Institute of International Bankers

Global Survey 2001

Regulatory and Market Developments

Banking - Securities - Insurance
Covering 44 Countries and the EU

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OVERVIEW

The Institute of International Bankers is an association whose mission is to represent internationally headquartered financial firms that engage in banking, securities and/or insurance activities in the United States. This fourteenth 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, 2000 to June 30, 2001 in 44 countries and the European Union (EU) and is published with the cooperation of banking associations and financial services supervisory authorities from those countries and the EU.

A striking feature of the country chapters in this year's Survey is the widespread efforts to adapt existing laws and regulatory structures to the requirements of an increasingly globalized and integrated financial system.

A number of countries continue to grapple with how to modernize their financial services laws to permit their domestic institutions to meet the challenges presented by advances in information and communications technology that make possible the delivery of a broad array of financial services and intensify the competitive pressures on them to provide their customers banking, investment, insurance and other financial services on an integrated basis. Canada, for example, has passed Bill C-8, which revises the policy framework for Canada's financial services sector and, among other important changes, for the first time provides bank financial groups the option of organizing their business activities in Canada under a holding company structure. Equally significant changes are underway in Denmark, which has passed the "Act on Financial Undertakings" unifying in a Single Act provisions relating to banking, investment, insurance and mortgage activities.

Similarly, reform of domestic regulatory systems to enable them to meet the challenges presented by the formation of complex financial groups that are engaged in a diverse array of activities both at home and abroad are high on the legislative agenda in many countries. In Austria, a "Financial Market Supervisory Authority Bill" has been introduced providing for the devolution of banking supervision from the Ministry of Finance, while also creating a central supervisory authority for financial services. Germany has under consideration legislation that would significantly revise the financial supervisory system by combining the three supervisory offices for banking, insurance and securities activities into a single organization, the "Federal Agency for Financial Service and Financial Market Supervision", which would be affiliated with the federal Ministry of Finance.

Ireland is contemplating legislation that would provide for a new structure for the regulation of financial services. It is proposed that the Central Bank of Ireland be restructured and called the "Central Bank of Ireland and Financial Services Authority", which would consist of two functional divisions, one responsible for prudential regulation of all financial services (the "Irish Financial Services Regulatory Authority") and the other charged with the management of external reserves and the country's participation in the European System of Central Banks (the "Irish Monetary Authority"). Portugal has adopted legislation creating a "National Council of

Financial Supervisors" to promote coordination among the three existing financial supervisors responsible for oversight of the banking, securities and insurance industries, respectively.

Reviews of existing regulatory and supervisory relationships are underway in other countries. For example, in Finland the government has assigned a special advisory body the task of preparing a proposal on how to integrate insurance companies into the financial markets supervisory structure. South Africa continues to debate whether to follow the route taken by Australia and the United Kingdom and establish a single financial regulator outside the central bank, while in Switzerland debate centers on the recommendation in the "Zuffrey Report" that the Swiss Federal Banking Commission and the Federal Office of Private Insurance should be melded into a single integrated financial market supervisory authority.

The global trend clearly continues to be in the direction of some form of consolidated oversight, but there remains as yet no international consensus on what kind of governmental authority should exercise this responsibility.

Another important development is the pending transition in the eurozone countries to the ultimate disappearance of their local currencies in favor of euro banknotes and coins as legal tender for cash transactions, which is scheduled to occur by January 1, 2002. As discussed in the EU chapter and chapters covering the effected countries, extensive efforts are underway to ensure that the changeover occurs with minimal disruption. Together with the shortage of euro cash in the first weeks of 2002, the logistical and security challenges of moving euro and legacy currencies at the end of the transition phase are the two major concerns of this gigantic project.

Several country chapters highlight the extensive debates surrounding the changes to the Basel Capital Accord proposed in January 2001 by the Basel Committee on Banking Supervision. Key issues in these debates include the use of an "internal ratings based approach" to setting risk-based capital standards and whether (and how) to incorporate measurements of operational risk into the standards. Another important issue, addressed by the Institute in its comment letter on the proposal (available at ww.iib.org), is the role of home and host country authorities in the supervisory review process contemplated under "Pillar 2" of the proposal as well as in connection with the application of disclosure standards contemplated under the market discipline principles set forth in "Pillar 3". The Institute's letter requests that the Committee clarify that a banking institution's home country supervisor has primary responsibility for oversight of matters relating to the institution's capital so long as the home country supervisor oversees the operations of the institution on a consolidated basis in accordance with international standards.

A matter selected for special attention in this year's Survey relates to the Institute's ongoing efforts to reform asset pledge requirements applicable to U.S. branches and agencies of international banks under state and federal law. Last year's Global Survey found that only one country other than the United States applies asset pledge requirements to branches of non-domestic banking organizations. In our discussions with U.S. government officials on this issue, questions have arisen regarding the applicability of "endowment" or "dotational" capital requirements (pursuant to which a branch must maintain a certain level of assets above third-party liabilities as prescribed by the host country) to branches of non-domestic banking organizations outside the United States.

Our survey of the countries participating in this year's Global Survey found a variety of approaches to this issue around the world. As reported in the new table appearing at page 1 of the Survey, many countries do not have an endowment/dotational capital requirement, while for those that do, the funds are generally available to a branch for use in its business. These results support our conclusion that asset pledge and endowment/dotational capital requirements are fundamentally different inasmuch as the funds provided in connection with a branch's endowment/dotational capital, like the capital of a corporation, may be used by the branch in its business to make loans and investments as it sees fit, whereas asset pledge requirements limit eligible assets generally to highly liquid but low-yielding instruments.

A second matter selected for special attention in this year's Survey is the availability of "daylight overdraft" credit from central banks in connection with banks' daily payments activities. As reported in the new table appearing at page 3 of the Survey, where daylight overdraft credit is available, it typically is made available on equal terms to both domestic and foreign banks but only on a fully collateralized basis. Among the countries surveyed, the United States is the only one in which daylight overdraft credit is provided to banks on an uncollateralized basis, subject to limitations based on a bank's capital. For international banks, these limits are significantly more restrictive than those applied to domestic banks, although the Federal Reserve Board recently proposed changes to its payments system risk (PSR) policy that would diminish this differential for international banks that either are classified as "financial holding companies" under the Gramm-Leach-Bliley Act or have received from the Board the highest ranking under its "strength-of-support assessment" (SOSA) system. In addition, a recent change in the Board's PSR policy permits qualifying domestic and international banks to obtain daylight overdraft credit in excess of their limits through the pledge of collateral.

A significant development regarding payments systems is reported in the chapter on Canada, where legislation has been passed allowing non-depository institutions – specifically, life insurance companies, money market mutual funds and securities dealers – access to the payments system.

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 charts on the applicability of host country capital and management standards to non-domestic banking organizations seeking to engage in the host country in expanded financial activities, the applicability of host country asset pledge requirements (mentioned above) to branches of non-domestic banking organizations, the permissibility of merchant banking activities, supervision of financial conglomerates, host country supervision of non-domestic banks' branches, host country "umbrella" supervision of non-domestic banking organizations, and implementation of capital adequacy requirements for market risk.

The Survey also describes several other significant developments occurring in global financial markets. Deposit insurance schemes have been introduced or strengthened in several countries, including Luxembourg, South Africa and Turkey, while in Korea deposit insurance coverage has been reduced. In the United States, reform of deposit insurance coverage is the subject of heightened scrutiny by Congress, which has under consideration several proposals to raise coverage limits as well as premium payments. Important revisions to bank liquidation procedures, including enhancements to depositor protection, are under consideration in Switzerland.

A number of countries, including India, Pakistan and Panama, are implementing changes to enhance their banks' practices regarding classification of assets and loan loss provisions. An especially interesting initiative has been undertaken in Spain, where a "insolvency statistical coverage fund" has been created. The idea behind the fund is to accumulate additional resources during healthy economic periods to be used in the worst periods of the cycle.

Corporate governance issues have received increasing attention in several jurisdictions, including Singapore, where a Corporate Governance Code has been introduced, and Germany, where consideration is being given to a corporate governance "best practices" code.

A theme common to many country chapters is the extensive efforts that are underway to adapt legal and regulatory systems to the changing world of electronic banking and commerce. Luxembourg, for example, has adopted a law on electronic commerce, and several countries, including Belgium, Italy and Sweden, have taken measures to establish the legal framework for electronic signatures. The chapters on Germany and Singapore describe initiatives to promote Internet payment systems and virtual banking. Legislation on electronic funds transfers (EFT) has been adopted in Belgium, while Australia has adopted an EFT Code of Conduct.

Many of the country chapters highlight actions that have been taken, or are under consideration, to combat money laundering. Particularly notable are the actions taken by countries identified in the June 2000 report by the Financial Action Task Force (FATF) as jurisdictions whose existing measures to combat money laundering are deemed to be inadequate. For example, the Cayman Islands and Panama instituted a number of remedial actions in response to the FATF report and in June 2001 were removed from the FATF list. Israel for the first time enacted an anti-money laundering law, an action recognized by FATF as "welcome" progress.

In other countries, including Bermuda and Luxembourg, legislation was enacted expanding the coverage of anti-money laundering laws. Likewise, the European Union has under consideration revisions to its Anti-Money Laundering Directive to expand its coverage. Actions to enhance the effectiveness of suspicious activity reporting have been instituted in Argentina and Canada. Italy has adopted a set of anti-money laundering guidelines (commonly known as the "Ten Commandments") providing for significant enhancements to anti-money laundering practices.

Privatization of banks continues in a number of countries, including the Czech Republic and Romania. Pressures for cross-industry consolidation resulted in Germany in the combination of Dresdner Bank and Allianz AG. Cross-border merger activity has also continued, as witnessed by the continuing integration occurring within the Nordic region. Several countries, including Israel and Poland, have taken measures to promote an expanded foreign bank presence in their country, while in Japan such actions have focused on the rescue of failed institutions. Japan is also notable in that it has permitted non-financial enterprises to establish commercial banking operations.

Measures to improve the operation of stock exchanges and the financial soundness of securities firms, and to enhance the regulation of financial institutions' securities and derivatives activities, are reported in many of the chapters, including Austria, Belgium, Denmark, Germany, Latvia, Luxembourg and Singapore. The European Union chapter includes an informative discussion of the ongoing efforts to develop a new regulatory structure for the EU securities markets on the basis of the Lamfalussy principles.

In closing, let me express the Institute's deep gratitude to the banking associations and financial services supervisory authorities that have contributed to this year's Survey and without whose assistance this publication would not be possible.

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TABLE OF CONTENTS

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	Canada[7]
Belgium	Cayman Islands
Denmark	Finland
France	Hong Kong
Germany	Ireland
Indonesia[3]	Japan
Italy	Latvia
Korea	Norway
Luxembourg	Sweden
The Netherlands	Switzerland
Panama	United Kingdom
Portugal[4]	United States[7]
Romania	
Singapore[5]	
South Africa[6]	
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] Use of funds is subject to the approval of the Bank of Indonesia.

[4] Funds must be invested in Portugal.

[5] Of the required amount, 50% must be in "approved assets" (i.e., Singapore Treasury bills, Singapore government securities and other highly liquid instruments).

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

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

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
	Denmark	Panama
	Finland	Philippines
	France	Poland
	Germany	Portugal
	Hong Kong	Spain
	India	Sweden
	Ireland	Turkey
	Italy	United Kingdom
	Japan	

[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". New York-licensed branches and agencies are currently subject to a 5% asset pledge requirement with respect to their third-party liabilities.

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] Czech Republic Hong Kong[1] Philippines[1] Singapore Switzerland[1]	Austria Belgium Denmark Finland Germany Ireland Israel Italy Japan Korea Latvia Norway Portugal Spain Turkey	United States[2]

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

[2] 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.

APPLICABILITY OF HOST COUNTRY CAPITAL AND MANAGEMENT STANDARDS TO NON-DOMESTIC BANKING ORGANIZATIONS SEEKING TO ENGAGE IN THE HOST COUNTRY IN EXPANDED FINANCIAL ACTIVITIES

Host Country Regulator Makes an Independent Assessment of the Capital of a Non-Domestic Banking Organization in connection with Expansion of Its Non-Banking Activities in the Host Country on the Basis of Standards Comparable to Those Applied to Domestic Banking Organizations	**Host Country Regulator Does *Not* Make Such an Independent Assessment of the Capital of a Non-Domestic Banking Organization in connection with Expansion of Its Non-Banking Activities in the Host Country**	
United States[1]	Argentina	Korea
	Australia[2]	Latvia
	Bahrain	Luxembourg
	Belgium	Netherlands
	Bermuda	Norway
	Canada	Panama
	Denmark	Philippines
	Finland	Poland
	France	Portugal
	Germany	Spain
	Hong Kong	Sweden
	Ireland	Turkey
	Italy	United Kingdom
	Japan	Venezuela

[1] In the United States, an international bank that operates U.S. branches or agencies may engage in the expanded financial activities permissible for financial holding companies under the Gramm-Leach-Bliley Act (such as securities underwriting, insurance underwriting and merchant banking), provided that the bank meets a capital standard "comparable" to the "well capitalized" standard that applies to the conduct of such activities by domestic financial holding companies – i.e., each depository institution subsidiary of a financial holding company must have a minimum Tier 1 and total risk-based capital ratio of 6% and 10% respectively, and a minimum leverage ratio (Tier 1 capital to total assets unadjusted for risk) of 5%. As applied by the Federal Reserve Board to international banks, the "comparable" capital standard calls for an international bank that seeks treatment as a financial holding company to have and maintain a Tier 1 and total risk-based capital ratio (as determined under home country standards where consistent with the Basel Accord) of at least 6% and 10% respectively. The bank is not required to meet any minimum leverage ratio requirement, but the Board considers the bank's leverage ratio among other factors it reviews when determining whether the bank satisfies the capital and management standards. Alternatively an international bank may request a prior determination from the Board that its capital is "otherwise comparable to the capital that would be required of a U.S. bank owned by a financial holding company."

[2] Where the expansion of non-banking activities involves insurance operations, authorization from the Australian Prudential Regulation Authority, the regulator of the insurance industry in Australia, is required. Any decision to grant an authority would involve an assessment of the standing of a non-domestic banking organization, including its capital adequacy, but this would not entail application of Australian capital standards to the banking organization.

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	Australia	Italy	Canada
China	Austria	Latvia	Egypt
Colombia	Bahrain	Luxembourg	Indonesia
Poland	Belgium	Netherlands	Israel[7]
Uruguay	Bermuda	Norway	Japan[8]
	Brazil	Panama[4]	Korea
	Cayman Islands	Philippines[5]	Nigeria[9]
	Czech Republic	Portugal	United States[10]
	Denmark	Romania	
	Estonia	Singapore[6]	
	Finland	South Africa	
	France	Spain	
	Germany	Sweden	
	Hong Kong[3]	Switzerland	
	Ireland	United Kingdom	
		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] The holding of shares by Hong Kong banks is subject to restrictions based on the capital of the bank.

[4] 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.

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

[6] 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, where banks may hold more than 10% of a company.

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

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

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

[10] 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.

REGULATION OF FINANCIAL CONGLOMERATES

A Single Regulator Oversees the Activities of All Financial Conglomerates as a Whole	Identity of the Lead Regulator for A Financial Conglomerate Is Determined on the Basis of the Financial Conglomerate's Principal Activity	Financial Conglomerates Operate Without A Single or Lead Regulator
Australia Bolivia Canada[1] Cayman Islands Colombia Denmark Ireland Japan Korea Norway Peru Singapore Sweden United Kingdom	Argentina[2] Austria Estonia[3] Greece Hong Kong Israel Latvia[4] Philippines[5] Spain Switzerland United States[6] Venezuela	Bahrain Belgium Chile Czech Republic Finland France Germany Italy Luxembourg Netherlands Panama[7] Poland Portugal Romania South Africa Turkey Uruguay[8]

For purposes of this chart, a "financial conglomerate" is a group of companies under common control that engage exclusively or predominantly in financial services in two or more financial sectors such as banking, securities and insurance. See "The Supervision of Financial Conglomerates," A Report by the Tripartite Group of Bank, Securities and Insurance Regulators (July 1995).

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

[1] In Canada, the Office of the Superintendent of Financial Services oversees the operations of financial conglomerates at the federal level. Certain companies within a financial conglomerate (e.g., securities firms and insurance companies) may also be subject to supervision by provincial authorities.

[2] In Argentina, only financial conglomerates headed by banks are subject to consolidated regulation.

[3] The Estonian Central Bank is the lead regulator of financial conglomerates that include banks. Financial conglomerates that do not include banks do not have a lead regulator.

[4] Effective January 1, 1999, but only with respect to conglomerates headed by a bank or financial holding company registered in Latvia, in which case the Bank of Latvia is the lead regulator.

[5] In the Philippines, the Central Bank (BSP) supervises and conducts periodic or special examinations of banking institutions and quasi-banks, including their subsidiaries and affiliates engaged in allied activities, as well as non-bank financial institutions engaged in trust/investment management activities.

[6] In the United States, financial conglomerates that include banks and that are organized as bank holding companies (or whose bank holding company qualifies for treatment as a "financial holding company" under the Gramm-Leach-Bliley Act) are subject to umbrella supervision by the Federal Reserve Board, with the activities of subsidiaries of the bank/financial holding company regulated by the appropriate primary bank and "functional" regulators (e.g., the Office of the Comptroller of the Currency (OCC) in the case of national banks, a state banking agency in the case of state-chartered banks, the Securities and Exchange Commission in the case of securities firms, and a state insurance commission in the case of insurance companies). Nonbank financial conglomerates (i.e., those comprised of only nonbank financial institutions such as securities firms, insurance companies and commercial finance companies) are not regulated at the group level, although the Securities and Exchange Commission requires registered broker-dealers to file with it quarterly risk assessment reports regarding their material affiliates. The Gramm-Leach-Bliley Act for the first time permits national banks, with the approval of the OCC, to establish "financial subsidiaries" through which they may engage in financial activities that are permissible for financial holding companies (including securities underwriting and dealing but excluding insurance underwriting and merchant banking). The activities of national banks and their financial subsidiaries are subject to consolidated oversight by the OCC, with the appropriate functional regulator responsible for oversight of individual financial subsidiaries.

[7] In Panama, only financial conglomerates that include banks are regulated on a group-wide basis.

[8] The Central Bank of Uruguay regulates separate companies within a financial conglomerate (e.g., banks, insurance companies, investment fund managers and pension fund managers) but not the group as a whole.

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]		
Bahrain	Argentina	Germany	Peru
Cayman Islands	Australia	Greece	Philippines
Panama[3]	Austria	Hong Kong	Poland
Romania	Belgium	Indonesia	Portugal
	Bolivia	Ireland	Singapore
	Brazil	Israel	South Africa
	Chile	Italy	Spain
	China	Japan[6]	Sweden
	Colombia	Korea	Switzerland
	Czech Republic	Latvia	Turkey
	Denmark	Luxembourg	United States[7]
	Estonia[5]	Netherlands	United Kingdom
	Finland	Nigeria	Uruguay
	France	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 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.

HOST COUNTRY "UMBRELLA" SUPERVISION OF NON-DOMESTIC BANKING ORGANIZATIONS[1]

Host Country Financial Authorities Apply Their Umbrella Supervision To Non-Domestic Banking Organizations	Host Country Financial Authorities Do Not Apply Their Umbrella Supervision To Non-Domestic Banking Organizations	Host Country Financial Authorities Do Not Apply Umbrella Supervision To Domestic or Non-Domestic Banking Organizations
United Kingdom United States[3]	Australia[2] Austria Bahrain Belgium Bermuda Canada[4] Cayman Islands Chile Denmark Estonia[5] Ireland Japan Norway Philippines Singapore[6] South Africa Spain Sweden	Colombia Czech Republic Finland France Germany Hong Kong Korea Latvia Luxembourg Netherlands Poland Portugal Romania Switzerland Turkey Uruguay Venezuela

[1] For purposes of this chart, "umbrella supervision" refers to oversight of a non-domestic banking organization's banking and nonbanking activities in a host country as a whole. It does not encompass the oversight of activities of individual nonbank affiliates that may be subject to a host country's separate regulation (e.g., bank subsidiaries, securities firms and insurance companies). The first two columns in this chart report whether a host country that exercises umbrella supervision over domestic institutions also applies such supervision to non-domestic banking organizations.

[2] In Australia, umbrella supervision is not undertaken provided that the Australian Prudential Regulation Authority is satisfied a non-domestic banking organization is subject to group supervision broadly equivalent to that applied to domestic conglomerate groups which include an authorized deposit-taking institution.

[3] International banks with U.S. branches or agencies are treated under U.S. law as bank holding companies, and the safety and soundness of their U.S. operations as a whole are subject to the Federal Reserve Board's oversight. Under the Gramm-Leach-Bliley Act, international banks with U.S. branches and agencies may engage in the expanded nonbank activities permissible for financial holding companies (e.g., securities underwriting and dealing, insurance underwriting and merchant banking) if they meet capital and management standards "comparable" to the "well capitalized" and "well managed" standards applied to the conduct of such activities by domestic financial holding companies. In applying these standards to an international bank, the Board treats the bank as a global entity. Thus, under the Board's regulations, an international bank meets the well capitalized standard if its capital "is comparable to the capital required for a U.S. bank owned by a financial holding company". This standard includes application of a leverage ratio (Tier 1 capital to total assets unadjusted for risk) to the bank regardless of whether the bank's home country capital standards apply any leverage ratio. The bank meets the well managed standard if its management "meets standards comparable to those required of a U.S. bank owned by a financial holding company." [Footnotes are continued on the next page.]

[4] In Canada, the establishment of nonbank affiliates by non-domestic banks is subject to the approval of the Office of the Superintendent of Financial Services (OFSI), but the OFSI does not supervise such affiliates on an ongoing basis.

[5] In Estonia, formulation of guidelines for host country supervision of nonbank affiliates of non-domestic banks will be considered subsequent to finalization of pending changes to the Law on Credit Institutions.

[6] In Singapore, the establishment of affiliates by non-domestic banking organizations requires approval of the Monetary Authority of Singapore (MAS). MAS may impose prudential requirements in granting this approval.

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 firms)	Belgium
Belgium	Brazil (securities firms)	Canada
Bermuda	Denmark (securities firms)	Cayman Islands
Brazil	European Union (securities firms)	Colombia
Canada	Finland (securities firms)	Czech Republic
Cayman Islands	France (securities firms)	Denmark
Colombia	Germany (securities firms)	Estonia[4]
Czech Republic	Greece (securities firms)	European Union[5]
Denmark	Ireland (securities firms)	Finland
Estonia	Italy (securities firms)	France
European Union	Korea (securities firms)	Germany
Finland	Luxembourg (securities firms)	Hong Kong
France	Mexico (securities firms)	Indonesia
Germany	Norway (securities firms)	Ireland
Greece	Philippines[2]	Israel
Hong Kong	Poland (securities firms)	Italy
Indonesia	Portugal (securities firms)	Japan
Ireland	Singapore (securities firms; futures brokers)	Latvia[6]
Israel	South Africa (securities firms)	Luxembourg
Italy	Spain (securities firms)	Netherlands
Japan	Sweden (securities firms)	Norway
Latvia[1]	Switzerland (securities firms)	Pakistan
Luxembourg	United Kingdom (securities firms)	Poland
Mexico	Venezuela (securities firms)	Singapore
Netherlands		South Africa[7]
Norway		Spain
Peru		Sweden
Philippines[2]		Switzerland
Poland		Turkey
Portugal		United Kingdom
Singapore		United States
South Africa		
Spain		
Sweden		
Switzerland		
Turkey[3]		
United Kingdom		
United States		
Venezuela		

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

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

[2] In the Philippines, pursuant to recent changes in the General Banking Law, the Central Bank (BSP) has adopted the risk-based capital adequacy framework. This framework currently covers credit risks only; supplementary guidelines incorporating market risks will be issued in the future.

[3] Effective January 1, 2002 (on an unconsolidated basis) and July 1, 2002 (on a consolidated basis).

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

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

[6] Use of VAR models is not allowed in Latvia. Delta-plus method for options can be used with the consent of the Bank of Latvia.

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

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	A bank can make equity investments in non-financial businesses up to an aggregate amount equal to 5% of its consolidated Tier 1 capital without prior reference to the Australian Prudential Regulation Authority. Individual investments are generally subject to a limit equal to 0.25% of a bank's consolidated Tier 1 capital. A bank may undertake equity investments in non-financial businesses in excess of the 5% aggregate limit, provided the excess is to be deducted from Tier 1 capital of the bank and/or the group as appropriate.	Shareholdings of more than 15% in a bank need the approval of the Treasurer. The Treasurer has signalled 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, but subject to limits based on the bank's capital	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 through subsidiaries	Permitted up to 10% interest in industrial firm	Permitted to hold up to 10% interest
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	Not permitted
Colombia	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%

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
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, but such investments are generally not made
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	The consent of the central Bank of Egypt's Board of Directors is a pre-requisite for the ownership of more than 10% of a bank's issued capital; ownership through heritage is exempted
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

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
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
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

[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
Germany	Permitted	Permitted, but only through insurance subsidiaries	Permitted, but subject to limits based on the bank's capital; unlimited through subsidiaries	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, subject to limits based on the capital of the bank	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 limits based on the capital of the bank	Permitted, subject to regulatory consent based on suitability of the shareholder
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

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
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) permitted to banks, others permitted through subsidiaries	Generally limited to holding bank premises	Limited to holding 5% interest[7]	Permitted, provided total investment does not exceed investing firm's capital or net assets
Korea	Permitted through affiliates	Permitted through affiliates	Generally limited to holding bank premises and to 60% of bank capital	Subject to prior approval for investments in excess of 15%	Permitted, up to 100% 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%

7 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
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	Generally, there is a maximum ownership limit of 10% for any single owner of a financial institution; some exemptions, the most important relating to subsidiaries of foreign institutions and domestic financial groups

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 subsidiareis	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; expanded commercial banks may engage in securities activities directly or through a subsidiary; regular commercial banks may engage in securities activities through subsidiaries only	Insurance agency and brokerage permitted for unibanks through subsidiaries	Permitted for unibanks through subsidiaries	Permitted for unibanks with limitations	Permitted with limitations

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 10, 20, 33 and 50%
Romania	Banks may directly provide custodial, safekeeping and transfer agency services. All other permissible securities activities must be conducted through subsidiaries.	Insurance brokerage permitted	Generally limited to holding bank premises	Interests may not exceed 20% of a company's share capital and 10% of the bank's own funds. Such investments in the aggregate may not exceed 50% of the bank's own funds.	Acquisitions of 5% or more requires regulatory approval, with stricter restrictions applicable to investments by companies in which the state has at least a 10% interest.
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 hold equity participation in stockbrokering firms with MAS approval	Locally incorporated banks may own insurance companies with MAS approval	Limited in the aggregate to 20% of bank's capital.	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 each 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
Sweden	Permitted	Permitted	Generally limited to holding banking premises	Limited	Not prohibited, but such investments are generally not made

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Switzerland	Permitted through specific license as securities dealer	Permitted through subsidiaries	Permitted	Permitted	Not prohibited, but such investments are generally not made
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 the bank's own funds and in the aggregate limited to 60% of the 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 limits on revenue), (2) a nonbank subsidiary of a financial holding company (no revenue limits) or (3) a financial subsidiary 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

Regulation and Supervision of Banks

The Central Bank of the Argentine Republic thinks that the bank supervisory function should be based upon the specific function of both the Superintendence of Financial and Banking Institutions (*Superintendencia de Entidades Financieras y Cambiarias - SEFyC*) and the market. This has led to a match between traditional supervisory mechanisms and market discipline that is implemented through a system called **BASIC**. Each letter of this acronym stands for a different instrument of supervision:

- Letter **B** refers to the obligation of the banks to issue bonds –or other long-term liabilities- on the capital market, for an amount equivalent to 2% of deposits, on a two-year term basis.

- Letter **A** refers to external auditors, who play a very important role in the banking supervisory function, assuring that information supplied by institutions adequately reflects their actual situation.

  Likewise, Central Bank rules define internal control as a process carried out by the Board of Directors, the management and other members of a financial institution, assigning specific roles to each of them. Within this framework, internal auditors are in charge of assessment and monitoring of internal control, and auditing committees are in charge of analyzing comments arising from internal audits, following up implementation of solutions to detected internal control weaknesses and coordinating internal and external control functions interacting in the financial institution.

- Notwithstanding the foregoing, letter **S** refers to the supervision carried out by the Superintendence, combining on-site inspection and off-site monitoring.

  The supervisory function carried out by SEFyC is intended not only to know a financial institution's situation, but also its medium term feasibility. That is to say, it is supervision aimed not only at determining whether the balance reasonably reflects the institution's situation, but also at knowing whether the quality of its management, current and future positioning, credit policies, funding, services, employment and compensation raising capacity, the quality of its geographical distribution, risk diversification, etc. allow to foresee the institution's safety and soundness over time.

  A bank supervisory process has been implemented, which goes further than periodic examinations carried out on financial institutions. This process is a continuous cycle combining both examination and off-site follow-up. It is comprised of four stages. The first three stages correspond to on-site examination of institutions and consist of planning, execution and communication of examination results and CAMEL rating. The fourth stage comprises off-site follow-up of the institution's situation through analysis of available information.

  At the end of each examination, each financial institution is assigned a composite rating, providing a framework to assess and summarize economic, financial, operating and rule compliance factors, expressed in a rating. To such end, SEFyC uses a supervisory method similar to the one used by the United States Federal Reserve, the CAMEL rating system, whereby risk key factors are analyzed and the following basic components are assessed: Capital, Assets, Management, Earnings, Liquidity.

- Regarding letter **I**, it should be remembered that adequate banking supervision can only be efficiently carried out if one has pertinent, reliable and timely information available. It is worth mentioning that the Superintendence is empowered to set forth information rules and regulations and to provide for monthly release of accounting statements and institutions' debt ratings. In this sense, the Superintendence makes a monthly release of economic-financial information about each institution.

- Last, referring to letter **C**, the Central Bank has set forth that any and all financial institutions should have at least a risk rating granted by an international rating agency previously registered on such institution's records. The final purpose of this system is to provide more information regarding solvency of financial institutions, especially to small-amount depositors.

  The joint action by the Superintendence, auditing firms, risk rating agencies and other supervisory bodies, is aimed at reducing to a minimum any negative connotations arising from excessive risk assumption and bad business practices, without having an essential adverse effect on the efficiency of the financial activity as a whole.

Bank Powers and Affiliations.

Argentine banks may generally conduct any activity not specifically prohibited by law, including futures and swaps transactions. Financial institutions are not empowered to conduct any operations – whatever their nature – not belonging to financial intermediation. Therefore, banks are not permitted to control industrial, commercial or agricultural firms unless they obtain Central Bank authorization.

Derivatives - Transparency

The Senate has approved a bill on derivatives and netting. Consideration by the House of Representatives is still pending.

Likewise, at the end of May 2001, the Executive issued Decree Law 677/2001, whereby Rules and Regulations on Public Offer Transparency have been approved. The purpose of this Decree is to position Argentina at the forefront regarding transparency and good corporate government practices through a legal framework that both acknowledges particular matters of companies operating in the public offer system, and streamlines treatment of problems of this sector.

Anti-Money Laundering Developments

On April 13, 2000, the Argentine Congress approved Act number 25,246, whereby the crime of aiding and abetting was amended to include money laundering within its scope.

Likewise, the Financial Information Unit (*Unidad de Información Financiera - UIF*) was created. This Unit will be functionally independent within the scope of the Ministry of Justice and Human Rights, and will be in charge of analysis, treatment and release of information in order to prevent and hinder laundering of money arising from different crimes. Additionally, this rule sets forth the competence and powers of this Unit.

It is worth mentioning that banks and other financial institutions mentioned in Act number 21,526 are included among persons bound to report any suspicious event or operation, notwithstanding the amount thereof. Likewise, the Act provides for criminal enforcement of its provisions.

The Executive issued Decree Laws 169/01 and 170/01, published in the Official Gazette on February 14, 2001. The first Decree sets forth rules and regulations applicable to Act number 25,246, defining basic aspects inherent to UIF's operations, as well as various concepts provided for in the Act in order to achieve efficient and effective functioning of the procedure provided for therein.

By Decree Law 170/01, the Executive appointed officers to act as representatives of the Central Bank of the Argentine Republic, the Public Income Federal Administration and the National Securities and Exchange Commission.

Notwithstanding the foregoing, the Executive is currently working on the final rules and regulations applicable to Act number 25,246.

Treatment of Non-Domestic Financial Institutions, Including Their Access to Local (Host Country) Markets.

On February 21, 1994, Decree 146/94 authorized the Central Bank to approve the opening of new branches, taking into account reasons of convenience and opportunity. In addition, differences in treatment between domestic and foreign-owned banks in opening new branches have been eliminated.

Mergers

The merger of a financial institution into one or several institutions of the same or different class shall be subject to Central Bank authorization. The merger agreement shall set forth that the merger is carried out "ad referendum" of the relevant shareholders meetings and has otherwise been duly authorized. The institution created after the merger (or the continuing institution, as the case may be) shall present an economic-financial structure that, at the discretion of the Central Bank, makes authorization of the project feasible.

Payments System Developments

The efficiency of the payment system continues to develop in connection with the operation of automated clearing houses for low value and gross and net settlements. In addition, systems for direct deposit of payrolls and check truncation have been implemented.

Various tasks related to the incorporation of a new means of payment – electronic transfers – have been carried out, thus integrating the whole country into a national clearing and settlement system.

AUSTRALIA

Regulation and Supervision of Banks

In September 2000, the Australian Prudential Regulation Authority (APRA) issued 10 harmonized prudential standards (available on APRA's web site www.apra.gov.au) for all authorized deposit-taking institutions (ADIs), which include banks, building societies and credit unions. These prudential standards and associated guidance notes (effective from October 1, 2000) establish the minimum prudential standards that ADIs are required to observe. They cover capital, liquidity, credit quality, large exposures, equity associations and audit arrangements.

