasoned companies with a record of reporting to the Authority;

- A thorough overhaul of the contents of the directors' report in both prospectuses and current reports to the Authority was approved following the recommendations of an expert committee. Besides strengthening the business contents of the report, companies are encouraged to include forecasts and prospective data. In order to protect those publishing forecasts that did not materialize, the Law was amended to include a "Safe Harbor" clause to apply when bona fide forecasts are thwarted by unforeseen developments.

- The settlement of securities transactions in the Tel Aviv Stock Exchange has been performed, since the establishment of the Exchange, by the settlement center, a subsidiary of the Exchange, that is regulated by internal rules. This arrangement was not mentioned in the Securities Law until a recent amendment that gives the sanction of the Law to various established procedures intended to guarantee the solvency of the settlement center.

There were no important regulatory changes in the insurance and pension markets during the past 12 months, but former legislation and regulatory initiatives had their impact on these markets in the last year. The profitability of insurance companies was favorably affected by the substantial decrease in the commissions paid to their agents following changes in the terms of life insurance policies imposed by the Supervisor of Insurance. The pension funds that were offered for sale as a consequence of the reform in the pensions market were all purchased by insurance companies. Becoming a major force in the pensions market will strengthen the position of insurance companies as leaders in the market of long term savings, a position that may be enhanced further if the banks are compelled to sell provident funds that they manage, following the enactment of recent legislation in the Knesset.

Another boost to the pensions business of the insurance companies may be the result of a recent income tax regulation that requires self employed persons, saving for retirement, to allocate a major portion of the amount allowed as a deductible expense for income tax purposes to a pension fund. As a result, only small amounts will be available for saving through provident funds.

It is worth mentioning that if banks are allowed to sell insurance products, in one way or another, insurance agents that are now the major vehicle for marketing insurance will face competition to which they are not accustomed. They may be obliged to sell other financial products and become organized in larger and more efficient units, options that they rejected when selling insurance was a very lucrative business.

Recently, the Knesset has implemented the far reaching reforms proposed in the report prepared by the Committee headed by the director general of the Ministry of Finance, and mentioned above. Full implementation of the new legislation will radically alter the present structure of the financial system.

ITALY

Important Legislative Changes

Amendments reform of Corporate Law and the Bank and Finance Consolidation Acts

The entry into force on January 1, 2004, of the provisions of Legislative Decrees no. 5 and no. 6 of 2003 on the reform of corporate law in its procedural and substantial aspects, required certain technical corrections. They were needed to co-ordinate the reform with the laws in force and, in particular, the laws on banks and listed companies set forth in the Consolidation Act on Banking and Credit matters (legislative decree no. 385/1993) and in the Consolidation Act on financial intermediation (legislative decree no. 58/1998), respectively. These corrections were effected by legislative decree no. 310 of December 28, 2004.

Directive 2002/65/EC on Distance Marketing of Consumer Financial Services

In May 2005, having recourse to the delegation allowed by law no. 306 of October 31, 2003 (Community law 2003), the Cabinet worked out a draft legislative decree on the "Implementation of Directive 2002/65/EC of the European Parliament and the Council of November 23, 2002, on the distance marketing of consumer financial services". By implementing in the Italian system the aforementioned European Directive, this draft – decree which is expected to be passed by the Cabinet shortly – introduces provisions to ensure considerable protection to consumers in relation to the marketing of "any banking, credit, payment, investment, insurance or individual security services" offered to consumers by distance marketing techniques.

Implementation of Directive 2003/6/CE on Abuse of Sensitive Information and Market Manipulation

Law no. 62 of April 18, 2003, which entered into force on May 12, 2005, implemented the new EU regulation on the abuse of sensitive information and the manipulation of markets (in particular, Directive 2003/6/EC).

Regulation and Supervision of Banks

Implementation of Directive 2001/24/EC on the Reorganization and Winding up of Credit Institutions

Directive 2001/24/EC of the European Parliament and the Council of April 4, 2001 on the reorganization and winding up of credit institutions, has been implemented with legislative decree no. 197 of July 9, 2004. The provisions set forth in this Directive apply to banks and their branches set up in a Member State other than the country where their legal office is located, as well as to branches of third-country banks that have branches in at least two EU member countries. In order to implement Directive 2001/24/EC, the Government needs to issue one or more legislative decrees that may also provide for amendments to the Bank Consolidation Act, the so-called TUB (legislative decree no. 385 of September 1, 1993), with special reference to provisions on the regulation of crises. The principles to be followed in implementing the Directive under consideration include the need to coordinate provisions issued in recent years on the regulation of crises, as set forth in the Bank and Finance Consolidation Acts. In particular, such coordination relates to the provisions of legislative decree no. 231 of June 8, 2001, which introduced a specific regime of administrative liability of the institutions.

Review of the Charters of Cooperative Banks

With reference to the review of the charters of cooperative banks, on the occasion of the reform of the corporate law, the Supervisory Authority has issued a new provision that includes the directions given to cooperative banks on the amendments to be introduced in their charters in accordance with legislative decree no. 310 of December 28, 2004. In fact, this decree also set forth specific provisions on the adjustment of charters to the new binding provisions of the Civil Code. Article 233-*terdecies* of the implementation provisions (amended by article 37 of decree no. 310) requires cooperative banks to review their charters on or before June 30, 2005. With a view to implementing this regulation, the Bank of Italy issued the directions referred to above requiring that "the people's banks and BCCs will promptly need to adopt amendments to their charters that are to ensure the consistency of their corporate regulations with binding civil law provisions".

Regulation of Securities Products

Legislative decree no. 310/2005 amended the provision of the Civil Code (article 2412) on limits relating to the issuance of bonds. These limits (two times the capital and the reserves) may be exceeded if the excess amount is subscribed by professional investors subject to supervision. In the event of a subsequent circulation of bonds among the retail public, those who distribute them must answer for the solvency of the company with respect to purchasers who are not professional investors. This regulation does not apply to bonds issued by companies whose shares are listed in the regulated markets, or to bonds that are to be listed in such markets or in other regulated markets.

The aforementioned regulation applies also to the sale of bonds issued abroad by Italian companies or by their controlled or controlling companies if they are sold in Italy. In this case, it is necessary to provide to the investor a prospectus showing the information required by Consob, even if the sale is made at the purchaser's request.

E-Commerce

Following the implementation into national law of Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000, on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market ('Directive on electronic commerce') (see the legislative decree no. 70 issued on 9 April 2003), the subject matter did not undergo any changes in the period in question.

In 2001, through a provision included in the financial law for that year, an *ad hoc* Fund was set up in support of businesses and enterprises implementing e-commerce projects. The Fund's endowment in the current year amounts to 50 million euros, which may be used to finance the best e-commerce projects, according to a ranking table (prepared in accordance with the criteria set out in the law) that includes all the businesses filing an application. The Italian Government renews the invitation to tender on a yearly basis, which is proof of the great interest in the widespread and massive development of e-commerce.

Anti-Money Laundering Measures

Implementation of Second Money Laundering Directive

With the legislative decree no. 56, issued on 20 February 2004, the Italian legislators implemented into national law the Second Money Laundering Directive, namely Directive 2001/97/EC. The enforcement regulations of this decree are forthcoming, and will be issued by the Ministry of Economy and Finance, with a view to regulating the contents of and procedures relating to the enforcement of the obligations of customer identification and records preservation, besides the procedures of identification, when establishing business relations or entering into a transaction with a customer who has not been physically present for identification purposes ('non-face to face' operations).

Implementation of Third Money Laundering Directive

On June 7, 2005, the Ecofin Council of the European Union approved the Third Money Laundering Directive, proposed on June 30, 2004. This Directive, which now also includes within its scope of enforcement the fight against the financing of terrorism, should be implemented into national law by the member States within 24 months from its publication in the Official Journal of the European Union. This EU measure also includes such significant principles as those relating to, (i) specific procedures for identifying and checking *beneficial owners* and politically exposed persons (PEPs), (ii) the protection of persons reporting any suspect transactions, and (iii) the assurance, by the member States, of feedback in connection with suspect transactions.

Meeting **with the International Monetary Fund**

On April 7, 2005, a meeting was held at the ABI Headquarters in Rome, with the representatives of the International Monetary Fund, in connection with a mission aimed at assessing the Italian system for contrasting money laundering and the financing of terrorist activities. On the following days similar meetings were held with two prime Italian banks. The meeting provided an opportunity to highlight the constant and active collaboration the banking sector has always ensured, with a view to fighting money laundering and the financing of terrorism. Following these meetings, the Ministry of Economy and Finance informed ABI of the thanks and appreciation expressed by the FMI for the willingness shown by ABI and the usefulness of the activities carried out.

Significant Market Developments

The Italian banking system has also increased its activity in the last 12 months: the increase of quality and quantity of the services on offer to clients goes hand in hand with the growth in loans and in terms of the conditions available to clients. At the end of 2004, the Italian banking system had 11% of the total banking assets of the 12 nations sharing the euro, lagging behind only Germany and France. At December 2004, bank loans as a percentage of Italy's gross domestic product rose to 82.8% from 81.6% in 2003. Among the largest European countries, Italian banks, whose loans in April 2005 totalled about 50% of total assets, came second only to Spain's 56.2%. When compared to European data, more Italian loans go to enterprises than to families, both as a proportion of the whole and on average: at the end of April 2004, loans to Italian firms were 63.1% of total credit, compared with an average of 45.3% in the euro zone. Loans to families totalled 36.9%, compared with an average of over 50% in the euro area. In the past year, however, banks have greatly increased home mortgage lending (+17.6% change at April 2004) and consumer loans (+15.7% change at April 2004).

The process of mergers and acquisitions has continued: at the end of 2004, the number of Italian banks is 778, with a reduction of 10 banks compared with the same month in 2003. On the other hand, in the last year has been an increase in the number of branches (+464 branches at the end of 2004 compared with the end of 2003 – from 30,480 to 30,944) and the number of POS (+79,418 – from 895,433 to 974,851). In the same period, the number of internet banking clients has also increased (from 4.4 million to 5.3 million clients). Phone banking clients have increased from 4.6 million to over 5.3 million.

Other Significant Market Developments

Following the issuance on February 24, 2004 by Banca d'Italia of a regulation providing guidelines for the Oversight of Payment Systems, which makes operational the content of Article 146 of Testo Unico Bancario, there have been no other regulatory developments related to Payment Systems. As to trends in payment instrument usage, payments at POS by means of debit cards have been overcome by direct debits, though showing, still a significant growth rate (+7%). Specific attention has been paid in 2004 to the development of the domestic "payment initiation scheme", called *Corporate Banking Interbancario*, through which more than 500,000 business customers are connected to their banks. The scheme is improving its technical infrastructure and increasing the number of services available through the network.

Further activity has been carried out by Italian banks inside the European Payments Council with regard to the building of the Single Euro Payments Area and, through Associazione Bancaria Italiana within the European Banking Federation, with respect to the New Legal Framework for Payment Systems in the EU. The New Legal Framework is a set of common rules that the Commission intends to define to achieve harmonization in the EU for payment services. In the field of wholesale Payment Systems, banks have participated, through their representatives in the EU Target Working Group, in the consultation concerning the building of a new version of TARGET 2, the new Eurosystem infrastructure for the transfer and settlement of large value payments.

JAPAN

Regulatory Developments

The Financial Services Agency (the "FSA") announced an administrative judgment relating to Citibank, N.A. in Japan on September 17, 2004. The decision was based on findings of material legal violations, improper transactions and other incidents, particularly with respect to private banking operations. Operational licenses for all four offices involved in private banking activities will be revoked on September 30.

The FSA filed charges with the Tokyo District Public Prosecutor's Office on October 7, 2004, asserting that UFJ Bank Limited had manipulated inspections. Furthermore, the FSA issued an administrative judgment that prohibited any loans to new corporate customers (excluding loans to small and medium-sized enterprises) for a period of six months, starting from October 18, 2004.

The new Trust Business Law was passed on November 26, 2004 and became effective on December 30, 2004. The law expands the types of property that can be placed in trust to intellectual property and other types of property. In addition, the Trust Business Law permits non-financial institutions to conduct trust business, whereas in the past only financial institutions were allowed to conduct a trust business.

As of December 1, 2004 banks and other financial institutions can act as agent in connection with sales of securities. This change results from amendments to the Securities and Exchange Law that were passed in June 2004.

A law partially revising the Financial Futures Trading Law was passed on December 1, 2004. The new law includes companies involved in foreign exchange margin transactions and similar over-the-counter financial futures trading (including banks) in the definition of "financial futures traders" and makes them subject to pertinent regulations. The new law authorizes the necessary regulations to protect customers conducting the transactions. It became effective July 1, 2005.

The law partially revising the Law on Customer Identification and Retention of Records on Transactions by Financial Institutions was passed on December 3, 2004 and implemented on December 30, 2004. Among other objectives, the law aims at preventing the illegal use of deposit accounts and establishes penalties for buying account passbooks.

The law on exceptions to Japan Post's operations for handling solicitation of beneficiary securities for securities investment trusts by Japan Post was passed on December 3, 2004 and implemented on June 2, 2005. This law allows post offices to sell investment trusts after registering with the Financial Services Agency and 575 post offices nationwide are expected to commence sales in October 2005.

On December 16, 2004, the Financial Services Agency published an administrative judgment terminating new transactions with corporate customers involving wire transfers to foreign countries from December 24, 2004 relating to Banco do Brasil S.A. in Japan. The judgment was issued based on multiple violations of the Law on Customer Identification and Retention of Records on Transactions by Financial Institutions and the Law for Punishment of Organized Crimes and Control of Crime Proceeds and Other Matters.

On December 24, 2004, the Financial Services Agency announced the Program for Further Financial Reform, a two year guideline for financial administration during fiscal 2005 and 2006. The program covers five perspectives consisting of:

1. Emphasis on users' needs and thorough implementation of user protection rules,

2. Strategic use of IT for strengthening the competitiveness of financial institutions and further developing financial infrastructure,

3. Further development of a financial system which is internationally open and administered with an international perspective,

4. Contribution to regional economies, and

5. Establishment of a reliable financial administration.

The specific measures include enactment of the Investment Services Law (tentative name), study toward financial legislation for financial conglomerates and establishment of the FSA's "Code of Conduct", etc. In addition, on March 29, 2005, the specific work schedule for the Implementation of the Program for Further Financial Reform was announced.

In preparation for the full implementation of the Law Concerning the Protection of Personal Information on April 1, 2005, the government on March 25, 2005, issued regulations concerning the safeguarding of personal information at the various ministries and agencies related to financial institutions. The Regulations on Enforcement of the Banking Law were partially revised and implemented on April 1, 2005. As a result, the following actions were required of banks:

(1) Establish necessary and appropriate measures to prevent damage from release of confidential information in the outsourcing of security management of personal customer information,

(2) Establish measures for ensuring that information on the debt-paying ability of parties requesting loans is not used for purposes other than studying repayment abilities,

(3) Establish measures for ensuring that non-disclosed information of customers is not used for purposes other than securing the appropriate management of operations and other reasons recognized as necessary.

The further restriction of protection limits of deposit insurance system was implemented on April 1, 2005. Demand deposit accounts, that had been fully protected, transferred to fixed amount protection (covered for their entire balance up to 10 million yen in principal and interest) , excluding interest-free settlement accounts. On April 2002, the application of deposit insurance had reverted from full protection to fixed amount protection, excluding demand deposit accounts. In the case of demand deposit accounts, the transfer to fixed amount protection was delayed from the initially planned April 2003 for two years from the perspective of securing stability of the financial system.

On April 22, 2005, a law partially revising the Insurance Business Law was passed. The law introduces rules for protecting policyholders of mutual-aid societies (which have no fundamental law) and makes changes to insurance policyholder protection system.

A law partially revising the Securities and Exchange Law was passed on June 22, 2005. It implements the following:

(1) Transactions similar to negotiated off-floor transactions (non-regular hours) transactions conducted within the exchange market shall have tender offer regulations applied when the resulting ownership of shares exceeds 1/3,

(2) Introduction of a system that requires the submission of a parent company's status reports, which describe items concerning the share owners of the company, when parent companies of listed firms have not submitted financial statements; and

(3) Introduction of an English language disclosure system for foreign companies and other companies.

The Financial Services Agency announced the Supervisory Guidelines for Financial Conglomerates on June 24, 2005. These Guidelines set forth the agency's strategy concerning the supervision of financial conglomerates that include banks, insurance companies and securities companies. Increased emphasis will be on administrative procedures related to supervision.

Market Developments

The Mitsubishi Tokyo Financial Group, Inc. and UFJ Holdings, Inc. concluded an integration agreement on February 18, 2005. As a result, each of the holding companies, banks, trust banks and securities companies of both groups will merge on October 1, 2005. The corporate names of the new companies will be as follows: Mitsubishi UFJ Financial Group, Inc. for the new holding company; The Bank of Tokyo-Mitsubishi UFJ, Ltd. for the new bank; Mitsubishi UFJ Trust and Banking Corporation for the new trust bank; and Mitsubishi UFJ Securities Co., Ltd. for the new securities company. The merger ratio for the holding companies has been reported to be 1:0.62 for MTFG:UFJHD. On August 12, only the merger of banks was rescheduled on January 1, 2006.

On April 27, 2005, the cabinet passed six bills related to the privatization of the postal services and submitted these to the Diet. These bills privatize postal services in April 2007 and divide Japan Post into four companies, postal services company, post office company, postal savings bank and postal insurance company, under a Japan Post holding company. Of these, the postal savings bank and postal insurance company will be completely privatized by the end of

March 2017. The House of Representatives passed the bills on July 5, but the House of Councillors rejected the bills on August 8.

The Housing Finance Support Agency Law was passed on June 29, 2005. This Law establishes the Independent Administrative Institution Housing Finance Support Agency on April 1, 2007 in connection with the abolition of the Government Housing Loan Corporation. The new Agency will support and supplement private financial institutions through securitization support and other operations.

KOREA

Amended Regulation on Credit Information Business

The FSC/FSS amended the Credit Information Business Supervisory Regulation effective July 1, 2004. The National Pension Corporation (NPC) and the Agricultural and Fishery Marketing Corporation (AFMC) now have access to the delinquent consumer database maintained by the Korea Federation of Banks (KFB) so that the NPC can better manage overdue contributions to the national pension plan and the AFMC can more efficiently share credit information with the KFB. The Direct Selling Mutual Aid Cooperative, a trade group representing direct sellers and multi-level (network) marketers, also now has access to credit information maintained by credit information service companies to enable them to better respond to and prevent harm to consumers.

Amended Guidelines to Enable Foreign Financial Institutions to Establish Subsidiary Banks in Korea

The FSC/FSS amended the *Guidelines for Authorization of Banking Business* to include the banking business licensing requirements for establishment of subsidiary banks in Korea by foreign financial institutions (e.g., financial holding companies). Thus far, foreign financial institutions have conducted their banking operations solely by establishing bank branches. A foreign financial institution must fulfill the following criteria to establish a subsidiary bank:

•- *The foreign financial institution must obtain the approval of its home supervisory authority on the establishment of a subsidiary bank, if requested by the FSC/FSS;*

•- *The home supervisory authority must supervise the foreign financial institution and its overseas subsidiaries and branches;*

•- *The foreign financial institution must be well capitalized, well managed, and internationally recognized;*

•- *The foreign financial institution must prudently manage its subsidiaries and branches; and*

•- *The foreign financial institution must provide the information required by the FSC/FSS to supervise its management and business activities.*

Amendments of KSE and KOSDAQ Regulations

The amended KOSDAQ business regulations, which went into effect on July 26, 2005, provide for new types of orders: “immediately executable” orders and “best bid/offer limit” orders.

The amended KSE business and listing regulations (effective August 2, 2005) will: (1) widen the permissible fluctuation band of after-hours basket trading from ± 5% of the closing price to ± 7%; (2) improve the calculation method for closing prices (i.e., reference yield for market making) of small-lot public bonds that must be purchased by certain transactions as required by law; (3) exempt firms simultaneously listed on the KSE and on an overseas stock exchange from the requirement that minority shares exceed 10% if their total shares outstanding exceed 700,000; and (4) allow firms to delist their bonds at their request if they have an agreement with the creditors holding their listed bonds.

KorAm Bank Approved to Acquire the Citibank's Korean Branch Operations

The FSC/FSS approved the agreement between KorAm Bank and Citibank, N.A. by which KorAm Bank assumed the fifteen branch operations of Citibank, N.A. in Korea. The new entity created from the consolidation of the fifteen branches by KorAm Bank, Citibank Korea Inc., began operations on November 1, 2004.

Major Changes to Loan-Loss Provision Rules for Banks to Be Implemented in Preparation for BASEL II

The FSS announced major changes to the rules on bank loan-loss provisions (LLP) in preparation for BASEL II. Domestic banks are currently required to set aside LLP based on the uniform minimum LLP rule that the FSC/FSS established for bank assets using past losses that the banks experienced.

Under the proposed LLP, each bank must determine its own internal LLP weightings based on its past losses and set aside LLP using the new LLP weightings beginning in 2005 (provided that the bank's LLP exceeds the minimum LLP currently required). Domestic banks will also begin setting internal LLP weightings based on the expected losses and, beginning in 2006, are to set aside LLP using the expected loss weightings. By the second half of 2006, the uniform minimum LLP rules are to be eliminated, and all domestic banks are to use their own individually determined LLP based on their expected loss weightings.

New Basel Capital Accord to Be Implemented by Year-End 2007

The FSC/FSS announced on December 21, 2005 that it had set year-end 2007 as the target date for the full implementation of the New Basel Capital Accord (Basel II). All domestic and foreign banks operating in Korea are to come under the new capital adequacy framework. Each bank will be permitted to calculate the capital requirement by any method it deems most appropriate.

Guidance on Reporting Requirements under the Amended "5% Rule" Which Became Effective in March, 2005

The FSS issued guidance on the reporting requirements under the amended "5% rule" which became effective on March 29, 2005 to help investors and companies avoid unnecessary confusion and ensure full compliance with new reporting regimes. Previously, the 5% rule required an investor who acquired 5% or more of a publicly traded company's total outstanding shares or changes his share ownership by 1% or more thereafter to disclose the fact thereof within five days from the date of the transaction. Among the highlights of the new guidance are the following:

•- *Re-filing of disclosures for investors subject to the 5% rule*

•- *Five-day "cooling-off period" after reporting "Exercising Influence on Management" as the intended investment purpose*

•- *New reporting requirements and forms with respect to a change in investment purpose*

•- *Additional information dissemination measures with respect to changes in the 5% rule*

General Public Notice on the Securities Class-Action Suit Law

The FSS issued a general public notice on the securities class-action suit law (SCASL) that took effect on January 1, 2005. The notice was issued to inform the general public that the new law initially affects KSE- and KOSDAQ-listed companies with assets of KRW2 trillion or more (there were a total of 82 such companies as of the end of September 2004). For companies with assets of less than KRW2 trillion, the new law will take effect on January 1, 2007.

Causes for class action	Effective Date	
	Assets more than KRW 2trillion	Assets less than KRW 2trillion
● False statement (including omission of material information) in the prospectus or registration statement filings ● False statement (including omission of material information) in the quarterly, semiannual or annual report ● Negligence by outside auditor	January 1, 2005	January 1, 2007
● Unfair trading involving inside information or market manipulation	January 1, 2005	January 1, 2005

Amended Prompt Disclosure Rule to Be Adopted for Unlisted Banks in April 2005

The FSC/FSS adopted an amended prompt disclosure rule to *Regulation on Supervision of Banking Business* and its enforcement rules according to which the number of disclosure items for banks not listed locally was raised from 3 to 34. Banks that were affected by the amended disclosure rule are Korea Development Bank, Citibank Korea, National Agricultural Cooperative Federation, National Federation of Fisheries Cooperatives, and foreign bank branches that operate in Korea. As a result of the amended disclosure rule, all the banks operating in Korea except for Export-Import Bank of Korea will be subject to the same prompt disclosure rule irrespective of whether or not they are listed locally.

The newly amended disclosure rule, which took effect April 30, 2005, was intended to ensure that the disclosure standards for unlisted banks were on par with those for listed banks and to improve consumer protection and bank transparency. Disclosures under the prompt disclosure rule may be made through the news media, the Internet homepage of the Korea Federation of Banks, or the Internet homepage of the bank.

New Initiative to Improve Supervisory Work Processes for Foreign Financial Service Companies

The FSC/FSS announced a new initiative aimed at significantly improving supervisory work processes for foreign financial service companies as a complement to efforts currently under way to streamline the existing supervisory and regulatory processes and make them more efficient, dynamic and investor-friendly in support of the Financial Hub Initiative.

International Supervision Support Office

The International Supervision Support Office, to be made up of Foreign Financial Service Company Support Team and Northeast Asia Financial Hub Team, will put forth and implement regulatory reform and supervisory assistance measures for foreign financial service companies in support of the Financial Hub Initiative. The new office will also receive and oversee regulatory approval requests for new financial products from foreign financial service companies and resolve problems they may encounter with business activities under FSC/FSS supervision. Regulatory decisions involving the establishment of a new commercial presence and M&A matters will continue to be handled by the appropriate supervisory department within the FSC/FSS.

International Supervision Advisory Committee

The International Supervision Advisory Committee is to consist of the three FSS Deputy Governors and two to three outside specialists. The primary function of the committee will be to review major issues concerning foreign financial service companies that are handled by the International Supervision Support Office and to coordinate decision-making involving regulatory approval requests, difficulties and feedback from foreign financial service companies. The committee will also give foreign financial service companies an opportunity to participate in the committee discussions and present their positions whenever desirable or necessary.

Improving Feedback from Foreign Financial Service Companies

The FSC/FSS also plans to adopt new measures to improve feedback from foreign financial service companies. The new measures will likely include the hiring of outside consultants with experience in foreign financial supervisory organizations and other supervisory expertise, establishing an international advisory committee made up of respected scholars and financial professionals at home and abroad, and instituting periodic surveys to monitor market participants' perception of the supervisory authority and identify areas of weaknesses.

Improving Services to Foreign Visitors

One of the improvement plans is redesigning the FSC/FSS English web site so as to make the organizational structure and the contact persons clear and easy to understand. Another is directing all calls from foreign visitors and foreign financial service companies to the English-speaking staff at the International Cooperation Office. As a way to help improve foreign visitors' understanding of the activities of the supervisory departments and the offices of the FSC/FSS, English documents will be available to foreign visitors.

LATVIA

Major Changes in the Latvian Financial Regulations and Significant Market Developments

The legislative framework for the financial sector complies with the requirements of EU directives in all material aspects. During the period July 1, 2004 through June 30, 2005, amendments to several laws were approved by the Parliament.

Amendments to the Law on Credit Institutions:

- The minimum capital adequacy requirement was reduced from 10% to 8%;

- The law defined a new type of credit institution – the electronic money institution, whose sole purpose of operations is to issue and service electronic money. The law sets forth the provisions governing the operations of such institutions. The law provides for an exemption from the requirement to obtain a license from the Financial and Capital Markets Commission for electronic money institutions that do not plan to issue more than 5,000,000 Euros in electronic money.

- In order to protect the rights of creditors and third parties in all of the EU member states, the law was supplemented to regulate the reorganization, bankruptcy and liquidation of credit institutions. The law specifies the role of the competent authorities involved in reorganization or the winding-up of entities. To ensure the fair treatment of creditors, principles of unity and universality are observed;

- The law was supplemented with provisions that specify the principles for supervision on a consolidated basis of banks that are subsidiaries of EU financial holding companies. It also specifies the co-operation and information exchange rights of involved supervisory institutions.

- The law specifies the requirements that credit institutions must meet with respect to outsourcing, accounting, the internal audit function, management or development of information technologies and the provision of financial services.

Amendments to the Regulations on the Calculation of Capital Adequacy:

- The list of Zone A countries was expanded to include new EU member states, which are not OECD members. The notional risk weightings were reduced for these countries' national governments and central banks (from 50% to 0%), as well as for local governments in Latvia (from 50% to 20%). The notional risk weighting for claims on credit institutions of the Republic of Latvia other than claims on demand was reduced from 50% to 20%;

- In view of the pegging of the lat to the euro starting from January 1, 2005, the open position in euro is not included in calculation of an open foreign exchange position, but the capital requirement for matched positions between the euro and the lat is set at 1% and 8% for unmatched position.

The Regulation on the Preparation of Reports Regarding Interest Rate Risk Management and Interest Rate Risk Maturity Structure further identifies the general requirements outlined in the Recommendations for the Establishment of Internal Control Systems pertaining to risk management in accordance with the specifics of interest rate risks. The Regulation defines the procedures for preparing and submitting interest rate risk maturity structure reports. Thus all of the Core Principles for Effective Banking Supervision of the Basel Committee on Banking Supervision are implemented in Latvia.

The Regulation Concerning the Preparation and Submission of Information on the Structure of Bank Loan Portfolios was drafted in order to ensure the strict supervision of credit risk assumed by banks. The Regulation also anticipates the need for banks to provide additional information to be used in connection with evaluating the quality of the banks' loan portfolios. This will permit the Commission to enhance the effectiveness of its supervisory activities, particularly in preparing for and conducting on-site inspections.

The Law On Financial Conglomerates and amendments to the Law on Credit Institutions, Law on Insurance Companies and Supervision and Financial Instruments Market Law became effective on June 9, 2005. The law provides for the supplementary supervision of credit institutions, insurance undertakings and investment firms in financial conglomerates.

Amendments to the Law on Insurance Companies and Their Supervision:

- The Law further specifies requirements regarding the supplementary supervision of insurance undertakings in insurance groups.

- The Law states that the branches of insurance companies from states that are not members of the EU or EEA must place a security deposit in a credit institution that is registered in the Republic of Latvia.

- The Law was supplemented with norms that list additional requirements for assets covering the technical provisions of insurers and branches of non-member insurance companies.

- The Law specifies the criteria regarding the transfer of insurance portfolios, reflective of the counterparties and their domicile.

- The Law was supplemented with rules to define the cooperation procedures and information exchange rights of supervisory institutions;

- The Law was supplemented with requirements that insurance companies and branches of insurance companies countries that are not EU or EEA members must meet with respect to outsourcing, accounting, internal audit function, the management or development of information technologies and the underwriting of insurance risks, except for certain reinsurance risks, the handling of insurance indemnity payments, and investment activities.

Amendments to the Law on Investment Companies:

- The Law expands the list of services that investment management companies may offer. They may now manage individual portfolios and provide consultations concerning investments in financial instruments;

- The Law adopts a single license principle for operations of investment management companies in the EU market.

Anti-Money Laundering Policies and Enforcement in the Latvian Financial Sector

On October 1, 2004, the FCMC approved the Guidelines for the Formulation of the Internal Control System for Prevention of Laundering of Proceeds Derived from Criminal Activity and Financing of Terrorism, in which the FATF recommendations and requirements of the PATRIOT ACT were incorporated. As compared to the previous Guidelines, the new guidelines amend the definitions of actual beneficiary, shell bank and politically exposed persons and further specify customer identification requirements in cases when intermediary services are used. On January 27, 2005, a new Money Laundering Prevention Advisory Board was created in order to establish priorities in the AML area on the political level. The Board is led by the Prime Minister and includes the Minister of Finance, the Minister of Interior, the Minister of Justice, Prosecutor General, the Chief Justice of the Supreme Court, the President of the Central Bank, and the Chairman of FCMC. According to amendments to the Law on Credit Institutions adopted by the Parliament on June 10, 2005, for operations violating requirements imposed by the Law On the Prevention of Laundering of Proceeds Derived from Criminal Activity, the Financial and Capital Market Commission will impose a fine between 5,000 lats and 100,000 lats (approximately $8,474 and $169,491).

LUXEMBOURG

Measures to Control Money Laundering and to Fight Terrorism

The law of November 12, 2004 on Prevention of Money Laundering and the Financing of Terrorism (the "Luxembourg AML Law") seeks to implement in Luxembourg the European Union Directive 2001/97/EC which amended Directive 91/308/EEC on the Prevention of the Use of the Financial System for the Purpose of Money Laundering. The Luxembourg AML Law makes a number of changes. Among the newly included offenses are fraud against the financial interests of the State and international institutions, including those of the European Union.

The Luxembourg AML Law removed any doubts about the applicability of the provisions relating to money laundering to the financing of terrorism. Professionals are obliged to "fight money laundering and the financing of terrorism". Procedures available for the prevention of the use of financial circuits for money laundering purposes are now available to fight the financing of terrorism.

The Luxembourg AML Law applies to financial institutions such as undertakings for collective investment, which sell their shares or units and their management companies, and pension funds (Assep and Sepcav). It also applies to a broad range of professionals, such as attorneys, real estate agents, tax and financial consultants and dealers in valuable assets.

As was already the case under the law of April 5, 1993, professionals will be required to ensure compliance with professional obligations by their branches and subsidiaries in Luxembourg and abroad. However, the scope of application of this obligation has been limited to the branches and subsidiaries "in which they have legal means enabling them to impose their will on the conduct of business, provided that these branches or subsidiaries are not covered by equivalent professional obligations under the laws applicable at the place where they are established". Thus, the existence of equivalent legislation for the prevention of money laundering in the country in which the subsidiary is established limits the obligations placed on the parent company in relation to such subsidiaries.

The Luxembourg AML Law increases the transaction threshold for the obligation to identify occasional customers from 10,000 to 15,000 Euros, in compliance with European Union Directive 2001/97/EC. New provisions stipulate that professionals may delegate the obligation to identify customers to national or foreign professionals, who are working in the same activity sector and are governed by an equivalent obligation to identify customers. The law requires a delegation to be made under a written mandate which guarantees the professional's right to access the identification documents at all times and to obtain at least one copy of such documents.

Professionals will not be covered by identification obligations if the customer is a national or foreign financial institution governed by an equivalent identification obligation. The term "financial institution" for the purpose of this law includes credit institutions and professionals of the financial sector (PSFs), insurance companies and undertakings for collective investment which sell their units or shares. The Luxembourg AML Law confirms the principle of monitoring of customers. Professionals are required to monitor their customers throughout the duration of their business relationship. This obligation must be adapted to the degree of risk that the customer may present. Professionals must be vigilant to any transaction which they regard as being especially suspicious.

The Luxembourg AML Law also adopts the special recommendation VII made by the FATF concerning the identification of originators of money transfers. Credit institutions and FSPs are required to include, in transfers of funds and the accompanying messages, the name or account number of the originator.

Creation of a Compliance Function

Circular CSSF 04/155 (the "Compliance Circular") specifies the procedures for implementation of Art. 5 (2) of the amended law of April 5, 1993 for banks. Art. 17 (2) of that law sets forth the procedures for investment companies. It stipulates the creation of a compliance function and sets out its working procedures. The compliance function as defined by the Compliance Circular is a regular form of supervision associated with the close and constant monitoring of the transactions of the establishments and of their risks. The creation of a compliance function seeks to organize, coordinate and structure the controls in the area of compliance already performed because of other regulations but which are at present often distributed between different levels of the organization.

Its further purpose is to protect the establishment from consequences which might result from failure to respect the current standards and to contribute broadly to effective risk management. The compliance function must not depend on a particular service or department of the establishment, but must be hierarchically attached to the management of the establishment. It must be able to perform its tasks and exercise its responsibilities on its own initiative. On the other hand the internal audit function must assess the operation and effectiveness of the compliance function. Banks and investment companies are required to comply with all the provisions of the Compliance Circular by January 1, 2006.

The Taxation of Savings Directive

This Directive was adopted in June 2003 and transposed into Luxembourg law on June 21, 2005. It became effective on July 1, 2005 in Luxembourg and in Europe. The Directive stipulates that EU citizens and EU residents will be subject to taxation on his/her income from savings. He/she will need to inform (either him/herself, or via the bank) the tax authorities where he/she resides where he/she will be taxed according to local rates, if he/she resides in an EU member state. If the customer chooses to be taxed in Luxembourg, 75% of the tax collected will be transferred to the tax administration where that person resides via a “blind” wire which means that all taxes for one country will be sent in one installment. Only individuals are subject to this withholding tax. Corporations are exempt. The taxation rate is set at 15% but will increase to 20% after 2 years and 35% after 4 years. This taxation is on income from savings. Products concerned are cash accounts, bonds of any form or bond/cash funds (provided they contain more than 40% of bonds or 15% of cash). The tax is on income but also on interest and any capital gains. Austria, Belgium and Luxembourg will apply this taxation system while all other EU member states will apply a system of exchange of information.

Law on the Prospectus for Public Offerings of Securities

This law seeks to transpose into Luxembourg law the requirements of Directive 2003/71/EC for a prospectus to be published in connection with a public offering of securities or trading of securities on a regulated market in an EU member state. The purpose of this Directive is to harmonize the EU requirements for the drafting, approval and distribution of such prospectuses.

The law is divided in three parts. Part one applies the rules of the Directive to transferable securities offered to the public in Luxemburg and to transferable securities negotiated on a regulated market in Luxemburg (operated by the Stock Exchange of Luxemburg). Part two is subdivided into two chapters. Chapter one regulates offers to the public of transferable securities not covered in the first part of the law, namely the public offers made by a Member State, a local or regional authority, an international public organization, etc. Chapter two describes the rules applicable to the trading of transferable securities on a regulated market in Luxembourg. These prospectuses will not benefit from the European passport and the rules relating to content are not as strict as for prospectuses covered by the first part of the law. Part three of the law describes the applicable rules for certain markets not registered on the list of regulated markets held by the European Commission.

Law on Financial Collateral Arrangements

The purpose of this law, which seeks to transpose Directive 2002/47/EC into Luxembourg law, is to strengthen the legal certainty of financial collateral arrangements, notably by harmonizing the conditions under which guarantees are valid, by removing these contracts from the scope of application of the rules on insolvency and by harmonizing the application of the rule of *lex rei sitae*.

Draft Law on Market Abuse

In December 2004, the Government published a draft law on market abuse with a view to replacing the law of May 3, 1991 on insider trading. The draft law would combine into a single law the provisions of four EU directives on insider trading and market manipulation. The purpose of this proposed law is to set up a legal framework capable of guaranteeing the integrity of the markets and safeguarding public confidence in the markets for financial instruments. The proposed law seeks to promote transparency of the financial markets by requiring issuers to make information available to the public at the earliest possible opportunity. Investment advisors are required to ensure that information is presented fairly, facts are clearly distinguished from interpretations and sources are reliable. As distinct from the directives, the Luxembourg proposed law would include the markets of third countries.

Credit institutions and financial service providers will be required to immediately alert the CSSF if they have reason to suspect that a transaction might constitute insider trading or manipulation of the market. This reporting requirement is based on the requirement to report money laundering and financing of terrorism.

Draft Law on Distance Marketing of Financial Services

The draft law on distance marketing of financial services to consumers is designed to transpose Directive 2002/65/EC into Luxembourg law. The proposed text merges into a single law all the provisions applicable to distance marketing of financial services, regardless of the means by which the contract was formed (by mail, telephone, electronic means or any other means of remote communication). The law of August 14, 2000 on electronic commerce will be amended to delete all the provisions relating to financial services.

In line with the Directive, the draft law imposes a number of obligations on professionals to provide pre-contractual information. This information relates both to the professional and to the proposed financial service, as well as to the content of the remote contract and certain technical provisions applicable when a contract is formed by electronic means.

The draft law increases legal certainty in that it specifies the time at which the contract is formed. The contract is considered to be formed at the time when the professional receives acceptance from the consumer. This rule incorporates the theory of offer and acceptance under Luxembourg law and protects the consumer against delays in implementation.

The Draft Law on the European Company

The draft law on the European company seeks to introduce into Luxembourg law the provisions of EU Regulation 2157/2001 relating to European company law. It makes far-reaching amendments to the Luxembourg law on limited companies.

Draft law 5352 on the European company seeks to create a legal framework which is as favorable as possible for European companies. In cases in which the EU regulation gives Member States options, the Luxembourg Government has adopted the solution which guarantees maximum flexibility. Regarding rules on the management of the European company, the option was given to choose either a single-tier system (administrative board) or a two-tier system (supervisory board and management board). Luxembourg, which previously had no provision for the two-tier management system, now has introduced it. By doing so, the two-tier system is not reserved for European companies alone since any limited company now has the choice between the two-tier or single-tier management system. The draft law seeks to render decision-making structures more flexible and does offer maximum flexibility.