In April 2001, APRA issued its self-assessment of the prudential supervision of Australian banks against the Basel Committee's Core Principles for Effective Banking Supervision. The self-assessment, which is available on APRA's web site, demonstrates that Australia's system of banking supervision is strong.

Regulation of Friendly Societies

In April 2001, APRA announced plans to review the *Life Insurance Act 1995* (LIA). The review will incorporate a fuller harmonization and integration of friendly societies than previously planned.

Since April 2000, APRA has been working closely with the Life Insurance Actuarial Standards Board and industry to identify issues raised by the proposed harmonization of actuarial standards for all life companies and friendly societies. During this process it became apparent that the issues were broader than just changes to actuarial standards and that a more comprehensive approach was needed.

APRA recognizes the LIA was comprehensively modified in 1995 and is widely regarded as among the most sophisticated in the world. It is not APRA's intention to overhaul the fundamental requirements of the Act, but instead to determine the best way of integrating life company and friendly society requirements, and of harmonizing the structure of the LIA with APRA's other legislative regimes. APRA will also take this opportunity to ensure compliance with the International Association of Insurance Supervisors (IAIS) principles for effective supervision and to shift from prescriptive legislative provisions to flexible standards.

There will be full consultation with industry before any changes are made.

Regulatory Reform of General Insurers

In March 2001, APRA issued its latest proposals to reform and modernize prudential supervision of general insurance companies in Australia. The revised proposals take into account comments from industry and other interested parties on the second Discussion Paper and drafts of the General Insurance Prudential Standards (covering Liability Valuation, Capital Adequacy, Reinsurance Arrangements and Risk Management) issued during 2000, and the "road test" results of the proposed technical standards on a representative sample of general insurers conducted in late 2000. Both the Discussion Paper and the draft Prudential Standards are available on APRA's web site.

The overall aims of the proposals for reform are:

- more consistent, rigorous and reliable valuation of insurance liabilities, supported by expert actuarial advice;
- capital adequacy requirements that are more sensitive to each general insurer's risk profile;
- reinsurance arrangements that are suitable to the scale, complexity and business mix of each company; and, most importantly,
- increased focus on corporate governance, ensuring that company Boards are well-equipped to fulfill their responsibilities to policyholders and other parties.

It is expected that the new regulatory regime for general insurers will come into effect on July 1, 2002.

Regulation and Supervision of Lloyd's Underwriters

On July 1, 2000, new rules and arrangements applying to the authorization and conduct of business of Lloyd's underwriters in Australia came into effect.

The main features of the new Lloyd's regime include:

- new security arrangements, requiring Lloyd's to maintain trust funds which are to be used to meet final judgements against Lloyd's underwriters in the event that through its usual arrangements Lloyd's does not pay such claims;
- an increase in the value of securities deposited with the Treasurer from $500,000 to $2 million. These deposits will be available to meet administrative costs in the event Lloyd's underwriters cease to conduct insurance business in Australia; and
- an improvement in the supervisory and regulatory framework governing Lloyd's.

The rules enhance the regulatory protection for Lloyd's Australian policyholders and accommodate Lloyd's new trading structure.

CLERP

Legislation enacting the sixth stage of the Corporate Law Economic Reform Program (CLERP) through the Financial Services Reform Bill (FSRB) has been introduced into Parliament (implementation of the new regime is intended to occur by October 1, 2001). The FSRB, which is to be administered by the Australian Securities and Investments Commission (ASIC), provides for streamlined regulation of financial products, operation of financial markets, clearing and settlement, financial service provision and disclosure. The FSRB can be viewed on the Commonwealth Treasury's web site (www.treasury.gov.au).

Responsibility for regulation of clearing and settlement in the Bill currently divides responsibility between the Minister for Financial Services and Regulation and ASIC. The Minister will retain responsibility for licensing, imposing license conditions, disallowing changes to operating rules and regulating ownership limits. ASIC is to ensure that operators of facilities are "fit and proper", and will be responsible for ensuring that facilities are operated in a fair and effective manner. Both the Minister and ASIC will be able to issue directions. Introducing the Bill, the Minister noted that he would be consulting with clearing and settlement facilities before introducing some amendments "to ensure that the Reserve Bank of Australia has an appropriate role in relation to systemic risk matters."

Developments Relating to Payment Systems, Electronic Commerce and Banking

In October 2000, the Payments System Board of the Reserve Bank and the Australian Competition and Consumer Commission (ACCC) released the findings of their joint study of interchange fees and access to debit and credit card schemes in Australia. A copy of this report can be found on the Reserve Bank's web site (www.rba.gov.au).

In early 2000, the ACCC formed the view that the collective setting of interchange fees was a breach of the *Trade Practices Act 1974*. Discussions between the ACCC and a group of banks continued from that date. In March 2001, the Chairman of the ACCC wrote to the Governor of the Reserve Bank recommending that the Bank consider using its powers to achieve reform of the credit card systems in Australia. In April 2001, under the *Payment Systems (Regulation) Act 1998*, the Bank designated the three open credit card systems in Australia (Visa, MasterCard, and Bankcard), bringing them under its regulatory oversight.

In November 2000, the Reserve Bank declared Australia's equity settlement system CHESS (Clearing House Electronic Subregister System) an approved real-time gross settlement (RTGS) system under section 9 of the *Payment Systems and Netting Act 1998*. The approval ensures that trades settled on an RTGS basis are protected from the "zero-hour" rule. CHESS now offers two settlement options: RTGS and net deferred, although a majority of transactions are expected to continue to be settled on a net deferred basis.

In December 2000, the Sydney Futures Exchange (SFE) merged with Austraclear Limited. The merger has integrated industry arrangements for clearance and settlement of debt securities and debt futures contracts. Austraclear Limited, which operates as a wholly-owned subsidiary of the SFE under the merged structure, clears and settles corporate and semi-government debt securities. The SFE also owns and operates the Sydney Futures Exchange Clearing House that settles payment obligations arising from exchange traded futures and options transactions. The merged entity is currently proposing to offer a central counterparty service for Commonwealth Government securities, semi-government bond trades and repurchase agreements. This is expected to generate savings in participants' back office systems and reduce the demands on liquidity needed to settle debt transactions.

A new futures exchange, the Australian Derivatives Exchange, commenced operations in January 2001 in competition with the SFE. However, it did not attract sufficient liquidity and closed in March.

In April 2001, ASIC released the Electronic Funds Transfer Code of Conduct (EFT Code) which provides the first regulatory framework for all forms of electronic funds transfer. The EFT Code (available on ASIC's web site www.asic.gov.au) will take effect on April 1, 2002, but early adoption by industry participants is encouraged. It is envisaged that the Code will provide comprehensive protection to users of electronic banking.

The EFT Code delivers protection by detailing the:

- disclosure consumers must receive before they first use a new form of electronic banking;
- information consumers must receive on receipts;
- liability for unauthorized transactions and system or equipment malfunction;
- protection of consumer's privacy; that, when the customer agreed, electronic communications rather than paper ones are allowed; and
- complaints investigation and dispute resolution processes.

Payments System Risk Policies

The Reserve Bank does not permit daylight overdrafts in Exchange Settlement (ES) accounts. Typically ES holders access intraday liquidity by entering into repurchase agreements with the Reserve Bank.

AUSTRIA

Reorganization of Banking Supervision

In 2001, a draft for a Financial Market Supervisory Authority Bill (*Finanzmarktaufsichtsbehördengesetz*) was sent out for review. It is supposed to devolve banking supervision from the Federal Ministry of Finance, while also creating a central supervisory authority for financial services.

Preparations for a New Capital Adequacy Framework

The Austrian banking community, as well as a number of other European states, criticized the focus on external ratings of credit customers in view of the differently structured clientele in Europe and asked for the equivalence of internal ratings.

Towards the end of 2000, the commentaries of national monetary/supervisory authorities and of interest groups were, though only partially, taken into account by Basel and Brussels and incorporated into the second consultative papers. The Austrian banking community convened numerous expert meetings to prepare a balanced joint position paper by all the groups concerned on the Basel consultative paper, for which the consultation period ended on May 31, 2001. Austria wants to avoid any competitive distortion and discrimination between small and big players in this field. The implementation of "Basel II", recently rescheduled to begin in 2005, and of the corresponding EU Directive will be one of the forthcoming priority issues for legislators and bankers.

Act on Enhancing Capital Market Activities

The Act on Enhancing Capital Market Activities introduces measures to improve the legal framework for the Austrian capital market. Alongside the abolition of the stock exchange turnover tax, this Act provides a number of new fiscal regulations for domestic and foreign investment funds: 20% of retained earnings are subject to a 25% tax, and the domestic investment funds are all subject to final taxation. Under the withholding tax regime on investment income, depositary banks have to make a so-called safeguard deduction on foreign investment funds unless the equity holder furnishes evidence that it discloses its income vis-à-vis tax authorities. Regarding the general fiscal treatment of speculative capital gains, Austria has, by and large, returned to the system applicable before the Tax Reform Act 2000 (*Steuerreformgesetz*).

US Withholding Tax Regulations

The Austrian Bankers Association tried to provide comprehensive information and was involved in the preparatory work for the conclusion of Qualified Intermediary (QI) Agreements. Based on a draft paper compiled by the Association, the Austrian "know your customer" documentation for identification of the economic beneficiary of an account and the necessary attachment (where the applicant assures compliance with the "know your customer" rules) were finalized. Before the end of last year, both documents were submitted to the IRS and accepted. This created the necessary framework to enable individual banks to conclude their QI

Agreements. The Association prepared a specimen paper that could be used by banks for customer information purposes.

Euro Cash Changeover

Within the euro project, January 1, 2002 marks a very special date. On this day, banks throughout the eurozone will start issuing euro notes and coins. It will also be the beginning of the so-called dual phase (to end on February 28, 2002), during which both the euro and the schilling will be accepted as legal tenders in Austria. However, on or after January 1, 2002 the Austrian schilling will cease to be used as deposit money.

Second Judicial Act Accompanying Euro Introduction

The introduction of the euro requires adjustments in laws and regulations also in the judicial domain. The First Judicial Act Accompanying Euro Introduction (*1. Euro-Justiz-Begleitgesetz*) of 1998 entered into force on January 1, 1999 and focused on the necessary civil, commercial and company law adjustments. Formal adjustments, especially those replacing schilling amounts with euro amounts, will be made under the Second Judicial Act Accompanying Euro Introduction (*2. Euro-Justiz-Begleitgesetz*) for numerous Acts.

Intra-Day Overdrafts

Being a member of the eurozone, Austria shall comply with the TARGET Guideline, which applies to the European Central Bank and the National Central Banks participating in the Eurosystem.

Applicability of Endowment/Dotational Capital Requirements

Under the Austrian Banking Law, 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 fulfil 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. The initial endowment capital is at least 5 million euro (the same amount as the initial capital required for a bank).

BAHRAIN

After the implementation of the market risk amendments to the Basel Capital Accord, the year 2000/2001 has been a period of consolidation in banking control rather than much innovation. The key developments were the issuing of updated "fit & proper" requirements for prospective shareholders of locally incorporated banks that wish to hold 10% or more of the voting stock of the concerned bank. The regulations also include a requirement for branches of foreign banks to notify the Bahrain Monetary Agency in the case of any new majority ownership of the bank.

In February 2001, new regulations concerning the consolidated capital adequacy of banking groups were issued. In brief, the regulations ensure that the distribution of capital within a banking group is such that all banks within the group have sufficient capital on a stand-alone basis. The regulations also require banks to maintain "target" capital ratios ½% above the minimum requirements set by the Agency, and to notify the Agency immediately such targets have been breached.

Finally for banks, the Agency issued a circular in March 2001 concerning the minimum requirements for a sound credit culture within the banks. This circular formalizes certain parts of the Basel Committee documents relating to credit risk and internal control systems in 1999 and 2000, and requires banks to carry out formal reviews of their credit policies, systems and controls on a regular basis.

Elsewhere, the implementation of IAS 39 (essentially fair value accounting and changes to provisioning policies) entailed significant preparations by banks and the Agency in terms of internal accounting systems and prudential reporting. The Agency was pleased to note that local banks have adopted IAS 39 with effect from January 1, 2001 and this standard has improved the transparency of published accounts and prudential returns.

For non-banks, the Agency introduced new quarterly information reports for money and foreign exchange brokers and investment advisors in 2000.

BELGIUM

Organization and Responsibility of Regulatory, Central Bank and Other Governmental Authorities in the Financial Sector

Central Bank

In late June 2000, the European Central Bank (ECB) switched to another procedure in its main refinancing operations. Until then, weekly tenders were conducted under the fixed rate tender procedure. Since the end of June 2000, the ECB has switched to the variable rate tender procedure, using the multiple rate (American) auction technique. The ECB thus addressed the overbidding issue.

Other authorities

A major change is being prepared by the Minister of Finance, especially concerning the Commission Bancaire et Financière (Banking and Finance Commission), which is the regulatory and supervisory authority for banks, investment companies and, partially, the financial markets. The purpose of this change is a more logical and efficient division of powers and resources both internally (according to the principles of corporate governance, among other things) and in relation to other bodies (the central bank, the courts, etc.). Generally, the banking sector is in favor of the changes, although some have favored further changes, such as addresing questions regarding supervision of insurance companies.

Definitive draft legislation is scheduled for publication in September 2001, and there will be a brief consultation of the different institutions concerned in order to adopt a law during the second half of this year. Moreover, a proposal to establish a framework for coordinating supervisory functions at the European level may be made during the period of the Belgian presidency of the EU.

Regulation and Supervision of Banks

Capital adequacy rules and reporting requirements for credit institutions were adapted to the provisions of the European Directives 98/31, 98/32 and 98/33 of June 22, 1998. Adaptations for calculating credit risk include:

- 50% risk weighting ratio for mortgage-backed securities;

- *under certain conditions, option to apply a 50% risk weighting to commercial mortgage loans granted after May 31, 2000; and*

- introduction of a 10% risk weighting, under certain conditions, for Pfandbriefe and similar instruments.

Other adaptations include the introduction of solvency requirements for commodity positions and the option to use internal models for calculating market risk requirements. An adaptation of the own funds rules for credit derivatives is being prepared.

With respect to the new Capital Accord, the Belgian banking sector agrees with the general principles, but many chapters still have to be improved or, in some cases, simplified. A fundamental aspect concerns the improvement and the application on a general scale of the cooperation between supervisory authorities in order to enhance convergence in the application of the rules and to support a level playing field.

Reporting and Disclosure Requirements

The Governing Council of the ECB has decided that from now on any major changes to statistics would be subject to a cost-benefit procedure. If they so wish, the national central banks can, under this procedure, consult informally with reporting agents. Belgium's central bank has already made use of this possibility to make four changes.

Internal Control and Audit Procedures

An organization rule concerning the compliance function is currently being prepared and should be published during the second half of 2001.

Regulation of Derivatives and Securities Products

A new prospectus scheme for warrants and reverse convertibles was approved by the supervisory authority. In addition, a new set of rules was imposed for advising on IPOs by financial institutions. These provide an alternative procedure for making a prospectus available. Whereas under the general rules a prospectus must be available in all branches of the sales network at least three bank working days before the *end* of the subscription period, under the alternative approach the prospectus must be available, at the customer's request after a telephone call, five bank working day *before* the start of the operation. Also, the supervisory authority encourages dissemination of the prospectus through the Internet. The intermediary must also prepare a summary of the prospectus and issue a press release at the latest the day before the prospectus is available.

Other issues include the following:

- Equal treatment of individual and institutional investors.
- Overbidding should be contained by closing the bid as soon as possible.
- Allotment rules must be stated beforehand in the prospectus, including the allotment between individual and institutional investors. There shall be no free allotment to "friends and family" (certain groups with which there is some affinity), nor preferential treatment for staff.
- Use of the "green shoe" (option given by the issuer to the lead manager to buy extra shares after closing of the bid in order to be able to meet the demand when it exceeds supply) is restricted. The number of securities covered by the option must remain within reasonable bounds and can no longer be used to sell securities on the secondary market, after allotment.
- As for justification of the issue price, for domestic issues the supervisory authority requires an analysis of the price range or the bid price. For international issues (where inclusion of such an analysis may give cause for liability claims), the supervisory authority requires a list of the risk factors, the corporate strategy and other data.

Anti-Money Laundering Developments

<u>Circular D1/BD/366 of the Banking and Finance Commission – List of Non-Cooperative Countries</u>

On July 19, 2000, the Banking and Finance Commission published a circular on the issue of non-cooperative countries and territories in the fight against money laundering. This circular is based on the document on this matter agreed by the FATF on June 22, 2000. The FATF aims at urging these countries to adopt the international standards in this field, and has identified 15 non-cooperative countries or territories. Hence, the Banking and Finance Commission has asked Belgium-based financial institutions under its supervision to pay special attention to their business relations and transactions with third parties, including financial institutions based in these 15 countries or territories. If there is no clear economic or legal motive for these transactions, their background and content should be determined as far as possible. The results of this research must be reported in writing, pursuant to article 8 of the Law of 11 January 1993 on preventing the use of the financial system for the purpose of money laundering (under this article, the financial institutions governed by the law must make a report in writing on any transaction which could be linked to money laundering. This report must be sent to the anti-money laundering compliance officer at each financial institution.

In its circular of August 9, 2001, the Banking and Finance Commission provided the Belgian credit institutions, investment companies, investment consultancy companies and exchange offices with an updated list, drawn up by the FATF, of countries and territories which do not take part in the fight against money laundering and which show big deficiencies in this respect. Four of the countries or territories included in the list of June 22, 2000 have found a solution for their deficiencies and have been taken off the list. Six new countries which do not join the fight against money laundering have been added to the list.

Significant Market Developments

On March 13, 2001, Dexia, the European banking group which is the worldwide market leader in local government finance, and Arcofin, the Belgian financial services group which is a shareholder of Artesia Banking Corporation, announced that their respective subsidiaries, Dexia Bank and Artesia Banking Corporation, would merge in Belgium. Together they would constitute Belgium's second biggest banking and insurance group, behind Fortis. Artesia Banking Corporation's and Dexia Bank's banking and insurance businesses will be fully integrated. This operation was completed on July 3, 2001. It was approved by the competent authorities (i.e., the supervisory authorities)

Developments Relating to Payment Systems, Electronic Commerce and Banking

During the period under review, a number of banking initiatives took place in the areas of electronic payments, electronic banking, and electronic and mobile commerce. The increase in electronic payments is expected to continue through 2001 and 2002 owing to the withdrawal of the eurocheque guarantee and the introduction of the euro.

In June 2000, the Council of Ministers approved a bill on electronic fund transfer instruments. This bill is to be put before Parliament in the fall of 2001 with a view to being adopted in late 2001.

Legislation establishing rules for the legal framework for electronic signatures and certification services has recently been approved by Belgium's House of Representatives; it should be adopted in the near future.

Payments System Risk Policies

In Belgium, domestic interbank payments are processed by either the ELLIPS or the CEC system, depending on the amount (and thus the risks involved). ELLIPS is the Belgian real time gross settlement (RTGS) system for large value payments. ELLIPS is also the Belgian component of TARGET, the European RTGS in euro.

Direct participation in ELLIPS is limited to the Post Office, credit institutions authorized in Belgium, credit institutions with a branch registered in Belgium or credit institutions operating in Belgium within the scope of the freedom of establishment and freedom to provide services in the Economic European Area. Participants must hold an account with the National Bank of Belgium (NBB). Moreover, direct participants should meet the conditions as described in the rules concerning operational ability, solvency (certain conditions concerning own assets) and legal security (the applicant-participant, subject to foreign law, provides the NBB with a legal opinion stating that the legislation it is subject to in its home country matches the conditions laid down in the rules).

ELLIPS being a RTGS, payments are settled on a one-by-one basis in the settlement accounts held by participants with the NBB. If funds in the sending participant's account are sufficient, individual transactions are booked instantly. Several instruments contribute to guarantee sufficient liquidity during the day:

- Monetary Reserves. The NBB opens a special reserve account for every counterpart liable to monetary reserves. After the period for an optional deposit (30 minutes after ELLIPS's close has expired, the credit balance on the settlement account is automatically transferred to the special reserve account. As soon as ELLIPS opens the next working day, the amounts held on the reserve account are automatically transferred back to the counterpart's settlement account where it immediately becomes available for settlement of ELLIPS operations.

- Intra-day Credit. The NBB grants its counterparts a free intra-day credit aimed at financing debit positions in euro on the settlement account opened in the name of the beneficiary institutions. In principle, intra-day credit is taken up in the form of collateralized overdrafts. The maximum amount of intra-day credit a beneficiary institution is allowed to take up is limited to the amount collateralized.

The NBB has a legal privilege on all eligible assets held as proper assets by its counterparts on a securities account opened with the NBB or in its securities clearing system.

At the end of the day, participants may draw upon the standing facilities, namely the marginal lending facility and the deposit facility, to satisfy their liquidity or investment needs for temporary liquidity shortages or surpluses.

The marginal lending facility is in principle applied in the form of overdrafts, and in exceptional circumstances also in the form of repurchase agreements, to satisfy the debit balances on the settlement account after ELLIPS's closure. After ELLIPS's closure, participants can deposit credit balances in euros in their settlement account with the NBB in a special deposit account. There is no limit to the amount a counterpart may deposit with the NBB under this facility.

The CEC is the net settlement system processing mass retail payments. Direct members must fulfil a number of financial (minimum risk asset ratio), operational (technical ability to operate), juridical (legal opinion for members incorporated under a foreign legislation) and volume criteria. The CEC multi-lateral net balances are settled via ELLIPS participants. Risk is also limited thanks to participation criteria (see above) and maximum unit value by type of transaction. Principles outlined in the "Core Principles for Systemically Important Payment Systems" BIS report (January 2001) are currently under review within the CEC in order to verify if implementation measures are necessary.

BERMUDA

Organization and Responsibility of Regulatory, Central Bank and Other Governmental Authorities in the Financial Sector

The review of financial regulation in Bermuda and the UK Overseas Territories in the Caribbean, commissioned jointly by the UK Government and the Governments of the six territories, was published in October 2000. The executive summary of the review concluded: "Overall, the BMA [Bermuda Monetary Authority] ranks as one of the most developed offshore regulators, meeting or exceeding many international standards and making considerable progress to meet those it is not yet in full compliance with. Similarly the controls in place in Bermuda, particularly in relation to the formation of companies are, in our view, a major deterrent to the criminal abuse of Bermudian companies."

The review endorsed Bermuda's framework for regulating financial services while also identifying a number of enhancements that could further reinforce its effectiveness. The review also recommended that "the section responsible in the Companies Registry for insurance should become an independent regulatory body and that the current powers exercised by the Minister of Finance are transferred to that new body." Government has accepted most of the detailed recommendations and a number of amendments and updates to financial legislation are currently being prepared, following consultation with industry and stakeholders.

Anti-Money Laundering Developments

The Proceeds of Crime Amendment Act 2000 came into effect on June 1, 2001. The amendment has the effect of extending the scope of the legislation to cover the proceeds of all indictable offences. It also enables the Court, in determining whether a person has committed an offence under the Act, to take account of relevant guidance issued by the National Anti-Money Laundering Committee. In addition, the amendment established a Confiscated Assets Fund. Following liaison with the National Anti-Money Laundering Committee, the BMA finalized and put in place during 2000 a targeted programme of on-site visits to licensed institutions designed to review and test their compliance with the legislation.

The review of financial regulation in Bermuda and the UK Overseas Territories in the Caribbean recommended that the scope of those covered by the anti-money laundering regulations should be extended in a number of respects. This recommendation, together with other issues identified in a joint public-private sector review of Bermuda's anti-money laundering framework, are to be the subject of consultation later in the year.

Other Legislative Developments

A minor amendment to the Bermuda Monetary Authority Act 1969 became operative on August 22, 2000. It provides formally for delegation of any power or the performance of any duty vested in the Authority to a director, officer or servant or to a committee constituted by the Board from persons who are directors, officers or servants of the Board. The change was necessitated by the increasing incidence of regulatory and licensing decision-taking in relation to the Authority's administration of various regulatory statutes.

The Segregated Accounts Companies Act 2000 became operative on November 1, 2000. It permits a company to register as a segregated accounts company if it is engaged in insurance business or, if it is not so engaged, to so register with the approval of the Minister of Finance.

The Companies Amendment Act 2000 came into effect on August 11, 2000. It amends sections of the Companies Act 1981 dealing with mutual funds, unlimited liability companies, repurchase of shares and certain other miscellaneous matters.

Payments System Risk

Bermuda's financial markets include only a very small number of local depository institutions. The BMA plays no role in the payments and settlements systems and the banks are responsible for their own arrangements for settling with counterparties. The question of daylight overdrafts with the central bank therefore does not arise.

BRAZIL

Restructuring the Brazilian Payments System

During the period under review, the Central Bank of Brazil was involved in a project to identify the four major sources of movement in banking reserve accounts: clearance and settlement of checks and other instruments; foreign exchange transactions; purchase and sale of government and private securities ("Cetip" and "Selic"); and stock exchange trading.

This project resulted in the enactment of Law 10214 of March 27th, 2001, which establishes the legal framework for restructuring the Brazilian payments system. Specifically, the Law provides for the creation of clearing houses to function as intermediaries in the payments system and, through the application of operating limits and collateral deposits, take over from the Central Bank much of the default risk in the payments system. The revised payments system is scheduled to be operational by January 2002.

Other Recent Developments in the Financial System

The Brazilian financial system is comprised of commercial banks, investment banks, financing companies, securities firms, saving banks and development banks, all of which are supervised by the Brazilian Central Bank. In addition, the Comissão de Valores Mobiliários (the Brazilian equivalent of the U.S. Securities and Exchange Commission) is also responsible for regulating equity investment funds.

Recent changes in the Brazilian financial system include the following:

- continuation of the consolidation process of the Brazilian banking system with increasing participation of foreign institutions and privatization of provincial banks;

- enactment of a new Law limiting the conduct by non-financial institutions of activities that are financial in nature;

- enactment of new legislation requiring banks to establish and/or formalize internal control procedures, creating responsibilities and functions similar to those of a "compliance officer";

- enactment of complementary and more detailed legislation on "money laundering";

- continuation of the segregation process between banking and asset management activities with the prohibition of banks (and their affiliates) from investing in funds managed by them and granting guarantees to such funds; and

- rules issued by the Central Bank of Brazil, regarding risk classifications of credit transactions, prescribing provisioning requirements for each of nine classification categories, and also providing that loans 60 days past due may no longer be held on an accrual basis. In addition, banks must factor into their provisioning policies their borrowers' credit history (i.e., performance on loans with other credit institutions and ability to service loans in the future). Banks must specify the criteria they apply in making provisions, maintain records of their provisions and make such information available to the supervisory authority upon request.

CANADA

Executive Summary

The last twelve months have seen considerable regulatory and legislative changes, which will have a significant impact on both domestic and foreign banks in the Canadian Financial Services Industry. The recent passage of the legislation (Bill C-8) to reform the framework of Canada's financial services sector is the result of more than four years of research, analysis and public policy debate about the future of Canada's financial services industry. With respect to foreign bank branches, the federal government introduced legislation (Bill C-22) to amend the *Income Tax Act* to establish the tax rules for foreign bank branches. The federal government is also in the process of implementing new anti-money laundering measures.

Federal Financial Services Reform

On June 13, 2001 the Canadian parliament passed Bill C-8, which revises the policy framework for Canada's financial services sector, including revisions to the laws governing domestic and foreign banks, trust companies, insurance companies, credit unions and other federally-regulated financial institutions. Much of the detail on how the regulatory framework will operate in practice will be set out in regulations, which are currently being developed and, therefore, it is likely that Bill C-8 will not be proclaimed into law until the fall of 2001.

Bill C-8 (and associated policy statements) implements several key measures that are intended to reshape Canada's financial sector in order to provide benefits to consumers and create opportunities for the Canadian financial services industry to be successful in an increasingly globalized financial services market. Expanded permitted investments for banks, a holding company organizational model, new ownership rules, expanded access to the payments system, a merger review policy, and a new foreign bank entry regime, are among the measures in the new policy framework.

- **Permitted Investments**

  Bill C-8 broadens the scope of investments that banks are permitted to make, with the intention of providing greater opportunities for banks to introduce new products and innovations to the Canadian marketplace. Importantly, the legislation also provides a regulation-making power to allow for further expansion in the range of permissible investments, thus adding to the capacity for more flexibility in the financial system.

- **Holding Companies**

  For the first time, bank financial groups will have the option of organizing their business activities in Canada under a holding company structure. Under the present structure in Canada (the “bank as parent” model), all banking functions and all subsidiaries of the bank are subject to the same broad regulatory regime which is designed to protect the safety and soundness of the parent banks. A "holding company" model creates the potential for lighter regulation in parts of the corporate group, because certain activities will be permitted to be undertaken in affiliates that are held by the holding company parent, rather than the regulated bank. Although the holding company itself will be regulated, the fact that activities that do not involve taking retail deposits will be offered through affiliates that may be subject to lighter regulation, should allow banks greater flexibility and lower costs, while still protecting retail depositors.

- **Ownership**

  Bill C-8 increases the limit that a single shareholder can hold of a widely held bank from 10% of any class of shares, to 20% of the voting shares and 30% of the non-voting shares. Bill C-8 also creates a tiered ownership regime, with banks that have over C$5 billion in shareholder equity being required to be widely-held, banks with between C$1-5 billion being allowed to be closely-held (though 35% must be publicly available), and banks under C$1 billion being allowed to be 100% closely-held.

- **Access to the Payments System**

  A measure that will change fundamentally the shape of Canada’s financial sector is the decision to expand access to the payments system to non-deposit taking institutions. Currently, as is the norm internationally, access to the payments system in Canada is available solely to deposit-taking institutions. Bill C-8 expands access to the payments system to allow life insurance companies, money market mutual funds, and securities dealers to gain access.

- **Merger Review Policy**

  The federal government has established (in a policy statement rather than the statute) a process to review mergers involving banks with shareholder equity over C$5 Billion.

- **Foreign Bank Entry Policy**

  The law allowing foreign bank branching was passed in Canada in 1999. Bill C-8 builds on the branching regime to provide greater structural flexibility to foreign banks. Foreign entities will now be allowed to hold more than one banking entity in Canada (e.g., several branches and bank subsidiaries may be held concurrently).

- **Consumer Provisions**

  Bill C-8 includes several measures intended to strengthen consumer protection, though most of them apply only to banks and not to other financial institutions. The consumer measures targeted solely at banks, include the following:

  - the extension of the existing *Bank Act* prohibition against coercive tied selling to all financial products offered by banks, not just loans;
  - account opening and check cashing requirements, under which some banks would be required to open accounts for any individual and cash federal checks for non-customers;
  - regulation-making powers relating to the provision of low-price accounts;
  - disclosure of check hold policies; and,
  - mandatory membership in the new Canadian Financial Services Ombudsman.

  Two other consumer measures apply only to certain types of federally-regulated financial institutions:

  - branch closure rules apply to federal deposit-taking institutions; and
  - annual public accountability statements will be required by all federal financial institutions with shareholder equity over C$1 billion.

  In addition, Bill C-8 creates the Financial Consumer Agency of Canada, a new regulatory agency to oversee compliance with the consumer provisions in the federally-regulated financial sector, monitor and report to Parliament on compliance with voluntary codes and public commitments, and provide consumer information and education on financial services.

Foreign Banks

- **Foreign Bank Branches: Tax Rules and Securities Activities**

  Although the statute allowing foreign bank branches was enacted in 1999, the legislation to amend the federal *Income Tax Act* and establish the tax rules for those branches was only passed on June 6, 2001. The amendments allow a foreign bank subsidiary to convert to a foreign bank branch on a tax-deferred basis, and also deal with the rules that will apply to a foreign bank branch.

  Securities regulation is under provincial jurisdiction in Canada, and the foreign bank community was successful in obtaining registration exemptions from the various provincial securities commissions for the securities-related activities of foreign bank branches; foreign bank subsidiaries have a statutory exemption from registration requirements for their "in-house" securities activities. As with the domestic banks, neither foreign bank branches nor foreign bank subsidiaries are able to underwrite shares, but they are permitted to be involved in such securities-related services as derivatives trading.

- **Deposit Insurance "Opt-out"**

  Changes were made recently to the legislation governing the Canada Deposit Insurance Corporation (CDIC), so “wholesale” financial institutions, including foreign bank subsidiaries, could "opt-out” of membership of the CDIC, since they do not accept retail deposits. Foreign bank branches cannot currently accept retail deposits and, therefore, are not required to be members of the CDIC. As of June 2001, eight foreign bank subsidiaries had opted out of the CDIC.

Additional Anti-Money Laundering Measures

The Proceeds of Crime (Money Laundering) Act (the Act), received Royal Assent in June 2000. The Act provides for the mandatory reporting of suspicious and prescribed transactions, as well as the reporting of large cross-border movements of currency and monetary instruments. The Act applies to financial institutions, as well as others including lawyers and accountants. It also establishes the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) for the receipt and analysis of these reports.

With the exception of the provisions in the Act that establish FINTRAC, the Act has not yet been proclaimed into force since regulations are needed to implement its new anti-money laundering initiatives.

Draft regulations were released for comment in Spring, 2001 and final regulations are expected by September. It appears likely that the final version of the regulations will make it mandatory for any person or entity subject to the Act to report to FINTRAC:

- any transaction where they are "reasonable grounds" to suspect that the transaction is related to a money laundering offence

- all (subject, perhaps, to certain exceptions) cash transactions of C$10,000 or more; and
- "electronic funds transactions" of C$10,000 or more.

In addition, the Act and its regulations will give FINTRAC powers to ensure compliance with its requirements and will continue the record-keeping and identification requirements established by previous legislation.