The text of the draft law strengthens the rights of shareholders at the decision-making level by providing that shareholders holding at least 20% of the share capital of a company are entitled to call a general meeting. Luxembourg law currently does not grant minority shareholders the right to require that certain subjects be added to the agenda of the meeting. The provisions of the EU Regulation 2157/2001 have increased the protection of minority shareholders. The draft law harmonizes Luxembourg law with the provisions of that Regulation. Provision is made for a general meeting to be convened when shareholders representing one-tenth of the subscribed share capital so request. Provision is also made for one or more shareholders who own a combined minimum of 10% of the subscribed capital to request that certain subjects be added to the agenda of a general meeting.

The regulations introduce the option for decisions to be taken by remote consultation. The members of the administrative board, management board and supervisory board are not obliged to meet physically at a particular place to attend their meetings. The draft law allows the use of any means of remote communication which guarantees effective participation in the meeting and continuous transmission of the deliberations. A meeting held by such means of remote communication is deemed to have taken place at the registered office of the company.

At the end of January 2005, draft law 5435 was tabled with a view to transposing into Luxembourg law Council Directive 2001/86/EC of October 8, 2001, and thereby supplementing the European company law with respect to the involvement of employees. The draft law addresses, among other items, the negotiating procedure which must be implemented for employees in European companies whose registered office is or will be in Luxembourg, the reference provisions which apply, and the methods for election or appointment of members representing workers employed in Luxembourg to the special negotiating group, or representative body for employees of the European company.

THE NETHERLANDS

A new supervision act for the financial sector

The Netherlands is still preparing for another major change in banking supervision besides the new capital adequacy rules, called the New Supervision Act for the Financial Sector. The Act will incorporate all existing Acts on the different parts of the financial sector and at the same time restructure and improve them. It will arrange the mandates of the three supervisory bodies on insurance, banking and securities, respectively. The new Act is an important reason why the Dutch government cannot make its goal of reducing the administrative burden caused by supervision on business.

Financial Services Act

The Financial Services Act will come into effect at 1 January 2006. The new supervisory rules are accompanied by a new set of rules for financial services, which is applicable to other institutions besides banks. The new Act for Financial Services will lead to consolidation and probably a lot of defaults in The Netherlands among the so-called mom-and-pop firms that offer advisory services. The Act address quality criteria, permanent education requirements and licenses.

Administrative costs

While good progress is being made on paper, the institutions have not seen any concrete results yet to diminish the administrative burden resulting from legal requirements. It is important that the target to reduce administrative costs with 25% for the financial sector are held on to, and the sector is willing to make contributions in the form of reduction proposals on an ongoing basis. This is certainly necessary now that it has been found that a number of proposals appear to produce less reduction than expected and that some will not be realized until later (after 2007).

The whole route of administrative costs is dominated by the cost aspect without any attendant explicit analysis of the need for new legislation and regulations. A reduction of administrative costs requires policy choices: which regulations are redundant and what is the need for new regulations? According to NVB, this would be the key to a sustainable reduction of administrative costs and, consequently, compliance costs.

Debt Rescheduling (Natural Persons) Act

The revision of the Debt Rescheduling (Natural Persons) Act *(Wet schuldsanering natuurlijke personen, Wsnp)* is in many areas an improvement compared to the present situation. However, that does not apply to the proposed introduction of a regulation under which the court may impose an amicable settlement. More important than a satisfactory (amicable or legal) debt rescheduling arrangement is the prevention of debt. For banks and financiers, credit registration with the Central Credit Registration Office *(Bureau Krediet Registratie, BKR)* is an indispensable instrument in this regard.

IFRS requires a new frame of reference from users

When the IFRS accounting principles are fully implemented – in the 2005 annual accounts of listed companies – an old wish of the European Commission (EC) will have finally come true: to achieve harmonization of reporting standards on the European capital market. According to the EC, such harmonization is good for the operation of the capital markets, because companies are more comparable and because, in the future, the international reporting standard will provide a passport for listing on the US capital markets. IFRS will give a strong boost to the transparency and comparability of the annual accounts of European corporations. One hundred per cent comparability will not be feasible. There will always be certain choices and options in the reporting, the use of which will vary from company to company.

Anti-money laundering developments

The Dutch Bankers' Association has made general guidelines for the subjective indicator. The goal of these guidelines is to give bank employees a helping hand in judging transactions. These guidelines will be looked at periodically to see if any amendments need to be made. These guidelines are based on an analysis of more than a hundred international money laundering cases and give in main groups an idea of relevant questions and subjects of attention. The described situations are only meant for focusing the attention to a later judgment.

Changes in health care system

The free market system and competition, in particular, are giving rise to heated discussions between proponents and opponents of this system change. What should be the role of the banks in the rapidly changing world of care institutions and hospitals? Key themes are matters relating to legislation and regulations and that are specific to health care.

New version of *'Handreiking Outsourcing'* (Toolkit for Outsourcing) Reference model for financial institutions

Outsourcing is a truly modern phenomenon. An effective strategy aimed at controlled, and consequently measurable and verifiable service is of great importance for financial institutions as well. The NVB EDP-Auditing Committee (CEA) has produced a toolkit on this subject. A second impression of this booklet will appear in the course of the first quarter.

Negotiating about PIN payment is possible but rarely done

During the NMa (the Netherlands Competition Authority) Congress, the NVB, commenting on the results, stated that the freedom of choice for retailers extends beyond PIN-payment rates. The NVB referred to research which has shown that only 30% of direct PIN-payment-associated costs for retailers are determined by the rates charged by network services.

NORWAY

Developments in the Financial Sector

- The Commercial Banks' Guarantee Fund and the Savings Banks' Guarantee Fund were merged in July 2004 to form the Banks' Guarantee Fund (the "Fund"). Administration of the Fund is shared between the Norwegian Financial Services Association and the Savings Banks' Association. The deposit guarantee, amounting to NOK 2 million for each depositor in each and every bank, remains unchanged.

- Norway has implemented the IFRS Regulation, which became effective on January 1, 2005. It requires all listed companies to apply international financial reporting standards from 2005 onwards. The legislative regulations allow unlisted companies to prepare group accounts in accordance with the IFRS Regulation and allow all companies to prepare corporate accounts in accordance with IFRS. The authorities have proposed in a consultative note that initially the option to prepare corporate accounts in accordance with the IFRS Regulation will not apply to financial institutions.

- A national enforcement body has been established to oversee companies' implementation of IFRS accounting rules and thereby support confidence in company accounts. In Norway, the responsibility for overseeing financial reporting is assigned to Kredittilsynet (the Financial Supervisory Authority). Kredittilsynet will follow the framework set forth by CESR.

- New regulations on accounting treatment of loans, which are based on relevant provisions in IAS 39, became effective on January 1, 2005.

- The Parliament has passed a Bill concerning the new Prospectus Directive which was adopted on July 15, 2003 and incorporated into the EEA agreement in 2004.

- The Government has appointed a separate committee to propose changes to regulations implementing the Market in Financial Instruments Directive (the "MiFID"), the Directive on Takeover Bids and the Directive on Continuous Reporting. The Committee is to submit its report to the Ministry of Finance by August 20, 2005. MiFID will replace the previous Investment Services Directive (the "ISD") of 1993 which in Norwegian law is primarily implemented through the Securities Trading Act.

- In 2005, the authorities have proposed amendments to the Mutual Funds Act which would permit the establishment of hedge funds and private equity funds. Initially, these funds will only be available to professionals.

- The new Foreign Currency Register Act was passed in 2004 and became effective on January 1, 2005. The Act requires banks to report international currency transactions in an official new Currency Register. This reporting requirement supplements the authorities' directives to the banks on electronic monitoring systems to reveal and report possible money laundering.

- In the fall of 2004, the Parliament passed amendments to the rules governing life insurance. Different parts of the amended Insurance Act will become effective at different times. The intention is to establish an integrated body of rules that assures Norwegian companies suitable framework conditions with which to meet international competition. Important aims of the Insurance Act are to create a clear distinction between assets of the insured and the company, a clear distribution of risk between client and company and more transparent pricing of life insurance products.

- Some small and medium-sized banks have been acquired:

  The Icelandic bank, Islandsbanki, has taken over all shares of Kredittbanken and Bolig-og Næringsbanken (BNbank).

  Sparebank 1 Midt-Norge has taken over all shares of Romsdals Fellesbank.

  The Swedish bank, Skandinaviska Enskilda Banken (SEB), has purchased all of the shares of Privatbanken.

PANAMA

During the period under review, the Superintendency of Banks issued Regulations on the following:

Mergers and acquisitions of banks, transfers of shares that entail a transfer of a controlling interest, applicable to banks or "economic groups" of which banks are part of and to natural or juridical persons holders of shares of banks that represent a "change in control" require previous authorization from the Superintendency of Banks. The regulation describes what is considered "change in control". Exchange of shares of Banks and Economic Groups of which Banks are part of will require previous authorization when as a result natural or juridical persons acquiring shares, individually or in concert, posses 25% or more of all outstanding shares.

The regulation describes the process that must be followed, which starts with a previous meeting with the Superintendent, lists the required documents, over which the Superintendency will analyze the request for authorization. As part of the process, the Superintendency will publish for public comments the request for authorization, and will then issue its decision to authorize or reject the request.

In cases of exchange of shares within an Economic Group of which the Bank is part of, when they represent a corporate reorganization, the Superintendency must be previously notified, and will issue its decision within 10 days.

The regulation also lists the motives for rejection of a request for authorization for the acquisition or transfer of shares.

The regulation describes Merger as the meeting of two or more existing corporations, be it that one is absorbed by another one (Merger by absorption) or results in a new corporation (Consolidation), that inherits the rights and obligations of the intervening corporations.

The Merger of Consolidation of Panamanian banks and Banks organized as a juridical personal according to Panamanian law, as well as any modification of their structure, and mergers or consolidations of Economic Groups of which such Banks are part of, will require previous authorization from the Superintendency of Banks. The procedure for this is similar to that for the exchange of shares.

In cases of mergers outside Panama that affect or involve branches or subsidiaries of banks located in Panama, approval from the Superintendency of Banks is required.

In cases of mergers within the same Economic Group that do not involve Banks nor bank holding corporations, the Superintendency must be notified not later than five days after the merger.

A new regulation was also issued requiring previous authorization from the Superintendency of Banks for buying, selling, transfer or cession of deposits, in which there exists a significant impact, as this is defined in the regulation, on the volume or nature of the business. Significant impact is defined as the buying/selling of portfolios and/or transfer or cession of deposits that involve 25% or more of the assets and/or liabilities of the seller or the buyer individually. The regulation establishes the requirements and describes the process for soliciting authorization, indicating the motives for its rejection. As a safeguard, the regulation establishes the confidentiality of any and all information received by the Superintendency of Banks.

Regulation was also issued for bank transfers, which is defined as a transaction ordered by a person, be it natural or juridical, by which the bank, through electronic means, makes it available to another person a determined amount of money, be it in the same or another different bank, in Panama or elsewhere, as a result of which the bank will assume the responsibility with its ordering party to make the respective transfer, that will result in an internal accounting transaction registered in the bank or banks involved. The ordering party and the beneficiary may be the same person.

The regulation establishes the obligation of the Bank to duly and properly identify the local ordering party and its responsibilities. It prohibits the processing of transfers if there does not appear the name of the ordering party besides the originating bank. The bank must maintain a register of all transactions for a period of not less that five years, and it identifies cases in which certain transfers are excepted from this regulation.

The Superintendency also issued a regulation that establishes that banks must rotate at least every three years their teams of external auditors, including managers and partners. The rotation also includes specialized personnel used in audits, such as fiscal auditors, system auditors. This rotation does not imply necessarily the change of external audit firm. It does permit, at the moment of the rotation, that one member of the audit team that had been attending the Bank, remain for an additional period of one year, but such person may not be the partner that was attending the bank. Banks must notify the Superintendency of Banks, within the next 30 days previous to the initiation of the audit, the name of their external auditors and a detail of the auditors that form the audit team, as well as any modification of the team.

Funding the activities of bank supervisory authorities

In Panama the Superintendency of Banks is funded through assessments based on the volume of assets and inspection fees paid by the regulated institutions, subject to the Government budget process, excluding freezes.

Basel II

Basel II will be implemented on a gradual and limited basis for all institutions that do not have a foreign head office. Branches of foreign banks will implement Basel II according to their head offices.

Consolidated supervision

Panama applies Consolidated Supervision to bank branches, affiliates and subsidiaries of non-domestic banks or economic (financial) groups of which a bank is a part. The Superintendency has issued a Resolution defining what it considers a Panamanian bank for purposes of applying consolidated supervision and application of Basel II, on the basis of where the control of the bank or group is located (country of origin). The Superintendency has signed MOU with over a dozen foreign supervisory authorities for conducting consolidated supervision.

Panama does not apply Host Country Endowment/Dotational Capital Requirement.

Securities

The National Securities Comisión issued new regulations defining what should be understood as a "relevant issue" that can influence the price of a security, and, thus, should be communicated by issuers to the NSC and should be made public. The regulation contains criteria for compliance with the requirement for informing the public about important issues affecting securities. The regulation also defines matters such as opportune information, methods and ways of informing the public, and establishing that the regulations will apply to issuers and subsidiaries.

The NSC also issued new regulations concerning the requirements applied to all authorized entities for the prevention of money laundering and financing of terrorism, and it applies to self-regulated organizations, brokers, traders and investment managers.

PHILIPPINES

The most significant developments that took place during the period under review are noted below:

Regulation and Supervision of Banks

- Approval of plans to adopt the new international capital standards contained in Basel II; universal/commercial banks are expected to comply with the basic approaches by 2007.

- Issuance of the exposure draft of the Basel II implementing guidelines for the Philippines for comments of the industry by end-September 2005.

- Approval of the adoption of new sets of Philippine Accounting Standards (PAS) and Philippine Financial Reporting Standards (PFRS) issued by the Accounting Standards Council (ASC) for annual financial statements beginning January 1, 2005, which aligns existing regulations with the new International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

- Revision of rules and regulations governing accounting for investments in debt and equity securities to align them, to the greatest extent possible, with the provisions of IAS 39 prescribed by the IASB (also applicable to non-bank financial institutions).

- Adoption of a policy requiring banks to develop and maintain an appropriate, systematic and uniformly applied process in determining the amount of reserves for bad debts or doubtful accounts (also applicable to non-banks with quasi-banking functions).

- Amendment of guidelines on the risk-based capital framework to allow the imposition of lower risk weights for highly rated private enterprises and higher risk-weights for non-performing loan accounts.

- Approval of the recognition, for bank supervisory purposes, of internationally accepted credit rating agencies (CRAs) that will undertake local and national ratings provided that said CRAs have at least a representative office in the Philippines.

- Adoption of a policy requiring thrift banks operating Foreign Currency Deposit Units (FCDUs) to comply with the regulatory minimum capital requirements of FCDUs within two years.

- The issuance of regulations governing the creation, administration and operation of Unit Investment Trust Funds (UITFs) by banks to align the operation of pooled funds under management by trust entities with international best practices.

- Issuance of regulations governing repurchase agreements covering government securities, commercial papers and other negotiable and non-negotiable securities or instruments of banks and non-bank financial institutions with quasi-banking functions (NBQBs) as well as non-recourse sales of such securities by banks, NBQBs and other financial institutions under the supervision of the BSP.

- Amendment of pre-conditions for the exercise of quasi-banking functions.

- Issuance of rules and regulations governing the development and implementation of banks' internal credit risk rating systems.

Regulation of Derivatives and Securities Products

- Issuance of guidelines allowing universal and commercial banks without expanded derivatives authority to invest in foreign-currency denominated structured products issued by banks and Special Purpose Vehicles without need of prior Monetary Board approval.

- Revision of guidelines for the Currency Rate Risk Protection Program, a non-deliverable USD/PHP forward contract (NDF) between the BSP and a universal/commercial bank in response to the request of bank clients desiring to hedge their eligible foreign currency obligations.

- Approval of guidelines for the capital treatment of banks' investments in the following products:

  Structured products or financial instruments where the return is a function of one or more underlying indices, such as interest rates, equities and exchange rates; and

  Securities overlying securitization structures, both traditional and synthetic.

- Approval of the shift in the process for settlement and recording of equity shares from a depository model employing nominee account to a name-on registry stock model using beneficial owner account allowing stockholders to have their securities in their own names in the books of listed firms. Previously, stockbrokers register investors' shares of stocks in the name of Philippine Central Depository (PCD) Nominee, Inc.

Regulation and Supervision of Securities Firms, Insurance Firms, Commodities Firms & Other Non-Bank Financial Institutions

- Issuance of guidelines to discourage unscrupulous collection practices of banks' subsidiary/affiliate credit card companies.

- Adoption of rules and regulations governing the registration and operations of foreign exchange dealers/money changers and remittance agents.

- Extension of the applicability of the policy requiring banks and financial institutions to entrust their securities, such as government bonds and commercial papers, to accredited third-party custodians for safekeeping to non-bank financial institutions.

- Adoption of the Risk Based Capital Adequacy Ratio (RBCA) requirement for securities brokers and dealers. As part of implementing the shift from the net capital to the RBCA regime, securities brokers and dealers were required to prepare Risk Management Manuals and assess their risk exposures to the following: position or market risks, credit risks, and operational risks.

- Amendment of the implementing rules and regulation of the Securities Regulation Code related to the Segregation and Limitation of Functions of Members, Brokers, and Dealers (Rule 34.1), and the Requirements on Nomination and Election of Independent Directors (Rule 38)

- Issuance of guidelines requiring all financing companies (FCs) with head office in location which require a lower minimum capital maintaining or proposing to maintain branch office/s in location which require a higher minimum capital shall have a minimum paid-up capital corresponding to that of higher capitalized locations. This is in addition to the additional capital for the branch office. FCs covered by the guidelines shall submit a program of capital build-up, including proof of compliance therewith

- Conduct of background check on directors and officers of FCs applying for registration with the Securities and Exchange Commission (SEC). Should the background check yield adverse findings, an affidavit of denial shall be filed by the director and/or officer concerned

- Requirement for the president and external auditor of FCs to issue a certification that their company has neither solicited nor will solicit investments from the public without a license from the SEC

- Submission of long term lease contract covering the office building of an FC

- Dispensing with the requirement of publication of Notice and Order re: Application for Certificate of Authority to Operate as a Financing Company

- Consultation with insurance firms/associations relative to increased capital requirement

- Accreditation of external auditors through Circular Letter No. 1-2005

- Issuance of Cease and Desist Order for 5 Non-Life Insurance Companies

- Consortium on Compulsory Passenger Insurance Coverage Program on Maritime Industry, and Land Transportation Franchising Regulatory Board

- Public Liability Sectoral Reform

    1. CTPL–LTO – 3 year insurance coverage
    2. Custom Bonds
    3. Judicial Bonds
    4. Comprehensive General Liability Insurance

- Issued Circular on Catastrophe Peril Protection to monitor the minimum amount of catastrophe excess of loss reinsurance protection based on aggregate net exposures of insurance companies' portfolio

- Proposed enhancements from the Office of the Insurance Commission:

    - Investment Generation & Capital Market Development through increased minimum capital requirement

    - Government revenue generation from the industry

- Study pre-need and amend Insurance Code through grant funding for a comprehensive code study and set up technical working group with stakeholders
- Improve reinsurance security
- Centralize authentication certification for motor vehicles
- Leveraging information technology on communication system (inter-office, web, inter-agency) and document management

Other Significant Developments

Mergers/Consolidation/Acquisitions

- During the period in review, two mergers took place involving six rural banks while another consolidation involved two rural banks.

Fixed Income Exchange

- Launch of the first phase in the trading of securities under the Fixed Income Exchange (FIE) in end-March 2005; this phase involves an inter-dealer trading platform that offers government securities, with maturities ranging from one month to 25 years, for secondary trading through the bucket system.

- The second phase of the platform roll-out, which refers to public trading on the exchange that will allow retail investors to transact deals through their brokers, is set to start in the third quarter of 2005 pending the finalization of the rules and conventions that will cover public trades.

Financial Stability Forum

- Establishment of the Financial Stability Forum in July 2004 composed of the BSP, the Securities and Exchange Commission (SEC), the Office of the Insurance Commission (OIC) and the Philippine Deposit Insurance Corporation (PDIC). The Financial Stability Forum was established to provide an institutionalized framework for coordinating the supervision and regulation of the financial system, without prejudice to the respective mandates of the four government agencies.

Corporate Governance

- Issuance of the rules requiring the creation of three board committees, namely the Audit Committee, the Corporate Governance Committee and the Risk Management Committee.

- Approval of the BSP Rules of Procedure on Administrative Cases involving Directors and Officers of banks, quasi-banks and trust entities filed with or referred to BSP's Office of Special Investigation.

- Issuance of rules and regulations allowing concurrent or interlocking ownership with prior approval of the Monetary Board.

- Harmonization of existing governance standards

Payment System

- Implementation of the transmission of SWIFT MT 299 for withdrawals of rural banks and thrift banks for credits to commercial and government banks, which is intended to improve the network infrastructure of Philippine Payment and Settlement System (PhilPASS) by incorporating recent innovations in network technology.

Permissible Activities

- Approval of regulations allowing banks to sell, discount, assign or negotiate unregistered commercial paper to investment houses, insurance companies, finance companies, investment companies, pension or retirement plans maintained by the government or managed by a bank/other persons authorized by the BSP to engage in trust functions and to funds managed by another bank/other entities duly authorized to engage in the trust business.

- Issuance of rules and regulations allowing banks' Expanded Foreign Currency Deposit Units (EFCDs)/FCDUs to purchase foreign currency-denominated government securities under resale agreements from other banks' EFCDUs/FCDUs, non-resident financial institutions and offshore banking units.

- Approval of regulations allowing private banks/non-bank financial institutions duly accredited by the BSP to act as trustee on any mortgage or bond issued by any municipality, government-owned or controlled corporation or any body politic.

- Issuance of rules and regulations allowing the outsourcing of the following banking functions: legal services from a local legal counsel and the internal audit function.

- Approval of the use of investments in bonds and debt instruments (IBODI) holdings in securities lending and repurchase agreements by banks subject to certain conditions.

Anti-Money Laundering

- Removal of the Philippines from the list of Non-Cooperative Countries and Territories (NCCTs) during the meeting of the FATF on 11 February 2005.

- Approval of the policies and guidelines in determining a covered institution's compliance with the prescribed reporting requirements under the Anti-Money Laundering Act of 2001.

- Issuance of guidelines requiring officers and staff of foreign exchange dealers/money changers and remittance agents directly involved in foreign exchange operations to attend a seminar on the requirements of the anti-money laundering law prior to the issuance of their Certification of Registration by the BSP.

- Acceptance of the Anti-Money Laundering Council (AMLC) of the Philippines as one of seven new members of the Egmont Group, the global network of financial intelligence units (FIUs) against money laundering and terrorist financing. Membership to the Egmont Group means AMLC now has free and unlimited access to a wealth of financial data contained in the databases of all the FIU-members of the group. All information exchanged by FIUs is subjected to strict controls and safeguards to ensure it is used only in an authorized manner, consistent with national provisions on privacy and data protection.

- Issuance of the guidelines in the preparation of revised anti-money laundering operating manuals for covered institutions in light of the amendments of Republic Act 9160 (The Anti-Money Laundering Act of 2001) by Republic Act 9194

POLAND

Market Developments

The Polish economy grew by 5.3 % in 2004 which was the fastest growth during the past seven years (3.7% in 2003; 1.4% in 2002). The growth was a result of strong domestic spending and very good export results. The banking sector remains the largest segment of the Polish financial market. At the end of 2004 the bank share of total assets of the Polish financial system was 74.4 % (compared to 78% in 2003 and 94.5% in 1996).

The actual number of commercial banks operating in Poland is 57 (58 in 2003). There are also 596 co-operative banks and 3 branches of credit institutions (another 4 branches of credit institutions is about to start their activity). Altogether investors from 17 countries held stakes in the banking sector at the end of 2004. Their share in the capital of commercial banking sector was 68 %. The largest investors are: Germany, USA, Belgium, Holland and Ireland. Foreign investors control 41 commercial banks. In Poland, like in other CEE countries the proportion of banks controlled by foreign investors is much higher than in most "old" EU countries.

The Polish branch network consists of 8366 offices. The traditional bank offices (large branches with back office functions) are being currently replaced by small front office branches. The decline in the number of commercial bank personnel has been continuing since 1999 (1644 employees lost their jobs in 2004 comparing to 7443 in 2003). At the end of 2004 commercial banks had 122010 employees. From the financial point of view, 2004 was a better year than 2003. The standing of banks improved and the assets of the sector grew by 10 % (4.8% in 2003). The most important factor increasing demand for loans was the boom in the real estate market (there was a 20.7 % growth in property financing in 2004). The growth in assets was financed by deposits from banks and non-financial sector. The increase was caused by growth in corporate deposits as downward trend in household deposits continues.

The situation of cooperative banks differs from that of the commercial banks. Once again cooperative banks have enjoyed a faster growth of assets than the commercial banks. As a result the cooperative banks share of financial sector assets increased once again reaching a level of 5.3%, the highest since 1995. The reason for business developments were loans to the non-financial sector - mainly preferential ones for agriculture related projects as well as large increase in non financial sector deposits. The most important was the EU structural funds absorption process.

EU Developments Affecting Polish Financial Markets

Poland EU accession presents new challenges for the banking industry. The most important change is the single passport principle allowing credit institutions from other Member States to carry out business in Poland without any licensing requirements from the Polish Banking Supervision. Foreign supervisory authorities have sent to the Polish Banking Supervision Commission notifice that more than 70 credit institutions are to start cross-border activity in Poland.

As a result of significant changes during the past few years, banks operating in Poland have become modern institutions with stable capital, state-of-the art technology and a broad range of services. Nonetheless, cost effectiveness is lower than in 'old' EU countries and the diversification of the income structure is relatively small. The concentration of banking services in Poland is currently at the average European level. As the majority of banks is controlled by foreign investors, the further consolidation of the banking sector is likely to occur, especially as a result of mergers abroad.

PORTUGAL

There were no significant changes during the period under review to the legal framework regulating banking activity in Portugal.

The main issue has been the application of IAS / IFRS to banks. The banks' national supervisor decided to apply the new standards to the consolidated accounts of all banks, thereby extending the scope of EC Regulation 1606/2002 that is limited to listed corporations.

Banks not listed have been given a transitional period until the end of 2005, when they are required to publish their annual financial statements according to the new standards.

As far as individual accounts are concerned, the IAS / IFRS rules have been adopted with a few transitional adjustments, to take into account the prudential and fiscal impact of the new standards.

ROMANIA

Significant Developments in Banking

In the period under review, macroeconomic stability improved. Efforts by banks to consolidate their position in the domestic market have accelerated. These developments have resulted in unprecedented stability in the Romanian banking system.

The most important change in 2004 was the completion of the first two stages of privatization of Banca Comerciala Romana (BCR), the largest Romanian bank, which is now primarily owned by private investors. Licenses were granted to two banks that specialize in real estate lending and car financing (Raiffeisen Banca pentru Locuinte and Porsche Bank Romania). RoBank was acquired by OTP (a Hungarian bank). Anglo-Romanian Bank Limited re-entered the Romanian banking market, in July 2004, after it merged with the Frankfurt Bucharest Bank A.G. In October 2004, Anglo-Romanian Bank Limited took over the Bucharest branch of Banque Franco-Roumaine. Romania will privatize CEC completely by 2005-2006. The Government Program for 2001-2004 has proposed restructuring Banca de Export-Import a Romaniei, in line with 2004 changes to Law 96/2000 that are intended to promote foreign trade. This bank provides insurance and re-insurance for short-, medium- and long-term export loans.

The level of capitalization of banks has increased, resulting from an increase in market share of foreign owned banks and from the threshold requirement for banks to hold 370 billion ROL in capital by May 31, 2004. The structural changes in the banking sector in 2004 affected a number of banks in Romania. There were 40 credit institutions in December 2004; two were state owned, seven were Romanian private owned and 30 were foreign owned (including branches of foreign banks). Among these institutions is the co-operative organization CREDITCOOP that has 133 territorial units.

Harmonization of Romanian Banking Legislation with EU Legislation

During 2004-2005, the central bank continued its efforts to modify and amend the legal framework governing credit institutions. The central bank's objectives are to conform Romanian laws to certain changes in EU legislation related to banking services, and to create a secure, modern and competitive banking system. Keeping in view its anticipated accession to the European Union, Romania has harmonized provisions of its banking law (Law No. 58/1998 - Banking Act, subsequently amended and supplemented) with European Union Directives (such as Directives No. 12/2000). For example, Law No. 443/2004 (Monitorul Oficial al Romaniei No. 876/10 December 2004) modifies Law No. 58/1998 to comply with EU bank legislation. New Romanian laws and rules affecting banking include the following changes:

- Clarification of the rights and obligations of EU and non-EU credit institutions upon accession;
- Elimination of language and education requirements for managers of branches and subsidiaries of EU credit institutions;
- Provision for a minimum level of initial capital;
- Elimination of the requirement to assess market conditions as part of the application procedure for bank licenses;
- Implementation of the structure of Directive 2000/12/EC in Law no. 58/1998.

The revised Statute of the National Bank of Romania (Law No. 312/28.06.2004 on the Statute of the National Bank of Romania) was adopted in 2004. The law was published in Monitorul Oficial nr. 582/30.06.2004 and became effective on July 31, 2004. Certain articles of the statute became effective on January 1, 2005. By adopting Law No. 312/2004, Romania fulfilled its commitment to transpose into Romanian law the provisions of the Treaty establishing the European Community, the Statute of the European System of Central Banks and the Statute of the European Central Bank.

Further progress has been made in harmonizing Romanian banking legislation with EU legislation. Rules on banking supervision now generally comply with core Basel principles. Secondary legislation, proposed by the National Bank of Romania, has been adopted. NBR Norms No 9/20.08.2004 amend NBR Norms No. 12/2003 on solvency and large exposures of credit institutions (Monitorul Oficial nr.786/26.08.2004), and transpose into Romanian law Principle 10 of the core Basel principles, regarding exposures to persons affiliated with the credit institutions, as well as exposures towards employees and their families.

Another transposition is effected by NBR Rule No. 10/2004 on the licensing of banks, electronic money institutions other than banks, savings banks and banks specializing in home loans, as well as branches of foreign credit institutions in Romania (Monitorul Oficial nr. 945/15.10.2004). The new rule establishes requirements for registered offices of credit institutions and introduces supervision procedures to be followed by competent authorities in evaluating individuals associated with the credit institution as officers and owners. New rules also specify the laws that will be overruled upon accession of Romania to the EU. They provide for new regulations related to licensed credit institutions supervised by authorities in their state of incorporation.

NBR Norms No.11/01.11.2004 on banks, electronic money institutions other than banks, depository banks, banks specializing in home loans and branches of foreign credit institutions (Monitorul Oficial nr.1099/25.11.2004) and NBR Norms No. 10/2004, implement a qualitative approach to licensing. Each applicant will be evaluated individually. A similar process will apply to applications for a change in status of credit institutions. The new rules call for feasibility studies to be conducted before new rules are implemented. They remove the requirements for approval of certain changes in status of credit institutions, including change of headquarters, reduction of operations, increase or reduction in share capital, changes regarding significant shareholders, etc. The new rules require foreign credit institutions to notify Romanian authorities of any change regarding significant shareholders, mergers and divestitures involving a credit institution and of steps taken that may result in liquidation. Law 58/1998 stipulates that secondary headquarters in Romania of a foreign credit institution shall be considered a single branch.

NBR Norms No. 14/2004 amending and supplementing NBR Norms No.4/2001 on supervision of foreign exchange positions require banks to adjust their foreign exchange positions to the equivalent in domestic currency of their paid-up subscribed share capital in foreign currency. NBR Norm No. 15/2004 on supervision of credit institutions on a consolidated basis sets forth a single set of rules for supervision of credit institutions and Romanian entities that are subject to supervision. The rules define the scope and method of consolidation, and reporting requirements. NBR Norm No. 5/2004 on capital requirements for credit institutions implements Directive 93/6/EEC, as amended by Directive 98/31/EC and Directive 98/33/EC on capital requirements of investment firms and credit institutions. By implementing the provisions of the Directive, the rules attempt to comply with international standards. Provisions on capital requirements have become relevant in light of Romania's involvement in transaction portfolios. The rules were amended by NBR Circular No.30/2004 and NBR Circular No.17/2005, which introduced a trial period that will last from the date the rules become effective in September 30, 2005. With Law No. 58/1998 on banking activity, as amended, and NBR Norms No. 10/2004 on licensing of banks, electronic money institutions other than banks, savings banks for housing and branches of foreign credit institutions, the NBR issued a bank license to Porsche Bank Romania SA, a credit institution specialized in car financing. In April 2005, the NBR issued a license to a second savings bank for housing HVB Banca pentru Locuinte SA, besides Raiffeisen Banca pentru Locuinte SA.

Law No. 122/19.04.2004, amending the Government Emergency Ordinance No. 97/2000 on credit co-operative organizations, will become effective in June 2005. This rule will permit the issuance of bank licenses to credit co-operative networks that had not been granted licenses in 2003 (Aurora Romana, Creditul Romanesc and Concordia Romana). Credit co-operatives which fail to apply for a license within the stipulated timeframe, and credit-cooperatives that are refused a license will be wound up and liquidated. The licensing process will be finalized in December 2005 after which appeals against NBR decisions may occur.

The framework for credit co-operatives was amended. In order to facilitate the licensing process of credit co-operatives stipulated in the Law No 122/2004, the NBR implemented Norm no.7/2004 on licensing credit co-operatives and credit co-operative organizations (published in Monitorul Oficial nr. 797/30.08.2004). NBR issued Norm No. 8/10.08.2004 amending and supplementing NBR Norm no.13/2002 on the minimum capital requirement for credit co-operatives and minimum aggregated capital of credit co-operative networks (Monitorul Oficial nr. 747/17.08.2004), to transpose Directive 2000/12/EC related to investments by credit institutions. The rules intend to insure a gradual increase, by June 30, 2006, of the capital requirement to the ROL equivalent of EUR 5,000,000 for the headquarters of a credit co-operative network, and to the minimum capital requirement of EUR 10 million for an entire credit co-operative network. The process of harmonizing the regulatory framework for banks and other credit institutions in Romania continued over the reference period. Most regulations issued are applicable to credit institutions.

Romania experienced a period of progress resulting in an increased confidence in the banking system. Progress was fuelled by restructuring of the banking sector, diversification of financial products, increased purchasing power in Romania, and the stabilization of the Romanian economy.

Accounting rules applicable to Romanian credit institutions are set forth in accounting regulations which implement Directive No. 86/635/EEC and the International Accounting Standards (Joint Order No.1982/5/2001, updated). In order to provide a framework for applying the accounting rules, a commission was established in 2003 to analyze problems in the application of the present accounting regulations and in the IFRS. The commission includes representatives of credit institutions, audit firms and officials from the Ministry of Public Finance and the NBR. The commission has issued draft accounting guides, which address International Accounting Standards applicable to credit institutions (IAS 21, IAS 32, IAS 37, and IAS 39). These drafts will implement the latest principles incorporated into the IFRS.

The NBR has taken several initiatives aimed at improving the payment systems to ensure financial stability and conform Romanian law to EU directives relating to the implementation of the electronic payment system, The NBR has modernized the Romanian payments infrastructure, and has implemented the regulatory framework for the operation of the new payment system. The NBR intends to harmonize the Romanian payment system with the European payment standards set up by the European Central Bank and the Bank for International Settlements and to ensure the necessary framework to allow the central bank to fulfill its task of promoting the smooth functioning of payment systems. The NBR finalized on March 14, 2005 the implementation of an electronic payment system. The present electronic payment system consists of 3 components: a real time gross settlement system (ReGIS), an automated clearing house (SENT) and a securities registration and settlement system (SaFIR). The implementation of the new payment system will facilitate the supervision of payment systems by the NBR and further develop the Romanian banking system by increasing payments flows, and reducing the settlement lag for interbank payments.

The first two components, the real time gross settlement system (ReGIS) and the automated clearing house (SENT), respectively, were successfully implemented on April 8, 2005 and May 13, 2005. The last component of the electronic payment system, SaFIR, will become operational after the adjustments to the national currency. The design and functional requirements for these systems have been set up taking into consideration: (i) the existing general policy of the European Union in the field of payment and securities settlement systems, (ii) the essential principles of the interbank payment and settlement activity, and (iii) the standards and recommendations set up in this field by the European Central Bank, the Bank for International Settlements and other international institutions and organizations acting in this field. As a result, the NBR has created the necessary conditions for development of an infrastructure similar to those of other European payment systems to allow the Romanian payment system to be in line with the European requirements in this field. The Romanian real time gross settlement system (ReGIS) is designed so that when Romania joins the European Economic and Monetary Union, it will be connected with the European settlement system for large value Euro payments via TARGET as well as the conversion of the national currency into Euro. The implementation of ReGIS system also increases the capacity of the central bank to implement its monetary policy by creating a framework for the development of the financial markets and for improving the risk management system.

In order to ensure an adequate regulatory framework for the development of the electronic payment system, the NBR has issued, among others, the following regulations:

- Norm No. 1/19 January 2005 sets forth a single procedure for specifications in the payment orders used in the ReGIS system and in the Automated Clearing House (Monitorul Oficial al României No. 75/21 January 2005).

- Norm No. 16/20 December 2004 sets forth the criteria for assessing the alternative techniques for guaranteeing the authenticity of signatures, having the same legal effects as the holograph signatures (Art. 23 para. 1 of Law No. 58/1998 on banking activity). It also states a procedure to obtain NBR approval for use of such techniques by credit institutions (Monitorul Oficial al României No. 1259/27 December 2004).

- Regulation No. 1/23 February 2005 governs the payment systems and ensures the clearing of funds. It focuses on the following: (a) licensing by the NBR of the payment systems that facilitate funds clearing; (b) the procedure of settlement risk management by the NBR for the payment systems unless there exist incumbent procedures for risk management imposed by the system administrator and approved by the NBR (Monitorul Oficial al României No. 265/31 March 2005).

- Regulation No. 2/23 February 2005 regulates payment orders used in credit-transfer operations. It applies to payment orders for domestic currency payments completed in Romania, except for payment orders for payments completed based on credit-transfer instructions between the operational units of State Treasury, payment orders processed in compliance with Regulation No. 10/1994 issued by the NBR, as republished, with subsequent amendments and supplements, and payment orders processed in compliance with Regulation No. 1/2003 issued by the NBR (Monitorul Oficial al României No. 265/31 March 2005).

- Regulation No. 3/23 February 2005 regulates direct debits via the Automated Clearing House. It refers to the manner of executing a direct debit instruction issued/initiated by a beneficiary through the payee's bank and drawn on the payor's bank account opened with the payor's bank (Monitorul Oficial al României No. 267/31 March 2005).

During 2004-2005, the NBR continued to meet its obligations completing the liberalization of foreign exchange operations prior to the date of accession to the EU. Bearing that in mind, commencing April 11, 2005 operations in deposit accounts opened by non-residents with credit institutions in Romania in domestic currency are not subject to NBR authorization. Postponement by one year of the scheduled liberalization of operations was mainly due to the long wait for results of impact studies on the Romanian foreign exchange and money market. These impact studies revealed that the high differential between internal and external interest rates could generate significant speculative inflows, with implications difficult to control.

With a view to restructuring the foreign exchange process, regulations issued by NBR incorporated the objectives of the new rules on foreign exchange. Subsequently, a new regulation on foreign exchange and specific implementing rules were proposed, and became effective on April 11, 2005. The key points of this new regulatory framework are:

- Capital accounts should be liberalized by September 1, 2006, according to an EU mandate. The operations left to be liberalized within this term are: (i) operations in financial instruments normally exchanged on money markets; (ii) residents' access to current and deposit accounts opened abroad with credit institutions and other entities;

- Establishing the protective measures which NBR is entitled to adopt, as a consequence of liberalizing the non-residents' access to deposit accounts in national currency (ROL) opened with credit institutions in Romania;

- Extending the use of foreign exchange between residents, in operations which are not related to trade in goods and services;

- Creating a more simplified and flexible framework for carrying on foreign exchange operations and eliminating certain burdensome administrative requirements;

- o Extending the scope of the foreign exchange rules to transactions performed by those entities which are governed by special legal provisions;
- o Eliminating foreign exchange bureaus, organized under Law no. 31/1990 on commercial companies; under the new provisions they can perform other secondary activities;
- o Harmonizing the definition of cash payment instruments with provisions of the Regulation Project of the European Parliament and of the Council on controls of cash entering or leaving the EU.