CAYMAN ISLANDS

Legislative Developments

During the second half of 2000, various legislative changes took place in the Cayman Islands. In response to the Financial Action Task Force Un-cooperative Jurisdiction Report, the Cayman Islands in mid-2000 enhanced its anti-money laundering legislation by issuing the Proceed of Criminal Conduct Law (Money Laundering) Regulations 2000 (PCCL), and in April 2001 issued Guidance notes on the Prevention and Detection of Money Laundering in the Cayman Islands. Under the money laundering regulations, banks and other financial businesses are required to ensure that they have in place adequate “know your customer” (KYC), and anti-money laundering procedures, that their staff are trained in such procedures and that records are retain for a specified minimum period. The regulations also make provision for the client identification of persons with whom a business relationship was formed before September 1, 2000 to be completed by December 2002, with a possibility of a six (6) month extension. An additional offence was also created under the Proceeds of Criminal Conduct Law (2000 Revision) making failure to report suspicious transaction a criminal offence.

An amendment to the Monetary Authority Law expanded the provision for the Monetary Authority to share information and cooperate with overseas regulatory authorities. In addition, provisions were included to prevent “fishing expeditions” and to safeguard the legitimate interests of the Cayman Islands.

Since the start of 2001, amendments have been made to the bank and trust company law, insurance law and mutual funds law empowering the Monetary Authority to conduct “fit and proper” tests of directors, officers and shareholders of institutions licensed to operate within or from within the Cayman Islands.

Further amendments to the Banks and Trust Law (2000 Revision) require all class B banks which are not branches or subsidiaries of banks licensed in other jurisdiction to establish a physical presence in the Cayman Islands. These banks will be required to maintain books and records and adequate resources (including staff and facilities) in the Cayman Islands.

The Cayman Islands received a favourable review on its financial regulatory system in The Review of Financial Regulation in the Caribbean Overseas Territories and Bermuda, published October 2000, and conducted by KPMG. The Report noted that Cayman’s legislation taken as a whole is extensive and covers most of the issues that would be expected in a jurisdiction that is fully compliant with international standards in the area of anti-money laundering.

In June 2001, the Financial Action Task Force (FATF) on Money Laundering removed the Cayman Islands from its list of non-cooperative countries issued one year ago. In its report, the FATF commended the Cayman Islands, stating that it had "taken concrete steps to implement legal reforms," and cited "significant improvements in its anti-money laundering systems." The FATF also announced its decision to withdraw the application of FATF Recommendation 21 to de-listed countries, under which FATF member countries were able to issue 'business advisories' to their financial institutions.

Financial/Banking Sector Performance

The number of active banking and trust companies licenses at the end of 2000 increased to 580 compared to a fall to 570 between 1998 and 1999. Despite this, forty-three of the top fifty banks in the world held active banking and trust companies licenses in the Cayman Islands, a symbol of confidence placed in the jurisdiction as a premier international financial center. Active licensees represented sixty countries, with 27% from Europe and 24% from North America.

Insurance

At December 31, 2000, the total number of insurance licenses on record was 673. Cayman's captive insurance industry continues to be one of the fastest growing despite increased competition from other domiciles and the continuing soft insurance market. During 2000, the Cayman Islands maintained its position as the second largest captive insurance domicile in the world, with an increase from 497 to 517 companies writing over US$3.3 billion in premiums and reporting total assets in excess of US$14.8 billion. Captives emanating from the U.S. increased slightly to 84%, followed by decreases for the Caribbean and Latin American region (4.8%) and Europe (3.8%).

Investment Services

In 2000, the Cayman Islands increased its dominance as the number two offshore mutual fund jurisdiction by eclipsing the 3,000 mark with assets of US$210 billion. At the end of 2000, there were 3,014 regulated funds, an increase of about 33%, reflecting the continued growth of the mutual funds industry in the Cayman Islands. In addition, the total number of mutual fund administrators licenses increased by 26, with Full Mutual Fund Administrators Licenses showing the largest increase, bringing the total number of mutual fund administrators to 202. The advent of the Internet and the introduction of on-line brokerage services contributed to the continued phenomenal growth in the mutual funds industry globally.

CHILE

Capital Market Initiatives

The Ministerio de Hacienda announced a set of policy initiatives aimed at opening the capital market. The principal features of these initiatives are as follows.

1. They will eliminate the disposition that is used to reduce the margin of subordinate bonds that could be calculated as effective assets, when investments in subsidiaries, either in the country (Chile) or abroad, exist. This also applies to banks with foreign branches. (Art. 66, paragraph 3, of the LGB)

2. The elimination of the restriction affecting subsidiaries of foreign banks with regards to receiving bills (letters) of credit from their home offices. These serve as guarantees to enlarge individual limits of credit. (Art. 84, paragraph 3, letter d of the LGB)

3. Banks shall not be affected by the retained tax of 4% on the interests paid abroad, when they make trans-border loans or investments using capital from foreign credits.

4. At this time banks may undertake the issuing and guaranteeing for the placement and service of commerce effects; they may also acquire, cede, and transfer titles. The activities, however, are not very developed because almost no company carries out such activities. With the new announced changes, these offerings should increase and with them the banks shall gain a market which up to now did not exist.

5. Banks shall be able to receive and administer voluntary savings and agreed deposits which presently are channeled exclusively through the AFPs (Administrator of Pension Funds). This opens the possibility for a new line of business for banking enterprises.

6. Bonds of national denomination (Chilean Peso) issued in the domestic market shall be subjected to a tax, which is lowered from 35% to 4%, on the interest when they are acquired by foreign investors. Banks are important issuers of the bonds, which makes them more attractive for foreign investors. This favors the integration of the banking system with the rest of the world.

7. The tax on capital profit through the sale of stock with a high stock exchange volume shall be eliminated when acquired after the April 19, 2001. Bank activities generally find themselves included in this definition. This generates even more incentives for banks to increase their capital through stock offerings.

8. The deregulation of mutual funds will promote expansion in this industry. Banks that maintain subsidiaries dedicated to this market will benefit from the expansion.

9. The introduction of the administrative entity of multiple funds will allow many various business activities currently conducted through many different companies to be grouped into one corporation. This will reduce the operating cost of bank subsidiaries.

10. Banks shall be able to participate in the placing of these private offerings of bonds and titles of fixed rent which will be regulated by the SVS (Superintendencia de Valores y Seguros). They shall also be able to act as qualified investors.

11. The new tax process for the short-term sale of stocks and bonds will promote these activities and consequentially the business of the bank subsidiaries that carry them out.

Anti-Money Laundering Developments

The Chilean Banking Association has been constantly worried about this issue, and therefore, the work of the Money Laundering Prevention Committee has continued.
The government has created the Unidad de Inteligencia Financiera (Financial Intelligence Unit). It will be in charge of the prevention and prosecution of Money Laundering.

CHINA

Regulatory Developments in the Banking Industry

In February 2001, the People's Bank of China (PBOC), the central bank of China, required that the capital adequacy ratio at Industrial and Commercial Bank, Bank of China and China Construction Bank reach 8% by the end of the year. Agriculture Bank of China was given one year of grace period due to its high percentage of policy (directed credit) loans. To achieve this goal, these banks will be allowed to issue debt in the domestic market.

More nonbank financial institutions, such as securities firms and fund management companies, were approved by PBOC to enter China's interbank lending market. By the end of 2000, the total number of members of the interbank lending market reached 465, up 146 from the previous year. According to the regulations set by PBOC, branches of securities brokerages that are members of the national interbank lending market are barred from engaging in interbank trading. Regulations also require that member securities brokerages borrow or lend money only through the trading system of the National Interbank Lending Center.

In December 2000, the PBOC and Ministry of Finance jointly announced 68 accounting firms that are eligible to conduct auditing for financial institutions. This development was the first of its kind in the history of China's accounting practice. The statement requires financial institutions to terminate their relationships with their auditors if these auditors are not on the list.

Starting September 2000, the PBOC lifted its restrictions on the foreign currency lending rate. Banks are free to determine the lending rate based on international interest rate movements, costs of funds and risk profiles. The deposit rate for US$3 million (or equivalent value in other currencies) and above can be set by the bank and the borrower. The rate for deposits below US$3 million is set by the Banking Industry Association.

Regulatory Developments in the Securities Industry

Since the beginning of 2001, the China Securities Regulatory Commission (CSRC) has issued a dozen regulatory rules to strengthen its supervision over the securities industry. These rules govern the share issuance, information disclosure and introduction of independent director systems.

On February 22, 2001, CSRC issued the Policy of Suspension and De-listing of Loss-making Companies from the Stock Market. The passage of this policy shows that in the future CSRC will be more concerned with the performance of public companies and investors' interests than making the stock market a financing channel for money-losing companies, even if they are state-owned enterprises.

In April 2001, CSRC issued new rules on guarantees given by securities firms. According to this rule, brokers with net assets of less than 200 million yuan (about US$24.4 million) are not eligible to provide guarantees; the total guarantee shall not exceed 20% of the net assets of the guarantor; securities firms cannot provide guarantees for those corporations whose securities they are underwriting; securities firms cannot offer guarantees for clients for the purpose of stock trading.

CSRC announced on April 17, 2001 that securities firms would no longer be allowed to become directly involved in venture capital investments or indirectly involved through equity participation in venture capital companies. This regulation is designed to make securities firms standardize their operations and prevent them from incurring risks by being excessively involved in venture capital investments.

On February 21, 2001, the PBOC and State Administration of Foreign Exchange (SAFE) jointly issued a statement that would allow individual domestic residents to invest in foreign currency stocks listed on the domestic stock exchanges (B-share stock) provided they have foreign currency deposit accounts in the commercial banks operating in China before February 19, 2001. After June 1, 2001, the time limit on the deposit accounts will no longer be valid.

Developments in the Disposal of Nonperforming Bank Loans

By the end of 2000, China Great Wall Asset Management Company (AMC) had recovered 4.03 billion yuan (about US$491.5 million) of nonperforming loans through rental, securitization and restructuring. The company also held an auction in Beijing in May 2001 to sell 12.7 billion yuan (about US$1.55 billion) of nonperforming bank loans that covered 19 sectors and 30 provinces and municipalities. However, the auction generated little interest among investors.

Banking Industry Developments

The restructuring plan of Bank of China Group was approved by the Central Bank in December 2000. Under this proposal, 10 current member banks of the Group in Beijing and Hong Kong would be consolidated into one entity, which would then seek stock listing on the Hong Kong Stock Exchange after the restructuring is completed. According to the original plan, the overhaul would take about one to two years, but current global economic and financial conditions are likely to lengthen the restructuring process.

In November 2000, China's only privately owned joint-stock bank, Minsheng Bank, went public after selling 350 million A shares and raising 4.13 billion yuan (about US$495 million). Minsheng is the third Chinese bank to list on the domestic stock market. The other two banks are Shenzhen Development Bank and Shanghai Pudong Development Bank. Shenzhen Development Bank, which issued shares to the public in April 1998, is jointly owned by Shenzhen Municipality, Guangdong Provincial Government and individual investors. The major shareholders of Shanghai Pudong Development Bank, which issued shares to the public in November 1999, are Shanghai Municipality and individual investors. Since February 2001, China Merchants Bank and Huaxia Bank made public their intention to become public-holding companies, and more Chinese banks have shown similar interests. Everbright Bank of China, Bank of Communications, CITIC Bank and Fujian Industrial Bank have already filed IPO applications with the CSRC. There is no indication yet whether the state will divest its stake in these banks if their IPO applications are approved.

In other developments, Industrial and Commercial Bank of China started building China's first banking data warehouse on March 14, 2001. It expected to deliver one or two application systems within the year.

Nonbanking Industry Developments

In January 2001, the PBOC issued new rules for China's trust and investment firms. The new rules define a trust and investment company as a financial institution dealing mostly in trust-related businesses; specify the establishment, modification and termination of a trust and investment company; and prescribe the scope of business that can be conducted by a trust and investment firm. In particular, the new rules prohibit trust and investment companies from accepting deposits, issuing bonds or borrowing from overseas.

Effective March 1, 2001, insurance companies, both domestic and foreign, were allowed to raise their investments in securities funds. Under the new rule, the cap was raised to 15% from 10%. By the end of last June, Chinese insurance firms had invested 9.65 billion yuan (about US$1.18 billion) in securities funds.

At its annual shareholders' meeting in April 2001, one of the largest Chinese insurance companies, Pacific Insurance Company, expressed it commitment to becoming a public company.

Future Developments

In December 2000, the CSRC announced that some securities brokerages would be allowed to go public in the coming year. GF Securities, Guosen Securities, China Communication Securities, China Eagle and CITIC Securities have been actively preparing for listing.

In April 2001, the PBOC announced that it would establish a nationwide financial information network to expedite its decision-making process and facilitate borrowers' credit checking requirements placed by financial institutions.

On April 27, 2001, the PBOC announced that it would deregulate the country's gold market and establish a gold exchange very soon. Although the location of the new exchange has not yet been decided, it is very likely that it will be formed by the end of 2001.

In April 2001, CSRC pledged that its major supervisory focus this year would be the corporate governance of exchange-listed companies. This demonstrated that shareholders' interests will be on the regulator's top priority agenda for the first time.

The Ministry of Finance announced in April 2001 that the business tax rate for the financial industry would be reduced by 1 percentage point each year in the next three years. Based on this new schedule, the business tax rate of financial companies would be 5% by January 1, 2003 from the current 8%.

CZECH REPUBLIC

Legislative activity increased significantly during the period under review. Numerous amendments to existing laws, forming the regulatory and legal framework for banks and other financial intermediaries, were either passed by the Parliament or reached various stages of drafting. The draft amendment to the Law on Banks (No. 21/1992 Coll., as amended) - the regulatory pillar of banking - was debated in the Parliament from April to November 2000, only to be rejected because of a controversial provision making mandatory coverage of bank deposits retroactive by seven years. The revised draft is again in the hands of the Government, with enactment of "harmonization" and other rules expected next year. In addition, the following bills are under debate in the Parliament or in advanced stages of drafting and awaiting submission to the Parliament: Law on the Conditions of Consumer Credit; Law on the Limitation of Cash Payments; and Law on Payment Transfer.

Legal acts, amending the existing laws and relevant for regulation of the financial sector, adopted between July 2000 to June 2001, include:

- Securities Law (as amended by Law No. 362/2000 Coll., in force from 1st January 2001);
- Stock Exchange Law (as amended by Law No. 251/2000 Coll., in force from 1st January 2001); and
- Commercial Code (as amended by Law No. 370/2000 Coll., in force from 1st January 2001);
- Law on Protection of Personal Data (No. 101/2000 Coll., after the expiration of delaying provision fully in force from June 1, 2001).

Laws and amendments enacted during the period under review brought about the following important changes in the regulatory framework for banking:

- establishment of a Guarantee Fund of the Security Traders (Brokers) *ex lege*, based on mandatory contributions from all financial intermediaries trading in securities;

- an improved legal regime for the satisfaction of claims, secured by real estate, by introducing the possibility of out-of-court (non-voluntary) auctions of mortgaged real estate;

- improvements in the legal regime of pledges (especially in the sphere of possessory liens);

- a new requirement that banks obtain special authorization from the Securities Commission to trade financial derivatives, notwithstanding that banks are otherwise legally obligated to use financial derivatives as hedging instruments;

- the introduction of a new class of claims under the Bankruptcy Law Amendment (payments to employees), which translates into a reduction of funds available for covering claims by banks on unpaid credits to 70%; and

- a new provision by the Czech National Bank modifying banks' minimum reserve requirements. Commencing July 12, 2001, (i) the base for calculating minimum reserves is reduced and (ii) for the first time, interest will be paid on such reserves at rates based on the rates paid in connection with the Bank's repo operations.

There was further significant progress in the accounting practices of banks. Through a ministerial provision to the Accountancy Law (in force from January 1, 2001) an improvement in accounting for financial derivatives was introduced, bringing the local standards closer to the IAS 39 rules.

Two issues affecting the sphere of commercial banking and stemming from the fundamental amendment to the Law on the Czech National Bank (in force from January 1, 2001) should also be mentioned:

- The Czech National Bank is no longer entitled to provide loans and credits for the Government.

- Banks will be supervised on a consolidated basis. However, implementation of this new approach has been delayed owing to the problems encountered in amending the Law on Banks (see above).

The Law on Payment Transfer, which is in an advanced stage of drafting, will bring in-market and cross-border credit transfers (including electronic transactions) into a high degree of compatibility with the respective EU Directives.

Completely new is the Law on Conditions of the Consumer Credit, which is under consideration in the Parliament. It represents an important upgrading of the consumer protection standards to a level comparable with the EU legislation. However, some issues, such as weakening of the bank secrecy protection and a non-equilibrium between the creditor and debtor rights, are being challenged by the banking community.

The enactment of the Law on Protection of Personal Data has raised strong concerns among banks and other financial intermediaries regarding its conflicts with the "know-your-customer" requirements of the anti-money laundering laws.

Market Developments

There were several important market developments during the period under review:

- the takeover of the Investiční a Poštovní Banka by the Československá Obchodní Banka, accompanied by a massive guarantee by the Government (the banks are among the four biggest in the Czech Republic);

- sale of the State's stake in the Komerční banka to Société Générale S.A. (this concluded the privatization of the banking sector in the country.

- the termination of Konsolidační banka as a bank and its transformation into the State Consolidation Agency (in accordance with the Law on the Czech Consolidation Agency, which is now in the Parliament; the legal founding of the existing Konsolidační banka, which is in the Law on Banks, as amended, expires on September 1, 2001).

Inter-Bank Exchange and Settlement System

An inter-bank exchange and settlement system has been founded and is owned and operated by the Czech National Bank. The inter-bank payment system operates on the following principles:

- real-time gross settlement;

- obligatory direct participation by all commercial banks;

- direct bilateral connections between head offices of commercial banks and the Clearing and Settlement Center;

- settlement on accounts held at the central bank (which also serve as the accounts on which obligatory reserves of banks are held);

- the irrevocability of all transactions accepted by the system;

- no overdrafts are permitted and no intra-day credit (daylight overdraft) is provided;

- uncovered transactions are not settled and held in a queue (with two priority levels);

- the processing of different types of transactions (credit transfers, credit transfer cancellations, information requests); and

- granting of overnight credit by the Czech National Bank.

Systemic risk is minimized by the real-time gross settlement on the basis of full cover for each payment. Irrevocability means that once the payment transaction has been accepted by the Clearing and Settlement Center, it cannot be cancelled or recalled.

The mandatory utilization of the system by all commercial banks is based on the Law on Banks. There is no difference in the treatment of domestic and non-domestic institutions. Certain financial institutions other than banks are allowed to participate in the system under bilateral agreements with the Czech National Bank and are given a special status as so called third parties.

DENMARK

Legislation Governing the Financial Sector

During the period under review, banks have seen the advent of new acts and executive orders, which stem to a large extent from the work of the Committee on the Financial Sector after the Year 2000. The Committee was appointed in August 1997 by the Minster of Economic Affairs to analyze and evaluate technological and market developments in the financial sector and identify areas where changes are needed.

The growing integration of the financial markets and financial groups led the Committee to recommend the implementation of a new statutory structure for the financial sector. The aim was to ensure uniform treatment of financial groups and to make various simplification measures possible.

The first part of the reform was completed in May 2001 when the Danish Parliament passed legislation called "The Act on Financial Undertakings".

The Act consolidates identical provisions in the Banking Act, the Investments Firms Act, the Insurance Business Act and the Mortgage Credit Banks Act in one Single Act. Thus, the Act contains provisions on joint definitions, good practice (detailed rules will be put forth in an executive order), ownership of financial institutions and financial holding companies, the duties and responsibilities of management, financial groups, new accounting rules, auditing, supervision standards and provisions on passing on customer data by one company to another within a financial group.

The word "financial undertakings" to which the Single Act applies is an umbrella term comprising banks/savings banks, investments firms, insurance companies, pension funds, mortgage credit banks and some specific financial institutions.

The provisions that have been transferred from the different specific Acts to the Single Act have been repealed and the residual provisions in the specific Acts remain in force for the time being.

The second part of the reform will focus on a review of the residual specific provisions. These provisions will either be retained in the specific Acts for the individual type of institution or they will be incorporated in the Single Act as specific parts of it. A Bill concerning the specific provisions will be tabled in the Parliament in the autumn.

Some amendments to the financial legislation were made, including the following:

- **Supervisory regulation of financial holding companies.** The Act contains provisions on minimum capital requirements for financial holding companies and upper exposure limits equivalent to those applicable to banks. Financial holding companies are considered as being banks and accordingly the minimum capital requirements have been set at 8% of the risk weighted assets of the holding company. In addition, financial group companies including the financial holding company shall be prepared on a consolidated basis. The Financial Supervisory Authority (FSA) may require a bank group to be separated from a financial holding company carrying on other business than banking activities under a new sub-holding financial company.

- **New accounting rules common to all financial undertakings**. The prudence principle (i.e., the lower of cost or market value) shall no longer be the fundamental criterion for financial reporting. In the future, the principal rule for valuation of assets and liabilities shall be the current value instead of the cost. The application of the new valuation principle will be implemented according to the development in European accounting conventions for similar undertakings.

- **The Financial Board**. This is a new decision-making body. The board consists of representatives of policyholders, banks, insurance companies and pension funds, among others (there are a total of 8 members). The Danish Bankers´ Association appoints one member of the board plus two experts to assist the member in specific, technical matters. The board is part of the FSA and reaches decisions in matters of principle and of significance to the future policies of the FSA. A majority of its members are independent of the institutions subject to supervision.

- **Passing on customer data.** Except in specific cases – limited to passing on usual information on customers for administrative purposes – any passing on of customer data requires the prior agreement with the customer, particularly in cases where the recipient company wants to use the data in its marketing activities or for advisory services.

- **Good practice**. The Act gives powers to the FSA to issue rules concerning good practice/honest business conduct. The FSA may for instance establish rules concerning customer information when opening accounts and information in case of passing on customer data. Cooperation will be established between the FSA and The Consumers Ombudsman, who also has powers to issue rules within the customer area, in order to avoid overlap or inconsistency in the rules.

The Capital Markets

In the area of capital market developments, there have been a number of initiatives to improve the Danish marketplace. In October 2000, bond trading on the Copenhagen Stock Exchange was transferred to the SAXESS trading system, the trading platform used in common with the NOREX exchange and for stock trading as well. Danish derivatives were switched to the same trading and clearing systems that the Stockholm Exchange uses, and a market-maker scheme in Danish stock derivatives will be launched in 2001. It is further expected that a new borrow-lending scheme for stocks will be implemented with the aim of supporting liquidity in both cash and derivatives markets.

Over the last year, the Copenhagen Stock Exchange has welcomed a number of new members, particularly major international investment banks.

In May 2001 the Danish Securities Council adopted new regulations for good practice for securities trading (best execution). The rules are based on the current rules for best execution issued by the Copenhagen Stock Exchange. The new rules will be effective December 1, 2001.

The regulations apply to all investment firms operating in Denmark, including subsidiaries and branches of foreign investment firms and all types of securities included in the EU-Investment Services Directive. The rules cover trades between investment firms and non-investment firms. The primary aim is to ensure transparency for private investors. Subsequently, detailed information shall be provided to the customer for trades up to certain limits. Some specific dealing requirements also are in place for such trades. The trading limits are the same as the current ones in place on the Copenhagen Stock Exchange (e.g., DKK 400,000 for stock trades and DKK 3 mill. for bond trades).

Payment System Risk Policies

Depository institutions are permitted to incur daylight overdrafts through the central bank (Danmarks Nationalbank) as long as they provide fully secured collateral for the overdrafts. Overdrafts are only allowed for institutions that hold a current account. The conditions for holding a current account at the central bank are described in "General Terms and Conditions for Current Accounts in Danish Kroner" or "Documentation for settlement of payments in EURO". Both descriptions can be downloaded from the central bank's website: www.nationalbanken.dk.

There is no differentiation between a domestically-owned institution and a domestically-chartered institution that is foreign-owned, as long as the institution holds a current account. Branches in Denmark of foreign credit institutions and investment companies which are subject to supervision in another EU Member State or in a country subject to a cooperation agreement with the EU on home country supervision can normally get a current account.

Since the central bank does not operate with a debit cap on daylight overdrafts, there is no differentiation between domestic institutions and branches or agencies of non-domestic institutions.

EGYPT

Financial liberalization in Egypt has been accompanied by structural reform of the banking system and increased focus on supervisory matters. In addition, independence of the Central Bank of Egypt (CBE) has become a significant issue.

A newly developed US$/L.E. exchange rate mechanism has helped bring greater stability to the market. The rate is announced by the CBE and is revised and determined daily according to the weighted average of exchange rates in the market as quoted by banks and exchange dealers. The CBE seeks to minimize fluctuations through its purchase and sale of foreign currencies.

Several actions have been taken to improve liquidity and promote credit availability. These include lowering the lending and discount rate and adjusting the local currency components of the banks' liquidity ratio by permitting inclusion in the numerator of local currency bonds issued by other banks. Reserve requirements were revised by excluding from the denominator savings accounts with a maturity of at least 3 years.

Steps also were taken to improve the investment environment in order to attract more foreign and local investments. These included amendments to the Investment Incentive Law to encourage investment in infrastructure projects and amendments to the Financial Leasing Law. Legislation amending the Real Estate Mortgage Law is also under discussion.

The Capital Market Authority (CMA) issued new rules for listing securities on the Cairo and Alexandria Exchanges. These rules stipulate that a company must offer a portion of its shares, either through public or private subscription, in order to be listed. In addition, an agreement was reached with the Financial Times Corporation to issue a new international index. Other actions were taken to enable companies to issue financing bonds upon submission to the CMA of an appropriate certificate from an authorized credit rating agency.

Egyptian banks are pursuing efforts to enhance their technological capabilities and promote electronic banking. An agreement was concluded to establish the first Egyptian company specialized in smart cards.

EUROPEAN UNION

Preparations for the introduction of euro notes and coin have gathered pace. The European Commission published a Communication on the preparations that acknowledged the efforts and contribution of the banks but nevertheless pointed to the obstacles that still exist. The banks are determined to play their part to ensure a smooth introduction of the euro in January 2002. The banks are also active in developing new cheaper and more efficient means of achieving cross-border retail payments in euro. As part of this effort the banks have developed the Multilateral Interbank Fee that will form the cornerstone to make the entire straight-through-processing architecture function.

Economic and Monetary Affairs

The Economic and Monetary Affairs Committee (EMAC) of the European Banking Federation (EBF), which was set up at the end of 1999 and is chaired by Dr Hüfner, Chief Economist of HypoVereinsbank AG, published its second economic outlook for the Euro area on June 11, 2001 (the first outlook was published in December 2000).

The outlook is based on a poll of forecasts carried out among the chief economists of European banks and banking associations. The chief economists have revised their outlook for growth by more than half a percentage point to 2.4% in 2001 and 2.7% in 2002. Nevertheless, the forecast rate of growth is still close to potential growth and higher than forecast for the US.

Introduction of Euro Notes and Coin

On April 3, 2001, the European Commission published a Communication on the preparation for the introduction of euro notes and coin. Whilst acknowledging the efforts and contribution of the banks, the Commission once again strongly complained about the lack of progress in reducing costs and improving services for cross-border credit transfers. The EBF subsequently met with the European Commission to discuss progress in this matter and presented the actions taken by the banks to the European Economic and Social Committee.

These actions include the publication of European Guidelines for best practice concerning customer and nostro legacy currency account conversion; European Guidelines for best practice concerning legacy currency cross-border checks and Joint recommendations concerning the transition of travellers checks to the euro.

Together with the shortage of euro cash in the first weeks of 2002, the logistical and security challenges of moving euro and legacy currencies at the end of the transition phase are the two major concerns of this gigantic project. Financial and logistical support from national authorities is still being negotiated in several Member States. On the grounds of subsidiarity the Commission is not taking an active role in this area.

The European Parliament, under pressure from consumer and retail organizations, is pressing the European Central Bank (ECB) for sub-frontloading of notes to the public. Many banks think this is a good idea, but again due to subsidiarity there is little possibility of a European-level initiative.

Multilateral Interbank Fee

For many years, market forces, EU legislation and demands made by the ECB as well as the European Parliament have been putting pressure on banks to reduce customer prices and increase price transparency for retail cross-border payments in Europe. Against this background, the European banking industry has agreed on a pan-European multilateral interbank fee (MIF) of EUR 3 concerning cross-border credit transfers. The objective of these discussions is threefold:

1. to create a common approach to the generation of cross-border payments in euro within the European Union and support the use of euro cross-border clearing systems;

2. to enable banks to meet the requirements of the 1997 EU Cross-Border Credit Transfer Directive, particularly in terms of providing clarity of information for remitting customers and avoiding double charging practices; and

3. to contribute to the factors which may help consolidating confidence in the euro

Within this context, the situation of non-recurring, low-value, cross-border credit transfers initiated by private individuals are a major cause of concern to the industry because they are the most cumbersome types of payment, involving a high workload.

The banking industry has committed itself to bringing substantial improvements to the processing of cross-border credit transfers within the EU by creating the conditions which will allow straight-through-processing (STP). If successful, this will be a major achievement and, moreover, be unprecedented on a European level. It will mirror, on a European level, the changeover to automated procedures that took place on a domestic level in the various Member States twenty to thirty years ago. The MIF Convention is one of the essential building blocks to enable straight-through-processing .

Various building blocks need to be put in place to achieve straight-through processing, among which:

- a (new) S.W.I.F.T. standard specifically designed to create a minimum message framework for STP transactions (MT 103+ and MT102+);
- a precise definition of straight-through-processing;
- a generic standard for automated cross-border credit transfers (EBS 200);
- an international account number format (IBAN);
- a Bank Identifier Code (BIC); and
- a harmonized level throughout EU for the exemption of Balance of Payment reporting Requirements.

However, the Convention on a Multilateral Interbank Fee ("MIF") is the cornerstone to make this whole STP architecture work. It establishes a MIF which, in the absence of bilateral agreements between the sending bank and the receiving bank, remunerates services provided at the receiving side of cross-border credit transfers in euro by the beneficiary's bank and/or any bank acting on its behalf.

The allocation and distribution – if any – on the receiving side of the interbank fee paid by the sending bank falls outside the scope of the Convention and is therefore left to an arrangement at national level or existing national market practice.

The MIF applies, if no specific bilateral agreement on an interbank fee is in place, to the following type of transfers:

1. credit transfers where all charges are borne by the sender ("OUR" option);

2. the transferred amount is denominated in euro;

3. the transfer is capable of being executed on a fully automated basis by debiting the ordering party's account and crediting the beneficiary's account, as defined in the document entitled "Definition of Straight Through Processing for Euro Transactions";

4. the transferred amount does not exceed EUR 12.500, i.e., the threshold concerning the exemption from Balance of Reporting Requirements in all EU countries on January 1, 2002;

5. the payment is cleared and settled through a cross-border euro clearing system either directly to the credit of the beneficiary's bank or through an agent of the beneficiary's bank;

6. the transfer is made by a sending bank established in an EEA country other than that of the receiving or beneficiary's bank; and

7. the transfer is made to a beneficiary with an account in a bank or its branch which is established in an EEA country other than that of the sending bank.

The MIF Convention is accompanied by a Code of Conduct which contains guidelines to ensure its harmonized application throughout the European Economic Area. The Convention will enter into force on January 1, 2002. It has been notified to the EU Competition authorities.

European Code of Conduct For Home Loans

In 1997, the European Commission turned its attention to the follow-up that it intended to give to its Green Paper entitled "Financial Services: Consumer Expectations" which it had published in 1996. The Commissioner responsible for Consumer Affairs, Mrs Bonino, had, in this context, expressed on several occasions her desire to see a lasting dialogue between business and consumers set up at the European level. She considered that "ambitious and realistic" objectives should be defined on a common basis and that the right conditions should be created to produce concrete results, based on a fair balance between consumer protection and market rules. The EBF responded positively to this appeal.

The European Commission officially inaugurated the dialogue between the financial sector and consumers at the European level in July 1997. The representatives of the consumer organizations and the financial sector decided to give priority to the examination of information in the area of mortgage credit and, more particularly, prepare a Code of Conduct on this. An agreement on a Code was reached after years of negotiations.

The European Code of Conduct for Home Loans consists of four parts:

1. The **definition** of the notion of "home loan" credit" was one of the most debated issues because it determines the Code's scope. It was clear to all negotiating parties from the outset that the Code would not only cover mortgage loans but also, to a certain extent, credits granted on the basis of other sureties, provided the purpose of these credits was to purchase or transform private immovable property. It also includes, more particularly, other sureties commonly used in a Member State for the purchase or transformation of private immovable property.

2. The **"implementation page**" explains what needs to be done by the European Credit Sector Associations and their members once their governing bodies have officially approved the Code. Adherence to the Code is voluntary. However, one of the key features of the implementation process is a website which will be set up by the European Commission and on which the individual banks adhering to the Code will be listed.

3. The core of the Code is the provision listing the **information to be given at the marketing stage** ("Customer General Information").

4. Finally, the Code introduces a major innovation by obliging banks to provide their customers with a **Standardized Information Sheet** (**SIS**) which summarizes the main features of the proposed loan and will therefore enable consumers to compare offers made.

The Code is a well-balanced compromise. It was approved by the EBF governing bodies as well as by the other parties that negotiated it. The European Commission issued a Recommendation in March 2001 that publicizes the Code.

Revision of The Basel Capital Accord

The EBF was heavily involved in the Basel consultation process. In a series of meetings with experts from the Basel Committee the EBF pointed out that due to the regulatory structure in the European Union all banks would have to meet the requirements of the new Accord. It was therefore essential that the needs of smaller banks were taken into account. For example, there was a clear need for a simple internal ratings based approach that would be available for the majority of banks operating in the European Union.

After careful consideration of the second Basel consultation document the EBF was very conscious that many areas of the proposals remained at an early stage. To bring this concern to the attention of the Basel Committee a letter signed by the President of the EBF, Mr. Sella, and the American, Canadian and Japanese banking associations was sent to Mr. McDonough on May 21, 2001. The letter requested that the Basel Committee produce additional interim papers for study by the banking industry on the key areas in the proposals that are either entirely new or only partially set out (retail exposures, project finance, equity exposures, counterparty risk in the trading book, securitization, operational risk and the third pillar) by August 2001.