One of the commitments agreed upon with the EU is the implementation in Romania of Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate, and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC. In order to fulfill this commitment, a committee was set up in 2004 by the Ministry of Public Finance. Its responsibility is to contribute to the transposition and implementation of Directive 2002/87/EC, with the assistance of authorities in the financial sector. The NBR also aims at transposing and implementing EU directives that refer to the provisions of the New Capital Agreement (Directive 2000/12/EC on investment by credit institutions and Directive 93/6/EC on the capital adequacy of investment companies and credit institutions, as amended). For the NBR, the transposition and implementation of the new capital requirements is a key objective and, beginning 2004, measures have been taken to draft the strategy for implementing the new capital requirements for credit institutions.

Presently, NBR's efforts focus on the following:

- o Assessment of the adequacy of certain prudential approaches to the Romanian banking environment, as well as the proposed implementation strategy;
- o Changes to the regulatory framework, in order to transpose the new capital requirements;
- o Adoption of the required rules on prudential supervision of credit institutions, following the adoption of the new capital requirements.

In line with the NBR's concern to strengthen its institutional and administrative capacity, the NBR's Board decided in October 2004 to create a Department on Financial Stability to deal with the increased complexity of the Romanian banking system and to encourage the central bank to keep in view macro-prudential aspects. The Department of Financial Stability will foster the stability of the Romanian financial system by identifying its vulnerabilities and proposing policies for preventing or reducing disruptions in the internal financial markets. At the same time, this department will be in contact with other national authorities involved in financial stability to ensure coordination of the central bank with these entities. Another task of this department is coordinating the implementation of a system of financial stability ratios as mandated by IMF to enable various countries to devise global matrices/yardsticks to assist the supervision of their national financial systems.

SINGAPORE

Organization and Responsibility of the Monetary Authority of Singapore

Objective and Principle of Supervision

In May 2004, the Monetary Authority of Singapore ("MAS") issued a monograph entitled "MAS Roles and Responsibilities in Relation to Securities Clearing and Settlement Systems in Singapore." This monograph provides an overview of the roles and responsibilities of MAS in relation to securities clearing and settlement systems in Singapore. It complements the MAS monograph "Objectives and Principles of Financial Supervision in Singapore" issued in April 2004 by providing more detailed information on some of MAS' activities relevant to achieving its supervisory objective of a safe and efficient financial infrastructure.

Powers and Functions of MAS

The first phase of a two-phase initiative to amend the Monetary Authority of Singapore Act (Cap 186), which sets out the powers and functions of the MAS, became effective on January 1, 2004. The second phase is underway and will include changes after more extensive reviews have been carried out. These changes will enable MAS to carry out its functions more effectively and to meet the operational challenges ahead.

Developments in Regulation and Supervision of Banks

Amendments to MAS Notice 625 on Compliance with Sections 31 and 33 of the Banking Act on a Consolidated Basis

The notice has been revised to extend its scope to include investments of associated companies to measure group compliance with the equity and property investment limits under Section 31 and 33 of the Banking Act, respectively.

Amendments to MAS Notice 637 on Risk Based Capital Adequacy Requirements

The amendments require a bank incorporated in Singapore to reverse the effect of fair value gains or losses in its capital computation if they result from the revaluation of certain classes of financial assets or financial liabilities required under new Financial Reporting Standard 39 on Recognition and Measurement of Financial Instruments. These adjustments, consistent with the recommendations of the Basel Committee on Banking Supervision, relate to the exclusion of those items from disclosed reserves that are included in Tier 1 capital. In addition, the amendments provide for exceptions whereby a Singapore-incorporated bank need not deduct goodwill and intangible assets not attributable to direct subsidiaries and associated companies from its Tier 1 Capital at the Solo level when certain conditions are met.

Basel II Framework: Internal Ratings-Based (IRB) Approach

In preparation for the implementation of Basel II, MAS has issued a set of guidelines for the adoption of IRB. The guidelines describe the process by which a Singapore-incorporated bank may apply to MAS for supervisory permission to adopt IRB, and the parameters within which a bank is to execute the IRB rollout.

Facilitating the Implementation of FRS 39

As of January 1, 2005, banks in Singapore have been required, under the Companies Act, to comply with the requirements of Financial Reporting Standard (FRS) 39 on the recognition and measurement of financial instruments. To help banks implement FRS 39 for financial reporting purposes, MAS has revised its regulations to provide supervisory guidance on provisioning requirements for loan impairment by banks. MAS has also taken steps to align its regulatory reporting requirements, where appropriate, with FRS 39 requirements.

Consultation Paper on Draft Deposit Insurance Bill

Following the conclusion of two consultation exercises on the Deposit Insurance (DI) Scheme, MAS issued a consultation paper on the draft DI Bill which will establish the DI scheme in Singapore to provide an explicit but limited guarantee to insured depositors in the event of a failure of a bank or finance company. Compensation under the DI scheme will be limited to S$20,000 per depositor per institution. Under the draft Bill, MAS is empowered to prescribe through Regulations certain requirements on the more detailed aspects of the DI scheme. These Regulations will describe the asset maintenance scheme for foreign banks in relation to DI and premium contributions payable by member institutions. In addition, the DI agency may issue rules relating to the operation of the DI scheme.

Consultation Paper on Draft Payment Systems (Oversight) Bill

On December 23, 2004, MAS released a consultation paper on the draft Payment Systems (Oversight) Bill. The draft Bill provides a uniform basis for MAS' oversight of payment systems and stored value facilities ("SVFs") in Singapore. It focuses on payment systems that are considered important in terms of stability of the financial system and public confidence. It also sets out MAS' new policy for SVFs, which allows any entity to hold the stored value in respect of a multi-purpose SVF ("MPSVF") as long as the stored value remains below the amount stated in the Bill. The draft Bill provides MAS with information gathering powers over all payment systems and SVFs and regulatory powers over designated payment systems and widely accepted MPSVFs (where the stored value exceeds the amount stated in the Bill).

Consultation Paper on Securitization

In April 2005, the MAS released a consultation paper to revise MAS 628 on Securitization and make consequential changes to MAS 637 on Risk-Based Capital Adequacy Requirements for Banks Incorporated in Singapore.

The key proposed changes are:

- Expansion of definitions associated with securitization consistent with the forthcoming provisions implementing Basel II;

- Change in the regulatory reporting procedure from a prior approval regime to an ex-post notification regime;

- Re-organization of separation and disclosure requirements for clarity;
- Distinction between legal requirements and best practice guidelines;
- Introduction of new capital requirements on Singapore-incorporated banks aligned with key elements of the Standardized Approach under the Basel II's securitization framework.

Developments in Regulation and Supervision of Capital Market Services and Financial Advisory Services (Banks, Securities Firms, Insurance Firms, Fund Managers and Other Non-Bank Financial Institutions providing such services)

Implementation of the Securities and Futures (Amendment) Act 2005 (SF(A)A) and Financial Advisers (Amendment) Act 2005 (FA(A)A)

On June 14, 2005, MAS issued subsidiary legislation and Guidelines to implement amendments to the SF(A)A and the FA(A)A, which were passed by Parliament on January 25, 2005. The amendments to the Acts and the subsidiary legislation became effective on July 1, 2005. The amendments relating to Part XIII of the Securities and Futures Act (SFA) on Offers of Investments will be implemented in the third quarter of 2005.

The SF(A)A introduces amendments to rules on capital raising, the provision of markets and clearing facilities and the conduct of intermediaries. The FA(A)A seeks to maintain high standards that promote fair dealing by financial advisers with customers. MAS had earlier consulted the industry on the SF(A)A and FA(A)A and the subsidiary legislation.

Implementation of Guidelines on Fit and Proper Criteria

MAS issued Guidelines on Fit and Proper Criteria, which became effective on July 1, 2005. These guidelines set out the "fit and proper" criteria applicable to all participants, including holders of capital market services licenses, financial advisers and insurance brokers, as well as exempt persons who carry out regulated activity under the Securities and Futures Act, the Financial Advisers Act and Insurance Act.

In considering whether a person is fit and proper, MAS will take into account the following criteria:

(a) Honesty, integrity and reputation;

(b) Competence and capability;

(c) Financial soundness.

The guidelines provide general guidance on how MAS would apply these criteria. It is the applicant's responsibility to prove that he meets these fit and proper criteria. Should the applicant fail to do so, MAS may refuse the application, revoke the person's authorization or exemption or take other regulatory actions.

Information Paper on Good Practices for Licensed Financial Advisors (FAs) and Exempt FAs

On November 17, 2004, MAS issued an information paper to highlight the good practices observed in the course of its supervision of FAs. This is to assist FAs in enhancing their advisory and sales process, and the competency level of their representatives, as well as the complaint handling and compliance functions.

Guidelines on Structured Deposits

On October 7, 2004, MAS issued several related measures to raise standards of market conduct in the advisory and sales process for structured deposits. The measures include a set of Guidelines on Structured Deposits under the Financial Adviser's Act ("FAA"). These Guidelines require banks to ensure that all marketing materials on such products disclose key information in a clear and adequate manner, and do not include statements that are false or misleading. In addition, bank representatives selling these products should be qualified and have a reasonable basis for making recommendations. Adequate steps should be taken to segregate the sales process for such investment products from other deposits so that consumers will not be misled into thinking that structured deposits have similar risk return profiles as traditional fixed deposits.

Guidelines on Switching

On October 26, 2004, MAS issued Guidelines on Switching of Designated Investment Products ("Guidelines"). The Guidelines aim to provide guidance to financial advisers on the controls, processes and procedures, which MAS expects them to implement for monitoring and deterring undesirable switching activities. They include disclosure requirements to ensure that consumers are fully informed of the costs and implications of switching. The Guidelines recommend that financial advisers structure remuneration packages that reward representatives who provide professional advice to consumers. MAS considers that any remuneration structure based solely on sales volume may encourage product promotion and undesirable switching.

Amendments to the Code on Collective Investment Scheme (CIS)

On March 21, 2005, MAS issued the revised CIS Code which includes, among other items, a requirement for trustees to submit to MAS certain statements to ensure the proper termination of a fund. It also incorporates enhanced reporting requirements for authorized hedge funds for periods ending on or after July 1, 2005. The code was revised on June 6, 2005 to facilitate the offer of Undertakings for Collective Investment in Transferable Securities (UCITS) III schemes in Singapore. The CIS Code provides guidance on disclosure in marketing materials and requires ongoing notification to MAS when the home regulator of a recognized UCITS III scheme or an underlying UCITS III scheme which an authorized scheme feeds into, imposes or varies any condition or restriction in relation to its authorization.

Securities and Futures Notice on Minimum Entry and Examination Requirements

In April 2005, MAS revised the Notice on Minimum Entry and Examination Requirements. The Notice sets out the minimum entry requirements for individuals applying for a representative's license under the Act, or employed by or acting for an exempt financial institution (FI) with respect to any of the regulated activities under the Act, application of the Capital Markets and Financial Advisory Services Examination ("CMFAS Exam") requirements to individuals intending to conduct regulated activities under the Act, circumstances under which the CMFAS Exam requirements do not apply, obligations of capital market services (CMS) license holders and Exempt FIs, and continuing education requirements for representatives of CMS license holders and Exempt FIs. The main changes include revision of the admission requirements for representatives, reorganization of the module on rules and regulations for dealing in securities and introduction of examination requirements for representatives who conduct leveraged foreign exchange trading for a holder of a Capital Markets Services license.

MAS Implements New Risk-Based Capital Framework for Insurers in Singapore

On August 23, 2004, MAS introduced a new risk-based capital ("RBC") framework for insurers in Singapore. The RBC framework institutes more transparent and risk-focused capital and valuation basis that reflects all major financial risks of insurers. The framework, which was formulated in close consultation with insurance practitioners and representatives from the actuarial and accounting professions, takes into account emerging international standards and good practices in developed countries. The shift from a one-size-fits-all approach will encourage insurance companies in Singapore to manage their financial risk more actively and to raise overall prudential standards.

Changes to Financial and Margin Requirements for Holders of Capital Market Services Licenses

On June 14, 2005, MAS issued The Securities and Futures (Financial and Margin Requirements For Holders of Capital Markets Services Licenses)(Amendment) Regulations 2005, which became effective on July 1, 2005.

The key changes relate to business limits and risk requirements for securities financing activities:

- Replace the Liquidation Method with the Collateral Method for computing Counterparty Risk Requirement (CRR).
- Compute business limits using current Free Financial Resources ("FFR") instead of a historically-based average FFR.
- Replace the 5% single security limit with concentration thresholds to offer greater flexibility for licensees to accept collateral for their securities financing business.
- Introduce a new method for computing the additional capital charges where collateral exceeds the prescribed concentration thresholds.

The Regulations also provide clarifications on the definition of aggregate indebtedness and base capital. In addition, going forward, provision of financial statements and accounts through electronic means will be a regulatory requirement. This is to automate the submission process using the MAS Network ("MASNET").

Business Trust Act ("BTA")

The Business Trust Act ("BTA") was passed in Parliament on September 1, 2004 and became effective on October 12, 2004. The Act implements a regulatory framework for the governance of business trusts with the following objectives:

- To safeguard the rights of investors (or unitholders in the business trust); and
- To establish the duties and accountability of the trustee-manager of a business trust and its directors.

Offers of units in business trusts are regulated under the Securities and Futures Act, which was amended at the same time. The Business Trusts Regulations and the Securities and Futures (Offers of Investment) (Business Trusts) Regulations were subsequently issued on January 6, 2005. In addition, the Business Trusts (Summary Financial Statement) Regulations set forth the circumstances and conditions under which summary financial statements of listed registered business trusts may be sent to unitholders.

Consultation Paper on Draft Regulations for Traded Endowment Policies and Traded Life Policies

On June 13, 2005, MAS issued a set of draft regulations that prescribe traded endowment and life policies ("TEPs/TLPs") as investment products under the Financial Advisers Act and set forth the restrictions that will apply to any distributor of TEPs/TLPs. This follows an earlier policy consultation on MAS' proposed approach to regulate the distribution of the products in November 2003.

Consultation Paper on Review of Participating Fund Business for Life Insurers

A Par Fund Review Workgroup, comprising representatives from the life insurance industry, the Singapore Actuarial Society and the MAS, was formed to review the operations of participating fund business in Singapore and to recommend measures to address any inadequacy. The findings and recommendations of the workgroup are detailed in the consultation paper issued on February 22, 2005. The key recommendations include requiring every insurer to have in place a clearly defined and well-documented, board-approved internal policy on participating fund management, enhancing disclosure to participating policyholders both at the point-of-sale, and on a regular basis after sale, as well as providing adequate training to the financial advisers on the new measures.

Consultation Paper on Review of the Regulatory Regime Governing REITs

Presently, a REIT is regulated as a collective investment scheme under the Securities and Futures Act, Chapter 289 (the "SFA"). It is also subject to the rules in the Property Fund Guidelines (the "Fund Guidelines") under the Code on Collective Investment Schemes. The MAS proposed tightening the regulatory landscape for this form of investment. Accordingly, on June 10, 2005, MAS issued a consultation paper which, among other things, proposes measures to align the interests of investors and REIT managers, raises the requirements that apply to related party transactions and also raises the bar in relation to disclosure requirements. These were proposed with the view to maintaining investors' confidence in the evolving REIT market.

Consultation on Financial Industry Disputes Resolution Center

On October 28, 2004, MAS published a consultation paper on the establishment of a Financial Industry Disputes Resolution Center ("FIDReC"). FIDReC will provide consumers with an independent and affordable avenue for resolving retail disputes with financial institutions in the banking, insurance and capital markets sectors. There are currently dispute resolution mechanisms for the banking and insurance sectors, namely the Consumer Mediation Unit (CMU) and Insurance Disputes Resolution Organization (IDRO), respectively, but there is no formal mechanism for the capital markets sector. This gap will be addressed by the creation of FIDReC. FIDReC was incorporated in February 2005 and will be launched by the end of 2005. Once it is operational, CMU and IDRO will be dissolved and all existing cases transferred to FIDReC.

Disclosure Requirements, Requirements for Listing on Exchanges and Exchange Trading Requirements

Singapore Exchange Ltd announced changes to Chapter 11 of its derivatives trading rules which became effective on August 9, 2004, following a public consultation in June 2004 on the proposed amendments. The amendments aim to combine all electronic trading rules for the SGX derivatives market into one chapter, making it a "one-stop" reference.

SGX also enhanced its listing rules and procedures in order to raise corporate governance standards and promote good regulatory practices. This was part of an annual review of SGX's regulatory framework and procedures. In this regard, a Public Consultation Paper was issued on May 30, 2005 to seek public feedback on proposals for specific rule changes. The proposed amendments to the listing rules are focused on two key areas – enhancing corporate governance and extending the role of intermediaries.

SGX has amended SGX-ST Rule 13.4 on customer order priority on July 1, 2005. With the changes, it is no longer required for Trading Members or Trading Representatives to withdraw an unexecuted order from the trading system if they receive a subsequent customer order on the same terms. In substitution, a list of factors which SGX will look into for compliance with Rule 13.4 has been set forth in a Practice Note. This is in line with practices of other global exchanges. Knowledge of client orders and Trading Representatives (TR) intention are key factors for consideration. This is a positive development for the industry as it removes the onerous requirements of TR having to constantly monitor unmatched orders when there is no intention to front-run.

Developments in Anti-Money Laundering Legislation

Consultation Paper on Draft Notice on Prevention of Money Laundering (AML) and Countering the Financing of Terrorism (CFT)

MAS began in 2004 a process of reviewing and revising Notice 626 on Prevention of Money Laundering, to ensure that the AML/CFT regime for Singapore's financial sector incorporates the prevailing international standards. MAS released for public consultation, a draft of the revised MAS Notice 626 in January 2005.

Key changes are as follows:

- The Notice was expanded to cover terrorist financing as well as money laundering.
- There is a more exhaustive regime of customer due diligence (CDD) measures that banks are required to perform. The timing for completion of CDD measures and the consequential steps to be taken should CDD measures not be satisfactorily performed are set more comprehensively.
- The new AML/CFT regime incorporates an element of risk sensitivity. In particular, banks are required to have in place measures to deal with politically exposed persons.
- There is also a proposal to implement the Financial Action Task Force's special recommendation on wire transfers.

Treatment of Non-Domestic Financial Institutions, Including Access to the Singapore Market, Powers Granted Them Under Host Country Law, and their Regulation and Supervision by Host Country Authorities

MAS Signs Memoranda of Understanding (MOU) with the China Banking Regulatory Commission (CBRC) and China Insurance Regulatory Commission (CIRC)

MAS signed an MOU with CBRC on May 14, 2004. The MOU aims to strengthen cooperation between the two regulatory authorities, including cooperation in training and staff exchange programs and the sharing of information on developments affecting their banking systems.

On May 23, 2005, MAS signed an MOU with CIRC. MAS and CIRC first signed an MOU in 1999 to facilitate cooperation in training and exchange programs. The new MOU expands the scope of co-operation to sharing supervisory information on Singapore and Chinese insurers operating in either market so as to strengthen the supervision of the insurers' cross-border operations. MAS is currently negotiating MOUs with other regulators on cooperation in insurance-sector supervision.

Singapore Signs Free Trade Agreement with India

The India-Singapore Comprehensive Economic Cooperation Agreement (CECA) was signed on June 29, 2005 and became effective on August 1,2005. Under CECA, Indian banks that satisfy Singapore's admission criteria will be given Wholesale Bank licenses and up to three bank licenses with Qualifying Full Bank privileges.

Other Significant Market Developments

Practical Application of Basel II Framework

On July 5 and 6, 2004, MAS in its capacity as Chair of the Executives' Meeting of East Asia and Pacific Central Banks ("EMEAP") Working Group on Banking Supervision, and the Financial Stability Institute ("FSI") jointly hosted a meeting on the Practical Application of Basel II. .