The Basel Committee has now postponed the implementation of the new Accord to 2005. This will allow much needed extra time for study of the areas of the proposals that require further work. The European Commission intends to continue to work on its legislative framework in parallel with developments in Basel.

Financial Conglomerates

On April 24, 2001, the European Commission issued proposals for a directive on the supplementary supervision of financial conglomerates. The proposals are largely based on the work of the Joint Forum on Financial Conglomerates. The European banking industry is, nevertheless, concerned that the timing of the proposals is inappropriate given the state of the Basel process. Moreover, there is fear that a European initiative in this area without parallel developments in other G10 countries, as envisaged by the Joint Forum, could seriously damage the international level playing field.

State Aid to Public Banks

The European Banking Federation lodged a formal complaint, on December 21, 1999, with the European Commission against the German system of “Gewährträgerhaftung” and “Anstaltslast” (public guarantees) of the German Landesbanken and savings banks. A supporting brief was subsequently filed on July 26, 2000.

The formal complaint set out the following points:

- The EBF considers the system of public guarantees for Landesbanken and savings banks to be illegal state aid, which creates significant market and competitive distortions not only in Germany, but also throughout the EU's single market.

- The purpose of the complaint is to end these distortions by the removal of "Anstaltslast" and "Gewährträgerhaftung". The EBF wants the German Landesbanken and savings banks to comply with Community law and to compete without unfair advantages.

- The system of public guarantees constitutes substantial financial aid, because among other benefits it enables public sector banks to obtain very favorable external credit ratings. They are thus in a position to reduce their refinancing costs and to facilitate refinancing in general.

- The current system adversely affects trade between Member States. This is true both for other banks wishing to compete in Germany with German savings banks as in other major financial centers outside of Germany (Paris, London etc.) where especially Landesbanken compete on an unfair basis.

On January 26, 2001, the European Commission sent a "letter of formal notice" to Germany stating that it considered the guarantees as incompatible with Community law. Since then negotiations have progressed on how the German authorities intend to solve the problem. As yet, no final solution has been reached.

The Lamfalussy Process and The First Two Directive Proposals

The Committee of Wise Men, led by Baron Lamfalussy, delivered its final report on November 15,2000, proposing a new regulatory structure for the regulation of EU securities markets. The proposals were aimed at improving the ability of the regulatory structure to adapt to fast changing market conditions. They were also a response to the challenge of implementing a vast range of legislation in the pipeline that had been identified as essential to create unified EU Single Market under the so-called Financial Services Action plan.

Basing itself on existing comitology procedures of the EU agreed to in 1999, the Committee recommended distinguishing between four levels of securities markets legislation and implementation, each fulfilling a distinct component of the unified regulatory framework. In each case, the core, or framework, principles ("Level 1") would be set through a modified co-decision procedure between the Parliament (with only one reading) and the Council, which would also identify the areas that would constitute the technical, second-tier measures. These second-tier, implementing measures ("Level 2") would be passed through a quicker procedure using the Commission's "comitology" powers. This structure would be supported by strengthened cooperation between national regulators to ensure harmonized and consistent implementation at the national level ("Level 3") and strengthened enforcement ("Level 4").

To implement the new process, the European Commission issued two Decisions on June 6, 2001, establishing the European Securities Committee (ESC) and the Committee of European Securities Regulators (CESR). The ESC is set up initially in its advisory capacity, in which it will advise the Commission on securities issues relating to the preparation of a Directive or Regulation to be adopted through the co-decision procedure (Level 1). In its regulatory capacity, which will be defined in each case within the framework directive or regulation, the ESC will assist the Commission in the exercise of its implementing powers (Level 2) delegated to it by Level 1 legislation and in accordance with the comitology procedures.

On May 31, 2001, the Commission proposed the first two directives that are to be passed according to the Lamfalussy principles, a directive for single prospectuses for issuers and the Market Abuse directive. However, given the timing of these two proposals (preparatory work on them had started before the Lamfalussy reports and the Commission had to rush to meet its deadlines), they resemble more closely traditional directive proposals in their level of detail. However, the Commission has set out to use the new procedure fully in the next piece of legislation, the revised Investment Services Directive, for which a lengthy consultation process is envisaged.

Having been a proponent of the Lamfalussy proposals from the beginning, the EBF is keen to steer, together with other market representatives, the future consultation practices of all institutions of the Lamfalussy process, with a view to establishing a clear and explicit framework for transparency and accountability.

Revising the Investment Services Directive

The European Commission issued two Communications dealing with the revision of the Investment Services Directive (ISD), which was adopted in 1993 to establish a single passport for investment firms but failed to accomplish this fully due to remaining differences in national rules. The Commission launched the initial consultation on the revision of the Directive with a "Communication on the Application of the Conduct of Business Rules Under Article 11" of November 14, 2000 and the "Communication on the Upgrading of the ISD" of November 15, 2000. The latter, which is the main consultation document, focused on the question of whether to apply the country of origin or host country regime for wholesale and retail business of investment firms, the categorization of investors and the conduct of business rules, a possible regulatory framework for alternative trading systems (ATSs) and clearing and settlement.

A new consultation document, outlining in more detail the Commission's strategy for revising the Directive, is expected in mid-July 2001, and will be open to consultation for three months. The proposal for the Directive is expected in December 2001 or January 2002.

The EBF has been actively involved in the consultation on the ISD so far and will also be active in the forthcoming process.

Harmonization of Conduct of Business Rules and Categorization of Investors

The Forum of European Securities Commissions (FESCO) issued a consultative paper on the harmonization of conduct of business rules in February 2001, with a consultation process that lasted three months. The second consultation paper is expected in July 2001. The paper is aimed at providing input to the ISD proposal by outlining a common level of investor protection that could be applied to a common categorization of investors.

The latter issue is the subject of two previous FESCO papers (November 1999 and March 2000) that attempted to introduce a new categorization of investors for the purpose of applying differentiated conduct of business rules, but, in the face of industry reactions, FESCO is expected to re-visit this categorization in the coming months.

The EBF has been actively involved in the consultation on the conduct of business rules and will be involved in the expected consultation for the categorization of investors.

Proposed Directive on Takeover Bids

After many years of negotiation, a political agreement was reached by the European Council in June 2000 on a directive to harmonize the rules in the European Union concerning takeovers and the rights of minority shareholders. The EBF supported this proposed directive, which was a key element needed to develop the European financial markets and encourage investment and sound management.

On May 23, 2001, in an unexpected move, the German government withdrew its support for the Common Position on the Takeover Directive, resulting in a compromise agreement being reached through the conciliation process. However, on July 4, 2001 the compromise agreement was rejected by the Plenary Session of the European Parliament, effectively killing the directive.

Euribor, Eonia and the Development of Eurepo

Euribor and Eonia, which were launched at the start of 1999 by the EBF and the ACI, the Financial Markets Association, have become firmly established as the benchmarks for the euro-denominated interbank market. Euribor (Euro Interbank Offered Rate) is the rate at which euro interbank term deposits within the euro zone are offered by one prime bank to another prime bank. Eonia (Euro OverNight Index Average) is an effective overnight rate computed as a weighted average of all overnight unsecured lending transactions in the interbank market, initiated within the euro area by the contributing panel banks.

The initial panel of 57 banks, selected to quote for both rates, has continued to shrink due to merger activity, and currently stands at 49 banks. The Euribor Steering Committee, consisting of independent money market experts, has overseen the management of the rates and the application of the Codes of Conduct.

In relation to Eonia, the EBF is working closely with the European Central Bank (ECB), which calculates Eonia on behalf of EBF / ACI.

With the increasing development of a European repo market the need for a benchmark for secured transactions has become urgent. Therefore, in collaboration with the European Repo Council, the EBF has commenced work on developing a benchmark for the European repo market called Eurepo. The rate would be based on quotes by a panel of banks, active in the European repo market, for repo transactions using general collateral. It is anticipated that the new benchmark would be available early in 2002.

European Banking Federation Master Agreement For Financial Transactions (European Master Agreement – EMA)

The EBF, in cooperation with the European Savings Banks Group, launched the European Master Agreement (EMA) on October 29, 1999. Subsequently, the European Association of Co-operative Banks associated itself with the Agreement.

The EMA consolidates into a single set of harmonized documents, various domestic master agreements used within the euro zone and certain neighbouring countries, particularly for repurchase transactions and securities lending. At the same time, parties to the EMA are able to choose the applicable law, jurisdiction and contractual language and can take into account various specific national legal requirements.

The EMA is primarily designed to replace master agreements existing under the laws of various continental European countries, which are used predominantly (though not exclusively) in a domestic context. It should also be suitable, however, for cross-border transactions. The EMA is innovative: it is a multi-jurisdictional and multi-product agreement.

- **Multi-jurisdictional**: It is intended to be used in different jurisdictions under the laws of different jurisdictions in different languages, particularly within the EU.

- **Multi-product**: It will enable market participants to document potentially all trading transactions under a single master agreement, including (in the current draft) repurchase transactions and securities loans. The structure of the agreement is open for new product annexes to be added in order to expand the scope of the agreement to include other financial transactions, such as FX, swaps and options.

The English version of the EMA, together with a detailed Explanatory Memorandum, is available on the EBF website (**www.fbe.be)**.

The EMA was officially launched on January 1, 2001.

Second EU Money Laundering Directive

The European Parliament adopted its Report, at second reading, on the Council common position.

The Parliament has endorsed the Council position to expand broadly the scope of offences to be covered in the new directive. In practice, it means that all serious offences pursuant to a controversial definition, in terms of sentences, will be covered by the new directive. This new definition has been retained notwithstanding the numerous efforts by the EBF to convince the EU authorities that such a wide definition would not serve the preventive fight against money laundering.

On the issue of identifying customers with whom a bank does not have face-to-face contact, the EBF was more successful as the Parliament finally followed the Council position to include a general provision in the body of the directive requiring banks to put in place adequate methods of such identification, but leaving the specific means to the banks' discretion.

COMMUNICATION ON ELECTRONIC COMMERCE AND FINANCIAL SERVICES

The publication of the European Commission's "Communication on Electronic Commerce and Financial Services" in February 2001 was received with disappointment by the banking industry in general. It is felt that the Communication leaves many legal issues related to e-commerce and financial services unresolved. Although the Communication sets some plans for action in view of the deadline of 2005 for the integration of financial services markets, it is not ambitious enough in itself.

FINLAND

Bank Regulatory Developments

A committee appointed by the Ministry of Finance to review questions relating to deposit taking, issuance of electronic cash, supply of payment transfer services and availability of banking services in general, submitted its report at the end of 2000. Perhaps the most important proposal of the committee was to allow companies other than banks to take deposits from the public for a maximum amount of EUR 3000. The committee also proposed that payment transfers be allowed only under authorization. Payment transfers could be provided under the current credit institution authorization or under a more limited authorization allowing companies to provide only payment transfers and electronic cash services. Preparation of the proposals continues in 2001.

The Ministry of Finance has also prepared revisions to the credit institution legislation concerning bank mergers and divisions as well as voluntary liquidation. With an amendment to the Act on Credit Institutions, election of a supervisory board for a credit institution was made voluntary.

The debate on combining bank supervision with the supervision of the insurance industry has continued. The Ministry of Finance proposed that the supervision of insurance institutions be made part of the financial markets supervisory structure. The Ministry of Social Affairs and Health (which presently is in charge of the insurance supervision) opposed this on grounds that the co-operation so far developed between the two supervisory authorities has been effective and sufficient. No decision was taken, but the Government assigned a special advisory body with the task of preparing a proposal on the matter by the end of 2001.

A committee appointed by the Ministry of Finance to prepare regulations concerning consolidated financial statements of conglomerates submitted its report at the end of 2000. The proposal will in practice not change the structure of the profit and loss statement of banks and insurance institutions. At the turn of the year, the Ministry issued a decree according to which the financial statements of banks and insurance institutions within the same group will be combined. However, their factual content will remain unchanged.

Discussion on the new capital adequacy proposals by the Basel Committee on Banking Supervision continued. In its statement on the proposals, the Finnish Bankers' Association pointed out that, in future work, attention should be paid to measures that ascertain that the implementation of the proposals be as uniform as possible in various countries and banks. A separate capital requirement for operational risks was not considered justified, nor was the proposal according to which the supervisory authority would have the right to set a higher capital requirement for an individual bank on the basis of its risk profile.

An agreement was reached within the European Union on the practice to be followed regarding the taxation of interest income earned in third countries. The system is based on the exchange of information, and it is scheduled to take effect from the beginning of 2004. Some member countries will be exempted from the system for a transitional period of seven years. During this time, interest income will be taxed at least by 15% at source during the first three years and at least by 20% during the remaining four years.

Payment Systems

The focus of co-operation in the area of payment systems shifted from risk management to the introduction of euro coins and notes. The Finnish banks agreed on the practical implementation of the cash changeover. According to the plans, the changeover will predominantly take place in connection with purchases in shops or when depositing markkas or withdrawing euros from cash dispensers. In this process, Finland will probably differ from many other euro countries as it benefits from a developed payment system based on account currency and consequent low level of cash in circulation.

The development of card systems continued actively. The banks participated in the definition of the next generation's card system (the so-called EMV project), and approved its recommendation. The banks also launched international debit cards, which, in addition to withdrawals from cash dispenser machines, can be used when making purchases at shops with online terminals.

The Bank of Finland grants access to daylight overdraft to credit institutions established in Finland that are subject to public supervision and that are counterparties to the Eurosystem monetary policy operations. The daylight overdraft limit must be fully collateralized. There is no difference in treatment between domestic banks and branches of foreign-owned banks.

Payments and cover transfers between the banks and the central bank have been transmitted in euros after its introduction. The same applies to securities trading and foreign payments. Card payments have been transmitted in euros from last Fall. The risk management procedures relating to the banks' payment systems required by the Bank of Finland, were started along with the introduction of the euro.

Other Developments

The privatization of the state-owned Leonia Bank was concluded on December 31, 2000, when the merger with the insurance group Sampo became effective and the Sampo-Leonia financial group was created. In February 2001, Mandatum Bank also joined the group. Within the group, banking operations are conducted by Sampo Bank and insurance operations by Sampo insurance companies. The Mandatum brand was kept, covering the group's investment bank and private bank functions.

The MeritaNordbanken Group, after having merged with Unidanmark in Spring 2000, purchased the Norwegian Christiania Bank after several bidding rounds at the end of 2000. The group adopted the name Nordea. It has a comprehensive distribution network throughout the Nordic countries, and a significant position within the whole Baltic Sea region.

FRANCE

Establishment of the Fédération Bancaire Française

The period under review has seen a further change in the French banking landscape with the setting up of the FBF (Fédération Bancaire Française – French Banking Federation) in February 2001. The Federation is a professional body made up of 512 banks of differing statuses:

- AFB Banks (Association Française des Banques - French Bankers Association) ;
- the Crédit Agricole regional banks;
- Banques Populaires;
- establishments affiliated with the Confédération Nationale de Crédit Mutuel;
- savings banks; and
- establishments affiliated with the Caisse Centrale du Crédit Coopératif.

The role of the French Banking Federation is to represent and defend the positions and interests of all banking establishments in France. These activities consist of:

- studies, analyses and proposals with regard to all matters concerning the profession on both a national and international level;

- information and services to its members; and

- communication initiatives aimed at increasing understanding of banks and their role in the economy.

The new Federation represents 25,500 branches, 500,000 employees, 48 million clients in France, for a total sum of 2.870 billion euros.

Developments in Bank Regulation and Supervision

Modernization of monthly settlement

As of September 25, 2000, transactions for all shares quoted on the Paris stock exchange have been payable in cash. However, for clients who prefer end-of-month settlement a deferred payment service is available. This enables clients to sell short by means of a securities loan and to buy short using credit.

Monthly settlement was ended for the purposes of European standardization and has been replaced by the "deferred payment service". Clients will therefore still be able to benefit from the leverage effect linked to such operations but must bear the cost of the credit thus accorded (order published on September 8, 2000)

<u>The law concerning new economic regulations was passed on May 15, 2001 (no. 2001-397)</u>

Apart from measures to combat money laundering (cf. section II), the main provisions of the law which are of concern to the banking sector are:

- with regard to global netting: the principle of global payment for interbank operations is established;

- with regard to persons having issued bad checks: the banning period for the writing of checks, provided for by article L 131 of the Monetary and Financial Code, is reduced from 10 to 5 years.

The order of January 17, 2001 no. 2001-45, regarding basic banking services, enacted in application of article L312-1 of the Monetary and Financial Code relating to the right to open <u>an account was published in the Official Gazette of February 18, 2001</u>

In a single text, it sets forth the nature and conditions for the provision of basic banking services. It defines the list of services proposed as part of the right to open an account and the pricing conditions applicable to holders of accounts opened at the request of the Banque de France. Analysis of this text reveals that:

- both private individuals and legal entities are covered;

- in the event that private individuals request the opening of a joint bank account, with or without plurality of creditors, all future co-account holders must be in the same legal position vis-à-vis the provisions of article L 312-1;

- minors not declared of full age and capacity, and thus unable to hold legal rights, cannot benefit from this procedure; and

- those of full age who are subject to protective measures can benefit from this procedure in conformity with the general law applicable in their regard.

<u>The law on save-as-you-earn schemes passed on February 19, 2001 (no. 2001-152)</u>

This law has the following main objectives:

- to create a long-term save-as-you-earn system enabling employees to prepare for the future by means of a diversified savings tool and to ensure stable and risk-free financing for companies, particularly small and medium-sized enterprises;

- to extend save-as-you-earn schemes to a wider section of the population by tackling the unfairness and inadequacies of the present system (profit-sharing, company savings schemes, employee shareholding schemes, etc.).

Law no. 2000-1257 of December 23, 2000, on the financing of Social Security for 2001

This law contains two provisions regarding credit institutions. The first concerns their role as financial companies or intermediaries, the second concerns their role as institutions which pay certain savings revenues that are liable to social contributions:

- reduction in the ceiling for social contributions and similar payments above which payment by bank transfer is mandatory; and

- change in the timetable for advance payments of general social contributions to which paying banks are liable on certain savings revenues.

The finance amendment law for 2000 (no. 2000-1353 of December 30, 2000)

This law provides for the adaptation of the fiscal regime of parent and subsidiary companies to the organizational structures of mutual or cooperative banks.

Under Article 58, and provided all conditions are satisfied other than those relating to the level of shareholdings, the scope of parent company and subsidiary fiscal regimes will once again include shareholdings for which the book value is at least 150 million francs, being held by:

- the Crédit Agricole regional banks in the capital of the Caisse Nationale de Crédit Agricole;
- by the Crédit Mutuel local banks in the capital of Crédit Mutuel's departmental or interdepartmental banks and by these latter institutions in the capital of the Caisse Centrale de Crédit Mutuel;
- by the Caisses d'Epargne et de Prévoyance in the capital of the Caisse Nationale des Caisses d’Epargne et de Prévoyance; and

- by the Banques Populaires in the Banque Fédérale des Banques Populaires (formerly the Caisse Centrale des Banques Populaires), the provision should be applied to the determination of taxable results from financial years closed as of December 31, 2000.

Financial markets

Two orders of August 1, 2000 reorganized the investigation and sanction procedures of the COB (Commission des Opérations de Bourse – independent regulatory agency). As a result, the members of the Commission who determine the nature of sanctions are not those involved in the investigation.

On August 11, 2000, the CMF (Conseil des marchés financiers – financial market watchdog) published the 2001 timetable for private-contract operations indexed on the Euribor index

Legislation Concerning Security and Money Laundering

- Security problems dominated the headlines throughout 2000, and the law of July 10, 2000 was passed as something of an emergency measure. It concerns security surrounding cash delivery and collection operations by private security firms and, in particular, aims to reduce the walking distance of security personnel.

  To this end, local authorities are authorized to block off parking spaces in front of the establishments concerned while customers using such services must make layout changes, with regard to buildings in particular. Failure to comply with the provisions of the law by December 31, 2002 will result in heavy fines. An order of December 18, 2000 sets forth the building changes required to increase the security of cash transfers with a particular focus on reducing walking distances.

- A charter relating to the security of payment cards was signed on February 22, 2001 by credit institutions, the bank card EIG and the Conseil National du Commerce (national trade council). It is particularly aimed at increasing protection for cardholders when entering PIN numbers. It also provides for removal of the account holder's number and name from the transaction receipt and strengthening of the role played by the Banque de France.

- Law no. 2001-420 of May 15, 2001 relating to new economic regulations amends section VI of the Monetary and Financial Code concerning obligations in the struggle against money laundering. In particular, this law imposes new obligations on financial bodies with regard to declarations. In addition to operations which may originate from the trafficking of drugs and organized criminal activities (so-called "suspect" activities), financial bodies are now obliged to declare to TRACFIN all operations of which the originator or beneficiary is considered questionable, even after an identity check, as well as transactions involving trust funds where the identify of the parties or the beneficiaries is unknown.

GERMANY

Germany’s banks are busy preparing for the changeover from deutschmark to euro banknotes and coins at the beginning of 2002. Following the entry into force of the tax reform, the political debate has now focused on the urgently needed reform of the German pension scheme. Also, it is expected that the operating conditions in the German financial marketplace will continue to improve. Besides improvements in financial supervision, company law, securities trading law, stock exchange regulations and payment systems, special mention must be made in this context of the action taken by the European Commission against anti-competitive state aid granted to Germany’s public banks.

Introduction of Euro Notes and Coins

Following the introduction of the euro for cashless payments in the EMU member countries on January 1, 1999, notes and coins denominated in euros will be introduced at the start of 2002. In Germany, the deutschmark will thus be replaced by the euro for good.

On January 1, 2002, the *Act amending Monetary Provisions following the Introduction of Euro Notes and Coin (Third Euro Introduction Act)* will enter into force, creating the legal framework for the introduction of euro notes and coins. It includes the following provisions:

- As of January 1, 2002, the euro will be the sole legal tender, which means the deutschmark will lose this status ("legal big bang"). From the beginning of 2002 onwards, the Bundesbank will exchange DM notes and coins for euros free of charge at the irrevocably fixed conversion rate.

- The use of notes and coins denominated in deutschmarks after January 1, 2002 is not regulated by law, but, in accordance with the "joint declaration" of the central associations of the banking industry, the vending machine industry, the retail trade and similar services, will be possible in practice until February 28, 2002.

- The Third Euro Introduction Act also extends the criminal and administrative sanctions against the counterfeiting of banknotes and coins to cover the deutschmarks which will still be in circulation during the changeover period.

Initiated in April 2001, the Bundesbank's "Concept for the circulation of euro notes and coins" has in the meantime been concluded and presented at a press conference. Germany has now finalized a solid framework for the introduction of the new euro currency. The milestones on the way to the final cash changeover between January 1 and February 28, 2002 are the campaign for the collection of hoarded deutschmark coins in May and September/October 2001, and frontloading (i.e., delivery of euro notes and coins to bank branches) and subfrontloading (i.e., delivery of euro notes and coins from banks to retailers), both beginning on September 1, 2001. Assuming that the frontloading and subfrontloading period of four months (September-December 2001) will be used effectively by banks and retailers, enough resources, transport and storage capacities are available for the delivery of the euro notes and coins. The campaigns for the collection of hoarded coins as well as the general cash changeover will be supported strongly by various information and marketing activities of the government and the banking community.

Pension Scheme Reform

On May 11, 2001, the German parliament passed a bill to reform the statutory pension scheme and promote funded pension provisions (Pension Provisions Act). The new law will cut the size of the pension provided by the statutory pension scheme, which is funded on a pay-as-you-go basis. This is necessary because of the demographic trend in Germany. In return, the creation of private, supplementary, funded pension provisions will be promoted by the state. Persons contributing on a compulsory basis to the statutory pension scheme can opt from 2002 onwards either for premiums that will rise progressively until 2008 or for deduction of their state-promoted savings from the income tax base. Funds flowing from private pension provision arrangements will be taxed at the payout stage and thus on a deferred basis.

The eligibility for promotion of private, supplementary pension products has been tied to a number of conditions. Among other things, product providers are to be required to guarantee that at least the contributions paid in will be available at the beginning of the payout stage. In addition, funds can only be paid out in the form of a life annuity or as a withdrawal plan, both in equal or rising installments. Following any withdrawal plan, an annuitization of the remaining capital is mandatory, starting at the age of 85 at the latest. The option for variable installments alongside fixed installments in the withdrawal plan agreement allows a certain flexibility as regards pay-out arrangements. Beforehand, however, a certification procedure is required to determine whether or not a supplementary pension product is eligible for promotion.

As regards company pension schemes, the Pension Provisions Act provides for the introduction of pension funds. However, these are not Anglo-Saxon-style pension funds but undertakings similar to insurance firms, which will be subject to insurance supervision.

Modernization of German Financial Supervision and Reorganization of the Deutsche Bundesbank

On August 15, 2001, the German government submitted a bill to reorganize Germany's financial market supervision. Under this bill, the three supervisory offices for banking, insurance and securities trading are to be combined organizationally under the roof of the "Federal Agency for Financial Services and Financial Market Supervision" (Bundesanstalt für Finanzdienstleistungs- und Finanzmarktaufsicht, BAFF), affiliated to the Federal Finance Ministry.

The BAFF will operate from both Bonn and Frankfurt and be subject to legal and technical supervision by the Federal Finance Ministry. The three current supervisory offices will continue to exist organizationally within the BAFF for the time being, with a special division being set up for overlapping issues such as risk assessment.

The reform has two main advantages. First, it eliminates any duplication of work and the present time-consuming, dual-track decision-making processes between the Bundesbank and the Federal Banking Supervisory Office. Second, the fact that banking supervision will not be concentrated in the hands of the Bundesbank keeps open the option of a “Europeanization” of financial market supervision. European financial supervision under the roof of the European Central Bank (ECB) is explicitly ruled out by Article 105 of the EC Treaty and European banking supervision by the ECB would hardly be acceptable to countries that do not belong to the euro zone.

With the setting-up of the European System of Central Banks (ESCB) and the introduction of the euro, the functions and tasks of the Deutsche Bundesbank have changed. This also has consequences for its structure. The German government, therefore, has presented a bill to amend the Bundesbank Act. The bill aims to strengthen the head office of the Bundesbank, which is the contact for the ESCB. A board of directors is to replace the central bank council and the directorate. The Presidents of the federal state central banks are to have no decision-making power of their own in the future, but to follow the instructions of the Bundesbank´s board of directors. In addition, the Bundesbank is to submit its projected costs and investments in the future. The lower house of the German parliament can comment on the efficiency of the Bundesbank's administration.

The bill is currently being debated in parliament. This will be difficult because the federal states, fearing a loss of influence, have indicated that they are fiercely opposed to this reorganisation. From the point of view of the German banks, the proposed bill is generally suited to creating a Bundesbank structure which ensures that the German central bank will perform its tasks efficiently, flexibly and at a low cost in future.

Decisions by the European Commission Against State Aid To Public German Banks Distorting Competition in the European Single Market

In July 1999, the European Commission announced its decision on the complaint submitted by the Association of German Banks against the Federal Republic of Germany in connection with the integration of the state housing agency (WFA) into the accounts of WestLB, Germany's biggest public-sector bank, by the state of North Rhine-Westphalia. The Commission's decision requires the Federal Republic of Germany to instruct the state of North Rhine-Westphalia to request WestLB to pay back the state aid which it provided by foregoing adequate compensation for the transfer of WFA's assets to WestLB. In May 2000, the European Commission filed a complaint with the European Court of Justice against the Federal Republic of Germany under Article 226 of the EC Treaty (failure to comply with this treaty), since the Commission's decision had not yet been put into effect. The European Court of Justice is expected to rule in this matter early in 2002. The German government, the state of North Rhine-Westphalia and WestLB have appealed against the Commission's decision in the WestLB affair. A decision is expected in the second half of 2002.

On December 21, 1999, the European Banking Federation filed a complaint under state aid rules against the system of guarantees (called *Anstaltslast* and *Gewährträgerhaftung*) for public-sector banks in Germany. The Commission has since announced that it regards this system of guarantees for savings banks and their central banks, the Landesbanken, as illegal state aid and has asked the German government to remove it. On July 18, 2001, the German government accepted this demand and agreed to abolish *Anstaltslast* and *Gewährträgerhaftung* for these credit institutions by July 18, 2005.

New Developments in Company Law

On July 11, 2001, the German government published a bill regulating public offers for the purchase of securities and takeovers (Takeover Act), which is based largely on the draft submitted for discussion in June 2000. This law will regulate all offers for the purchase of securities, even if they do not seek to acquire a controlling interest in the target company. Regulation of all offers is intended to ensure a fair and transparent procedure that also takes into account the interests of minority shareholders and employees.

Besides rules for general purchase offers and voluntary takeover bids, the bill contains provisions on mandatory bids that must be submitted once 30% of the voting rights of the target company have been acquired. In the case of a voluntary takeover bid or mandatory bid, the bidder generally has the option of cash payment or conversion into liquid shares. Moreover, both the supervisory board and the board of directors of the target company must generally adopt a neutral position whenever a takeover bid is made, even if defence strategies are permissible within certain limits. Examples of these are looking for a third competing bidder (white knight), issuing new shares on the basis of the previously approved capital while safeguarding old shareholders' subscription rights, and defence strategies approved by the shareholders' meeting either during the bid or, subject to certain requirements, in advance of it.

In connection with this bill, an amendment to the German Stock Corporation Act will, in addition, allow a major shareholder with more than 95% of the voting rights to buy out minority shareholders (squeeze-out rule).

On January 25, 2001, an amendment to the Stock Corporation Act bringing the rules for registered shares into line with those for bearer shares came into force. The aim of this amendment is to make trading in registered shares much easier. The amendment also abolished the previous 15-month period for voting proxies of depository institutions.

The discussion of corporate governance issues, which was promoted on the international level by, among other things, the appointment of the OECD Steering Group, is also being conducted very actively in Germany. In May 2000, for example, the government commission "Corporate governance – corporate management – corporate control – modernization of stock corporation law", whose members include academics and representatives of government ministries along with high-ranking business names, was set up. In its final report, submitted on July 18, 2001, the government commission closely examined the economic regulatory framework and incorporated its findings into a recommendation for a code of best practice. The commission sees such a code as, among other things, the chance to make the German system of corporate governance, which is already protected at present by high statutory standards, more transparent for the international capital market.

Further Integration of Financial Markets in the Euro Zone

Transactions between the central bank system and banks on the interbank money market, on the foreign exchange market and in other financial market segments have been conducted exclusively in euros since January 1, 1999.

An infrastructure comprising several payment systems is available for handling large-value payments resulting from money market and foreign exchange trading in the euro. Besides TARGET, which links the national real-time gross settlement (RTGS) systems of the euro area's central banks, mention should be made, in particular, of Euro Access Frankfurt (EAF), a hybrid system combining gross and net settlement operated by the Bundesbank. In November 2001, the liquidity-saving settlement system RTGS^{plus} will replace EAF and today´s RTGS system ELS (Electronic Counter).

Following publication of the English version of the European Master Agreement (EMA) in October 1999, the European Banking Federation and the European Savings Banks' Group were able to win the European Association of Cooperative Banks as a further EMA sponsor in 2000. Initially, the EMA will be used for documenting securities lending and securities repurchase transactions and, in the medium term, for financial derivatives transactions as well. The aim of this initiative is to replace the numerous national master agreements used in Europe by a common European standard. The advantages of the EMA are, on the one hand, its design as a multi-product agreement and, on the other hand, the free choice of law it offers. Once the German, French and Italian versions of the EMA and the legal opinions on it for a large number of jurisdictions had been completed, the EMA was presented once again to the public in January 2001.

New Stock Market Developments

On September 12, 2000, the London Stock Exchange announced its decision to withdraw its merger plan with Deutsche Börse in order to focus attention wholly on the hostile bid by OM Gruppen, which was made in late August. The OM Gruppen bid was accepted by only a few shareholders, however, and ultimately failed.

Following the merger of Deutsche Börse Clearing AG and Cedel International S.A. (Luxembourg) into Clearstream International, securities held on current account were transferred to the common platform "Creation" in Luxembourg during a so-called "first migration phase" at the end of February 2001. The system used so far, OLGA, will therefore be switched off after an appropriate waiting period. This so-called "cut over" saw the transfer of securities holdings totalling EUR 230 billion in value and cash balances amounting to EUR 850 million.

Deutsche Börse plans to introduce a central counterparty in autumn 2001. The role of central counterparty will be performed by the clearing house of the German-Swiss futures and options exchange EUREX, Eurex Clearing AG, which will assume the counterparty risk and settlement risk as a contracting party for every transaction concluded in selected securities. Affected are all transactions in securities held in collective safe custody by Clearstream Banking Frankfurt and tradable on Xetra (Deutsche Börse's electronic platform), no matter whether the transactions are concluded on Xetra or on the Frankfurt Stock Exchange. The technical and legal conditions for the introduction of the central counterparty are currently under discussion.

To improve the transparency of companies listed on the Neuer Markt for investors, Deutsche Börse amended its rules and regulations at the beginning of 2001. Since January 1, 2001, companies listed on the Neuer Markt are required to publish detailed, standardized quarterly reports. They now have to display their most important operating ratios uniformly so as to make it easier to check the consistency of such data and compare them. Since March 1, 2001, an issuing company is required to inform the market electronically without delay, but no later than three days after conclusion, about any transactions in company stocks by the company, its board of directors or supervisory board. The ad hoc reporting already required under the Securities Trading Act is not affected by this. The Stock Exchange can impose penalties, ranging from a warning to delisting, for any breach of these rules.

Deutsche Börse has announced that a company´s weight in any stock market index will be based on its freely floating stock. At the moment, the index weight of a company is based on the total number of shares admitted to trading.

New Bank Regulatory Developments

The new liquidity standard announced by the Federal Banking Supervisory Office on November 25, 1998, which is better geared to banks' liquidity management, replaced the existing standards on an optional basis on January 1, 1999 and on a mandatory basis with effect from July 1, 2000.