The meeting provided a platform for members of the G10 central banks and supervisory authorities to share key features of the recently approved Basel II framework with Asian central banks and supervisors. It gave the central bankers and regulators the opportunity to discuss the implementation of Basel II in their respective jurisdictions. The final version of the new Basel II framework was released by the G10 central banks and supervisory authorities on June 26, 2004. The EMEAP Working Group on Banking Supervision will continue its efforts to assist EMEAP members in implementing the Basel II framework in Asia. Asian central banks and supervisors will contribute to the utilization of the new Basel II framework internationally.

MAS Financial Stability Review

On December 31, 2004, MAS released a new semi-annual publication, the Financial Stability Review ("FSR"). The FSR analyzes the risks and vulnerabilities arising from developments in Singapore and the global economy and their implications for the soundness and stability of the financial system. Specifically, it assesses the health of the financial and non-financial sectors and their ability to withstand potential macroeconomic and financial shocks. The FSR aims at contributing to a greater understanding among market participants, analysts and the public of issues affecting Singapore's financial system.

Singapore Announces Measures to Enhance Competitiveness of Financial Sector

On February 18, 2005, Prime Minister and Minister for Finance Lee Hsien Loong unveiled several measures in his annual budget speech to enhance Singapore's competitiveness as an international financial centre. These measures related to the finance and treasury activities sector, wealth management sector and capital markets sector. The measures aim at enhancing Singapore's position as a regional headquarters for corporate financial treasury activities, strengthen Singapore's position as Asia's premier wealth management center and develop greater depth and breadth in Singapore's capital markets.

Revisions to the Code of Corporate Governance The Council on Corporate Disclosure and Governance ("CCDG") had set up a Review Committee comprising members and non-members of the CCDG to embark on a review of the existing Code of Corporate Governance ("Code") for listed companies. The review is intended to introduce improvements to the Code, taking into account feedback received since the inception of the Code and international developments in corporate governance.

A public consultation on the proposed revisions to the Code was conducted from December 1, 2004 to February 15, 2005.

The Review Committee has since completed its review and submitted its preliminary recommendations to the CCDG. The CCDG will consider the Code revisions proposed by the Review Committee and present its final recommendations to the Ministry of Finance.

Important Legislative or Other Changes Expected to Occur after June 2005

Companies' (Amendment) Act 2005

The Companies (Amendment) Act 2005 (Act 21 of 2005) was passed in Parliament on May 16, 2005 and published on June 6, 2005, but has yet to become effective. Key amendments will include abolishing the concepts of "par value" and "authorized capital", introducing an alternative capital reduction process which does not require court sanction, liberalizing the financial assistance restrictions, allowing share-buybacks to be funded out of profits as well as capital so long as the company is solvent, permitting repurchased shares to be held as treasury shares and introducing a more effective and efficient statutory form of merger and amalgamation process.

Draft Guidelines on Competition Act 2004

On May 26, 2005, the Competition Commission of Singapore (CCS) released a second set of four draft guidelines on the Competition Act for public consultation. This set of guidelines deals with how the CCS will investigate and enforce infringements of the Section 34 and/or 47 prohibitions, CCS's leniency program for 'whistleblower' cartel members and the procedure for obtaining guidance or decision from the CCS with respect to particular agreements and conduct. According to the CCS's public consultation paper which accompanies the release of the second set of draft guidelines, the provisions relating to these guidelines will come into force on January 1, 2006.

Trust Companies Bill 2005

In July 2004, MAS released a consultation paper on establishing a new regulatory framework for trust companies. Under the new framework, MAS will regulate trust companies in Singapore. Licensing will become mandatory for trust companies. However, there will be limited exemptions from licensing for certain entities and persons. The new framework will increase legal clarity and guidance for trust companies in Singapore. It will also ensure high standards of business conduct, professionalism and competence in the trust services industry in Singapore.

The Trust Companies Bill 2005 was subsequently passed by the Parliament on February 18, 2005 to introduce these changes. Key measures under the new regulatory framework include mandatory licensing, the requirement for resident managers, seeking MAS approval for Directors, Managers and significant shareholders, financial soundness requirements, supervisory powers MAS has over trust companies, anti-money laundering and countering the financing of terrorism requirements and MAS powers to change systems and processes. The new regulatory framework will become effective shortly after the regulations are published in late 2005.

Brief Discussion of Singapore's Approach to Funding the Activities of Banking Regulators

Bank regulation and supervision activities are financed from banks' license fees and income from the MAS' other operations. The MAS is self-financing and sets its own budget, which is approved by the President.

SPAIN

The Spanish financial system is undergoing intense reform which is partially as a result of purely internal circumstances (the need to modernize the operation of the financial markets to make them more efficient and thereby increase the competitiveness of these markets and of the operators working in them) and partially due to the need to adapt Spanish law to the new regulations passed by the European Union.

The starting point for this reform process is in the passing of Act 44/2002, of 22nd November, on the Financial System Reform Measures. There were three objectives of the said Act as explained in its Statement of Purpose:

a) To ensure that the Spanish legal system did not impose unnecessary impediments that would put the financial institutions to a disadvantage vis-à-vis their European counterparts.
b) To ensure that the increase in the competition and the use of new technologies did not leave the clients of financial services with a lack of protection.
c) To facilitate the channelling of the savings towards the real economy facilitating the financing conditions of small and medium sized companies.

Apart from these objectives, the Act transposed into the Spanish legal system various European Directives relating to insurance against civil liability in respect of the use of motor vehicles, exchange of information with third countries, the taking up, pursuit of and prudential supervision of the business of electronic money institutions and relating to the taking up and pursuit of the business of credit institutions.

To do so the Act modified Act 24/1988, of 28th July, on the Stock Market; Act 13/1994, of 1st June, on the Autonomy of the Bank of Spain; Act 31/1985, of 2nd August, Regulating the Basic Rules on Governing Bodies of the Savings Banks; Act 30/1985, of 8th November, on the Regulation and Supervision of Private Insurance; Act 50/1980, of 8th October, on Insurance Contracts; Act 13/1985, of 25th May, on Investment Coefficients, Equity Capital and Information Obligations of the Financial Intermediaries; Act 46/1984, of 26th December, Regulating Collective Investment Institutions; Act 1/1999, of 5th January, Regulating Capital-Risk Entities and their Management Companies; Act 26/1988, of 29th July, on Discipline and Intervention of the Credit Entities; Act 19/1988, of 12th July, on Account Audits; Legislative Royal Decree 1564/1989, of 22nd December, which passed the Consolidated Limited Liability Companies' Act, and Act 19/1993, of 28th December, on the Prevention of Money Laundering, amongst other regulations.

As can be seen from the above, a significant number of the laws making up the Spanish financial system were modified as a result of the passing of the said Act.

After this other legislative initiatives have been completing the reform of the Spanish financial system, some of which, as will be seen below, are still going through Parliament.

The first of these regulations is Act 35/2003, of 4th November, on Collective Investment Institutions, whose rules of development are close to being passed at the time this document is being prepared. Like in the above case, the Act is a response both to the need to modernize the operation of these institutions, improving their effectiveness as instruments to attract collective savings, as well as to the obligation to transpose two European directives that recently modified the regime of the undertakings for collective investments in transferable securities.

The general rules of the new regulation are to liberalize the investment policy, reinforce investor protection through new instruments and improve the administrative intervention regime.

We must also highlight Act 26/2003, of 17th July, which modifies Act 24/1988, of 28th July, on the Stock Market and the Consolidated Limited Liability Companies' Act passed by the Legislative Royal Decree 1564/1989, with the aim of reinforcing the transparency of the limited liability companies listed on the stock market. This Act contains the conclusions of the "Aldama Commission Report" on good corporate governance of listed companies.

The year 2003 saw the passing of another two laws that are important from the point of view of the activities of the financial entities, namely Act 19/2003, of 4th July, on the legal regime for capital movements and overseas economic transactions and about certain measures to prevent money laundering.

Apart from the above, two laws were passed in the same year which, although not directly referring to the financial system, had a profound repercussion on the operation of the same: Act 22/2003, of 9th July, on bankruptcy, and its Complementary Organic Law, which regulate the effects of the declaration of bankruptcy on individuals and legal entities, and the General Tax Law, which contains the legal framework for the action of the Tax Administration and the rights and guarantees of the taxpayers.

In 2004 regulatory rules were passed to develop the laws passed in the previous year. Amongst which we must highlight Royal Decree 1778/2004, of 30th July, which establishes the information obligations in relation to the preferential shares and other debt instruments and certain income obtained by individuals residing in the European Union, Royal Decree 303/2004, of 20th February, which passes the Commissioners Regulations for the defence of the clients of financial services and Royal Decree 302/2004, of 20th February, on participative quotas of the Savings Banks.

In 2005 the reform activity of the financial system continues with legal regulations, from amongst which we can highlight both those that have already been passed as well as some provisions that are well advanced in their progress through Parliament, probably achieving final approval before the end of the year.

Insofar as the rules that have already been passed, first of all we can highlight Royal Decree-Act 5/2003, of 11th March, on Urgent Reforms to Boost Productivity and to Improve Public Transactions which partially transposed Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003, on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (the Prospectus Directive). This Act also transposed the important Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002, on financial collateral arrangements, the said regulation being completed with that relating to the financial compensation agreements, regulated together with them.

Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganization and winding up of credit institutions was also transposed by the passing of Act 6/2005, of 22nd April, on the reorganisation and winding up of credit institutions.

Also transposed is Directive 2002/87/EC of the European Parliament and of the Council of

16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending the previous Directives on the issue. In this case, the transposition was done by Act 5/2005, of 22nd April, on the supervision of financial conglomerates, which modified other financial laws.

On the regulatory rule level, in 2005 we must emphasize the passing of Royal Decree 54/2005, of 21st January, which modifies the Rules of Act 19/1993, of 28th December, on certain measures to prevent money laundering, passed by Royal Decree 925/1995, of 9th June, and other rules regulating the banking, financial and insurance system.

Lastly, currently being considered are the Private Insurance and Reinsurance Mediation Bill, which transposes the European Directive on the issue into the Spanish Code, the Bill adapting Spanish legislation to the cross-border activities regime regulated in Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision and the Bill regulating the capital-risk entities and their management companies. Also well advanced are the very important Regulations developing the Collective Investment Institutions Act, which should be passed through the corresponding Royal Decree before the end of 2005.

SWEDEN

Market Developments

Bank profitability is still on the rise. Net interest income continues to be the largest source of income but during the four-quarter period through March 2005 the improvement in profitability came mainly from increased commission income from securities trading and a reduction of loan losses.

Total lending by the four major banks rose in the latest four-quarter period by approximately 10 per cent. There was some increase in lending to firms but it is mainly an increase in credit to households, above all for housing, that is growing in the Swedish market. For the four major banks combined, the rate of lending to households in the latest four-quarter period was the highest since the early 1990s but there are some differences among the banks.

Housing credits now make up approximately 35 per cent of the major banks' combined credit portfolios. The risk on these credits is considered, by banks as well as regulators, to be smaller than on corporate loans, partly because housing credits have residential real estate as collateral. For this reason, the growing proportion of home mortgage loans should reduce the level of risk in the banks' credit portfolios. A contrary effect may result, however, from the increasingly generous loan terms (such as higher loan-to-value limits and lower amortization requirements) that are a feature of increased competition. It should be noted, however, that in contrast to the period before the Swedish bank crisis in the early 1990s, when the banks focused more on the value of collateral, credit assessments now concentrate mainly on borrowers' ability to service debt.

Loan losses are declining in all the major banks and most market analysts see no grounds at present to anticipate an appreciable increase in corporate loan losses in the coming year. The improvement in bank profitability in the past two years has generated increased capital. The Tier 1 capital ratios at the end of March 2005 averaged 7.1 per cent. The major Swedish banks have Tier 1 ratios that are somewhat lower than those of most major European banks. For the first time since 2001, borrowing by Swedish companies is rising again. During 2004, higher corporate borrowing from credit institutions, primarily the banks, was accompanied by decreased borrowing in the securities markets.

Borrowing by households in Sweden is still rising rapidly. In the twelve months through February 2005, total borrowing rose almost 12 per cent, which is the highest rate since the late 1980s. The strong growth of household debt over a number of years is partly related to falling interest rates and rising real disposable income. Market analysts consider that demand for household credits will continue to be strong this year. But if interest rates rise in keeping with market expectations, in the coming years the rate of household borrowing is expected to slacken to some extent.

Although debt has risen faster than disposable income and now amounts to almost 125 per cent of the latter, the ratio of household sector debt to financial assets has been unchanged since the end of 2002.

The ability of households to service debt, measured as the ratio of interest expenditure to income, has also been stable. During the past year this ratio has remained historically low at less than 4 per cent. If interest rates move up as market participants expect, the interest expenditure ratio will rise. At the same time, since a growing proportion of new household borrowing is being arranged at variable rates, households have become more sensitive to interest rate movements. Over the past five years the average duration of interest terms has shortened from 19 to 12 months.

However, the rapid growth of debt since 2003 means that the proportion of households with very large interest payments could rise relatively quickly if interest rates move up again. Although the general expectation is that the financial situation in Sweden's household sector will remain strong in general, with satisfactory margins for coping with rising borrowing rates and temporary losses of income, there is a risk of problems arising for individual households. Large interest payments do not by themselves mean that households are financially vulnerable but can affect future ability to purchase consumer goods and services.

SWITZERLAND

Reform of Financial Market Regulation - Integration of Supervision

The proposed Federal Law on Financial Market Supervision ("FINMAG"), designed to establish a Financial Market Authority ("FINMA"), has been under preparation since the Commission of Experts chaired by Professor Zimmerli delivered its report to the Federal Government (see Global Survey 2004, p.p. 139-140). The next stage is for the Government's proposals to be submitted to Parliament. The Swiss Bankers Association ("SBA") welcomes the merger of the Federal Banking Commission with the Federal Office of Private Insurance as well as the Government's commitment to include the Money-Laundering Control Authority in the new body from the start. However, the SBA regrets the Government's unwillingness to establish the prudential supervision of asset managers within the framework of the FINMAG ("same business, same risks, same rules" as for banks).

Reform of the Dual Supervisory System

In June 2001, the Swiss Federal Banking Commission ("SFBC") established a mixed working group under the leadership of the SFBC to prepare for the implementation of the recommendations of an expert group in the field of external auditing. In October 2004, this working group presented its final report. Based on an analysis of the international context as well as the national situation, the working group made suggestions for a reform of the Swiss framework for banking supervision.

The dual approach based on auditing companies acting on behalf of the SFBC will be maintained. This approach has also been approved recently by the IMF in the context of its Financial Sector Assessment Program ("FSAP"). According to the working group, however, there should be more risk orientation in the future approach to auditing. In particular, the working group's draft suggests that the external auditor should perform a risk analysis as well as define an auditing strategy in advance of the audit. In order to increase transparency, the working group suggested that audits should be split into a "financial audit" on the one hand and a "regulatory audit" on the other.

In the last few months, the SFBC has run a series of sample-based impact studies to assess the implications of the suggested improvements to external auditing. Based on the results, the SFBC is expected to decide on further steps and the possible enactment of its corresponding circulars. As part of the project, some circulars of the SFBC have already been put into force, cf. those on "Self-regulation as Minimal Standard" and "Supervision of Large Banks." Overall, the proposed reforms will further strengthen the already high standards of banking supervision in Switzerland.

Depositor Protection

On July 1, 2004, the latest amendments to the Swiss Federal Banking Act ("SFBA") came into force, providing a sound legal basis for the existing self-regulation in depositor protection (Article 37h of the SFBA). The protection scheme continues to build on the existing two elements:

- There is an insolvency "privilege", i.e., priority of depositors' claims against an insolvent bank's or securities dealer's branches in Switzerland for up to CHF 30,000 per person over all non-privileged claims. This privilege makes the protected deposits safe in terms of solvency, but not necessarily in terms of liquidity.

- Self-regulation is now mandatory for all banks and securities dealers in Switzerland, in order to provide the liquidity needed for the payment of privileged claims in case of an insolvency. The existing, non-mandatory Depositor Protection Agreement provided for liquidity up to a total of CHF 1 billion. The new self-regulation will be mandatory for all banks and securities dealers and will cover privileged deposits up to a total of CHF 4 billion. The liquidity needed in case of an insolvency will be raised from the banks and securities dealers if necessary, but not in advance by creating a fund. However, banks and securities dealers will be obliged by law to hold liquidity in addition to the legal requirement for a total of CHF 2 billion. The allocation of these amounts among the banks and securities dealers will be an element of the self-regulation.

An amended self-regulatory Agreement has been submitted to the SFBC for approval as required by Article 37h of the SFBA.

Revision of the FATF's 40 Recommendations

The Working Group for the implementation of the FATF 40 Recommendations prepared draft legislation in January 2004 and submitted its proposals to different associations and representatives of specific professions affected by the planned new rules and regulations. It organized hearings with these persons and entities. The SBA was twice invited to participate in these hearings and drew attention to its concerns. The main criticism focused on the lack of coordination of the proposed legislation with existing laws and on the unwillingness of the interdepartmental Working Group to take into consideration cost-benefit issues. The consequences of the proposed legislation for financial intermediaries in the non-banking sector were not fully disclosed. Instead, the Working Group obviously acted under self-imposed time pressure in order to be in a position to present definite proposals to the FATF experts when evaluating compliance with the FATF Recommendations in Switzerland earlier this year. In early 2005, the SBA participated in the public consultation procedure with regard to the proposed legislation and submitted its comments and criticisms. The results of this consultation procedure will determine the time schedule for the government to report to Parliament and the submission of the draft legislation to Parliament.

International Administrative Assistance among Supervisors

A revision of Article 38 of the Swiss Federal Stock Exchange Act, strongly supported by the SBA, is currently under consideration by Parliament. It will clamp down on any insider trading abuse in the Swiss securities market by making it easier for the SFBC to extend administrative assistance to foreign supervisory authorities. Current law, as interpreted by the Swiss Federal Supreme Court, places significant restrictions on the degree of administrative assistance the SFBC can offer to foreign regulators in cases of insider trading.

The Government's proposal represents a balanced solution to the problem as it pragmatically joins the interest of customers for legal rights on the one hand with the need for effective market supervision on the other. The SBA welcomes the fact that the proposed revised article continues to explicitly guarantee legal rights for those involved.

TURKEY

The banking sector's restructuring program was launched in 2001 by the Banking Regulation and Supervisory Agency (the "BRSA"). Important steps for strengthening the effectiveness of banking supervision have been taken and banking rules and regulations have been harmonized more closely with international standards.

Banking Supervision

In the field of banking supervision, substantial steps have been taken towards the transition from a rule-based approach to a risk-based approach. Due to this, market discipline has started to have a greater importance in ensuring financial stability. With the aim of providing the public and market participants with the information necessary to make meaningful assessments of banks, accounting standards as well as reporting and public disclosure requirements have been strengthened recently.

Risk Management

Banks generally have made serious efforts to develop a risk-based approach to management, reduce operational costs and increase the quality of the financial services they provide within the framework of applicable prudential regulations and banking principles. Developments concerning Basel II (New Basel Capital Accord) have been monitored closely, and the effects of Basel II both on the banking system and on the economy have been analyzed.

An updated "Roadmap for Transition to Basel II" which provides guidance on making an efficient transition to Basel II has been published by the BRSA on its web site.

Amendments to Banking Law no. 4389

With three consecutive amendments (Laws no. 5189, 5228 and 5354) promulgated in the Official Gazette on July 2, 2004, July 31, 2004 and May 28, 2005, respectively, article 15/7(a) of Banking Law no. 4389 was modified to increase the authority of the Savings Deposit Insurance Fund to collect receivables in spite of the rights of third parties.

Amendments to Execution and Bankruptcy Law

The amendments made to the Execution and Bankruptcy Law on February 21, 2004 (Law no. 5092), declaring a maximum period of adjournment of bankruptcy of 5 years, were followed by related amendments through Law no. 5311 and Law no. 5358.

Law no. 5311, which became effective upon promulgation in the Official Gazette on March 18, 2005, facilitates appeal to an upper court against the decisions of the execution courts.

Law no. 5358, which became effective upon promulgation in the Official Gazette on June 1, 2005, changed the penal clauses to conform to the new Criminal Code no. 5327.

Foreign Currency Net General Position/Equity Capital Standard Rate

Amendments related to the application and calculation of the foreign currency net general position/equity capital standard ratio (the "FCNGP/ECSR") by banks with/without consolidation became effective upon promulgation in the Official Gazette on May 11, 2005. The amendments affected calculation methods of the FCNGP/ECSR and revised the schedule for sending the mandatory reports.

Accounting Practices

In 2005, the relevant authorities declared that an inflationary economic condition no longer exists, and the BRSA has stopped requiring inflation-adjusted financial statements from banks.

Decrease in Intermediary Costs Affecting Banks

Important measures were taken in order to lower intermediary costs affecting financial transactions. In line with these measures, the stamp tax and certain other taxes imposed on loans and transactions yielding foreign exchange income have been removed.

With the decrease in general interest rates, the Central Bank of the Republic of Turkey (the "CBRT") has gradually reduced interest rates applicable to required reserves from 20 to 12.5 per cent.

The Resource Utilization Support Fund (the "RUSF") deduction rate, applicable to retail and corporate credits issued by banks and other credit institutions, was reduced to zero pursuant to the resolution of the Council of Ministers No. 2004/7633 on July 29, 2004. In addition, pursuant to resolution No. 2004/7735, on August 15, 2004, the RUSF deduction rate on consumer credits was increased from 10 per cent to 15 per cent.

Savings Deposit Insurance Scheme

Resolution No. 1419, dated November 25, 2004, of the BRSA limited insurance premiums for savings deposit accounts to those accounts which were subject to an insurance guarantee, thereby reducing the premium burden on the banking sector.

A new regulation, which linked interest rediscounts to the scope of guarantee scheme, was adopted by resolution no. 1584 of the BRSA on February 23, 2005.

Act on Conformity of Tax Laws to New Turkish Lira and Amendments in Other Laws

The Act on Conformity of Tax Laws to New Turkish Lira (the "Tax Conformity Act") became effective upon publication in Official Gazette no. 25687 on December 31, 2004.

New taxation regulations, scheduled to become effective as of January 1, 2006, details of which can be found in the Tax Conformity Act, attempt to simplify taxation of profits.

Draft Acts

Turkish Commercial Law and Law of Obligations

Draft Acts on Turkish Commercial Law and Law of Obligations, drawn up by the Turkish Ministry of Justice to replace the Turkish Commercial Code No. 6762 and Law of Obligations No. 818, have been publicized.

Banking Law

The legislative process related to Banking Law No.5387, which has been accepted by the Turkish Grand National Assembly continues.

Bank Cards and Credit Cards

A draft Act on Bank Cards and Credit Cards, drawn up by BRSA, was introduced to the public through the Agency's web site on February 23, 2005. This Act, which has the objective of healthy development of the bank card and credit card sector, sets forth the rights, obligations and responsibilities of the parties, stipulates the general transaction framework of card usage, draws up the general framework for audit of the related institutions in the sector, establishes rules for information flow between the institutions covered by the Act and related public agencies, guarantees the rights of bank card and credit card customers, clarifies the burden of proof and describes the pertinent criminal laws. It has been submitted to the Ministry of State.

Social Security and General Health Care Insurance

A draft Act on Retirement Insurance, drawn up by the Turkish Ministry of Social Security, has been placed on the agenda of the Turkish General Assembly under the title "Draft Act on Social Security and General Health Care Insurance". The Draft anticipates a transition to a single social security system and would include the funds of banks that were established according to provisional article no. 20 of the Social Security Law no. 506.

Mortgage System

Parts of the Draft Act on the Mortgage System introduced a mortgage system to Turkey and amended various other laws, including:

1) Regulations on the new institutions and instruments related to the new finance model,
2) Regulations on tax and other mortgage related costs,
3) Regulations pertaining to improvement of credit facility environment,
4) Regulations accelerating the mortgage liquidation process in problematic credits.

Market Developments

The number of banks operating in Turkey declined to 48 as of June 2005. This development resulted from the transfer of Credit Lyonnais SA, previously in the group of foreign banks, to Credit Agricole Indosuez Türk Bank AŞ, and the transfer of Pamukbank TAŞ to Türkiye Halk Bankası AŞ.

Deutsche Bank AŞ became a depository bank; therefore it was transferred from the group of non-depository banks to foreign banks established in Turkey. Bnp-Ak Dresdner Bank AŞ was transferred from the group of foreign banks to privately owned commercial banks and its trade name was changed to Ak Uluslararası Bankası AŞ.

Of the banks operating in Turkey, 35 are commercial banks (depository). Of these three are state-owned banks, and 18 are privately owned banks, 13 are foreign banks. There was one bank under the management of the Savings Deposit Insurance Fund, namely Bayındırbank AŞ. There are 13 non-depository banks. Of these, three are state-owned banks, eight are privately owned banks, and two are foreign banks.

YTL (New Turkish Lira)

The Law for YTL (New Turkish Lira) was published in the Official Gazette No. 25363 dated January 31, 2004. YTL and its sub-unit YKr were put into circulation on January 1, 2005. When Turkish Lira values are converted into the New Turkish Lira, one million Turkish Lira (1,000,000 TL) will be equivalent to one New Turkish Lira (1 YTL); in other words six zeros have been dropped from TL. The Turkish Lira banknotes and coins that are currently in circulation will be circulated along with the New Turkish Lira banknotes and the new coins between January 1, 2005 and December 31, 2005. Accordingly, an extensive information campaign has been launched in order to familiarize the general public with the new currency.

IBAN Implementation

The Turkish banking sector has agreed to use the IBAN (International Bank Account Number) standard for customer accounts. An IBAN structure for Turkey has been prepared and is scheduled to be implemented in September 2005. The IBAN structure for Turkey is composed of 26 characters, and it can be viewed at ECBS (www.ecbs.org) and at the TBB web site (www.tbb.org.tr).

Regulation on the Establishment and Operations of Banks

Regulations no. 25537 and no. 25639 promulgated in the Official Gazette on July 29, 2004 and November 10, 2004, respectively, amended the Regulation on the Establishment and Operations of Banks, as indicated below:

1. In order to eliminate practical problems, the limit of risk exposures on indirect loans shall be set at as 40 per cent instead of 50 per cent.
2. Indirect loans extended through credit cards shall be subject to loan limits.

UNITED KINGDOM

Introduction

Although the domestic and international economic conjuncture became increasingly unfavorable through the second half of 2004 and into the early months of 2005, the performance of major UK banks has remained strong, with record profitability once again, albeit tempered somewhat by rising bad debts and an increase in insolvencies. Financial markets remained relatively stable, though there has been greater volatility in commodity markets.

Financial Services Regulation

Financial Services Authority: Role, Organization and Burden of Regulation

After the major changes which were highlighted in the last Global Survey, the period under review has been marked by a period of stability as the FSA's new organizational structure is implemented, and it absorbs responsibility for supervising several thousand more insurance and mortgage brokers. The FSA has also promised to reduce the volume of new rules and regulations, notably by cutting down on the number of consultative papers it issues. However, as noted last year, the considerable demands of the EU Financial Services Action Plan with 42 separate measures, means that this is a difficult objective to achieve, particularly given the complexity and detail of two major EU legislative initiatives that have not yet been implemented: the Capital Requirements Directive and the Markets in Financial Instruments Directives ("MiFID"). An added layer of complexity (as with the Prospectuses and Market Abuse Directives) has been the degree of detail present in the ancillary ("Level 2" under the Lamfalussy process) measures which have accompanied MiFID in particular.

Major domestic initiatives by the FSA have also continued, with the announcement of reviews affecting the Handbook and Enforcement, whose results should be known in the second half of 2005, together with continued development of initiatives on treating customers fairly and financial capability. It is therefore hardly surprising that institutions continue to be concerned at the increasing costs of compliance with changes in regulation. One effect has been for major UK banks to increase their monitoring of, and lobbying on, regulatory issues, notably through the enhancement of public and regulatory affairs units, and through their commitment to representative bodies such as the banking associations.

Treating Customers Fairly

The three year project on "Treating Customer Fairly" (TCF") began in July 2004, and a progress report, which would contain the FSA's preliminary views, was due in July 2005. Building up to this, the industry has been active in engaging in a number of consultative groups with the FSA and others, as well as cluster groups working on topics such as remuneration, complaints handling and optimal use of management information. Earlier in the year, the FSA published on its website a series of case studies and other introductory materials, which the July 2005 paper will build on. Throughout, the key messages to the regulator have included the need not to impose new minimum standards but to 'let a thousand flowers bloom', since different firms will have different ways of treating their customers fairly, a fact the FSA has now acknowledged. The FSA has also been urged to ensure that its supervisors are properly trained with respect to TCF issues and expectations. The FSA has already initiated a training program relating to TCF issues. Finally, the FSA was urged to acknowledge good work undertaken by the industry - such as the use of the 'balanced scorecard' in remunerating staff - where account is taken not only of volume of sales, but also of indicators such as customer service. The new FSA paper is expected to cite specific examples of good practices in this respect. Going forward, a further industry objective will be to ensure that the FSA remains alert to the innovative practices already underway in many firms and to integrate them fully it in its approach.

The Hampton Review

The final Hampton Committee report on "Reducing administrative burdens: effective inspection and enforcement" was published in March 2005. The review considers how to reduce administrative burdens on business without compromising the UK's regulatory outcomes. From a retail credit perspective, it is in fact a footnote, asking whether the consumer credit functions of the Office of Fair Trading (OFT) should pass to the FSA, as it represents an opportunity to streamline the UK's regulatory regime around credit.

Presently there are two statutory regimes/ regulators. The Consumer Credit Act (CCA), as regulated by the OFT, covers all secured and unsecured lending to individuals up to a limit of

£25,000, not captured by Financial Services and Markets Act (FSMA). This limit will be removed for personal customers when the Consumer Credit Bill is enacted. The FSMA, which determines the role and functions of the FSA, covers all lending to personal customers and unincorporated businesses with a turnover below £1 million, secured by a regulated mortgage contract (broadly, a first legal charge over owner-occupied land) through mortgage regulation. In addition to statutory requirements, the Banking Codes also have sections relating to lending and small businesses that are further protected by the Statement of Principles (presently under review).

The Department of Trade and Industry (DTI), which is the lead department for consumer issues, acknowledges the unique situation that aspects of the consumer credit market present, given the heterogeneity of product offerings covered by the CCA. Due to such complexities, the DTI will consult separately on this specific component of OFT's mandate during the first quarter of 2006.

Retail Credit

The UK's retail credit regime has been under unprecedented scrutiny under the present government, with the introduction of mortgage regulation for the first time from October 31, 2004 and in parallel, a comprehensive review of existing consumer credit legislation. All the secondary legislative changes instigated by the DTI's review of consumer credit have now been implemented, and the review has moved to more detailed issues that will make the fit between the CCA and the FSA's mortgage regulation regime neater.

The second reading of the Consumer Credit Bill (CCB) in the House of Lords (which passed through the House of Commons materially unaltered) is scheduled provisionally for October 2005. This was something of a bitter-sweet outcome as industry concerns relating to the imprecise nature of the definition of the unfairness test within the Bill had not been satisfied, nor do the powers of the OFT appear to have been circumscribed. That said, against a threat of pricing restraints which ultimately did not materialize, and restrictions on credit card practices which may yet emerge, the outcome as it is retains the government's starting position. It is positive in the sense that it meets industry concerns on enforceability of agreements (presently a significant structural risk) and provides accommodations for higher net worth individuals.

In Europe, the European Commission has also considered the time right to review the present Consumer Credit Directive (CCD), with a view to introducing a new directive that will both further consumer protections and drive a single European market for consumer credit. The CCD has become mired in the European Commission while that body decides whether or not a formal impact assessment should be made to substantiate the legislative changes proposed. The latest timeline for publication of the modified proposal (coalescing the Commission's and European Parliament's thinking) is now anticipated during October/ November 2005, though this may slip into early 2006.

The industry has long been frustrated with the definition of regulated mortgage contracts under the mortgage regulation regime which captured (unintentionally) elements of business lending and lending to wealth management clients. The industry has lobbied hard for change, with some success on business lending, but having considered carefully the number of queries and applications for waivers made around the application of mortgage regulation to higher net worth individuals, the FSA has concluded that it is not appropriate to progress with a formal change at this time to accommodate wealth management.

Review of the Banking Codes

Following an extensive independent review, the codes, which govern the relationship between institutions and their customers, which are in widespread use in the banking and building society sectors, and relate to both personal and business customers, were introduced on March 1, 2005. Features in the personal code include commitments to provide basic bank accounts and greater transparency in the cheque clearing cycle. There are also new commitments to customers when branches are closed or services reduced, as well as new guidelines on dormant accounts. In addition, best practice guidelines for credit cards have been enhanced. The business code was changed in line with the personal code, and additionally on account switching, valuation and other charges for transferring securities. An interim review of the new codes will take place during 2006.

Financial Capability

This FSA work, initiated in November 2003, has made some progress in identifying seven priority sectors (schools, young adults, the workplace, families, retirement, borrowing and advice) and is now looking to move to its implementation phase. The Endeavour has raised awareness of the issues and proposed the development of pilot solutions in seven priority areas. To this end, the FSA and HM Treasury are currently undertaking a short review of the National Financial Capability Strategy. This review will examine the options for the financial, legal and organizational frameworks for implementing the national strategy. The focus of the review will be on the framework for delivery. In particular, the review will examine the issues of funding, governance, and consider possible operating models through which the strategy could be implemented. The review was scheduled to report back to FSA and HM Treasury in mid September 2005.

FSA Handbook Review

In order to make the Handbook more accessible and useful, the FSA has recently focused on three themes: Handbook Accessibility, Handbook Review and Implementation of Directives. The FSA has been working on accessibility for a number of months: improved electronic and specific handbooks (e.g. Corporate Finance Handbook) were due to be available on the FSA website by the end of May 2005. In addition, via the website, it will be possible to create a customized Handbook by answering a number of pertinent questions related to specific businesses.

The Handbook review element of the strategy contains two threads: remove the Money Laundering Handbook entirely and changes to the approved persons regime specifically, lifting the requirement for FSA approval for those who only deal with non private clients (e.g. Professional Clients and above). This may involve reducing the number of approved persons categories from the current 28 to around 6. Another important element of the Handbook Review is likely to be a complete revision of the Conduct of Business Sourcebook. This will probably be part of the implementation of the Markets in Financial Instruments Directive and will be a very substantial project for the FSA. All these aspects were due to be covered in a consultation paper which the FSA was due to publish in mid-July 2005.

UK Implementation of the Basel Capital Accord: the Capital Requirements Directive

The Capital Requirements Directive ("CRD"), which was proposed by the European Commission in July 2004, has been moving slowly through the EU legislative process. A compromise agreement in the EU Council of Ministers was achieved on December 1, 2004. The text is now making its way through the committee and plenary processes of the European Parliament, with the expectation that the relevant committee would vote on the Directive in early July 2005, with the European Parliament legislative process being concluded during the second half of 2005. After further scrutiny in the Council, it is anticipated that the text can be finalized by the end of 2005. This timetable is also necessary to achieve implementation by January 1, 2007 (except for the credit risk Internal Ratings Based Approach and operational risk Advanced Measurement Approaches which will take effect a year later). Despite the uncertainty over the final text, the UK Financial Services Authority has made an early start on clarifying how it intends to transpose the Directive in its prudential sourcebook, notably in the first of its consultative papers in January 2005. The (Lamfalussy Level 2 body) Committee of European Banking Supervisors, which was set up in London, has also begun to clarify the EU-wide approach towards CRD issues, particularly supervisory review and reporting, and model validation, although the CRD is not itself a Lamfalussy-style Directive.

Business Continuity/Disaster Recovery

The Tripartite Authorities (Bank of England, FSA and HM Treasury) have worked to enhance and refine the overall arrangements for ensuring that the financial system as a whole, including its infrastructure, can withstand unexpected events, including terrorist action and natural disasters. With the UK being particularly susceptible (as subsequent events of July 2005 demonstrated), the focus has been on improving the authorities' collective response and interaction with financial firms, as well as modifying the regulatory framework to assist firms' preparedness. Building on its 2001/2002 Risk Matrix approach, the FSA initiated in January 2005 a review, designated as the Resilience Benchmarking Project, which ultimately will be rolled out to some 60 major firms and infrastructure providers, including all the major global banks present in the UK. The framework takes institutions through key areas of their business and enables them to assess their response and state of preparedness against operational disruption. It also facilitates peer group comparisons. Ultimately the project will be added to the FSA's assessment of an entity's risk management capacity in the ARROW framework, but will not result in hard-coded rules. An FSA discussion paper is promised for the end of 2005.

Payments Regulation

The first report of the Payments Task Force (PTF) set up by the Office of Fair Trading (OFT) on electronic payments appeared in May 2005. In it, the OFT recommended that the banking industry should move to faster clearing for electronic (telephone and internet) payments, on the ELLE ("in early, paid later the same day; in late, paid the next day") basis. This recommendation is already being implemented by two of the largest UK retail banks and now seems likely to be adopted as the overall industry standard. An industry implementation group will report back to the PTF in November 2005. The PTF is now turning its attention to the cheque clearing cycle, which generally lasts three days. There is less consensus on this, with notable concerns on whether there is a real customer demand for additional speed, infrastructure consequences, certainty of outcome and consumer interest issues. Work will begin in the autumn of 2005.

Money Laundering

Third Money Laundering Directive

Following the European Parliament's report in May 2005, the EU Council of Ministers was able to accept most of the Parliament's amendments and endorsed the text on June 6, 2005. The Third Money Laundering Directive (the "3MLD") has to be implemented in member states by early 2007. The 3MLD is intended to incorporate previous Directives of 1991 and 2001, to bring terrorist financing within its Directive, and to incorporate the revised 40 recommendations of the Financial Action Task Force that were agreed by FATF member governments in June 2003. The 3MLD also requires member states to amend the definition of serious crime, which is not a problem for the UK because of the all-crimes definition of predicate crime that already exists in the Proceeds of Crime Act 2002.

The FATF considerably extended the level of detail in its recommendations, notably on customer identification and verification ("Customer Due Diligence") and introduced the concept of a risk-based approach (RBA) in situations where a higher risk of money laundering might justify enhanced anti-money laundering measures and, conversely, those where a lower risk might justify simplified due diligence. The RBA is welcome for the industry and reflects the allocation of finite AML resources according to the degree of risk presented by a customer, jurisdiction, product or delivery channel.

The areas in the 3MLD that are likely to be most problematic are those relating to identification of beneficial owners and Politically Exposed Persons (PEPs), which critically depends on whether firms are able to obtain the necessary information. Unless this aspect of the Directive is interpreted on a practical and risk-sensitive basis it could be more difficult for a non-resident to open a bank account, even within the EU. Additional work also needs to be undertaken on technical criteria for assessing whether situations represent a low or high risk of money laundering or terrorist financing, and whether it is justified not to apply the 3MLD to certain legal or natural persons carrying out a financial activity on an occasional or very limited basis.

Revision of Joint Money Laundering Guidance Notes

The Joint Money Laundering Steering Group (JMLSG) published in March 2005 a consultation version of its proposed revision of its guidance on Money Laundering (ML) and terrorism financing. The revision, which aims to guide firms on how to approach a risk-based application of their money laundering prevention policies and systems, takes a new approach, which has been the subject of extensive dialogue and consultation in the industry and among official bodies. The new guidance proposes a basic level of customer identification that recognizes that most customers are not money launderers - the standard identification requirement can be met by a single document. As the money laundering risk increases, so the firm should require additional evidence. It also approaches the identification of entity customers in a way that recognizes that firms knowing their customer's business are of equal importance to verifying the customer's identity. The guidance emphasizes the role of senior management in the assessment of the money laundering risk facing a firm and of the measures to mitigate it. Part I of the guidance is of general application; Part II provides additional guidance, tailored to particular business areas, to take account of special features in a number of financial services industry sectors.

The proposals were open for comment until June 30, 2005, with the objective of publishing a final version in late 2005. The final guidance will then have to be offered to HM Treasury for approval. Until firms have had time to adjust their procedures to the new guidance, the 2003 edition of the JMLSG Guidance Notes which have been approved by HM Treasury, will continue to have effect.

UK Taxation Developments

Consolidation of UK Tax Authorities

The two Government taxation departments, HM Inland Revenue, and HM Customs and Excise merged in April 2005. The new unified tax entity has been renamed HM Revenue and Customs ("HMRC").