New Developments in the Regulation of Securities Trading

A draft of the Fourth Financial Market Promotion Act is expected to be submitted in autumn 2001. This law should, in particular, further deregulate stock exchange law and give stock exchanges more scope for arranging trading. It should also define the ban on price rigging more precisely so that it will be easier to tell in future which measures are permissible to stabilize prices. In addition, plans to introduce disclosure requirements to ensure more transparency in connection with securities transactions by boards of directors and supervisory boards are also under discussion. Moreover, a dismantling of the formal requirements for the conclusion of future transactions with private clients can be expected. Finally, abolition of the plea of invalidity of contracts for difference should create more legal security for intra-day transactions.

On July 15, 2000, the Federal Banking Supervisory Office and the Federal Securities Supervisory Office published their joint announcement on staff transactions. The announcement defines the responsibility of credit institutions and financial services institutions to safeguard their solvency and protect investors by ensuring that transactions in securities and derivatives carried out by members of their staff are not contrary to the interests of the institution or its customers. The new guidelines replace an announcement published by the Federal Banking Supervisory Office in 1993 and are a key feature of the German compliance framework.

Online Banking and Electronic Commerce

In the second half of 2000, the Association of German Banks, in collaboration with the research group Wahlen Online, conducted a representative survey of online banking and e-commerce in Germany. The survey revealed that 31% of Germans already have Internet access. A further 16% said they intended to join the Internet soon, showing that the use of the Internet will continue to grow in the future. Most people use the Internet to get information on prices and financial products. Almost half of Internet users shopped or bought services online last year. Internet shopping is usually no trouble. Only 7% of Internet shoppers during the last six months experienced any problems. The main reasons for the still poor use of the Internet for shopping are the impossibility for customers of physically handling goods, and the fear of data protection and payment security problems.

Online banking is used by 11% of Germans. Thanks to the German direct banks, which are mainly subsidiaries of the big private banks, the private banks are the clear market leaders in this field, operating half of the 10 million online accounts. The reason for the still poor use of online banking is the supposed security risks. While 26% of Germans assume that online banking is safe, only 3% think it is very safe, 41% not so safe and 18% not safe at all. Germans who have already used online banking see security completely differently, however, with 86% rating this form of banking as safe or very safe.

The private banks in Germany have sponsored or themselves developed a number of projects dealing with Internet payment systems and new home banking modules for marketing banking products, in particular, SET (Secure Electronic Transaction) in conjunction with a credit card and HBCI (Home Banking Computer Interface). Both SET and HBCI are based on user certification to allow verification of the sender's identity and of the authenticity of electronic documents. In order to promote user-friendly and secure electronic commerce via the Internet, the four German big banks set up the service provider TC Trust Center as a common certification body for the private banks. TC Trust Center will offer the new security services to all interested banks, in close collaboration with Bank-Verlag, a subsidiary of the Association of German Banks.

The Fight Against Money Laundering

At the legal policy level, the European Parliament and the Council are still debating the amendment of European Anti-Money Laundering Directive 91/308/EEC. In addition, the German banking industry is currently involved in the discussions on the Basel Committee on Banking Supervision's consultative document of January 2001 entitled "Customer due diligence for banks". Also of importance for German anti-money laundering legislation is the examination of the "40 Recommendations" of the Financial Action Task Force on Money Laundering.

At a practical level, the focus of the fight against money laundering is on development of appropriate measures to prevent money laundering in connection with the introduction of euro banknotes and coin at the start of 2002. Germany's banks helped draft governmental guidelines for banks and other institutions concerned, which were published in June 2001.

The Federal Banking Supervisory Office supplemented its anti-money laundering rules by publishing an announcement concerning "*Anti-money-laundering safeguards at credit institutions acting as correspondent banks*" on November 6, 2000.

Tax Developments

On January 1, 2001, a sweeping income and corporation tax reform (Tax Reduction Act) went into force, providing for a cut in tax rates and a reform of business taxation. The law abandons, as of 2001 for foreign dividends and as of 2002 for domestic dividends, the existing imputation system of corporate tax on joint stock corporations and their shareholders in favour of a definite 25% flat-rate on retained and distributed profits in conjunction with income tax payable on 50% of shareholders' dividends. Capital gains from the sale of shares in corporations will be tax exempt for corporations, while for individuals only 50% of the capital gain will be subject to tax. Another key feature of the reform is a phased reduction in the top rate of income tax from 50% to 42%. The tax reform is now to be continued in the areas of group taxation, German external taxation legislation and taxation of corporate restructuring.

Non-Discriminative Payments System Risk Policies

The Bundesbank allows, in the course of a day, overdrafts against collateral and a safety margin of 1% of the amount collateralized. Such overdrafts are available to all banks that are subject to the minimum reserve requirement and have access to the Bundesbank's overnight lending facility, also to German branches and subsidiaries of foreign banks.

HONG KONG

Deregulation of Interest Rates

On July 3, 2001, the longstanding arrangement under which interest rates on deposits placed with banks are regulated and under which no interest may be paid on current accounts will fall away. Over the past few years, this arrangement has gradually been reduced in its scope and now only applies to savings accounts and current accounts. Once the arrangements fall away, banks will be free to charge interest at such rates as they think fit and to pay interest on current accounts. It is widely thought that this will increase interest rates as banks compete for deposits and the likely outcome is that in order to reduce costs arising out of the need to pay higher interest rates, some banks will review the charging basis for the operation of accounts. Accounts which previously had been operated free of charge may now be subject to bank charges. However, the final outcome will very much depend on the amount of liquidity in the market and individual banks' strategies to compete for deposits.

Future Role of the Hong Kong Association of Banks

The Hong Kong Association of Banks' present role is heavily linked to the setting of interest rate ceilings in accordance with the interest rate rules. Following the final phase of interest rate deregulation scheduled to take place in July 2001, this role will no longer be relevant. A review of the future role of the Association is currently underway. As part of the review, consideration is being given to providing the Association a more active role in the oversight of the conduct of banks.

Banking (Amendment) Bills

There are two Bills before the Legislative Council involving changes to the Banking Ordinance. The principal changes are as follows:

(a) To enhance the regulatory net of the Monetary Authority in respect of persons engaged by authorized institutions which are exempt from the licensing requirement under the proposed Securities and Futures Bill and who are engaged in relation to securities related businesses conducted by those exempt authorized institutions.

(b) To require the auditor of an authorized institution to advise the Monetary Authority of any matter of which it becomes aware which adversely affects the financial position of an authorized institution to a material extent.

(c) To require the auditor of an exempt authorized institution to advise the Monetary Authority of any matter of which it becomes aware which constitutes the failure of the institution to comply with certain applicable requirements under the proposed Securities and Futures Bill.

(d) To require persons who become executive officers of exempt authorized institutions in relation to securities business to obtain the consent of the Monetary Authority.

(e) To require every exempt authorized institution to appoint not less than 2 executive officers to oversee the institution's securities business.

(f) To provide an appeal route via the Securities and Futures Appeals Tribunal to be established under the proposed Securities and Futures Bill for persons aggrieved by certain decisions of the Monetary Authority in relation to staff engaged by exempt authorized institutions in securities related business and executive officers appointed to oversee the institutions' securities business.

(g) To require authorized institutions to inform the Monetary Authority when a person becomes or ceases to be a senior executive of the institution.

(h) To impose as a condition for authorization of an institution, a condition to the effect that the Monetary Authority is satisfied that the authorized institution has adequate systems of control to ensure that each person who is appointed as a senior executive is a fit and proper person to hold the particular position which he is to hold.

Check Imaging and Truncation

The banking community is considering the implementation of a new system for the clearing of checks whereby low-value checks will not be physically presented through the Clearing House for collection but will be truncated by the payee's bank with basic details and digital images of the checks being presented to the drawee bank for the purpose of collection. The proposals will probably involve changes to the Bills of Exchange Ordinance principally to cater for the electronic presentation of checks.

Intra-Day Liquidity

Licensed banks and restricted license banks which participate in the clearing house for interbank payments ("Direct Clearing Members") are eligible to obtain intra-day liquidity from the Monetary Authority. Liquidity is provided by the Monetary Authority to both Hong Kong and non-Hong Kong incorporated banks and restricted license banks on the same terms.

The liquidity is provided by virtue of the sale of various types of eligible security to the Monetary Authority with an obligation on the part of the Direct Clearing Members to repurchase those securities later in the day. The eligible securities concerned are Exchange Fund Bills and Notes and to a limited extent notes issued before September 1998 by a limited number of commercial issuers. The Exchange Fund represents the Hong Kong Special Administrative Region Government's reserves, including foreign exchange reserves. The commercial issuers are local issuers of high standing including the Mass Transit Railway Corporation, the Airport Authority and the Hong Kong Mortgage Corporation.

The sale and purchase transactions occur on an automatic or discretionary basis.

(a) Automatic Sale and Repurchase

This occurs when there is insufficient funds in the Direct Clearing Member's account with the Monetary Authority for settlement of interbank payments to meet its settlement obligations and the authorized institution has eligible securities in the Monetary Authority's Central Moneymarket Unit (a depository system operated by the Monetary Authority for holding certain types of security) of sufficient value to cover a purchase which would cover the insufficiency of funds.

(b) Discretionary Sale and Purchase

This occurs on a case-by-case basis on application by the Direct Clearing Member to the Monetary Authority.

The Direct Clearing Members can initiate repurchase whenever they have sufficient funds in their settlement accounts. The repurchase will also occur automatically at the end of the day where there are sufficient funds in the Direct Clearing Member's settlement account to repurchase the securities which are the subject of the sale and purchase.

If the repurchase is not effected within the same day, it is converted into a sale and purchase under the Discount Window which is a system operated by the Monetary Authority to provide overnight liquidity to Direct Clearing Members.

INDIA

Regulation of the Financial Sector

Three segments of the Indian financial sector, namely, banking, insurance and capital markets are regulated by the Reserve Bank of India (RBI), the Insurance Regulatory and Development Authority (IRDA) and the Securities and Exchange Board of India (SEBI), respectively.

Developments in Banking Regulation

On the basis of the review of developments in the international and domestic financial markets, including the foreign exchange market, RBI on July 21, 2000 announced the following measures:

- The Bank Rate was increased from the then existing 7% to 8%.

- A two-step increase in the Cash Reserve Ratio (CRR) from the then existing 8% to 8.5%. (to 8.25% effective July 29, and to 8.5% effective August 12 in two stages).

- A temporary reduction in all refinance facilities available to banks by 50% of eligible limits.

With effect from February 16, 2001, RBI reduced the Bank Rate from the existing 8% to 7.5% and further to 7% with effect from March 1, 2001.

The Cash Reserve Ratio was reduced from the then existing 8.5% to 8% in two stages by 0.25%, each effective from fortnights beginning February 24, 2001 and March 10, 2001, respectively. The CRR was reduced further to 7.5% with effect from May 19, 2001. Interest rate on eligible balances would be aligned with the Bank Rate in two stages. Initially from the fortnight beginning April 21, 2001, the rate was increased to 6.0% and at a later date, it would be made equal to Bank Rate. The inter-bank term liabilities of maturity of 15 days and above were exempted from the prescription of minimum CRR requirement of 3.0%.

Treatment of NPAs: The RBI announced the following measures during July 2000-June 2001 to check non-performing assets (NPAs):

- Modified guidelines for the recovery. These simplified guidelines pertaining to one-time settlement scheme was to be operationally effective initially until March 31, 2001, but was extended to June 30, 2001. The modified guidelines distinguish between NPAs up to Rs. 50 million and above Rs. 50 million. The RBI has issued certain criteria in respect of coverage, settlement formula, payment, reporting, etc. in the case of NPAs below Rs. 50 million. As for NPAs above Rs.50 million, the Chairmen and Managing Directors of banks have been given the responsibility to recover them and report to RBI on a quarterly basis.

- Revised the norms for NPA classification in cases of credit impairment. Banks are advised to straight away classify impaired loans as doubtful or loss assets.

- Advised banks to incorporate a condition in the loan agreement for obtaining consent of the borrowers to disclose their names in the event of their becoming defaulters. Banks which have not yet put in place the system of obtaining consent of the borrowers were advised to complete the process by September 30, 2001.

- Advised banks to adopt the 90 days norm for recognition of loan impairment, from the year ending March 31, 2004, but provisions will be required to be made from the year ending March 31, 2002.

- In addition the Union Budget has proposed the establishment of 7 more Debt Recovery Tribunals to deal with the settlement of cases relating to bad debts of the banks.

Banks and Insurance: The RBI has issued guidelines for banks' entry into insurance business. According to these guidelines, banks having minimum net worth of Rs.500 crore, and satisfying other criteria in regard to capital adequacy, profitability etc. could undertake insurance business through joint venture on risk participation basis.

Measures to prevent frauds in Banks: The RBI has instructed banks to observe the formalities in connection with the opening of deposit accounts by customers, with a view to prevent frauds arising out of non-compliance of the stipulated formalities for opening of deposit accounts.

Mid-Term Review of Monetary and Credit Policy for 2000-01: In the mid-term review, which was announced in October 2000, RBI issued operational guidelines for the development of the money market. Permission granted to selected corporate bodies to route call money transactions through Primary Dealers (PDs) was extended from December 2000 to June 2001. Also, guidelines on the issue of Commercial Paper (CP) were issued with a view to provide considerable flexibility to participants and to add depth and vibrancy to the CP market. To improve the financial efficiency of the market, rating was made mandatory for the term deposits accepted by all-India financial institutions with effect from November 1, 2000. In the Monetary and Credit Policy for the year 2001-02 announced in April 2001, additional measures were announced. These measures include a gradual reduction in four stages the access to other non-bank institutions (including financial institutions, mutual funds and insurance companies) to operate in call /notice money market.

Term Deposits: The minimum maturity period for term deposits was reduced to 7 days from 15 days in respect of wholesale deposits of Rs.15 lakhs.

Banks were permitted to formulate fixed deposit schemes specifically meant for senior citizens offering higher and fixed rates of interest as compared to normal deposits of any size.

Banks were given freedom to exercise their discretion to prevent premature withdrawal of large deposits held by entities other than individuals and Hindu Undivided Families.

Renewal of overdue deposits at the rate of interest prevailing on the date of maturity would be allowed only for an overdue period of 14 days.

Interest Rate Policy: In the Monetary and Credit Policy announcement in April 2001, the RBI has relaxed the requirement of Prime Lending Rate (PLR) which is the floor rate for loans above Rs.2 lakhs. PLR will serve as a benchmark and banks are permitted to offer loans at below-PLR rates to exporters or other creditworthy borrowers including public enterprises on the basis of a transparent and objective policy approved by their boards.

Capital Adequacy Measures: General provision on standard assets was allowed to be included in Tier II capital. Loans given to banks' staff are to be treated as 100% risk weight. To bring more transparency in the working of the banks, public sector banks are advised to annex to their balance sheet, beginning from the year ending March 31, 2001, the annual statement of each of these subsidiaries such as the balance sheet, Profit and Loss Account, Report of the Board of Directors and the Report of the Auditors.

Operational Freedom: Banks were given the freedom to recruit the personnel required for their purpose in the Union Budget 2001-02. Earlier, the recruitment for the public sector banks was routed through a centralized agency namely the Banking Service Recruitment Board, which ceased to exist with effect from July 31, 2001. The RBI has given the new private sector banks, which are operational since 1996, 2 to 3 years to meet the priority sector lending target of 40%. All public sector banks have already achieved this target.

Legal Reforms: The RBI has forwarded its recommendations to the Government of India for comprehensive amendments to the RBI Act, 1934 and the Banking Regulation Act, 1949, which are under consideration by the Government.

Capital Markets Regulatory Developments

During April -March 2001, resources raised through initial public offers (IPOs) stood at Rs.53.78 billion as against Rs.62.56 billion in the corresponding period of 1999-2000. The information technology sector continued to be the largest mobilizer of resources.

In December 2000, the Securities and Exchange Board of India (SEBI) had issued guidelines which allowed public issue through stock exchange terminals. During the period the issue is open to the public for subscriptions, the applicants have to approach the brokers of the stock exchanges through which the securities are offered under on-line system, to place an order for subscribing to the securities.

The SEBI also relaxed the restrictions regarding the minimum public issue size to 10% of the post-issue capital of companies in all industry sectors planning to tap the primary market.

In the case of Mutual Funds, the SEBI changed the eligibility criteria for overseas investments by the Indian Mutual Funds. The SEBI had removed the $10 million floor limit for the mutual funds to invest abroad.

Trading in Index Options was introduced in June 2001 with BSE Sensex as the underlying indices. India has adopted European model according to which a buyer or holder of the option would be able to exercise option only at the expiration of the contract. The buyer of the option would pay premium to the seller in cash at the time of entering into the transaction. Every contract, which would expire on the last Thursday of the month and would have call and put options with a one, two and three month’s maturity period. The permitted lot size for the BSE options contract is 50 units while that of NSE is 200.

Stock for Option trading was introduced in July 2001. The SEBI issued various guidelines for stocks to be traded in the stock options market which include:

- the stock had to be among the top 200 stocks in terms of market capitalization during the previous six months;

- the average daily turnover of the scrip in the cash market should not be less than Rs.50 million; and

- non-promoter holding should be at least 30%.

INDONESIA

Bank Regulatory Developments

Act of June 14, 2000 on Prudential Banking

Bank Indonesia issued two regulations and one circular; the regulations amend previous measures on credit restructuring and the Legal Lending Limit, while the circular regulates Assessment of Productive Assets. The amendment is aimed at enhancing the national economic recovery, while adhering to international prudential standards.

Act of October 2, 2000 on the Obligation to Submit Reports on Foreign Debts.

Banks, non-banks and any persons having foreign debts should submit reports on each of their foreign debts to Bank Indonesia in a regular, complete, accurate and timely manner as determined by Bank Indonesia. This is stipulated in Bank Indonesia Regulation (PBI) 2/22/PBI/2000 dated October 2, 2000 on the Obligation to Submit Reports on Foreign Debts. The PBI was issued as a follow-up to the 1999 Act on Foreign Exchange Flows and Exchange Rate System, which authorizes Bank Indonesia to request information and data on the foreign exchange flows of Indonesian residents. The amount and term of foreign debts reported to Bank Indonesia are further regulated in a Bank Indonesia Circular Letter. The report on foreign debts submitted to Bank Indonesia will be treated as confidential.

Act of October 20, 2000 on Status BBKU (frozen the business activity) of PT Bank Ratu and PT Bank Prasidha Utama.

As of October 20, 2000, Bank Indonesia has frozen the business activities of PT Bank Ratu and PT Bank Prasidha Utama and directed that they be placed under the Indonesian Bank Restructuring Agency (IBRA) for further process in accordance with the pertinent authority and regulations.

Act of November 17, 2000 on Bank Indonesia's Real Time Gross Settlement (BI-RTGS)

Bank Indonesia officially launched Bank Indonesia Real Time Gross Settlement (BI-RTGS) system. The BI-RTGS system has been implemented in all banks in Jakarta since November 17, 2000. At this preliminary stage, Bank Indonesia requested banks operating in Jakarta to become BI-RTGS system participants, while banks with head offices outside Jakarta were requested to become BI-RTGS participants through their branch offices in Jakarta. There have been 124 banks registered as BI-RTGS up to now. The total amount of payments settled through RTGS currently averages over Rp25 trillion a day.

Act of December15, 2000 on Commercial Banks

Bank Indonesia issued Regulation (PBI) 2/27/PBI/2000 dated December 15, 2000 on commercial banks. The measure was based on Bank Indonesia's review of the banking regulations, feedback from the banking industry, as well as technical assistance from the International Monetary Fund (IMF). The regulation was designed to improve the national banking system and support the national economic recovery as well as to support the framework of self-regulatory banking and risk-based supervision. The new PBI also refers to the Basel Core Principles for Effective Banking Supervision.

Act of January 4, 2001 on Micro Credit Projects

After being delayed due to adjustments in the implementation of the Act 23/99 on Bank Indonesia, Bank Indonesia is prepared to channel loans for micro credit projects. The fund totals Rp116 billion and covers 15 provinces.

Act of January 4, 2001 on Credit to Small Scale Business

As of January 4, 2001, Bank Indonesia amended the regulation on credits to small scale business. The amendment covers various obligations on the part of banks in connection with credits to small businesses.

Act of January 12, 2001 on the Restriction of Rupiah Transaction and Foreign Currency Credit *Offer by Banks*

With regard to foreign currency transactions unrelated to investment activities in Indonesia, since January 2001 banks are restricted from performing foreign currency derivative transactions against rupiah with certain non-residents, including foreign citizens, foreign legal entities, Indonesian citizens with foreign permanent residency status and domiciled outside Indonesia, as well as representatives of foreign countries and international institutions in Indonesia and offices of Indonesian banks/legal entities abroad. In addition, the regulation restricts banks from carrying out certain other transactions with the above-mentioned non-residents, including provisions of credit, overdrafts in rupiah and/or foreign currency, placement of rupiah funds including rupiah transfers to banks abroad, purchase of securities in rupiah issued by parties mentioned above, and inter-office transactions in rupiah.

Capital Market Regulatory Developments

Act of July 25, 2000 on Implementation of Scripless Trading

Starting on July 25, 2000, scripless trading was fully implemented in four stocks – PT Suparma Tbk., PT Dankos Laboratories Tbk., PT Sari Husada Tbk., and PT Multipolar Tbk.

Act of October 20, 2000 on Multi-Fraction Application

The Jakarta Stock Exchange (JSX) announced that as of October 20, 2000 it would replace the current maximum bid/offer price spread from a single fraction to a multi-fraction, as described below:

- Share prices of below Rp 500 will have a fraction of Rp 5, with a maximum bid/offer price spread of Rp 50.

- Share prices of Rp 500 to Rp 5,000 will have a fraction of Rp 25, with a maximum bid/offer price spread of Rp 250.

- Share prices above Rp 5,000 will have a fraction of Rp 50, with a maximum bid/offer price spread of Rp 500.

The JSX also applies the multi-fraction policy to warrants.

Act of February 15, 2000 on Exchange's Share Auction and Buy Back

The Jakarta Stock Exchange announced changes and additional requirements regarding the Exchange's Shares Auction. Securities companies whose membership at the JSX has been terminated are required to transfer their holdings to other securities companies that are eligible to become JSX members. The transfer should be completed within 90 days starting from the day their membership was revoked by the JSX. However, if the securities companies improve their performance within this 90-day period, enabling them to meet the Exchange's membership requirements, they will not be required to transfer their holdings.

Furthermore, pursuant to the implementation of Chapter 8 Articles 4 of Government Regulations Number 45/1995 regarding the Capital Market Activity, JSX needs to set new regulations regarding the Exchange's buyback of shares that failed to transfer through the auction market arranged by the JSX. Under the new regulations, the JSX can start buying back shares shortly after the auction closing on March 1, 2001 at a nominal price or Rp 60 million.

Act of March 6, 2001 on The Obligation of Listed Companies Under Suspension Condition To Make Certain Public Disclosures

Listed companies the trading of whose shares has been suspended owing to the issuance of qualified financial statements in two consecutive years, the declaration of bankruptcy or failure to disclose material corporate actions are required to make certain disclosures to the JSX and the public before trading can resume.

Anti-Money Laundering Developments

On June 26, 2001, the Bank of Indonesia announced "know your customer" (KYC) regulations requiring banks within six months to:

- establish written internal policies and controls;
- implement KYC principles;

- establish audit and compliance functions to test the adequacy of the bank's KYC policies;

- train employees on anti-money laundering measures and the identification of suspicious transactions (such transactions must be reported to the Bank of Indonesia within seven days of their detection).

IRELAND

Supervision of Financial Institutions

Introduction

The Central Bank of Ireland supervises a wide range of financial institutions. Responsibility for the authorization and ongoing prudential supervision of credit institutions is discharged by the Banking Supervision Department. The supervision of entities other than credit institutions, including the Irish Stock Exchange, stockbrokers, moneybrokers, investment intermediaries, insurance intermediaries, various entities in the International Financial Services Centre (IFSC), futures exchanges and collective investment schemes, is carried out by the Securities and Exchanges Supervision Department and the IFSC and Funds Supervision Department.

Banking Supervision

The Central Bank of Ireland is the licensing authority for all credit institutions incorporated in the State and for branches of credit institutions from outside the European Economic Area. The Bank derives its supervisory powers from the Central Bank Act, 1971, 1989, 1997 and 1998, the Building Societies Act, 1989; the Trustee Savings Banks Act, 1989; the ACC Bank Act, 1992; the ICC Bank Act, 1992; and to an increasing extent, from various EU Banking Directives. In addition, the Bank has formulated non-statutory Licensing and Supervision Requirements and Standards for Credit Institutions, which it applies to all licence holders.

Developments regarding the Regulation and Supervision of Credit Institutions

During 2000, the following codes of conduct for the banking industry were issued for consultation:

- Code of Conduct for the Investment Business of Credit Institutions – outlining requirements governing any investment business conducted by credit institutions.

- Advertising Requirements applicable to Credit Institutions – this is divided into different sections applicable to different types of product being advertised by credit institutions.

- Code of Practice for Credit Institutions – outlining standards of good banking practice to be compiled with in providing general banking services to consumers.

It is expected that these codes will be statutorily imposed on credit institutions in the near future.

A detailed application form, which standardizes the Bank's assessment of the probity and competence of proposed directors and senior management of credit institutions, was finalized during the year and became effective in August 2000. All current directors and management of credit institutions completed this form.

Developments in the Banking Sector

Seven banking licenses (CNH Capital plc, CIBC World Markets Ireland plc, ICC Bank plc, ICC Investment Bank Ltd, GMAC Commercial Mortgage Bank (Ireland) plc, Citibank Ireland Financial Services plc and Maxblue Ltd) were approved and issued during the period under review. Two licenses were revoked at the request of the license holders: Bank of Ireland Finance in September 2000; Ansbacher Bankers Ltd in November 2000, following transfer of its business to Anglo Irish Bank Corporation plc.

The high rate of credit growth remained the principle prudential concern in 2000. Focused on-site inspections were carried out to examine both residential and commercial property lending. In addition, a survey was carried out in late 2000 to ascertain the maximum amount that financial institutions were prepared to lend to three hypothetical home mortgage loan applicants. Finally, a detailed comparison of institutions' lending practice with stated policy was carried out. These exercises culminated in the identification by the Bank of some additional characteristics of prudent home mortgage lending policy and practice, which it would consider as best practice. A letter was issued to credit institutions in February 2001 detailing these characteristics and requesting them to confirm the consistency of their home mortgage lending policy with these characteristics.

Banking Supervision also strengthened its assessment of the macroprudential situation, through more detailed analysis of trends in the financial sector, refinement of regular stress testing exercises, deeper examination of the financial fragility of borrowers and assessment of the exposure of the banking system to macroeconomic risks.

Securities and Exchanges Supervision; IFSC and Funds Supervision

Apart from credit institutions, the Central Bank of Ireland is also responsible for the supervision of a wide range of nonbank financial institutions which is carried out by two separate departments: Securities & Exchanges Supervision and IFSC & Funds Supervision.
The Central Bank's responsibility for the supervision of nonbank financial institutions is derived from various pieces of legislation:

- The Investment Intermediaries Act, 1995 (as amended by the Central Bank Act, 1997 and the Investor Compensation Act, 1998) provides for the authorization and supervision of investment firms; the Stock Exchange Act, 1995 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 Bank does not have a role in relation to listing requirements or insider dealing requirements for members of the Irish Stock Exchange; these functions are undertaken by the Irish Stock Exchange.)

  Both these pieces of legislation transpose the obligations of the EU Investment Services Directive, the key element of which is that once an investment firm has been authorized to undertake investment business by the competent authority in the State in which it has its head office, that firm can carry on the business covered by their authorization throughout the EU (either directly or through branches) without seeking further authorization in that other State.

In such circumstances, the firm is required to comply with the conduct of business rules and advertising requirements applying in the host country.

- Under the Central Bank Act, 1989 (as amended by the Central Bank Act, 1997) the Bank supervises certain institutions operating in the International Financial Services Centre (IFSC). However, many of these IFSC firms are now regulated under the Investment Intermediaries Act, 1995, as investment firms and the remaining firms regulated under the 1989 Act comprise mainly of futures brokers. Two Futures Exchanges operating in the IFSC are regulated under a separate section of the Central Bank Act.

- The Bank 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, 1989 (UCITS Regulations), the Unit Trust Act, 1990, Part XIII of the Companies Act, 1990 and the Investment Limited Partnerships Act, 1994.

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 Bank's assessment of, among other things, the prudential risk involved, the nature of the activities of the firm, the status of the owners and the experience and expertise of the management. The typical supervisory framework includes the submission to the Bank of financial and other information on a regular basis, together with on-site inspections and meetings to review firms' operations and their compliance with the Bank's requirements. Such requirements include: general requirements which apply to all firms; capital requirements; advertising requirements; conduct of business rules; client asset requirements; and anti-money laundering guidance notes. In particular, the advertising requirements and the conduct of business rules require regulated firms to disclose all relevant information to their clients. These rules seek to ensure that clients are dealt with in a just and equitable manner according to the standards set down in these rules.

Securities Regulation Developments

Responsibility for the authorization and supervision of insurance intermediaries transferred to the Bank on April 1, 2001 following the enactment of the Insurance Act, 2000. This Act amended the Investment Intermediaries Act, 1995 to require insurance intermediaries to be regulated under the regulatory framework developed for investment intermediaries under that legislation.

The Bank participated in discussions relating to the European Commission's two proposals to amend Directive 85/611 regarding Undertakings for Collective Investment in Transferable Securities (UCITS). This Directive provides a passport for mutual funds authorized in one Member State to market in other Member States. The first proposal seeks to extend the range of instruments in which a UCITS can invest and also to interpret some of the existing provisions of the original directive. Agreement at the EU Council level was reached on this proposal in October 2000. Agreement on the second proposal was reached in early 2001; this deals with the authorization of management companies of UCITS and extends the range of their permitted activities. Both proposals are now subject to a second reading in the European

Parliament and when finally adopted will result in significant changes to existing legislation governing the authorization of UCITS.

In September 2000, a Handbook for Investment and Stockbroking Firms was issued to authorized investment and stockbroking firms. This Handbook, which includes general and supervisory requirements, a code of conduct, advertising requirements and record-keeping requirements, updates pre-existing requirements, some of which were first issued in 1995. In addition, a Code of Conduct and Advertising Requirements were imposed on investment firms passporting services into Ireland for the first time under the provisions of Articles 17 and 18 of the EU Investment Services Directive.

During 2000, the Bank also issued, under the provisions of the Investment Intermediaries Act, 1995, a revised and more comprehensive Code of Conduct as well as Supervisory and Reporting Requirements and Conditions for RAIPIs (i.e., restricted activity investment product intermediaries, a limited form of investment business firm which typically acts as a deposit agent or broker for a client or transmits orders received from clients to a product producer from whom it holds an appointment).

Developments Affecting Financial Institutions Supervised by the Bank

Prevention of Money Laundering

The anti-Money Laundering Guidance Notes, issued in April 1995 with the approval of the Money Laundering Steering Committee chaired by the Department of Finance, are under review and the revised Guidance Notes are expected to be approved by the Money Laundering Steering Committee in 2001.

At the EU level, discussions are continuing regarding revisions to the EU Directive on the prevention of the use of the financial system for the purpose of money laundering which will, inter alia, extend the scope of the directive to other bodies such as solicitors, accountants and real estate agents.

Regulatory Capital Requirements for Credit Institutions and Investment Firms

Proposals by the Basel Committee on Banking Supervision and the EU Commission for a new capital adequacy framework to replace existing capital requirements will have a considerable impact on supervisory practices over the coming years. The Bank participated in a number of EU working groups to consider in greater detail the proposed new framework and the responses from both industry and supervisory authorities to the consultative document. The Basel Committee issued a second consultative paper in January 2001 with a closing date for responses of end May 2001. The EU commission is also expected to issue a second consultative paper in the near future. It is expected that the present proposals will be finalized and that work on an EU Directive will commence in 2001.

Developments Affecting the Supervision Function of the Central Bank of Ireland

In February 2001, the Government announced a new structure for the regulation of financial services in Ireland. Having reviewed the proposals contained in a report commissioned by the Government (McDowell Report) on the regulation of financial services, the Government has decided that the Bank should be restructured and called the "Central Bank of Ireland and Financial Services Authority". The structure will include two functional divisions: the Irish Financial Services Regulatory Authority (IFSRA), which will be responsible for the prudential regulation of all financial services, and the Irish Monetary Authority (IMA), which will carry out administrative functions required by the role of the Governor within the European System of Central Banks and will manage the external reserves. Legislation to give effect to the Government decision is currently being drafted.

Developments Relating to Payment Systems

Regulation of Payment Systems

Under the Central Bank Act, 1997, the Bank was given a statutory role in relation to the regulation of payment systems. The provisions of this Act require all payment systems to be approved, and have their rules vetted, by the Bank. The Bank may impose conditions on approval, revoke approval and issue directions to the system or its members. Specifically, in approving rules, the Bank must have regard to the equity and openness of the system. The definition of a system in the Act encompasses the "clearance and settlement of any means of payment or of any securities". The regulatory role extends, therefore, to securities settlement systems. The Act states that actions of the Bank relating to conditions/requirements imposed, etc., on a system shall be "as the Bank sees fit in the interest of the proper and orderly regulation of the payment system concerned and of competition between payment systems". Moreover, in relation to the possible exemption of payments systems, it is stated, more generally, that any such exemption from some or all of the requirements, may be made where the Bank "is of the opinion that it is not necessary in the interest of the proper and orderly regulation of financial transactions in the State".

The general objective of the regulatory regime reflects, therefore, the Bank's concern to ensure that such systems in the State are effective, efficient and open and that the systems themselves do not add to, or cause, instability in the operation of financial markets. In 1998, an amendment to the 1997 Act was implemented to ensure that the Bank's ESCB-related involvement in payment systems would not be prejudiced by the Bank having to have the consent of the Minister for Finance prior to its refusal to approve the rules of a payment system or subsequently revoke such approval. This provision is contained at Section 28 in the Economic and Monetary Union Act, 1998.

Operational Developments

Large-value interbank payments are made on a real time gross settlement (RTGS) basis since March 1997. All lending (e.g., overdrafts/provision of liquidity) to participants in this system is fully collateralized in accordance with ECB regulations. The RTGS system in Ireland

– IRIS – is fully integrated into the TARGET system, which facilitates cross-border payments in Euro on an RTGS basis.

There is no large-value netting system in Ireland.

A reform of the retail clearing mechanisms is underway which will include legal agreements specifying obligations and responsibilities. This should be completed in 2001.
The Bank maintains the register of bonds issued on the domestic market by the Government. The settlement function, however, was transferred to Euroclear on December 4, 2000. The total of all holdings of Euroclear participants in each bond is recorded in an omnibus account on the Bank's register in the name of Euroclear Nominees Limited. Transactions between Euroclear participants are effected within the Euroclear system without affecting the Bank's register while transaction between the local market and Euroclear participants have to be notified between the Bank and Euroclear.

Settlement for Irish Equities in euro is via the CREST mechanism (a UK-based system).

ISRAEL

Introduction

The Israeli economy grew strongly during the first three quarters of 2000, a trend that was reflected in the financial markets and produced very healthy results for most banks and insurance companies. The outbreak of hostilities in October, however, will probably affect the results of the financial sectors in 2001.

Despite the political unrest and the slowdown in the activity of high-tech firms, Israel continued to attract foreign investors and financial firms that act on their own or in collaboration with Israeli firms. One important example is the opening of a branch office of HSBC in Tel-Aviv, the second major international bank (following Citibank) to open for business in Israel. The imminent privatization of the banks still majority-owned by the government (Leumi and Israel Discount Bank) may attract further foreign interest.

Developments Regarding the Regulation and Supervision of Banks

During the period under review, there were only minor developments in the regulation and supervision of banks:

- A banking corporation planning to acquire a controlling interest in a foreign nonbank financial corporation is required to apply for prior approval of the Supervisor of Banks and show that its procedures for monitoring and supervising its foreign holdings are satisfactory.

- The directive prohibiting dividend distribution, without prior approval of the Supervisor in loss years and in other instances of financial weakness, was updated to take account of the new Companies Law.

- The banks received permission to give to minors, from age 14, cash withdrawal cards that will enable withdrawal when the balance in the account is positive.

Several minor changes were made in some other directives: the capital adequacy regulations, the directive limiting potential conflicts of interest in the banks' capital market activities and the procedures for granting residential mortgages.

In a recent address the Supervisor of Banks revealed that his office is contemplating several important changes in the regulatory framework, including tightening of the capital adequacy requirements (in light of the recommendations prescribed by "The New Basle Capital Accord"), strengthening the cooperation with foreign supervisory agencies, improving the large payments clearing system and studying the feasibility of introducing a deposit insurance clearing system (the current substitute to formal deposit insurance is the authority of the Bank of Israel to guarantee the deposits in failing banks that was used in several instances of bank failures in the past).

Regulation of the Securities Market

An important development in the regulation of the securities market was the amendment of the Securities Law enabling Israeli companies listed for trading in the United States (there are more than 100 such companies, mostly in the high-tech sector) to list their securities for trading on the Tel-Aviv Stock Exchange on the basis of the registration and listing requirements of the American authorities. It is expected that the dual listing will substantially increase over time the capitalization of the T.A.S.E.

Regulation of the Insurance Market

Two significant changes took place in the regulation of the insurance market:

- The investment powers of insurance companies in investing their life insurance reserves were expanded, allowing them to invest part of the reserves in foreign securities.

- The statutory arrangements of the mandatory motor vehicles insurance, in force more that 20 years, will be gradually replaced by a more competitive scheme that will give the insurers more discretion in pricing the premiums to be paid by various groups of the insured population. The existing setup of a mutually owned company co-insuring the risks will be gradually dismantled.

Anti-Money Laundering Initiatives

The efforts to block the laundering of money in Israel were reinforced by the enactment of The Prohibition of Money Laundering Law in August 2000. The basic provision of the law is that any disposition of property, derived from the commission of crimes (enumerated in a supplement), that is intended to disguise or cover up its origin, its owners, its location or any disposition of it, is a crime punishable by an imprisonment of 10 years.

A major element of the law is the imposition of a duty on providers of financial services to identify persons involved in a variety of transactions, and to report certain transactions to a pool of information to be administered by a newly established authority in the Ministry of Justice. The law provides for the management of the pool in a way that will reconcile its efficient operation with a minimum of infringement on the right of privacy.

The reporting duties imposed on banking institutions include:

- Automatic ("objective") reporting of certain types of transactions which exceed a given amount.

- "Subjective" reporting of transactions which, after due consideration by the bank, are viewed as unusual and not fitting into the regular profile of the account involved.

Reporting requirements will come into force in early 2002, following the establishment of the necessary machinery.

Payment System Risk Policies

The Bank of Israel and the commercial banking system form the backbone of Israel's payment system. The Bank of Israel manages current and other accounts for the government, the banks and various other entities, and transfers across these accounts are the principal method of settlement between those entities. The Bank of Israel also directly manages two systems for large value transactions. The first is for interbank transfers in connection with liquidity trading (in order to meet the Bank of Israel's reserve requirements), while the other is an interbank system for settlement of USD\NIS transactions.

The banks operate a paper based clearing house for checks and an automated clearing house for debits and credits via electronic media. The transfer of securities and derivatives, traded on the Tel-Aviv Stock Exchange, and their related payments, is executed by means of the TASE securities and derivatives clearing house.

Banks maintain domestic currency accounts with the Bank of Israel, which serve as liquid assets against their reserve requirements. In order to satisfy those requirements a bank may draw (value same day) on a credit line within the quota of the monetary loan agreed by the bank and the Bank of Israel. The monetary loans are collateralized by foreign or local currency deposits with the Bank of Israel and by floating charge on government bonds and treasury bills. The local branches of non-domestic institutions are not treated differently than domestic ones. (For a full description see "Payment Systems in Israel" a study prepared by the Bank of Israel and the Committee on Payment and Settlement Systems of the Central Banks of the Group of Ten countries and published by the Bank for International Settlements in August 2000. The study is available on the BIS web site (www.bis.org)).

ITALY

Bank Regulatory and Supervisory Developments

The Bank of Italy has provided general clarifications concerning the prudential treatment of securitizations, supplementing the provisions of the Supervisory Instructions. The treatment of asset-backed securities depends on the combination of the classes of notes in the acquiring bank's portfolio and the capital requirement that applies to the securitized assets. In particular, when the assets consist of various types of credit claims, the highest of the various capital ratios is applied.

As for accounting practices, rules were introduced to govern the shift of securities from the trading to the banking book, in line with international accounting standards.

Developments in the Regulation of Derivatives and Securities Products

During the period under review, the Bank of Italy issued measures concerning the supervisory, accounting and reporting treatment of credit derivatives as well as some organizational matters useful to the correct evaluation of credit risk.

The Bank of Italy's rules on credit derivatives are not definitive. They must still take account of the revisions to the Basel Capital Accord. The crucial elements governing application of the rules introduced by the Bank of Italy relate to the purpose for which the credit derivatives are held (i.e., trading book or banking book) and the bank's position within the contract (seller or purchaser of the hedge). The rules also recommend that banks adopt suitable technical, operational and organizational instruments to ensure that those responsible for these operations are constantly aware of their real, objective credit risk exposure vis-à-vis all the counterparties for whom credit risk is taken.

Anti-Money Laundering Developments

There were two significant developments in this area during the period under review. On January 12, 2001, the Bank of Italy issued new "Operating instructions for the identification of suspicious transactions" (commonly known as the "Ten Commandments") and furnished the banking industry with a list of countries that are uncooperative in the fight against money laundering.

The issue of the "Ten Commandments" gives the new anti-money laundering guidelines of the Bank of Italy the status of "Supervisory Instructions". The main features of the new guidelines are the following: (i) extension of the classes of intermediaries required to comply with the instructions (not only banks and financial companies but now also the Post Office and insurance companies); (ii) specification of the scope of the provisions, in the light both of changes in types of banking and financial contracts and of the reform of the law on fiscal crimes; (iii) identification of organizational requirements relating to the implementation of the instructions and to relations between intermediaries and the courts and law enforcement authorities; and (iv) confidentiality requirements in the reporting of suspicious transactions.

The second document comprises fifteen countries that are systematically deficient in cooperating with the rest of the world in combating money laundering. The Bank of Italy instructed Italian financial intermediaries to pay the "greatest possible attention" to transactions involving any of the countries on the list.

Developments in Electronic Commerce and Banking

It is expected that Italy will transpose into law (i) Directive 1999/93/EC of December 13, 1999 on electronic signatures, whose purpose is to make sure that all Member States recognize the legal validity of electronic signatures, and (ii) Directive 2000/31/EC of June 8, 2000 on electronic commerce, whose aim is to provide uniform regulation within the single market of commercial activities carried on electronically or via the Internet.

Payments System Risk Policies

Italian depository institutions are generally permitted to incur daylight overdrafts in their accounts in connection with payments effected through the central bank. This is also true of branches of non-domestic institutions, which for legal purposes are treated as Italian banks. Other foreign-owned entities operating in Italy are not permitted to incur daylight overdrafts. For example, foreign banks having a "remote access" to the Italian payments system are not allowed to have daylight overdrafts.

JAPAN

Reform of the Financial Services Agency

The reform of central government ministries and agencies that took place on January 6, 2001 abolished the Financial Reconstruction Commission and reorganized the Financial Services Agency as a subsidiary organization of the Cabinet Office. The Financial Services Agency took over responsibility for the resolution of failed financial institutions from the Financial Reconstruction Commission.

The Cabinet Office also established a "Financial Crisis Management Meeting" and a "Minister of State for Financial Services", who deals with general matters to build an environment for smooth financing. The Financial Crisis Management Meeting consists of the Prime Minister, the Chief Cabinet Secretary, the Minister of Finance, the Minister of State for Financial Services, the Director-General of the Financial Services Agency and the Governor of the Bank of Japan. It serves as a consultative body to the Prime Minister for the discussion of policies in dealing with financial crises such as large-scale and systemic failures of financial institutions and other important matters.

Deregulation

The restrictions on acquisition of insurance companies by banks were lifted on October 1, 2000. The Financial System Reform Law that took effect on December 1, 1998 allowed banks to own insurance companies as subsidiaries, but included a transitional measure limiting banks to the acquisition of failed insurance companies. A Cabinet Order on October 1, 2000 removed this restriction.

On April 1, 2001 relevant sections of the amended Insurance Business Law took effect to enable banks to sell certain insurance products. An Ordinance of the Cabinet Office defines the insurance products permitted for banks to sell as: 1) long-term fire insurance, long-term income indemnity insurance and credit life insurance when such insurance is associated with housing loans, and 2) overseas travel personal accident insurance. Credit life insurance can only be underwritten by subsidiaries of the bank selling the insurance or subsidiaries of its holding company. The Financial Services Agency will continue to monitor the result of the deregulation and will reach a final decision on these restrictions during fiscal 2001.

On January 26, 2001, the Financial Services Agency announced that it would allow city banks, long-term credit banks and the Norinchukin Bank to offer trust banking services directly (not through subsidiaries). Although companies engaged in trust businesses are allowed to deal in brokerage in sales and leases of real estate, the bans on new entries into these fields will remain in place.

On January 1, 2001, regulations were relaxed on new entry into the insurance area situated midway between life and casualty insurance (e.g., medical insurance and disability insurance). Life insurance companies are allowed to sell disability insurance through non-life subsidiaries and non-life insurance companies are allowed to sell medical insurance through life insurance subsidiaries. The Financial Services Agency allowed the parent companies directly (without using subsidiaries) to sell these products in July 2001.

New Types of Banks and the Regulations on Them

Several new types of banks have been established: IY Bank, established by Ito Yokado, a nationwide supermarket chain, started operations on May 7, 2001; The Sony Bank, established by Sony Corp., started operations on June 11, 2001; and eBANK, funded by ITOCHU Corp., etc. started operations on July 23, 2001. IY Bank has its ATMs in supermarkets and convenience stores run by its parent company, and its main source of revenues will be fees from the customers of other banks who withdraw their deposits through IY's ATMs. Sony Bank and eBANK will specialize in Internet banking services. Prior to this, Japan Net Bank, an Internet bank, began operations on October 12, 2000 with investments from Sakura Bank, Fujitsu, Nippon Life Insurance and Sumitomo Bank.

The Financial Reconstruction Commission and the Financial Services Agency responded to the establishment of these new forms of bank by formulating "Measures for Licensing for and Supervision of New Types of Banks including Entry into Banking Business by Non-Financial Entities (Operational Guidelines)" on August 3, 2000. Among the issues covered in the guidelines are: 1) maintaining the independence of a subsidiary bank from non-financial parent entities, 2) shielding the subsidiary bank from business risks of its non-financial parent entities, 3) ensuring the confidentiality of customer information when a subsidiary bank is involved in comprehensive business operations with its non-financial parent entities, 4) risk management and profitability when the asset structure of the bank is biased toward securities (including government bonds), and 5) customer protection issues for banks operating through ATMs and over the Internet with no face-to-face contact with customers.

The regulator also plans legislation regarding the introduction of supervision over major shareholders of banks; the "Law Partially Amending the Banking Law, etc." is now under deliberation in the Diet.

Government Emergency Economic Package

The government finalized an "Emergency Economic Package" at the cabinet meeting held on April 6, 2001 to discuss economic issues. The package requires banks to take sweeping steps to move bad loans off balance sheet and imposes a deadline in principle of three years for the completion of this process. The package also acknowledges the need for restrictions on banks' equity holdings. It plans to restrict the monetary value of equity holdings to an amount within the risk management capacity of the bank (for example, within the bank's capital) and to provide a scheme under which an entity with government guarantee will temporarily purchase the equities held by banks. The Financial System Council has initiated a study on equity holding restrictions of banks.

Consumer Protection

The "Law on Sales of Financial Products " and the "Consumer Contract Law" both took effect on April 1, 2001. The Law on Sales of Financial Products defines rules for the sale and solicitation of financial products, and the Consumer Contract Law for the process and content of consumer contracts, including contracts for financial transactions.

Risk Reduction in the Payment and Settlement Systems

The Bank of Japan Financial Network System (BOJ-NET) is an interbank payment and settlement system run by the Bank of Japan. The BOJ-NET has two systems: the BOJ-NET funds transfer system and the BOJ-NET JGB transfer system. In the past, the BOJ-NET supported both designated-time settlement and RTGS, but the Bank of Japan abolished designated-time settlement and moved to mandatory RTGS on January 4, 2001 in order to reduce systemic risk. The Bank allows interest-free, daylight overdrafts backed by collateral in order to provide intra-day liquidity.

The Zengin System is an electronic fund transfer network connecting all depository institutions in Japan run by the Tokyo Bankers Association. Ordinary domestic fund transfers between bank clients are performed on the Zengin System. On January 4, 2001, the Zengin System introduced risk reduction measures in conjunction with the switch to mandatory RTGS on the BOJ-NET. These measures include: 1) bilateral netting of balances between participating banks with the Tokyo Bankers Association as counterparty (rather than the former system of settlement subject to multilateral netting with the Bank of Japan as counterparty), 2) sender net debit caps set at a level no more than the value of collateral deposited by the bank with the Tokyo Bankers Association or the guarantees received from other banks, 3) clear loss-sharing rules in the event of default, and 4) new schemes under which designated banks to provide liquidity.

Competition among Securities Exchanges

Amendments to the Securities and Exchange Law on December 1, 2000 provided the option of organizing securities exchanges as joint stock companies in addition to the traditional form of membership organizations. On March 1, 2001 the Osaka Securities Exchange merged with the Kyoto Securities Exchange; it converted its organization to a joint stock company on April 1. The Tokyo Stock Exchange also plans to convert into a joint stock company. On February 1, 2001, the Japan Securities Dealers Association transferred its OTC equity market operations to its subsidiary, "JASDAQ Co. Ltd."

In January 2001, the Financial Services Agency licensed four securities companies (Monex Securities, Instinet, MTS Japan Securities and Garban Totan Securities) to deal with proprietary trading systems (PTS). MTS Japan Securities and Garban Totan Securities have begun PTS services for JGBs; Monex Securities offers nighttime PTS services for individual investors.

Electronic Commerce

The "Electronic Signature Certification Law" took effect on April 1, 2001. The law has two primary thrusts: 1) assumption of true validity for electronically recorded information when that information has a pre-defined electronic signature from the individual affixed; and 2) accreditation of "designated certification services" from the competent minister when certain conditions are met by entities engaged in electronic certification services. Some banks may be given a certification for "designated certification services" in order to provide certification services related to the banking business.

Secure Internet debit services were launched to provide immediate debiting of bank accounts to settle electronic transactions. In November 2000, the Sumitomo Bank (now the "Sumitomo Mitsui Banking Corp.") launched its "Net Debit" Service, and the service was also introduced by the Japan Net Bank, Asahi Bank, Sanwa Bank and Suruga Bank. On April 23, 2001, the Japan Internet Payment Promotion Association launched "Inter-Debit" service, using SET (Secure Electronic Transaction) technology. Fuji Bank and the Postal Savings System are the initial providers of this service. The two services are based on different security technologies.

Failed Institutions Sold to Foreign Entities

The Kofuku Bank that failed in May 1999 was sold to the Kansai Sawayaka Bank established under the leadership of the Asian Recovery Fund L. P. (an investment fund affiliated with the Rothschild Group in the United States) on February 26, 2001 under the provisions of the Financial Reconstruction Law. On June 11, 2001 the Tokyo Sowa Bank that failed in June 1999 was sold to the Tokyo Star Bank established by the U.S. investment fund, "Lone Star" under the provisions of the Financial Reconstruction Law.

Five life insurance companies have failed since 2000: Daihyaku Life Insurance, Taisho Life Insurance, Chiyoda Life Insurance, Kyoei Life Insurance, and Tokyo Life Insurance. In April 2001, Daihyaku was sold to Canadian life insurer, Manulife Financial; Chiyoda to the

U.S.-based American International Group (AIG), and Kyoei to U.S. life insurer, the Prudential Insurance Co. of America.

Daylight Overdrafts

Depository institutions in Japan are permitted to incur daylight overdrafts in their Bank of Japan accounts, and foreign-owned domestically-chartered institutions and non-domestic institutions are not treated differently from domestic institutions.

The principal policies for the risks are as follows, and there is no difference in the policies applied to non-domestic institutions:

- Liquidity is provided in the form of fully collateralized intra-day overdrafts.
- Intra-day liquidity is provided for all BOJ account holders that apply for the liquidity facility.
- A quantitative limit is not imposed on the amount of intra-day liquidity.
- Interest is not charged on intra-day overdrafts.

KOREA

Establishment of A Financial Holding Company

On March 23, 2001 a financial holding company named Woori Financial Holding Company Ltd. was established pursuant to the Financial Holding Company Act.

Woori FHC was incorporated with equity shares swapped for the shares of five subsidiary banks – Hanvit, Peace, Kwangju, Kyongnam Bank and Hanaro Merchant Bank that are under the control of the Korea Deposit Insurance Corporation (KDIC).

With combined assets of 103 trillion won, Woori FHC will become the world's 90^{th} largest bank in terms of total assets. Woori FHC plans to enhance competitiveness by making most of the economies of scale and synergy effects anticipated gained from the formation of a financial holding company structure. Woori is expected to finalize the organizational structure of its subsidiaries by June of 2002.

Reduction in Deposit Insurance Coverage

The blanket deposit insurance system expired at the end of 2000 and replaced with the partial deposit insurance system where deposits are guaranteed only up to 50 million won.

Examination Manuals on Corporate Governance of Financial Institutions Published

On January 5, 2001, the Financial Supervisory Service (FSS) made further step to renovate the corporate governance structure of financial institutions by publishing examination manuals which clearly specify the role, functions and major operations of compliance officers and the audit committees which have been installed in the board of directors of financial institutions during 2000. The manuals are supposed to facilitate the implementation of such systems at the earliest date.

Introduction of Corporate Restructuring Vehicle

On November 24, 2000, the Financial Supervisory Commission (the regulatory authority) established a directive for registration of corporate restructuring vehicles under the Corporate Restructuring Vehicles Act, which is regarded as the last step to complete the institutional base for the corporate restructuring vehicle (CRV) system in Korea.

The CRV is a paper company with a limited period of operation (maximum of 5 years) which will pool ailing assets set aside under the workout program of financial institutions and then entrust their assets to an asset management company (AMC) specializing in corporate restructuring.

**FSC Orders Capital Reduction at Six Non-Viable Banks;
Requests Capital Injection by KDIC**

In line with plans to complete banking sector restructuring, the FSC in December 2000 granted conditional approval to the management improvement plans submitted by five banks, – Hanvit, Peace, Cheju, Kwangju and Kyongnam Bank– and then subsequently designated them as 'non-viable financial institutions' along with Seoul Bank under "The Act on Structural Improvement of Financial Industry".

The condition of the approval included the devaluation of shares of stockholders, including, if necessary, complete write-off when the bank's liabilities exceed the value of its assets. The FSC formally requested the Korea Deposit Insurance Corporation (KDIC) to make capital injections into the six ailing banks following its official designation of them as 'non-viable financial institutions. Capital was injected to raise their BIS capital adequacy ratios above 10% and lower their ratios of loans classified as 'substandard and lower' to total loans below 6%.

Introduction of Supervisory Regulation on Electronic Financial Transactions by Financial Institutions

The Regulation on Supervision of Electronic Financial Transactions by Financial Institutions came into effect from April 2, 2001. The increasing threat of computer 'hacking' and widening concerns for consumer protection were major factors behind the enactment of the new regulation.

The regulation demands that financial institutions establish internal security guidelines (including confidentiality, integrity, security, availability, internal control system and terms and conditions for strategic alliances and outsourcing) and seek approval from the FSS regularly regarding the adequacy of their electronic finance security.

As for consumer protection, the regulation orders that financial institutions maintain critical financial documents and deal/order records of electronic financial transactions for a period of 10 years and 5 years respectively, as stipulated under the Commercial Law. In cases where a client submits a written request for information, the concerned financial institution must meet the request in a timely manner.

New Insurance Dividend System Introduced

The FSS announced plans to introduce a new dividend system to the insurance industry. Under the new system, a proportion of expense savings will be paid out as dividends to policyholders.

Policies eligible to receive the dividends will be limited to active insurance policies with one year or more of persistency under life insurance, long term non-life insurance, individual annuity, and retirement insurance contract. Meanwhile, from the end of FY 2001, life insurance firms will be required to set aside an adequate amount of reserves in advance for the purpose of paying out all types of dividends.

Cyber Reporting System

On October 16, 2000, the FSS launched a newly created cyber reporting system by which financial institutions can submit various reports through a secure Internet network, eliminating the need to directly visit the FSS. In order to ensure network security, the FSS has established an electronic signature and encryption system.

Banks, securities companies, investment trusts, merchant banks, credit card companies, and financing companies are the initial beneficiaries of the new reporting system. Other financial institutions including insurance companies will be eligible for the new system no later than the latter half of 2001.

Instituting Daylight Overdraft System

On September 30, 2000, the Daylight Overdraft System was launched to allow banks (including foreign bank branches in Korea) to settle the claims exceeding the balance of their accounts with The Bank of Korea by creating automatic overdraft credit against the shortfall. The amount of overdraft is limited to the average balance of banks' accounts with The Bank of Korea and the services are supplied with a zero interest rate. But the temporary credits must be secured by government bonds and reimbursed by closing time of services.

LATVIA

Developments in the Bank Regulatory Framework

The Board of Governors of the Bank of Latvia approved a number of regulations to harmonize further the regulatory framework for banking activities with the EU banking directives and Basel Core Principles for Effective Banking Supervision.

The revised “Regulation for Compliance with Restrictions on Exposures” specifies rules for compliance and reporting requirements on exposures. Exposures in the banking book and trading book have to be evaluated and stated separately. The “Report on Exposures Exempt from Restrictions on Exposures” was introduced to provide more information for supervisory purposes.

The amended “Regulation for Compliance with Liquidity Requirements” details requirements for credit institutions’ liquidity management policies.

A new version of the “Regulation for the Preparation of the Credit Institution Investment Reports” establishes procedures for preparing and submitting credit institution investment reports. Likewise, it stipulates that restrictions on investments are not applicable to investments in financial instruments included in the trading book. Besides semi-annual investment reports, credit institutions are required to inform the Bank of Latvia Credit Institutions Supervision Department in writing about the acquisition of a qualifying holding in the share capital of a credit institution, financial institution or ancillary undertaking prior to acquisition.

In compliance with the requirements of the Law, “On the Prevention of Laundering of the Proceeds Derived from Criminal Activity”, guidelines were approved for developing procedures for identifying suspicious financial transactions.

In March 2001, the Board of Governors of the Bank of Latvia approved “Guidelines for Management of Credit Risk” (effective as of April 1, 2001), which replaced “Guidelines of the Bank of Latvia for Development of Credit Policy in Credit Institutions in the Republic of Latvia”. The Guidelines feature major requirements which should be met to establish a system for management of credit risk consistent with the nature, scope and complexity of banks’ activities. It is particularly noted that credit risk is inherent not only to lending, but also throughout other banking activities.

In mid- 2000 the Bank of Latvia conducted a self-assessment of the compliance of its legal framework and supervisory practices with the Basel Core Principles for Effective Banking Supervision. The self-assessment was carried out using the Core Principles Methodology in structuring and presenting information for evaluating compliance. Upon the Bank of Latvia's request, IMF experts conducted an independent evaluation of the self-assessment. The evaluation confirmed that the information provided by the Bank of Latvia self-assessment is correct, relevant and adequate.

To improve cross-border collaboration between banking supervisors, MOUs were signed with Swedish and German supervisory authorities, the Bank of Lithuania and the Bank of the

Republic of Belarus, in addition to previously signed MOUs with the Swedish supervisory authority and the Bank of Estonia.

Securities Market Developments

In 2000, in order to complete the process of harmonizing securities market legislation with European Union directives, the Securities Market Commission (SMC) drafted and adopted important regulations, prepared extensive amendments to laws and proposed several drafts which have been submitted to Parliament for review.

Law on Investment Companies. In order to finalize normative acts governing activities of investment companies, the SMC drafted "Amendments to the Law on Investment Companies", which was passed by Parliament on June 1, 2000 providing for amendments to part 4 of Article 19, bringing it into line with terminology used in the Criminal Law which prescribes qualification requirements for management officials.

Law on Mortgage Bonds. There are amendments to the law "On Mortgage Bonds" which update some norms of the law and differentiate the volume of a mortgage loan depending on the uses to which the mortgaged real estate is put.

As real estate that a borrower utilizes on a permanent basis is more secure than the real estate that is used for other needs, the amendments provide that the mortgage loan together with debts encumbering the relevant real estate and which are recorded in the Land Register shall not exceed 75% of the market value of mortgaged residential real estate and 60% of the market value of other types of real estate.

The amendments are being reviewed by the Commissions of the Parliament. It is planned that the amendments will come into force in sometime in 2001.

Regulation on Capital Adequacy Requirements for Investment Firms. Regulations "On Capital Adequacy Requirements for Investment Firms" passed by the SMC on July 4, 2000, represent a major step towards alignment of the financial and capital markets. The regulations were drafted in line with the European Union Directive No 93/6/EEC "On the Capital Adequacy of Credit Institutions and Investment Firms" and amendments to this Directive No 98/31/EC and No 98/33/EC. They provide for differentiated amounts of required minimum initial capital to be maintained by investment firms, depending on the services offered, as well as prescribe the procedure for calculating capital adequacy requirements, position risk requirements for debt and equity securities and the procedure for assessing settlement risk, counter-party risk, commodities risk, foreign exchange risk and large exposure risks. The regulations become effective on July 1, 2001.

Other Amendments. In order to continue the development of the securities market, align the regulation of the market of debt securities, including mortgage- backed securities, ensure provision of high quality information from market participants and continue approximation of legislation with European Union Directives, the following amendments have been made to normative acts issued by the Securities Market Commission:

- Regulations on the Procedure for Licensing Professional Specialists to Conduct Activities in the Securities Market (amendments adopted on June 14, 2000);

- Regulations on Licensing Stock Exchanges (amendments adopted on June 20, 2000);

- Regulations on Licensing Natural Persons to Conduct Intermediary Activities in Public Circulation of Securities (amendments adopted on June 20, 2000 and September 28, 2000);

- Regulation on Licensing Investment Companies (amendments adopted on October 3, 2000).

Draft Investors Protection Law. In order to introduce an investors protection mechanism for paying compensation in the event of individual losses, the SMC, in agreement with European Union Directive 97/9/EC on investor-compensation schemes adopted in 1997, drafted the "Investor Protection Law".

The draft Law provides that in the event that providers of investment services (under the present legislation – credit institutions and brokerage companies licensed to perform activities in the securities market) are not able to settle their liabilities, investors are entitled to compensation. It provides for compensation of 90% of the value of irreparably lost securities or losses resulting from non-provision of an investment service in the event of a default on obligations.

Insurance Industry Developments

The Cabinet of Ministers adopted rules liberalizing restrictions on insurance company investments and reinsurance and encouraging in particular transactions with counterparties in the OECD and Baltic countries. Since January 1, 2001 the Insurance Supervision Inspectorate has required insurance companies to match their the asset and liabilities in accordance with applicable regulations.

Payments System Risk Policies

Banks are allowed to incur daylight overdrafts against pledged securities only if they are members of the real time gross settlement system SAMS. Daylight overdrafts are free of charge and banks have to ensure that at the end of the day there is a credit balance. In case of debit balance at the end of the day, it is automatically transformed into an overnight loan subject to interest payment at the rate set by the Bank of Latvia. Rules are not differentiated depending on ownership of banks.

LUXEMBOURG

1. A law on electronic commerce

On August 14, 2000, the Grand Duchy adopted a wide-ranging law in the hope of turning the financial center into a hub for electronic commerce. Without being one of the very first European countries to adopt legislation in this field, the Grand Duchy is nevertheless the first to have a framework law which covers all aspects of electronic commerce: the electronic signature, electronic certification, responsibility of intermediate service providers, adaptation of the Criminal Code, commercial communications, conclusion of contracts by electronic means, protection of the consumer and electronic payments.

The law sets out a series of rules designed to create a legal framework conducive to the development of electronic commerce. In its very first articles, two fundamental principles for the creation of a liberal environment are asserted: the free use of cryptographic techniques and the exemption from prior authorization for access to electronic service provision activities.

One of the main contributions of the law resides in the recognition of the electronic signature, which is given the same ranking in civil law as a hand-written signature. The law now allows private contracts to be concluded in electronic form with the same legal value as an act concluded traditionally, provided that the absence of any amendments to the document can be guaranteed. Grand Ducal implementing regulations remain to be adopted. The law also regulates the activity of certification service providers whose role is vital to guarantee the link between the identity of a person and his electronic signature. The right to anonymity is also respected by offering users the possibility of adopting a pseudonym and submitting certification service providers to a professional secrecy requirement. This provision must ensure the security of users and create their confidence in the use of electronic communication tools.

Accordingly, the law of August 14, 2000 should meet its fundamental goal, which is to attract the activities of electronic commerce to the Luxembourg financial centre. For local banks, most of which are developing their e-banking activities at present and converting their Internet sites from their initial information-providing role to perform transactions, the law has come at just the right moment. Because of the particularly small scale of the Luxembourg market, e-business of banks established in Luxembourg must reach out beyond the borders of the country. By adopting Internet sites, the Luxembourg banks are in a position to make a permanent offering and become potential service providers for all persons who can access the site world-wide.

In this regard, it is to be hoped that the European regulatory context will remain favorable to the development of electronic commerce. In its interpretative communication on the freedom to provide services in the second banking directive, the European Commission takes the view that banking services offered via the Internet cannot be regarded as a provision of service effected abroad to the extent that the place where the characteristic service is provided is in fact the place where the bank is established. This factor also determines the applicable body of law. A movement in the other direction is reflected in attempts to render the law of the consumer country systematically applicable; but that approach is impracticable in the absence of maximum harmonization of the European legislation on consumer protection.

2. Measures to control money laundering

On July 14, 1999, the European Commission adopted a proposal for a directive amending Directive 91/308/EEC of June 10, 1991. A common position with a view to the adoption of this directive was reached by the Council on November 22, 2000. The text seeks to strengthen the control of money laundering and, with that end in view, provides for a broader scope of application. The intention is to (i) extend the obligations imposed by the directive to professions that are not in the financial sector, (ii) broaden the definition of suspect transactions and (iii) improve the procedures for identification of clients at a distance.

Extension of the professions concerned

At the level of the financial sector, the new text extends the notion of "financial institution" to investment companies and investment funds. The text also applies to the branches of credit institutions and financial institutions, which are required to disclose any suspicions to the authorities of the host country.

Moreover, the European Commission and other international bodies, such as the Financial Action Task Force and the United Nations Office for the Control of Narcotics and Crime Prevention, have found that professional money launders no longer merely use the financial sector but also lawyers, accountants and property developers to hide the origin of criminal funds. That is why the text proposes the inclusion among the professions to which obligations concerning the control of money laundering apply the following:

• company auditors;

• estate agents;

• notaries and other members of independent legal professions when they represent or assist clients for the purpose of certain activities (purchase and sale of real estate or commercial companies, money management, management of securities or other assets belonging to the customer, opening or management of bank, savings or securities accounts, assistance with the formation, management or administration of companies, trusts or similar structures) or when they act for the account of their customer to implement any financial or real estate transaction;

• persons selling articles of high value, such as gemstones and precious metals, when the payment is made in cash in an amount equal to or higher than 15,000 euros;

• casinos.

In the present legal situation embodied in the law of August 11, 1998, the adoption of the directive should result in the extension of Luxembourg legislation to real estate agents, attorneys and vendors of high value articles.