Tax and Introduction of International Accounting Standards

The switch to International Financial Reporting Standards from January 1, 2005, and in particular IAS 39, has resulted in a number of tax issues. In the Pre-Budget report in December 2004 it was announced that transitional adjustments arising on January 1, 2005 would be treated for tax purposes as arising on January 1, 2006. A particularly important objective for industry has been to have the tax effect of all transitional adjustments spread over a number of years and discussions have continued over the year.

The Paymaster General announced in July 2005 that some transitional adjustments, principally those arising from Effective Interest Rate adjustments and on Assets Available for Resale, would be spread over 10 years, commencing 1 January 2006. This is of advantage to some banks, but defers tax relief for others. A decision on the spreading of the tax impact of impairment provisions and reinstatement of dormant accounts has been deferred, pending further government consideration of the figures and HM Treasury's discussions with the banks about surrender of unclaimed balances.

The Loan Relationships and Derivative Contracts (Disregard and Bringing into Account of Profits and Losses) Regulations 2004 (SI 2004/3256) are intended to reduce tax volatility by disregarding fair value movements on particular derivative contracts for tax purposes. The government has postponed until October 1, 2005 the deadline for making an election under regulation 6 of these disregard regulations. By making such an election institutions can, for tax purposes, elect to follow their accounts based on the new IAS 39 fair value method rather than the old UK GAAP basis. Making such an election involves accepting a degree of volatility, but is likely to involve much simpler compliance procedures for those companies that have many derivative transactions.

Finance Act 2004

Sections 306-319 of Finance Act 2004 included new anti-avoidance disclosure requirements relating to corporation tax, income tax and capital gains tax. These measures require users and promoters of tax avoidance schemes to make an early disclosure of tax avoidance schemes (as defined). The initial proposals, announced in the 2004 Budget, were soon recognized to be deficient and would have resulted in an avalanche of unnecessary disclosures. As a result of industry lobbying, together with a common understanding of the government's aims, a much more practical and restrictive disclosure regime has been developed. The disclosure regime has also now been extended to transactions involving avoidance of Stamp Duty Land Tax.

In contrast, the banking industry was unsuccessful in its efforts to mitigate the effects of Section 19 and Schedule 11A relating to anti-avoidance disclosure requirements for VAT. Institutions notably explained how simple regulatory planning was being tarnished with an unacceptable tax avoidance motive. However, few practical problems appear to have so far been encountered, and this will become clearer in the light of experience.

In 2005 the disclosure regime was extended to include transactions involving Stamp Duty Land Tax avoidance.

Finance Act 2005 and Finance (No2) Act 2005

There were two Finance Acts during 2005 as the first one was curtailed when a General election was called. The new legislation continued the Government's targeting of tax avoidance involving the finance industry.

Schedule 7 of the No2 Act dealt with a range of avoidance including financial arrangements where subsidiaries of banks provided finance in the form of preference shares. The banks' principal concerns have revolved around amendments to Section 91 of the Finance Act 1996, in particular the treatment of preference shares issued within a group when a public issue is passed from a holding company to an operating company. Guidance notes have been prepared and will be incorporated in the HMRC Corporate Finance Manual. Broadly, these guidance notes deal with the problem areas in a clear and satisfactory way; it is expected that they will be published before the end of September.

Schedule 8 of the No2 Act deals with domestic transfer pricing and is more problematic. The banks' concerns are that the mere presence of a guarantee or an equity holding could bring the new provisions into play, particularly when a bank is involved in a joint venture with a number of partners and a UK transfer pricing adjustment is made. The legislation will, in a number of cases, deprive the joint venture partner a tax deduction for corresponding adjustments to taxable profits. HMRC have explained the policy behind depriving a company of a corresponding adjustment even though the recipient is taxed on the income. Draft guidance has also been produced by HMRC and is currently under review.

A third area of concern relates to Sections 24 -30 and Schedule 3 of Finance (No2) Act 2005, which deals with avoidance involving tax arbitrage. The legislation is very widely drawn and could be interpreted as affecting many normal and previously accepted arrangements. One particular concern of the banks related to innovative tier 1 capital issues. Other concerns included: the impact on certain investments issued to non-residents in line with previous rulings given by the Revenue, the impact on tick-the-box US entities, which are automatically hybrid companies as defined in the new legislation. The major concerns of the finance industry have been alleviated, to a degree, by HMRC guidance notes and new HMRC clearance procedures. Fair and reasonable clearance procedures are vital if this legislation is not to create a major block on normal commercial practice. The industry is now satisfied that the position of tier 1 issues is effectively the same as it was before the new legislation, when banks always took the precaution of obtaining an advance clearance. The Paymaster General has given an assurance that the purpose of the legislation is not to act as tax policeman for other countries.

Operational Taxes

The EU Savings Tax Directive was due to enter into force on July 1, 2005. As part of the implementation process, HMRC has updated its excellent EU Savings Tax Guidance Notes (which are already considerably more detailed than any other EU Member State). At the European level, the European Banking Federation has compiled a dossier of identity documents and Tax Identity Numbers to assist member banks who are implementing the EU Savings Tax Directive. In the absence of any official guidance in most EU Member States, the EBF has also prepared a non-exclusive list of residual entities and has recently reviewed a number of standard forms. Regular meetings are held with the European Commission, and the assumption of the EU Presidency by the United Kingdom in H2 2005 will also provide the opportunity to discuss problems with the Directive, particularly in those countries that are imposing a withholding tax instead of exchanging information with other countries' tax authorities.

Miscellaneous Regulatory and Funding Issues

Regulatory Responsibilities

There were no major changes in the allocation of responsibilities among the FSA, the Bank of England and HM Treasury (collectively the Tripartite Authorities). However, the Bank of England did announce that it was paring down its work under its Third Core purpose relating to the effectiveness and efficiency of financial markets, except where this has a demonstrable impact on its second Core Purpose of maintaining Financial Stability. In contrast, the Bank is enhancing its market intelligence function in its Markets Area. Following the considerable advances made in strengthening collective financial sector business continuity arrangements (see above), the Tripartite Authorities are also looking at revising their October 1997 Memorandum of Understanding to reflect the relative roles in a crisis.

Funding Financial Regulation

As in previous years, day to day financial supervision continues to be financed from periodic fees levied on institutions, supported by levies to fund the Financial Services Compensation Scheme and the Financial Ombudsman Service. However growing concern about certain inconsistencies in the fee block structure (notably in the way in which corporate advice is charged for), together with the perceived imbalance in retrospective charging of affected sectors for losses on products is leading the Financial Services Authority to conduct a review of the way in which these three segments are funded. A formal consultative paper reviewing the charging of levies for the FSCS and the FOS is promised for the end of 2005. Thereafter, the FSA is expected to look at the system of periodic fees through the fee block structure during the course of 2006.

Cash Ratio Deposits

The Bank of England is currently in the process of revising its operations in the sterling money markets. The changes are intended to take effect in the second quarter of 2006. Under the new system, reserve accounts maintained by institutions at the Bank in respect of monetary operations will be remunerated (at the repo rate) for the first time. Although the current agreement of the framework for CRDs runs until 2008, as a result of these changes, the maintenance of reserve account balances will have an impact on the calculation of an institution's eligible liabilities, on which CRDs are based. HM Treasury are currently consulting on this effect.

UNITED STATES

Introduction

There were many U.S. legal and regulatory developments during the 2004-2005 time period that have important implications both for domestic banks and international banks with U.S. operations. Among the most significant was the April 29, 2005 release by the federal banking agencies of information relating to the implementation of Basel II indicating that the minimum regulatory capital charges resulting from the recently concluded fourth Quantitative Impact Study ("QIS4") were more variable across financial institutions and that these capital charges dropped more, in the aggregate, than the federal banking agencies had expected. For these reasons, the release stated that the federal banking agencies would, in contrast to the European Union's rapid progress, delay the issuance of proposals for implementing Basel II. On the separate matter of U.S. regulatory relief, there were also significant developments during the past year. The federal banking agencies are currently on track to meet the 2006 deadline imposed by the Economic Growth and Regulatory Paperwork Reduction Act (the "Paperwork Reduction Act") to have solicited comments on four broad categories of regulations, including those governing bank applications, banking activities, money laundering and consumer protection.

Deposit insurance reform has also been a focus of Congressional and federal banking agency attention during the past year. Legislation permitting inflation-related indexing of deposit insurance coverage appeared to have a chance of being passed by Congress before the end of 2005. A further important development was the approval in July 2005 by the Senate Banking Committee of legislation that would replace the Office of Federal Housing Enterprise Oversight ("OFHEO") with a new independent regulator to exercise oversight with respect to Fannie Mae and Freddie Mac. Also ranking as a very significant development during the 2004-2005 time period was the June 30, 2005 release by the federal banking agencies and the Financial Crimes Enforcement Network ("FinCEN") of a comprehensive BSA/AML Examination Manual (the "Exam Manual"). The long-anticipated Exam Manual is designed to promote greater consistency and clarity in anti-money laundering ("AML") examination standards. Finally, there have been important developments with respect to the umbrella supervision of consolidated supervised entities or "CSEs" and concerning bank corporate governance principles.

Basel II

In contrast to the European Union's rapid pace of Basel II implementation, there have been continuing concerns and uncertainty about the implementation of Basel II in the United States. The unexpected variability and levels of minimum capital charges among U.S. banking institutions that became evident as a result of QIS4 caused the federal banking agencies to delay issuance of a next round of proposals for Basel II while they review the QIS4 results. At the same time, the federal banking agencies have emphasized that they remain committed to moving forward with the implementation of Basel II. The delay in issuing a notice of proposed rule making is intended to ensure that any proposed changes to the risk-based capital framework to be implemented in the United States are consistent with safety and soundness, good risk management practices, and the continued competitive strength of the U.S. banking system.

It was anticipated that representatives of the U.S. federal banking agencies would meet in the early fall of 2005 to prepare for presentations on Basel II implementation at the quarterly meeting of the Basel Committee on Banking Supervision (the "Basel Committee") in October 2005. Meanwhile, in the European Union, many observers expect that the Capital Requirements Directive (the "CRD") which would transpose the Basel II regulations into EU law, will be passed on the First Reading, sometime in the fall of 2005. The CRD would apply risk-based minimum capital rules to credit institutions and investment firms in the European Union. The major open question is whether the U.S. plans for implementation of Basel II will eventually converge with European Union developments. If the United States does not adopt an approach similar to that of the European Union, it is possible that two capital standards - - one for the United States and one for the European Union - - will be implemented, at least for an interim period.

Regulatory Relief

The U.S. federal banking agencies continued to voice their support for regulatory relief during the 2004 – 2005 time period. The agencies are concerned about the current and growing regulatory burden that is imposed on banking institutions in the United States, particularly since this burden often falls with particular impact on small institutions. In this connection, Congress regularly reviews the federal banking laws to determine whether they can be streamlined without compromising the safety and soundness of banking organizations, consumer protections or other important objectives that Congress has established for the financial system.

There is also an ongoing regulatory review process being conducted jointly by the federal banking agencies pursuant to the Paperwork Reduction Act. The federal banking agencies are required, at least once every ten years, to review and seek comment on the burden associated with the full range of the agencies' regulations that affect insured depository institutions. The federal banking agencies are currently on track to meet the 2006 deadline imposed by the Paperwork Reduction Act and have solicited comments on four broad categories of regulations, including those governing bank applications, banking activities, money laundering and consumer protection in lending transactions.

Each of the Federal Reserve Board (the "FRB") and the Office of the Comptroller of the Currency (the "OCC") have identified regulatory relief issues of particular concern for their agencies. High priority regulatory relief proposals for the FRB include allowing the Federal Reserve to pay interest on balances held by depository institutions at Reserve Banks, providing the

FRB with greater flexibility in setting reserve requirements and permitting depository institutions to pay interest on demand deposits. Representatives of the OCC have emphasized that attention should be focused on the regulatory burden presented by massive consumer disclosure requirements as well as on improving the quality of information provided to consumers in required disclosure statements. The OCC has also noted that distinctions need to be made between banks based on the size, complexity and scope of their operations.

Deposit Insurance Reform

Deposit insurance reform has been a focus of Congressional and federal banking agency attention during the past year. As of September 2005, H.R. 1185, the House of Representatives bill, and S. 1562, the Senate bill, each propose several significant reforms. H.R. 1185 would raise the general insurance limit to $130,000 per ownership category and would be indexed to inflation. S. 1562 would retain the current $100,000 limit, but would allow for inflation-related indexing. Other provisions in the two bills address other issues and problems with the deposit insurance system, which is currently composed of two funds, the Bank Insurance Fund ("BIF") which insures banks, and the Savings Association Insurance Fund ("SAIF"), which insures savings and loan associations.

Current law requires that balances in each fund must equal 1.25 percent of insured deposits, a requirement which is sometimes referred to as the Designated Reserve Ratio ("DRR"). In addition to indexing for inflation, it is anticipated that the proposed legislation would merge the BIF and SAIF funds into a single Deposit Insurance Fund (the "DIF") and that the DRR would be changed from 1.25 percent of insured deposits to a range of from 1.15 percent to 1.40 percent as designated by the FDIC based on the condition of the DIF and economic conditions. Also under consideration are proposals that would allow the FDIC to impose a premium assessment on institutions that experience a net increase in new insured deposits during a particular assessment period well in excess of industry averages and to require the FDIC to pay dividends to insured institutions when the reserve ratio exceeds a specified percentage, such as 1.4 percent.

Government-Sponsored Enterprises ("GSEs")

The key role of housing-related government-sponsored enterprises or "GSEs" Fannie Mae and Freddie Mac in developing the secondary mortgage market in the United States has long been acknowledged. Nonetheless, the unique position and presumed competitive advantages enjoyed by Fannie Mae and Freddie Mac have resulted in regulatory and legislative concern. Although prospectuses for GSE debt are required by law to stipulate that such debt securities are not backed by the full faith and credit of the U.S. government, investors have concluded that, as a practical matter, the U.S. government would not allow GSEs to default. As a consequence, market participants offer to purchase GSE debt at interest rates substantially lower than those required of comparably situated financial institutions lacking government ties. It is this market advantage which has allowed Fannie Mae and Freddie Mac to essentially dominate the market for purchasing conforming home mortgage loans.

Increasingly, the FRB and others have become concerned about the huge balance sheets held by Fannie Mae and Freddie Mac. The FRB has recommended that Congress limit the portfolio assets that may be held by GSEs. Further, it has been argued that the GSEs need a regulator with authority similar to that of banking regulators, with a free hand to set appropriate capital standards and with a clear and credible process legislated by Congress for placing a GSE in receivership, where the conditions under which debt holders take losses would be made clear. As approved by the Senate Banking Committee, one current form of proposed legislation, S. 190, would replace OFHEO with a new independent regulator over Fannie Mae and Freddie Mac as well as over the 12 Federal Home Loan Banks. Under S. 190, the new agency would have the power to set minimum and risk-related capital standards for Fannie Mae and Freddie Mac and to limit the size of their mortgage portfolios to levels needed to carry out their mission in supporting the secondary mortgage market.

Exam Manual

The Exam Manual replaces separate manuals formerly issued by each of the federal banking agencies and attempts to provide a uniform approach to AML issues. The Exam Manual provides a comprehensive overview of regulatory expectations and requirements for AML programs, policies and procedures of U.S. domestic banks and international banks with U.S. operations. The Exam Manual generally does not indicate explicitly that (or how) its guidance applies to examinations of U.S. branches and agencies of international banks (or explain what, if any, procedures would apply to a representative office of an international bank). As a result, many of the specific descriptions in the Exam Manual speak in terms that do not relate precisely to U.S. banking offices of foreign banking organizations, such as the role of the board of directors of the examined institution. Nonetheless, it appears to be the expectation of the regulators that the Exam Manual will apply fully to branches, agencies and representative offices of international banks, as well as generally to all U.S. domestic banks.

The Exam Manual contains a number of separate sections, including a distinct focus on “core principles” followed by separate sections with an “expanded” perspective. A third section provides details of specific examination procedures and requirements. The “core principles” restate AML developments and requirements to date and in that regard provide a very useful summary of key principles, requirements and best practices. A risk-based focus is followed throughout the Exam Manual and sections on OFAC requirements are included. The “expanded” sections address specific lines of business, products and types of customers and entities that may present unique challenges and exposures for which banks should institute appropriate AML policies, procedures and processes. The expanded sections also provide guidance on enterprise-wide AML risk management.

As new products and services are introduced and existing products and services change, or a bank expands through mergers and acquisitions, management’s evaluation of money laundering and terrorist financing issues is expected to evolve. A number of products and services that may present a “higher risk” of money laundering are identified, including: funds transfer and remittance activity, private banking, correspondent accounts, international trade finance, certain lending activities and non-deposit account services. Among the cited customers and entities that may pose “specific money laundering risks” are foreign financial institutions, non-financial institutions such as broker-dealers, foreign corporations with transaction accounts and nonresident alien accounts. The specific risks associated with doing business in certain countries or opening accounts for customers from certain geographic locations are also highlighted. International high-risk geographic locations include (among others) countries subject to OFAC sanctions and jurisdictions cited on certain State Department lists. Domestic high-risk geographic locations are also identified and include “High Intensity Drug Trafficking Areas” (“HDTAs”) and “High

Intensity Financial Crime Areas" ("HIFCAs"). Perhaps as a direct result of the heightened focus on corporate governance, the increasingly important role of a bank's board of directors is highlighted throughout the Exam Manual. A final area of particular note is the emphasis on customer due diligence ("CDD") requirements as a supplement to CIP requirements. The objective of CDD procedures is stated to be to enable a bank to predict with relative certainty the types of transactions in which a customer is likely to engage. As a result of such CDD, a bank may determine that a customer poses a high risk because of the customer's business activity, ownership structure, or anticipated or actual transaction volume and types of transactions, including those transactions involving high-risk jurisdictions. Continued monitoring of such accounts to detect any suspicious activities that might need to be reported is expected.

The high level of detail in monitoring and recordkeeping that is now expected of all U.S. domestic banks and international banks with U.S. operations is evident in the surveillance expected even of routine customer transactions such as trade finance. In the context of a risk-based approach to evaluating the money laundering risks of trade finance transactions, banks are expected to conduct sufficient customer due diligence on prospective import/export customers before establishing the account or credit relationship. When appropriate, a bank's policies, procedures and processes are apparently expected to include a thorough review of all applicable trade finance documentation to enable the bank to monitor and report unusual and suspicious activity. In addition to financial transaction monitoring and OFAC filtering, the bank's review is supposed to be able to detect such items as shipping terms that are inconsistent with the nature of the customer's business, any customer business with high risk jurisdictions, any transactions with businesses involved in high risk activities, irregular pricing of goods and any transactions designed to evade home country legal restrictions. These are difficult standards to meet in practice and are likely to be the subject of further discussions between banks, representative trade associations and the federal banking agencies.

Other Developments

Over the past year, there have been extensive discussions between senior U.S. and European officials on U.S. concerns about the duplicative and burdensome consolidated supervision requirements imposed on international banks seeking favorable alternative net capital treatment under the SEC's consolidated supervised entity ("CSE") rule and the resulting disparity when compared to the full deference accorded by the European Union to the SEC's supervision of U.S. securities firm financial groups. Concerns have been expressed about the competitive inequality resulting from restricting the economic benefits of the CSE rule to only those banks with the largest U.S. broker-dealer capital even when other international banks have larger broker-dealer capital and operations globally. Specifically, the problem results from the fact that to be eligible to utilize the SEC's favorable alternative net capital rule (which is expected to result in much lower capital costs) the parent organization of the U.S. broker-dealer must subject itself to global consolidated supervision by the SEC.

The Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") continued to influence the concept of corporate governance. The focus of the federal banking agencies is likely to remain on this issue, particularly in light of the July 29, 2005 issuance by the Basel Committee of a revised guidance, entitled Enhancing Corporate Governance for Banking Organizations (the "Bank Corporate Governance Document"), to help promote the adoption of sound corporate governance practices by banking organizations. In its current form, the Bank Corporate Governance Document is a draft and public comment has been invited prior to October 31, 2005. The draft highlights (a) the importance of effective management of conflicts of interest; (b) the role of internal and external auditors and other control functions; (c) the important role of boards of directors in promoting transparency in corporate governance; and (d) the role of bank supervisory agencies in promoting sound corporate governance. The Bank Corporate Governance Document has been cited in several speeches of various Governors of the FRB and is likely to influence directly both bank regulations and "sound practices" in the United States.