Extension of the notion of criminal activity

Directive 91/308 primarily requires Member States to control the laundering of capital accruing from narcotics trafficking. The new text significantly extends the notion of criminal activity, which is now defined as any criminal involvement in the commission of a serious offence. The concept of a serious offence now covers not only narcotics trafficking, but also participation in activities associated with organized crime, fraud or any unlawful activity prejudicial, or liable to be prejudicial, to the financial interests of the European Communities, together with corruption and any offence capable of generating substantial earnings and punishable by a severe prison sentence.

This is a broad definition, but it already takes on board much of the definition of the offence of money laundering embodied in the law of August 11, 1998. In particular, fraud against the financial interest of the Community must be added.

However, application of this directive is likely to be somewhat delicate in respect of the requirement that the Member States must, within three years of the entry into force of the directive, adapt the definition of a “serious offence” to bring it into line with the definition given in the common action 98/699 of the Council of December 3, 1998. By virtue of Article 1 of this common action, the notion of a “serious offence” must comprise “offences punishable by a sentence depriving the offender of liberty or a prison sentence for a period of more than one year or in States whose legal system provides a minimum threshold for offences, offences punishable by a deprivation of liberty or a prison sentence for a minimum period of more than six months”. The scope of this definition is liable to be extremely broad. In particular, the notion of a serious offence might be extended to minor offences and at all events less serious than those referred to in the Convention on laundering the proceeds of crime which lies at the basis of the common action of 1998.

Remote identification

The common position that has been adopted introduces a number of principles applicable to the identification of customers on the assumption of business relations or financial transactions at a distance. The text does not set out binding rules but merely requires the introduction, in relation to the persons covered by the directive, of “specific and adequate measures” to avert the increased risk of laundering in the absence of any physical relationship. Examples are given by way of indication. The identification of the customer must be established by means of one or more convincing documents. Verifications or certifications of the documents may be requested. A certification may also be required from an institution designated in the directive. Moreover, a requirement may be made for the first payment relating to the transaction to be effected via an account opened in the name of the customer with a credit establishment covered by the directive.

The content of the common position is far more constraining than that of the Commission’s initial proposal which comprised a whole series of binding measures and rendered any business relationship or financial transaction effected at a distance somewhat suspect.

As this text does not impose more constraints than those resulting from Circular CSSF No. 94/112, the adoption of the directive is unlikely to bring any changes for the Luxembourg banks in respect of the identification of customers served at a distance.

3. Definitive character of a settlement in payment systems and settlement of securities transactions

A draft law tabled in December 1999 and adopted by the Chamber of Deputies on December 20, 2000 permitted the transposition into Luxembourg law of Directive 98/26/EEC, which seeks to contribute to the effective and orderly operation of payment systems and settlement systems for securities transactions. This text is of undeniable interest for the future development of the financial center.

Going beyond the requirements of the directive, the law creates a regime for approval and prudential supervision by the CSSF of payment systems and systems for the settlement of securities transactions. Only approved systems benefit from the legal protection stipulated in the law.

The essential provisions of the text concern the irrevocable nature of transfer orders and the abolition of the “zero hour” rule. As a result, it is now impossible to cancel a transfer order introduced into a system once this order has been accepted by the system. It follows that even if a procedure for insolvency is opened against one of the participants in a system, the transfer orders and the netting will produce their legal effects between the parties and are enforceable against third parties. The law eliminates the retroactive effect of the “zero hour” rule with the consequence that the liquidator of an insolvent participant in the system can no longer contest the validity of the transfer orders introduced into the system by the insolvent participant before the judgement which declared his insolvency.

The introduction of these two rules into Luxembourg law is an essential condition for the legal certainty of transactions. By reducing the legal uncertainties and limiting the problems to which a system is liable to be exposed if insolvency proceedings are opened against a participant, the legal framework established by this text helps to strengthen the solidity of the systems and the stability of the financial markets.

4. Circulation of securities

The circulation of transferable securities was governed up to now by the Grand Ducal regulation of February 17, 1971. This has been replaced by new texts whose purpose is to reform the provisions relating to fungible securities. The law of June 28, 2001 takes over a number of provisions of Grand Ducal Regulation of 1971 as they stand, but does make significant changes in other respects.

The new text helps to strengthen legal certainty through a better definition of the rights of depositors and the rules surrounding the depositing of financial instruments. The deposit of fungible assets is in future qualified in law as an act conferring a real right of an intangible nature in securities or other financial instruments of the same kind deposited with the same depository.

The law also introduces more flexible rules for setting up and enforcing sureties. A strong presumption of ownership is now established for the benefit of the person who sets up the surety. The validity of the surety is only contested in the event that the beneficiary is notified in writing that the party putting up the surety is not the owner of the assets.

Moreover, the law grants central importance to payment and settlement systems for securities transactions. The objective of the new wording of the text is to place Luxembourg depositories who operate a payment and securities transaction settlement systems under conditions of competition that are at least as favorable as those enjoyed by their foreign counterparts. The text provides, in particular, for the prohibition of the impounding of securities and other fungible financial instruments when they have been entered into a netting or settlement system. Similarly, provision is made for payments made into a payment or settlement system to release the author of the payment from all liability. Thus, the chain of payments through these systems is reassuringly secure for the operators and the issuers. Finally, as in the case of the 1971 regulation, the text grants depositories who manage a netting or settlement system for transferable securities the right to enter securities definitively in their accounts on the basis of a promise of delivery when this promise is made by a body which offers full guarantees of security for performance of the transaction. This admittedly bold provision facilitates the circulation of securities and other financial instruments and confers legal certainty on a practice which existed even before it was enshrined in a text in 1994 (Grand Ducal regulation of June 8, 1994 amending Grand Ducal regulation of 17 February 1971).

5. Transfer of ownership by way of guarantee

The law of June 28, 2001 introduces into Luxembourg law the technique of the transfer of ownership by way of guarantee, by analogy with the trust system: ownership of securities can be transferred to guarantee present or future obligations. The assets handed over by way of guarantee are then handed back when the guarantee lapses.

Provision is made for this technique to be used by a great many operators because it is open to financial sector professionals in the broadest sense of the term and also to commercial and industrial establishments when they have professional access to the financial market and to the national or international public bodies operating in the financial sector.

The law seeks to confirm the validity and enforceability against third parties of transfers of ownership by way of guarantee in an ordinary situation and in a situation of bankruptcy. In the latter hypothesis, the provisions on bankruptcy are set aside to permit netting and also to ensure that the market operators enjoy the certainty that is essential for their business. Similarly the law legalizes the contractual clauses, which provide that a seizure or any other conservation measure must be treated as a default leading to automatic compensation, which is deemed to have taken place before the seizure was effected.

This new regime, which remains exceptional, will give the legal certainty that is essential to transactions between professionals and to those made in the financial sector on the basis of standardized contracts of Anglo-Saxon inspiration. While drawing on the relevant French and Belgian texts, this text will be advantageous to Luxembourg operators because it regulates in a very complete and progressive manner the problems that may arise in the area of the transfer of ownership by way of guarantee.

6. Trusts and trust settlements

The approval of the Hague Convention of July 1, 1985 on the law applicable to trusts and their recognition was the subject of a draft law tabled on November 16, 2000. The ratification of this convention by Luxembourg has several consequences. In the first place, the convention equips our courts with rules enabling them to resolve the problems of private international law, which are liable to arise when the effects of a trust extend to Luxembourg territory. Secondly, the entry into force of the convention will have the effect of facilitating recognition of Luxembourg trusts abroad. Although Luxembourg law does not recognize trusts as such, Luxembourg trust settlements do have the characteristic features of the trust enumerated in the convention. The latter therefore creates a bridge between a trust and a Luxembourg trust settlement. The legal certainty of our own institution will therefore be strengthened.

Moreover, the draft law makes certain adjustments to the legal regime governing the Luxembourg trust settlement scheme. The Grand Ducal regulation of July 19, 1983, which introduced the concept of a trust settlement into Luxembourg law will be replaced by a text whose scope of application is much wider. The new text broadens the list of professionals who may act as trust agents. Moreover, the absence of any compulsory link of attachment to Luxembourg opens the way to many applications of Luxembourg law, including transactions in which neither the organizer nor the trust agent is established in Luxembourg.

Relations between the trust organizer, the trust agent and third parties are specified. Thus, neither the trust organizer nor third parties may refer to the contract as being binding on the trust operator and the trust agent. This is in fact a reassertion of the effect of the contract and the absence of representation.

Although the trust settlement concluded for guarantee purposes was not specifically envisaged by the Grand Ducal regulation of 1983, the project under consideration here fully embodies this specific use of the trust arrangement.

The draft law under consideration introduces a general rule to the effect that, as in the case of conventional sureties, the transfer of ownership by way of guarantee, including the trust settlement, is null and void when it was concluded in a suspect period for debts contracted previously (Art. 445 amended of the Code of Commerce). In parallel, the draft law on the transfer of ownership by way of guarantee rules out the provisions on bankruptcy and in particular those embodied in Art. 445 of the Commercial Code. In this context, the assignor does not risk his surety being null and void in respect of debts contracted previously. However, this law will also apply to transactions for the transfer of ownership by way of guarantee through a trust settlement. This apparent contradiction is explained by the difference between the respective fields of application of the two texts. The draft law on the transfer of ownership by way of guarantee relates to transactions transferring ownership in securities that are liable to be entered and transferred between accounts. The text relating to trust settlements for its part has a much wider field of application because it covers transactions involving all kinds of assets.

Essentially, the regime for the transfer of ownership by way of guarantee under draft law No. 4696 will in practice serve to govern situations between professionals whereas the trust settlement may perfectly well be used in more conventional credit situations.

Another specific feature of a trust settlement resides in the principle of the autonomy of assets, whereas the principle of the universality of assets is applicable to the transfer of ownership by way of guarantee outside the fiduciary framework.

In conclusion, the new text will provide greater legal certainty for trust transactions and will give the Luxembourg trust settlement scheme greater international legitimacy. The creation of an appropriate legal framework is also likely to attract to Luxembourg foreign economic operators wishing to use trust schemes when no equivalent provision exists in their State of origin.

7. Evolution of the law on pension funds

In the course of the year 2000, the government tabled a draft law amending the law of June 10, 1999 creating pension funds in the form of open-ended private pension fund companies (sepcavs) and private pension funds (asseps). The new text does not embody a far-reaching reform of the existing law, but does clarify and define a number of points in more detail.

The main amendment applies to conditions and procedures for the approval of liabilities managers. In the future, the mission of the liabilities manager will be legally defined in detail, involving in particular the establishment of the financing plan and ongoing verification of its adequacy in relation to commitments. The CSSF will keep the official list of professionals who are authorized to act as liabilities managers for asseps.

The draft law also seeks to resolve a number of problems arising from the link between the pension regulation and the statutes. According to the present text, any change in the pension regulation requires, on each occasion, compliance with all the formalities of depositing and publication applicable to the articles of incorporation of the corporate body. In the future, the pension regulation will be exempt from the depositing and publication requirement. Any amendment of the pension regulation will be subject to prior approval by the CSSF.

Under the present regime, it is sometimes difficult to set up a pension fund because the initial capital sums provided for the account of the beneficiaries are too small. The draft law provides for the possibility of an initial provision of resources by non-beneficiary contributors. Thus a sepcav and an assep may be endowed with a starting capital whose amount is limited to the minimum share capital. The share capital may therefore be immediately attained and a better risk diversification ensured. Another provision of the draft tends in the same direction when it stipulates that a single partner is sufficient to set up a sepcav.

Some provisions of the law will be aligned on the legislation governing investment funds. As in the case of investment funds, the possibility of providing for solidarity between the different compartments of a pension fund is introduced, whereas the clear distinction between compartments will be the rule. The provisions concerning the qualification and task of the company auditor also draw on those applicable to investment funds.

Provision is likewise made for the depository bank to be given the supplementary task of checking the specific payment of contributions by the contributor(s) in the interest of protection of the beneficiaries.

Decisions of the supervisory authority concerning the grant, refusal or revocation of authorization may in future be the subject of an appeal to the Administrative Court.

The law will prohibit a pension fund from granting credits and acting as a guarantor for third parties. Within the limits set by the investment policy a fund may, however, acquire bonds or similar instruments, make use of derivative instruments or place securities from its portfolio on pledge to guarantee its own commitments.

Finally, the possibility will be created for asseps to communicate information, via the direct taxation authority, to foreign tax authorities to allow the country of residence of the affiliate or the beneficiary to apply its own tax regime. The law at present provides for a similar regime for sepcavs.

The ABBL welcomes this amendment of the text, which eliminates some technical imperfections in the present law. However, it is clear that the legislation on sepcavs and asseps will continue to change in future, notably after the adoption of the proposal for a Community directive on supplementary retirement schemes.

8. New Statute on the Deposit Guarantee Association, Luxembourg

The Deposit Guarantee Association, Luxembourg (AGDL) was set up on the basis of two European directives, which were transposed into domestic Luxembourg legislation by the Laws of June 11, 1997, and July 27, 2000. The purpose of the AGDL is to set up a mutual guarantee system covering deposits in cash (deposit guarantee) and claims resulting from investment transactions (investor compensation) as defined by the law and by its statutes in favor of customers and investors who maintain accounts with members of the Association.

Essential features of the guarantee system are as follows:

- In the event of insolvency of a member establishment, the AGDL protects all cash depositors by guaranteeing the reimbursement of their deposits up to 20,000 euros.

- Claims of investors arising out of investment transactions also are guaranteed up to 20,000 euros.

- Members of the AGDL are credit institutions, i.e., banks and investment firms.

- All deposits in cash, including funds associated with investment transactions, are eligible for the deposit guarantee. All claims in accordance with investment instruments qualify for investor compensation. No claim can be covered by both guarantees simultaneously.

- Luxembourg branches of foreign establishments are likewise covered by the AGDL, except for those which originate from other countries of the European Community, which are covered by the system applicable in their home country. If a branch in Luxembourg from a Community country is covered n its home country by a lower guarantee than that provided by the AGDL, it may apply for membership in the AGDL to cover the difference.

THE NETHERLANDS

DEVELOPMENTS REGARDING PAYMENTS SYSTEM, INFORMATICS AND SECURITY

Payments System

The introduction of euro notes and coins on January 1, 2002 requires a major effort on the part of the banks. All banking systems must be europroof by July 1, 2001 at the latest. During the past year, some principles in respect of the payment system, as formulated by the National Forum for the Introduction of the Euro, have been amended at the users' request. In the spring of 2000, the definite version of the notes and coin conversion scenario was adopted.

The European Commission launched an inquiry into an alleged illegal agreement between The Netherlands Bankers’ Association (NVB) and the banks about the rates charged for the exchange of cash from euro zone countries. NVB is confident of the outcome of the inquiry, which is expected to be completed by the summer of 2001.

The banks are seeking to make cross-border funds transfer within the European Economic Space cheaper and more efficient.

The Minister of Finance has asked NVB to urge its members to achieve an even greater measure of transparency regarding transfer time and value-dating.

Informatics/Telematics

The millennium transition went very smoothly, yielding several positive results in the process. As more and more banking services are provided electronically, there is a concomitant increase in the importance of adequate protection of information. NVB plays an important part in this regard. A case in point is the creation of the new “Information Protection Code” to which NVB made a contribution last year. NVB sets great store by adequate rules and regulations governing electronic commerce.

Security

During the year, a co-ordinated interbank approach and collaboration between the banks, the police and the Public Prosecutions Department again helped prevent many fraud cases. Collaboration between the banks and the public authorities was formalized at the end of October with the establishment of the so-called Enforcement Arrangement, in which the parties agreed to a cooperative and coordinated approach to the prevention and repression of fraud.

The number of disclosures under the Disclosure of Unusual Transactions (Financial Services) Act continued to rise during the year. Feedback on disclosures remains a strong wish on the part of the banks.

A total of 83 banks were raided in 2000, down 30% from the corresponding 1999 figure. As regards the euro and security, NVB catalogued the various fraud and money-laundering risks and made agreements with the police concerning physical security before and during the conversion operation.

DEVELOPMENTS REGARDING BANKING SUPERVISION AND RETAIL AFFAIRS

Banking Supervision

In 2000, the structure of supervision and the supervision of financial conglomerates was an important focus of attention. It is important to ensure that additional group supervision of financial conglomerates never results in overlap.

NVB supported the direction of the proposed New Basel Capital Accord (Basel II), but suggested attention should be focused on the following:

- neutral implementation, without higher capital charges for the banking sector as a whole;
- a supervisory platform that ensures a level playing field during implementation;
- a level playing field with insurance agencies and other financial institutions;
- a third consultation round for unresolved issues; and
- proposals for technical improvements.

NVB also actively participates in the international Joint Working Group of Banking Associations on Financial Instruments to assess the consequences of the introduction of Fair Value Accounting.

Brussels has set off a harmonization wave within the framework of the Financial Services Action plan with the issuance of Directives on financial conglomerates, a single passport for investment services, cross-border of financial collateral, savings taxes, UCITs and pension funds, and distance marketing of financial services.

Consumer Affairs

Discussion of the draft directive on the distance-selling of financial services, a test case in the endeavor to achieve maximum harmonization, made little headway in 2000. It remains uncertain whether “genuine” harmonization can be accomplished in this important area, which is an absolute requisite to the creation of the uniform market. At the domestic level, too, the government is seeking to improve consumer information in respect of (complex) financial products.

With a (partly NVB-instigated) amendment to the Consumer Credit Act, the government is more able to deal with misleading consumer credit advertisements. If necessary, NVB will urge the government to stick to its promise of utilizing this particular avenue.

The financial sector is preparing for “transparency” obligations for investment products, including a “risk indicator” per product, due in the summer of 2002.

Mortgage Credit

In 2000, fewer new mortgages were registered than last year.

The Netherlands Competition Authority approved the new Mortgage Finance Code of Conduct, which came into effect on March 1, 2001. In addition, the European Code of Conduct was finally accepted by all parties.

In 2000, some 185 (attempted) fraud cases were reported to the mortgage fraud desk. During the year, *Stichting Erkenningsregeling Hypotheekadviseurs* (Mortgage Advisors Certification Board) issued over 5,000 certificates.

OTHER DEVELOPMENTS

Fiscal Affairs

During the past year, NVB made a strong case for improving or lifting a few proposed supplementary measures under the 2001 Income Tax Act and the corresponding implementing act. Examples include those taken against dividend stripping and limitation of the deduction of interest paid on hybrid loans.

In June 2000, a European agreement was reached on withholding tax. The exchange of information will impose a minor additional burden on the Dutch banks.

Securities Affairs

Stock exchange organizations among the NVB membership doubt whether the speed at which the merger of the Amsterdam, Paris and Brussels stock exchanges was effected is realistic. NVB is holding talks with *STE* (Securities Board of the Netherlands) and the Ministry of Finance about STE's cost attribution. NVB does not agree to attribution of all costs to the banking industry.

NVB also evaluated the *Nadere Regeling toezicht effectenverkeer* (Specific Regulation governing the supervision of securities transactions) and is consulting with STE about the matter.

External Relations

NVB is actively participating in various national consultative bodies about communication activities to be undertaken in connection with the introduction of the euro.

In 2000, NVB was approached 417 times by the media. The main topics were WW II deposits, funds transfer, the millennium problem and the introduction of the euro.

NIGERIA

Bank Regulatory Developments

1. Financing of SMES

During the period under review, further emphasis was given to the banking industry's initiative towards financing Small Scale Industries, which requires banks to set aside 10% of their annual pre-tax profit for equity participation in small-scale industries.

2. Universal Banking

Under the universal banking program adopted in December 2000, the longstanding barrier between merchant and commercial banking business was breached. Merchant banks can now go into clearing, and commercial banks are at liberty to go into securities, underwriting/issuing house activities.

Banks are also permitted to provide some aspects of insurance services such as, agency services, brokerage services, underwriting services, loss adjusting services, re-insurance services and retrocessionaire services. However, while banks can provide agency and brokerage services directly, the rest can only be provided through subsidiary or associated companies

3. CBN Certificates

Owing to the prevalence of excess liquidity in the system following the continued expansionary fiscal policy of the government, the Central Bank of Nigeria (CBN) in February 2001 introduced a new monetary policy instrument called "CBN Certificate".

This instrument, which is available in two tenors of 180 and 360 days, each with market-based interest rates, is designed to help manage perceived excess liquidity in the system. The instrument is available to government agencies, banks and private sector investors.

4. Cash Reserve Requirement (CRR)

The Cash Reserve Requirement (CRR) is used to complement other policy instruments in achieving desired monetary stability. In April 2001, the CBN, in an attempt to contain persistent excess liquidity, further revised the CRR upward from 11%to 12.5%. The CRR of 10% set in 2000 fiscal year was first raised to 11% in the first quarter of 2001.

5. Minimum Rediscount Rate (MRR)

The Central Bank of Nigeria on January 17, 2001 increased its minimum rediscount rate to 14.5%. Two weeks later, it was further revised upwards to 15.5%. As at June 2001, the MRR stood at 16.5%.

6. Minimum Paid-Up Capital

The CBN in its commitment towards further strengthening the capital base of banks directed that in the 2001 fiscal year, the minimum paid-up capital for new banks be raised from ₦1.0 billion to ₦2.0 billion. However, the minimum paid – up capital for existing banks remains ₦500 million.

7. Qualifications for Appointment to Board and Top Management Positions in Nigerian Banks

In an attempt to improve the quality of management in banks, the CBN has set minimum qualification requirements for individuals appointed to top management positions in banks. For instance, a managing director, apart from having postgraduate degree or professional qualification, should have 20 years post-qualification experience, 15 of which must be in the banking industry.

A general manager, in addition to academic and professional qualifications, should have 15 years post-qualification experience, 10 of which must be in the banking industry. Similar academic qualifications, but with 12 years experience, 8 of which must be in the banking industry, are prescribed for a Deputy/Assistant General Manager.

Foreign Exchange and Trade Developments

1. Payment for Services by Nigerian Companies

In pursuance of the guided deregulation stance of the government, payment in foreign exchange for services rendered by a Nigerian company to another Nigerian company is no longer accommodated in the Inter-bank Foreign Exchange Market (IFEM). Where the payer agrees to pay in foreign exchange, the funds shall be from either its domicilliary account or offshore sources.

2. Bills Of Exchange

Transactions done on the basis of bills for collection shall be negotiated and paid for within the tenors of the bills while the tenor and terms of each bill of exchange shall be strictly adhered to. Also, payment for such bills shall not exceed 180 days from the date of receipt of the goods. Noncompliance shall render the bills stale and invalid for payment.

3. Life Span of Form 'M'

The initial validity for an approved Form 'M' in respect of payments for the importation of machinery, plant and equipment made to specification shall be 360 days, subject to extension for another six months by the processing bank. However, where there is need for further extension, application shall be made to, and approval be obtained from the Central Bank of Nigeria. Thus, the maximum lifespan of an approved Form ‘M’ for importation of machinery, plant and equipment is 720 days.

Other Developments in the Financial Sector

1. Transparency in Banking Operations

In connection with its efforts to promote utmost transparency and ethical standards in the banking sector, the CBN, from January 2001, intensified its regulatory oversight while also encouraging self-regulation in the banking industry. Related to these efforts, banks under the aegis of the Bankers Committee have set up a Sub-Committee on Ethics to address issues regarding ethics in the banking system.

2. Introduction of On-Line Dealing System

In line with global trends and in order to further develop transparency and international standing of the Interbank Foreign Exchange Market (IFEM), the CBN in March 2001 introduced the on-line dealing system by hooking up to the Reuters Broadcast Network.

NORWAY

Capital Adequacy Requirements

In 2000, the Ministry of Finance opened the way for Hybrid tier 1 capital (capital securities) to be employed as core capital (in accordance with Basel Committee Press Release of October 27, 1998). In order to be authorised to issue Hybrid tier 1 capital, a financial institution must have a minimum of 6.5%-7% core capital prior to the issue, depending on its risk profile. The capital securities may be issued directly by the bank and will be treated as debt for tax purposes.

In 2001, the special requirement of 100% risk weighting for home loans between 60 and 80% of a prudent valuation has been dropped, thereby bringing Norwegian rules in line with rules in effect in most countries.

In the view of Kredittilsynets (the Banking, Insurance and Securities Commission), an institution’s right to issue subordinated loan capital with a fixed term should as a rule be conditional on a core capital adequacy of 7%. However, this year it has been opened for that the requirement could be reduced to a core capital adequacy between 6% and 7% for institutions which have considerably lower risk than the average.

In 2000, a new regulation on minimum capital requirements for market risks etc. incurred by credit institutions and investment firms was laid down by the Ministry of Finance. The new regulation is in accordance with the regulations in the Capital Adequacy Directive 98/31 (CAD II-Directive). The implementation of the CAD II-Directive means that credit institutions and investment firms may be allowed to use so-called “value-at-risk” models to measure capital requirements for market risks. The new regulation sets many quantitative and qualitative requirements which have to be fulfilled before the model can be approved by Kredittilsynet.

Securities Trading

The Storting (Parliament) passed a new Exchange Act in 2000. The new Act entered into force in the spring of 2001. Its object is to lay the basis for effective, orderly and confidence-inspiring markets for financial instruments. Under the new Act, stock exchanges and other authorized marketplaces for securities will be subject to general supervision by Kredittilsynet, in line with other institutions in the securities market. Commodities derivatives market operators now also may apply for a license in accordance with the new Act. Commodities derivatives trading generally will be regulated as trading in securities and other financial instruments. Another consequence is that certain tasks related to supervision of market players will be transferred from the Oslo Stock Exchange to Kredittilsynet.

Significant Market Developments

In December 2000, Christiania Bank (the second largest commercial bank) was sold to MeritaNordbanken. The Norwegian Government owned around 34% of Christiania Bank's outstanding share capital. MeritaNordbanken is a part of the Nordic financial group Nordea (earlier Nordic Baltic Holding). Christiania Bank will be carried on as a subsidiary in Norway supervised on a single basis by Norwegian authorities.

In March 2001, the Norwegian Government sold shares in Den norske Bank (the largest commercial bank) which represent 13.4% of the bank's outstanding share capital. Pursuant to the sale, the Norwegian Government owns 47.3% of the outstanding share capital of Den norske Bank. However, the state has declared its intention to sell down this stake to about 34%, thus maintaining a controlling minority position.

Union Bank of Norway (the country's largest savings bank) joined forces with the mutual insurer Gjensidige (the country's largest non-life insurer and second largest life insurer) in 1999. The joined group has declared its intention to demutualize, but this requires government approval and amendments to the Savings Bank Act. The prospects of necessary and legal amendments seem positive, though not sure.

Payments System Risk Policies

In Norway, depository institutions are permitted to incur daylight overdrafts in their accounts in connection with payments effected through the central bank (Norges Bank). In this connection, non-domestic institutions are treated in the same way as domestic institutions. Daylight overdrafts are also permitted for domestically-chartered institutions that are foreign-owned and for branches of non-domestic institutions.

Daylight overdrafts through the day are subject to collateral requirements. There is not any difference in the requirements applied to non-domestic depository institutions.

PAKISTAN

During the period under review, there were a number of changes to existing prudential regulations for banks and other financial institutions.

The maximum limit on loans/advances for the purpose of credit card operations by banks has been increased to Rs 500,000 and banks were advised to follow a new criterion issued in respect to classification and provisioning of credit card loans/advances under Prudential Regulation-VIII. Guidelines providing safety parameters for the domestic growth of credit card operations by commercial banks have been issued and will be implemented on July 1, 2001.

Financial institutions have also been advised to observe certain guidelines in connection with the classification of their asset portfolios and their provisioning against such assets. In this context, it was decided that loans made by financial institutions under a government policy for the revival of ailing industrial units would not constitute part of the outstanding amount of loans in default, but instead would be kept in a separate account.

In response to complaints against commercial banks regarding the amounts needed to open accounts and the size of service charges, a new regulation advises banks against deducting service charges from non-remunerative deposit accounts or accounts opened on a profit and loss-sharing basis.

In another development, foreign banks operating in Pakistan have been permitted to provide financial and advisory services if the bank's parent company is incorporated in one of the countries where banking supervision and regulation standards are acceptable to the State Bank of Pakistan.

With a view to expediting credit processing, minimizing the risk of default and effective monitoring after disbursement of funds, a new regulation provides that financial institutions must obtain information from each borrower according to the requirements of the "Borrower's Basic Fact Sheet".

Another new regulation provides that financial institutions are allowed to use FE 25 deposits for their trade-related activities in Pakistan or abroad, provided they maintain a 25% cash reserve against such deposits in U.S. dollars.

A number of requests were received from banks and nonbank financial institutions (NBFIs) to permit them to launch new deposit mobilization schemes offering insurance coverage to their account holders by entering into an agreement with an insurance company. On December 16, 2000, it was decided that banks/NBFIs may provide insurance products to their depositors provided (i) coverage is not mandatory and (ii) there is no discrimination in the deposit interest rates based on whether the deposit is insured.

PANAMA

Bank Regulatory Developments

The Superintendency of Banks continued to issue new regulations under the 1998 banking law in order to fully comply with the Basel criteria and standards on banking supervision as well as with the International Monetary Fund reviews.

New regulations were issued for evaluation, assesment and rating of the loan portfolio, and the determination and establishing of corresponding provisions with respect to loans rated below the highest category. The internal rating system adopted by each bank must follow patterns provided in the regulations as a minimum, starting with compliance with provisions in the International Accounting Norms or USGAAP, whichever is chosen by the bank and authorized by the Superintendency. Loans are rated and classified in one of five categories: Normal, Special Mention, Subnormal, Doubtful and Loss, with provisions set, starting with Special Mention, at 2%, 15%, 50% and 100%.

Similar regulations were issued for evaluation, assesment and rating of the investment portfolio, following similar patterns. Investments are classified in one of the following categories: For Trading, For Sale, Held to Maturity and Permanent.

Regulations were also issued for the measurement of interest rate risk. A formula was established for all banks to follow at a minimum, with more complex formulas required, depending on the complexity of a bank's operations.

Also regulated as of September 2000 is country risk, for which a general principle was adopted, giving banks autonomy to determine if, when and how much they should provide for country risk on their loan and investment portfolios.

Anti-Money Laundering Developments

On October 2000 the Penal Code was modified in order to replace the crime of money laundering with the new crime of asset laundering in order to cover other assets in addition to cash, and expand its coverage beyond the laundering of funds derived from drug trafficking to include fraud, illicit arms traffic, kidnapping, extortion, theft of government funds, corruption of public officials, acts of terrorism and theft or international trafficking in vehicles.

A new law was also adopted extending the obligation to report cash and suspicious transactions to the Financial Analysis Unit, already obligatory for banks, to other activities such as securities dealing and brokering, insurance, leasing, real estate sales companies, gambling and companies involved in international trade particularly from free trade zones.

As a result of these laws, the Superintendency of Banks issued new regulations requiring all banks to establish the internal position of Compliance Officer, listing its functions, duties and responsibilities, and establishing minimum requirements to be a Compliance Officer.

New regulations were also issued to adapt those already in place under the previous money laundering crime to the new asset laundering crime. New rules and guidelines regarding the identification of suspicious transactions under the new crime of asset laundering were also issued. Additionally, new Know Your Customer regulations were issued to comply with the new crime of asset laundering.

The new KYC regulations were approved by the U.S. Internal Revenue Service, so that banks established in Panama can obtain from the IRS the status of Qualified Intermediary for handling investments for clients in the United States without having to disclose the identity of clients and withouth being subject to the retention of the witholding tax on incomes derived from such investments.

The National Securities Commission also adopted new regulations concerning anti-money laundering rules for anyone involved in the securities market with an authorized license, establishing the requirement that all companies involved in the securities market must have a Compliance Officer and adopt its own KYC rules.

As a result of these and other additional new legal instruments, Panama was removed from the list of non-cooperative countries issued by the Financial Action Task Force in June 2000.

Additional Expected Regulations

Presently under consideration for likely approval are several new regulations by the Superintendency of Banks with respect to:

- criteria for the authorization of new banking licenses;
- criteria for the authorization of foreign branches and subsidiaries of Panamanian banks;
- corporate governance of banks;
- limits to the investment by banks in other companies not involved in the banking business to not more than 25% of a bank's capital funds on a consolidated basis, and defining those types of non-banking business in which the limit does not apply, such as leasing, factoring and others; and
- regulation of market risk.

Non-Domestic Institutions

Under Panama´s banking law, non-domestic banking institutions are treated the same as domestic institutions. Non-domestic institutions are not subject to any different or additional prudential requirement than domestic institutions. Panamanian banking law establishes the consolidated supervision of branches of foreign banks, as well as other affiliates that consolidate with their head offices and are supervised by the foreign authority. The law authorizes Panama´s Superintendency of Banks to agree and sign memoradums of understanding with foreign supervisors concerning consolidated supervision of establishments in Panama of foreign banks. But all non-domestic institutions are subject to the Panamanian banking law just as domestic institutions.

PHILIPPINES

Bank Regulatory Developments

During the period under review, the following developments took place regarding the regulation and supervision of banks in the Philippines:

- On July 31, 2000, the Bangko Sentral ng Pilipinas (BSP) decided to adopt the lagged system in the measurement of banks' and quasi-banks' reserve requirement for deposit and deposit substitute liabilities. The reserve requirement in the current period shall be computed based on the corresponding levels of deposit and deposit substitute liabilities of the prior week.

- On August 15, 2000, banks were advised that the target level of capitalization prescribed for banks as of year-end 2000 has been set aside and the level of required capitalization as of year-end 2000 shall be the same as that prescribed as of year-end 1999.

- On October 12, 2000, the BSP approved the expansion of the coverage of the Currency Rate Risk Protection Program (the "CRPP Facility"). As a result, eligible obligations in CRPP Facility now consist of foreign exchange obligations in amounts not less than US$50,000 which are current and booked as of September 30, 2000 and outstanding as of the date of application and that are fully unhedged or without a natural hedge. Subsequently, on August 17, 2001, this was extended in terms of coverage and maturity to include the following: (i) net importers, (ii) registered foreign currency-denominated bonds and FCDU loans with original maturities longer than one year and up to 5 years, and (iii) OA/DA and other trade transactions of clients other than oil companies, including manufacturing.

- On October 20, 2000, the BSP expanded the coverage of leasing companies as financial allied undertakings by allowing, with prior BSP approval, the investment by banks in companies engaged in leasing of stalls and spaces in commercial establishments, provided that such investments are made through the conversion of outstanding loan obligations into equity.

- On December 5, 2000, the BSP issued rules and regulations implementing Section 55.1 (e) of the GBL regarding duties and responsibilities of banks and their directors/officers in all cases of outsourcing of banking functions, the prohibition against outsourcing certain banking functions, and the outsourcing of information technology systems/processes.

- On February 27, 2001, offshore banking units (OBUs) were classified as resident entities for statistical reporting purposes to conform to the 5th edition of the IMF Balance of Payments and the Monetary and Financial Statistics Manual.

- On March 29, 2001, the BSP decided to restore the six-month lag in the computation of the loan-to-deposit ratio of banks for the purpose of determining compliance with the loan-to-deposit ratio requirement provided under the Manual of Regulations for Banks.

- On March 29, 2001, the BSP issued guidelines implementing Section 34 of the General Banking Law (GBL) of 2000 pertaining to the adoption of the risk-based capital adequacy framework. The guidelines initially cover capital requirements for credit risks, pending issuance of supplementary guidelines to incorporate market risk.

- On April 19, 2001, the BSP issued policy guidelines that will govern the rediscounting facility available to rural banks and cooperative banks intending to provide microfinance loans.

- On May 17, 2001, the BSP amended the provisions of the Manual of Regulations for banks and nonbank financial institutions to include the following: (i) powers and authority of the board of directors; (ii) general responsibility of the board of directors; (iii) specific duties and responsibilities of a director; and (iv) sanctions for erring directors.

- On July 27, 2001 and August 10, 2001, the BSP increased the liquidity reserve requirement against peso demand, savings, time deposit and deposit substitute liabilities of universal banks and commercial banks and nonbank financial intermediaries with quasi-banking functions (NBQBs) by two percentage points each. The two-step increased raised the liquidity reserve requirement of commercial banks and NBQBs from 7% to 11%, with their corresponding statutory reserve requirements remaining unchanged at 9%.

Developments in the Capital Markets

The Philippine capital markets recently underwent a significant change with the passage of the Securities Regulation Code (SRC), embodied in Republic Act No. 8799. The law took effect on August 8, 2000. The Implementing Rules and Regulations of the SRC took effect on January 2, 2001.

The Code and its IRR effected the following changes:

- encouragement of full and fail disclosure by moving away from a purely merit-based regulation to full disclosure type of regulation;

- promotion of self-regulation in the securities industry;

- elimination of fraud and manipulation by imposing heavier penalties and sanctions;

- reorganization of the Securities and Exchange Commission (SEC), to equip it with the structure and powers to administer the Code;

- increased responsibilities of SEC for governance of the capital market—to develop and regulate as well as monitor the market, and to provide the information and other support required by the market;

- provide the framework, as well as rules and regulations, for the securities and derivatives markets; and

- make possible the demutualization of the Philippine Stock Exchange and give non-brokers majority control on the Exchange's board of directors.

Anti-Money Laundering Developments

On July 7, 2000, the BSP issued the first of a series of anti-money laundering measures to bring the country's regulatory regime on money laundering closer to international standards, and it is supporting the passage of a consolidated bill on money laundering to meet international standards. The regulation requires, among other things, the following:

- Banks and non-bank financial institutions (NBFIs) should adopt the "know your client" policy in the conduct of their business. (As a separate matter, it is noted that insurance companies are also adopting the "know our client" policy in the conduct of their business.)

- Unless otherwise prescribed under existing laws, anonymous accounts or accounts under fictitious names are prohibited. In cases where a numbered account is allowed, banks/NBFIs should ensure that the client is properly identified.

- Records of transactions should be maintained for at least five years.

- Suspicious transactions not involving deposits should be reported to competent authorities.

On July 31, 2000, the BSP required banks to report within five banking days any transaction intended for the purpose of laundering proceeds of criminal or other illegal activities. Notification should be made either within five days of the transaction itself, or within five days of the bank's becoming aware of the purpose of the transaction.

On September 6, 2000, the BSP required banks to take necessary measures to establish and record the true identity of their clients in cases of numbered foreign currency accounts authorized under existing laws.

On September 29, 2000, a regulation was issued prohibiting the issuance of cashier's, manager's or certified checks or similar instruments payable to cash, bearer, a fictitious payee or a numbered account.

On October 26, 2000, the BSP required foreign exchange corporations which are subsidiaries or affiliates of banks, quasi-banks and non-bank financial intermediaries, to require a written notarized application and supporting documents from the resident-buyer of foreign exchange of $10,000 or more. The exchange corporations are also instructed to ensure that the limit is not breached by the splitting of a foreign exchange purchase into smaller amounts. On July 26, 2001, this amount was reduced to $5,000.

On January 2, 2001, the BSP advised banks/NBFIs of the creation of a special committee that shall take charge of the evaluation and investigation, as well as the maintenance of the database, of the reported suspicious transactions and required them to submit their reports directly to said committee.

On January 15, 2001, the BSP included OBUs in the coverage of anti-money laundering rules and regulations and required them to comply with all the requirements of all existing regulations.

On April 2, 2001, the BSP required banks and non-bank financial institutions to:

- phase out within a period of one year or upon their maturity, whichever is earlier, anonymous accounts or accounts under fictitious names as well as numbered accounts being kept or managed by them, which are not expressly allowed under existing law; and
- submit annually to the BSP through the appropriate supervising and examining department of the Supervision and Examination Sector a certification signed by their President or officer of equivalent rank and by their Compliance Officer to the effect that they have monitored compliance with existing anti-money laundering regulations.

On August 16, 2001, the BSP allowed the issuance of cashier's, manger's or certified checks or similar instruments in blank or payable to cash, bearer or numbered account, subject to the following conditions:

- the amount of each check shall not exceed P10,000;
- the buyer of the check is properly identified;
- a register of said checks complying with required minimum information shall be maintained;
- banks shall take measures to ensure that said instruments are not being used for money-laundering activity; and
- deposit of said instruments shall be subject to the same scrutiny applicable to cash deposits.

Market and Other Developments

- On December 21, 2000, the BSP issued new guidelines in connection with electronic banking activities of banks.
- On August 15, 2000, the BSP issued regulations implementing Section 11 of the GBL, raising the ownership limit of foreign individuals and non-bank corporations in the voting stock of a domestic bank to 40%.
- On January 8, 2001, regulations were issued implementing Section 3 of the GBL on the definition, classification, powers and scope of authorities of banks. These regulations establish a clear delineation of the functions of universal, commercial, thrift, rural,

cooperative and Islamic banks. The same circular set the prerequisites for the grant of universal banking authority.

- On January 30, 2001, the BSP issued regulations implementing Sections 40, 43 and 44 of the GBL on the grant of micro-financing loans to facilitate the flow of financial resources to the marginalized sectors of the economy. Under the implementing guidelines, the maximum principal amount of micro-financing loans shall not exceed P150,000; interest rates shall be reasonable but shall not be lower than prevailing market rates; micro-financing loans, which are small unsecured loans, may be exempted from rules and regulations of the Monetary Board governing unsecured loans subject to certain conditions; and micro-financing loans shall be considered in compliance with required loans to small and medium enterprises.

- On February 28, 2001, the BSP issued the policy guidelines on the sale of branches of existing operating banks. The guidelines require, among other things, the following: selling and acquiring banks must seek prior written consent of the Philippine Deposit Insurance Company in the transfer of assets and assumption of liabilities; selling banks must obtain the prior approval of the BSP to close branches to be sold and to submit a certification that affected depositors were given the option to withdraw their deposits or to maintain the same with the acquiring bank; and the acquiring bank must pay a licensing fee per branch.

- On March 21, 2001, the BSP issued rules and regulations implementing Section 8.3 of the GBL in connection with the moratorium on the establishment of new commercial banks to include the issuance of new commercial banking licenses, upgrading or conversion of old banking licenses into commercial banking licenses, the organization and incorporation by foreign banks of new commercial banking subsidiaries and any other transactions that may result in the issuance of new commercial banking licenses within 3 years from June 13, 2000.

- On April 3, 2001, the BSP issued amendments on the conditions for banks to convert into a lower category. Under the new rules, the bank shall: (a) upon receipt of notice of approval of conversion shall not engage in or renew transactions under authorities not associated with those allowed for the lower bank category into which it is converting and within six months from the receipt of notice of approval of its application for conversion shall phase out all inherent powers and activities under special authorities not normally associated to the lower bank category into which it is converting; and (b) start operation in the lower category into which it is converting after the approval by the Securities and Exchange Commission of the bank's amended articles of incorporation and by-laws, its compliance with all the conditions of the conversion and the issuance by the BSP of a certificate of authority to operate.

- On August 14, 2001, the BSP issued amendments on the capital of non-stock savings and loan associations (NSSLAs), requiring a minimum capital contribution of P1,000 which shall apply to all NSSLAs established after August 14, 2001 and all pending applications to establish NSSLAs received prior to August 14, 2001.

Daylight Overdrafts

On March 26, 2001, the BSP approved the establishment of the "intraday liquidity facility" (ILF) to support the settlement of transactions involving interbank loans and government securities under repurchase agreements with the BSP in connection with its open market operations.

POLAND

Developments in the Banking Sector

In 2000, the total number of commercial banks decreased to 75 from 77 at the end of 1999. Following are some of the major developments:

- The head office of American Express put its Warsaw branch into liquidation.
- Bank Staropolski SA was declared bankrupt.
- BWR Real Bank was acquired by Bank Współpracy Regionalnej SA, with the two institutions subsequently merging.
- Bank Austria Creditanstalt merged with Powszechny Bank Kredytowy S.A.
- Gliwicki Bank Handlowy was taken over by Wielkopolski Bank Kredytowy S.A.
- Toyota Bank Polska SA was established, with 100% foreign equity.

The number of banks with majority foreign equity increased to 46 from 39. The total capital base of banks with majority foreign equity represented 76.9% of total capital within the Polish banking system.

The principal alterations seen in the ownership structure of banks were the result of foreign investors acquiring direct or indirect control over banks previously under majority Polish ownership, as follows:

- Deutsche Bank AG undertook the rehabilitation of Bank Wspolpracy Regionalnej SA. However, this did not involve any increase in German investment in the Polish banking industry, since the rehabilitation process is being conducted via the offices of Deutsche Bank Polska SA, a subsidiary already operating in Poland.
- Deutsche Bank AG abandoned its attempts to assume control of BIG Bank Gdanski SA, disposing of the interest it previously held to Banco Comercial Portugues, which – together with other institutions acting in concert – acquired control over the latter bank and its subsidiary, BIG Bank SA. The new owners have resolved to merge these two banks, and have already received approval for this from the Commission for Banking Supervision.
- Citibank Overseas Investment Corporation purchased a 66% holding in Bank Handlowy w Warszawie SA from the previous shareholders, thereby acquiring control of the bank and its subsidiaries, Cuprum-Bank SA and Bank Rozwoju

Cukrownictwa SA. In March 2001, the final merger of the two institutions took place under the name Bank Handlowy w Warszawie S.A. - member of Citibank Group.

- Bank Austria Creditanstalt International purchased a 10.29% interest in Powszechny Bank Kredytowy SA from the Treasury, thus assuming control over that bank and its subsidiary, Gornoslaski Bank Gospodarczy SA.

- The proportion of equity in BRE Bank SA held by foreign investors rose to 58.7%, with the bank consequently being recategorized as a bank with majority foreign equity.

- Nordbanken AB took over 94.1% of the shares of the bank Komunalny S.A.

In addition to the developments outlined above, the following changes in the ownership structure of Poland's banks occurred:

- The National Bank of Poland sold a 24.5% interest in Bank Rozwoju Budownictwa SA to Bank Gospodarstwa Krajowego.

- Den Danske Bank acquired a 83.2% interest in Polsko-Kanadyjski Bank Sw. Stanislawa SA from the previous (Canadian) shareholders and undertook to recapitalize that bank.

- Caisse Centrale de Credit Cooperatif increased its holding in Bank Inicjatyw Spoleczno-Ekonomicznych SA to 31.9%.

The largest investments in the Polish banking system have been made by American and German institutions, with these investments standing at 1,138.4 million zloty and 973.2 million zloty, respectively. Sums above 300 million zloty have also been invested by institutions from Holland, France, Ireland and Austria, with further investments of over 100m zloty from Belgium and Portugal.

In other developments, the number of cooperative banks fell to 680 in 2000 from 781. The relative weight of the cooperative banks within the overall market for banking services has been dwindling steadily.

The Polish banking industry is highly concentrated, with the 5 largest banks holding 46.7% of total banking system assets at the end of June 2000, while the 15 largest institutions commanded 78.6%.

The concentration ratio is set to increase further, given that work is under way on the merger of Bank Komunalny SA and Bank Wlasnosci Pracowniczej – Unibank SA (both are controlled by the Finnish-Swedish group MeritaNordbanken); Bank Zachodni SA and Wielkopolski Bank Kredytowy SA (both belong to Allied Irish Bank European Investments Ltd); and Bank Przemyslowo-Handlowy SA and Powszechny Bank Kredytowy SA (in view of the takeover of Bank Austria by HypoVereinsbank).

In the retail market, the strategy currently being pursued by banks is based on the expansion of their network of small customer service offices and the rapid development of electronic delivery channels, including telephone and Internet banking. An increasingly large role will also be played by home banking.

By the end of June 2000, the number of bankcards issued climbed to 11.3 million, up from 8.3 million, while the number of outlets accepting cards rose to 93,100. Three settlement centers processed card transactions with a total value of over 9 billion zloty.

During the period January-June 2000, commercial banks opened 171 new offices. The application of modern IT technologies meant that this did not entail an increase in the number of staff employed.

PORTUGAL

Developments in the Regulation and Supervision of Banks

The main development during the period under review concerns the creation by law of a National Council of Financial Supervisors intended to promote the coordination of the work between the three existing financial supervisors: Banco de Portugal (banking), Instituto de Seguros de Portugal (insurance) and Comissão do Mercado de Valores Mobiliários (securities markets).

Other entities, including associations representing the different kinds of institutions subject to supervision, may be invited to participate in the discussions held by the Council.

The main reason for the creation of this new body is to develop rules and procedures for the supervision of financial conglomerates.

Securities Markets

During the period under review, a large set of new rules was published, following the new Code for Securities that entered into force in 1999.

The main developments are the creation by the Stock Exchange of the so-called “New Market” to promote the trading of shares of firms assessed as having a high potential, and the MEDIP, a special market for trading public debt securities.

Payments System Risk Policies

Institutions participating in the several payments systems – SPGT, SICOI and SITEM – hold a single settlement account with Banco de Portugal, the debit balance of which cannot exceed the standby collateralized credit ceiling previously agreed upon. Orders that exceed the predefined credit ceiling are held in a queue.

Any operation entering the queue must be covered by sufficient funds and/or collateral within 90 minutes (a system parameter) and always before the time at which the queuing mechanism normally closes, otherwise it is cancelled.

These requirements apply to all participating institutions whether they are domestically-owned, domestically-chartered but foreign-owned or branches of non-domestic institutions.

ROMANIA

Developments in the Bank Regulatory Framework

The Romanian bank regulatory framework comprises three laws in force since 1998: the Banking Law, the National Bank of Romania Statute, and the Law Regarding the Bankruptcy Procedure for Banks. The Banking Law as well as most of the regulations issued regarding its applicability are, by and large, in accordance with the provisions of the European Directive 2000/12/EC regarding credit institutions.

In the year 2000, efforts to ensure the soundness of the banking industry expanded to cover small financial institutions such as credit cooperatives, which are now licensed, regulated and supervised by the National Bank of Romania (NBR), according to the provisions of the Government Emergency Ordinance no.272/2000, subsequently amended.

Further to the Government Emergency Ordinance no.56/2000, new provisions related to the start-up capital of foreign bank branches were introduced. At the same time, the National Bank of Romania (NBR) issued various regulations (cited below) to respond to the necessity of harmonizing the Romanian banking legislation with European and international standards, thus strengthening of the central bank's supervisory capacity:

- NBR Methodological Norms no.3/2000 on the applicability of Law no.190/1999 concerning mortgage credit for real estate;

- NBR Norms no.5/2000 regarding the merger and spin-off of banks;

- NBR Regulation no.2/2000 concerning classification of loans and placements and their provisioning, together with the NBR Methodological Norms no.2/2000 issued regarding its applicability; and

- NBR Norms no.9/2000 regarding the minimum share capital of banks and foreign bank branches.

The provisions of NBR Norms no.9/2000 achieved two main objectives: preserving the minimum level of the share capital of domestic banks as well as that of the start-up capital of foreign bank branches over the minimum threshold set by European Directives (Euro 5 million) and, at the same time, preserving a permanent level of the own funds of banks not lower than the minimum level of the share capital.

In addition, NBR Regulation no.2/2000 provides for an integrated treatment of credit risk according to the methodology set by NBR Norms no.8/1999 regarding the limitation of banks' credit risk. The regulation, applicable to banks which are Romanian legal entities, provides for the classification of loans to banks and non-bank customers as well as their provisioning. Moreover, related to credit risk, in compliance with all other legal measures regarding loan recovery and of covering all potential losses and the provisions specific to credit risk, banks may utilize the general reserve for credit risk, made up of gross profit up to 2% of the granted loan portfolio balance. NBR Circular no.5/March 2001 amends the provisions of NBR Norms no.8/1999 as concerns the solvency ratios, large exposure and connected lending.

During the year 2000, the NBR also issued important regulations for credit cooperative organizations, in accordance with the provisions of Government Emergency Ordinance no.272/2000, subsequently amended, such as:

- NBR Norms no.4/2000 regarding the licensing procedure for joint-stock companies established following the alteration of the status of credit cooperative organizations which choose to operate as banks under the terms of the Banking Law;

- NBR Norms no.6/2000 regarding the minimum aggregate capital of a credit cooperative network; and

- NBR Norms no.7/2000 regarding the credit cooperative organizations' licensing.

Regarding the prudential supervision of banks, the NBR supervises the banks' performance either by prudential reports submitted under the terms established by the NBR in its compulsory regulations (off-site supervision) or by on-site inspections. At the same time, every bank must have an internal control system included in its own operational regulations, approved by the statutory bodies. Apart from these, a bank should also have an independent auditor, whose main tasks consist of providing assistance to the bank for book-keeping, drafting an annual report reflecting the condition of the bank, analysis of the procedures involved in the internal control and auditing system, etc.

The NBR is also the institution authorized to supervise credit cooperative organizations on a consolidated basis – in the case of the credit cooperatives belonging to a network or an individual institution, both by compulsory reports submitted by these institutions in accordance with the legal framework and by on-site inspections performed by the NBR or by independent auditors appointed by it. The activity of the credit cooperative organizations affiliated to a network is also individually supervised by their central bodies. Apart from these, every credit cooperative and every central body of the affiliated credit cooperatives must have an internal control system included, and at the same time, they must have independent auditors.

Related to the case of banks declared insolvent, in 2000 the NBR issued the Norms no.10 regarding the opening by the central bank of the "insolvent bank" account.

NBR Norms no.1/April 2001 prescribes the liquidity ceiling for banks, both Romanian entities and branches of foreign banks operating in Romania. The liquidity indictor shall be computed as a ratio between necessary liquidity and the effective liquidity for banks on a monthly basis, and should be equal to at least 1.

The issue regarding the capital adequacy of banks will be settled during 2001, together with those regarding the derivative instruments related to banking activities and consolidated accounts under the twinning agreement concluded in 1999 with the Bank of France for technical assistance.

In April 2001, the National Settlement and fund Transfer Company (TransFonD) entered into operation as a joint-stock company.

With regard to depositor protection arrangements, at present the Government only guarantees household deposits held with the State Savings Bank. A more general deposit insurance scheme is provided for in the Government Ordinance no. 39/1996 regarding the setting up and functioning of the Banking Deposits Guarantee Fund, further amended. The Fund is mainly financed through contributions from banks, covering only deposits of individuals up to an amount adjusted semi-annually in line with the consumer price index. Starting with July 1, 2001, the ceiling up to which the Fund guarantees deposits held by natural persons with banks was raised from ROL77,095,000 per depositor (enforced up to June 2001) to ROL88,505,000 per depositor.

Data Disclosure

Every bank and credit cooperative organization publishes the accounting balance sheet (balance sheet, profit and loss account, annexes and annual report), after its approval by the general meeting of the shareholders, accompanied by the opinion of the independent auditor in the format and under the terms set by the National Bank of Romania and the Ministry of Finance. The same provisions are applicable in the case of the central body of credit cooperative organizations, but they refer to the consolidated accounting balance sheet of the network.

As regards the treatment of non-domestic financial institutions, it should be mentioned that foreign banks may open branches in Romania, provided they have minimum start-up capital equivalent to the minimum level of share capital required for Romanian banks. The scope of activity of branches is confined to that of the respective foreign bank. Concerning supervision, the branch is supervised by the banking supervisory authority from the country of origin, but it is still subject to certain rules issued by the National Bank of Romania, such as changes in their condition, minimum level of the start-up capital and the level of the foreign exchange position. At the same time, information regarding foreign banks may be provided to the home supervisory authority only on reciprocal basis with respect to Romanian banks operating abroad.

Market Developments

The main objective of the Government concerning the Romanian banking system is the privatization of state owned banks (Banca Comerciala Romana SA, Banca Agricola SA, Eximbank and CEC – the Savings Bank).

Referring to the stage of the privatization process of Banca Comerciala Romana SA, the draft privatization strategy was endorsed by the State Ownership Fund Board of Directors, the National Agency for Regional Development and by the Privatization Commission of Banca Comerciala Romana SA (in January 2001).

Regarding the process of restructuring of Banca Agricola SA, in March 2001 a pre-agreement was signed between the State Ownership Fund, the Romanian-American Enterprise Fund (RAEF) and Raiffeisen Zentralbank Oestereich. The final agreement as regards the privatization of Banca Agricola was signed by the parties mentioned above in the second half of July. The new name of Banca Agricola is now Raiffeisen – Banca Agricola.

The Government and the National Bank of Romania will continue the process of restructuring of the CEC (Casa de Economii si Consemnatiuni) and Eximbank.

SINGAPORE

Introduction

Singapore's financial sector reforms are continuing. Deputy Prime Minister and Monetary Authority of Singapore (MAS) Chairman, B.G. Lee Hsien Loong was quoted on March 12, 2001 as saying, "We must press on with liberalizing and rationalizing our financial industry…. We've got the pieces in place for all the sectors now – insurance, capital markets, banking, fund management. What we need to do now is to broaden and deepen them." He added that previously it looked like there would be two or three financial centers in Asia, in which case, Singapore would certainly be one of them. But the aftermath of the Asian crisis and global financial trends had changed the picture. "Increasingly, we have to compete against Tokyo, Sydney and Hong Kong, to be the only Asian center. The risk of being left out altogether is very real," he said. Against this background, the Government has forged ahead with further measures to develop Singapore into a key financial center in this part of the world.

Banking Developments

Singapore has opened up all areas of the financial sector, including banking, to greater competition. In May 1999, MAS announced a five-year program to liberalize access by foreign banks to the domestic banking industry. In the first package of measures, MAS committed to award six banks Qualifying Full Bank (QFB) privileges (QFBs are allowed additional branches, off-premise ATMs and ATM sharing). Four QFBs were awarded in October 1999. On June 29, 2001, MAS announced the second phase of the liberalization program, which would enable the broadening of access to the domestic wholesale banking industry and further enhance competition in the domestic retail banking industry. In keeping with its commitments to allow six QFBs, MAS will award another two banks QFB status. It has also granted all QFBs further enhanced privileges in branching and establishing off-premise ATMs. In addition, QFBs will be allowed to provide debit services on electronic funds transfer at point of sale (EFTPOS) services from July 1, 2002.

New measures have also been put in place to strengthen Singapore banks in the face of increasing competition. On June 21, 2000, MAS announced that Singapore banking groups would be required to separate their financial businesses from their non-financial businesses. The banking groups would be given three years for the necessary restructuring and divestments to be made. The three-year countdown began on July 18, 2001, when the Banking (Amendment) Act, giving legislative effect to the policy, came into force.

Meanwhile, a Corporate Governance Code has been introduced. It requires all listed companies, including banks, to disclose their corporate governance practices and explain deviations from the Code in their annual reports for Annual General Meetings held from January 1, 2003 onwards. The Code deals with four major areas. First, at least a third of the Board should be independent to provide a certain degree of independence from Management. Second, a Remuneration Committee should be set up to provide objectivity in compensating executive and non-executive directors. Third, the Audit Committee should be made up entirely of non-executive directors, to ensure independence and objectivity. Finally, companies are encouraged to engage in more effective communication with shareholders.

In March 2001, MAS released a set of guidelines on Internet banking to protect banks and their customers. Called, *Internet Banking: Technology Risk Management Guidelines*, they spell out how banks should set up, operate and maintain a risk management framework for doing business over the Internet. The MAS has issued draft guidelines in certain areas of banking activity. It has asked bankers and other interested parties to submit comments on the proposed guidelines. On March 20, 2001, MAS released a consultative paper on banks investing in higher-risk private equity and venture capital. The paper proposed greater flexibility for banks within specified limits and with adequate capital commensurate with the risks. Banks will need to set aside more capital for the riskier investments.

From September 30, 2000, the minimum Tier 1 Capital Adequacy Requirement (CAR) for Singapore-incorporated banks was lowered to 8% from 10% previously. However, the overall CAR requirements – Tier 1 and Upper Tier 2 – remained unchanged at 12%. The components of both Tier 1 and Upper Tier 2 were also unchanged. Tier 1 includes the paid-up capital, disclosed reserves and perpetual preference shares, while Upper Tier 2 includes general provisions and equity-like instruments such as preference shares with original maturity of more than ten years. Nevertheless, the MAS said it might still require individual banks to maintain higher capital than the regulatory minimum, when necessary.

Given the rapid changes that have taken place in the financial markets, the authorities have moved to consolidate and rationalize legislation to keep abreast of the changes. Thus, the MAS has announced it will introduce two new pieces of legislation. The first is the Financial Advisers Act (FAA) which will govern financial advisory activities in respect of investment products and the distribution or marketing of functionally similar investment products, e.g. life insurance policies and collective investment schemes, including unit trusts. The regulatory regimes governing the provision of financial advisory services in respect of securities, futures and life insurance products are currently contained in different Acts. It is proposed that they be consolidated into a single Act, i.e. the FAA. This will provide a consistent set of requirements and regulations for market intermediaries engaging in similar activities across investment products.

The MAS also proposes to introduce a new Securities and Futures Act (SFA), as there is a need to update the present legislation governing the capital markets so as to keep abreast of the many developments that have taken place since the present laws were enacted and to introduce several structural policy reforms. Also, following the merger of the Stock Exchange of Singapore (SES) with the futures exchange SIMEX (or Singapore International Monetary Exchange) in December 1999, there is a need to consolidate and rationalize the securities and futures legislation. This will be done in the proposed SFA which consolidates provisions in the existing Securities Industry Act and the Futures Trading Act. The corporate fund raising and unit trust provisions currently in the Companies Act will be migrated to the SFA as part of the consolidation-cum-rationalization effort. The MAS has released drafts of the proposed FAA and SFA and invited comments from financial intermediaries and other market participants.

Another development is the effort to ensure manpower excellence to meet the challenges of a changing banking and financial landscape. In consultation with the financial services industry, MAS has developed a framework of strategies to strengthen and sustain excellence in financial manpower. The framework has two prongs. One involves the setting up of a Financial Network for Excellence in Training. This would provide a collaborative approach towards financial sector training and seek synergies within the financial industry and with top quality training providers. The other is the deployment of the Financial Sector Development Fund to co-fund programs to enhance the expertise and skills of executives in the industry.

From April 1, 2001, a voluntary Supplementary Retirement Scheme (SRS) was put into effect. It offers tax incentives to encourage Singaporeans to save more for their old age (i.e., in addition to their compulsory contributions to the Central Provident Fund or CPF), by means of voluntary contributions to their SRS accounts. Under the scheme, employees who are Singaporeans or permanent residents can choose to contribute up to 15% of their annual income to the SRS. Foreigners, who do not enjoy tax relief for CPF contributions, have the choice to contribute up to 35% of their income. Contributions to the SRS are subject to income caps, and are tax deductible, but half of the savings withdrawn at retirement will be subject to tax. Capital gains from investing the savings are also tax-free but not Singapore dividends. Four banks, viz., Development Bank of Singapore, Overseas-Chinese Banking Corporation Bank, Overseas Union Bank and United Overseas Bank, have been appointed “SRS operators” to perform administrative and custodial roles.

The SRS will have no involvement or guarantee from the government or the CPF Board. The operators are left to decide on the kinds of investment products they would offer. No property investments are allowed and there are restrictions on the types of insurance products. The withdrawal age for SRS savings is set at the statutory retirement age of 62 currently. Early withdrawals are allowed, but a penalty fee of 5% would be imposed on the amount withdrawn. However, no penalty fee will be charged in cases of death, permanent incapacitation and bankruptcy. For foreigners, no penalty will be charged after the account has been maintained for at least 10 years. Foreign fund managers, insurance companies and banks are encouraged to offer their products through the four SRS operators.

Developments in the Bond Market

The policy initiatives taken by the Government over the last few years to facilitate the growth of the debt market in Singapore have produced positive results. The total amount of debt securities in 2000 increased by 159% over 1999, from S$19.5 billion to S$50.5 billion. Non-S$ issuance accounted for about 70% of the total issuance. In terms of sub-sectors of the total debt market, the outstanding amount of the Singapore Government Securities (SGS) market had grown at an average annual rate of over 20% since 1998. Average daily turnover in 2000 rose by 60% from 1999 to over S$800 million. Repo market volume doubled in 2000 to S$543 million, with the introduction of a repo facility for primary dealers and with MAS using repos more actively as part of its money market operations. Likewise, the corporate bond market also fared well. Statutory boards, government-linked companies as well as foreign entities continued to be active issuers in the S$ bond market.

Fostering a liquid swap market is one important aspect in the development of secondary market liquidity in the bond market. Measures were introduced in March 2001 to develop the Singapore dollar swap market. These included allowing offshore banks in Singapore to engage in swap transactions with non-banks. Hitherto, such offshore banks had been restricted in terms of the purpose and value of the swap transactions. Banks were also no longer required to set aside reserves for Singapore dollar swap transactions that were of less than one-year maturity with non-bank financial institutions and corporates.

To provide players with other hedging mechanisms to manage their risk, the SGX launched the Singapore Government Bond Futures contract on June 29, 2001. This will help to stimulate secondary market activity in the swap and bond markets.

The MAS has recognized the importance of a progressive regulatory framework to the development of the debt securities market. It has refined its regulatory framework to cater to new developments in the capital markets arena. Guidelines addressing capital treatment for banks dealing in credit derivative products such as the credit default swap, the total return swap and the credit-linked note have been introduced. Likewise, guidelines for banks dealing in asset securitization transactions have also been introduced. Meanwhile, efforts have been made to cultivate awareness of the fixed income market among a wider investor base. To foster familiarity with bonds as an alternative investment instrument, the Singapore Investment Bankers' Association organized an inaugural Singapore Bond Investment Fair on March 17, 2001. All the main players in the bond market participated in the Investment Fair, which was targeted at retail investors. The participants ranged from banks, which are active in Singapore's bond market, to bond fund managers and major issuers in the Singapore dollar bond market, as well as credit rating agencies.

Developments in the Equities and Derivatives Markets

Following its formation on December 1, 1999, the Singapore Exchange (SGX) on November 23, 2000, made a successful initial public offering of its shares, which were then listed on the exchange itself. There apparently was some uneasiness concerning whether there could be a conflict of interest for the SGX to run the stock and futures exchanges and at the same time act as a regulator of the exchanges. This question was even raised in Parliament. The

DPM and MAS Chairman, B.G. Lee Hsien Loong, gave an assurance that the SGX's dual roles were not incongruent. In any case, the SGX could be taken to court if it acts against the interest of investors. He also explained that there was an additional safeguard in that MAS, as the statutory regulator, has powers to ensure that the interest of the investing public is not compromised. Earlier, it had been announced on February 16, 2001 that the MAS would, in the forthcoming Securities and Futures Act be vested with the power to pursue civil prosecution of listed companies which failed to make timely disclosure of material information and also of any market participant suspected of misconduct, to complement the existing criminal prosecution regime.

It was announced on March 13, 2001 that the SGX was reviewing the role of the second board known as Sesdaq, since many companies which in the past could only qualify for a listing on the second board could now list directly on the main board. Since the SGX eased listing requirements as part of the move towards a disclosure-based regime, less well-established and smaller companies have been able to list on the main board and the government is now apparently questioning the need to have a separate board for small-cap stocks. As of the end of February 2001, Sesdaq's market capitalization was S$4 billion against the main board's S$392 billion.

The government had originally decided on January 1, 2001 as the date from which stockbroking commissions on all trades would be fully negotiable. However, it decided in May 2000 to bring forward the liberalization of stockbroking commissions, which became fully negotiable on October 1, 2000, i.e. three months earlier than originally planned. At the same time, the SGX amended its bylaws to allow third-party trading representatives (remisiers) to negotiate freely with their stockbroking houses their share of the commissions for trades done. The share of these commissions had previously been limited to no more than 40%.

The SGX and the MAS are developing a new "risk-based capital" framework to determine the capital adequacy rules for Singapore securities and futures intermediaries. It involves a shift from a high minimum capital requirement to one which varies according to the level of risk involved in the business. Broker-dealers will be required to hold capital according to the type and extent of business risks they undertake. This means that those engaged in low-risk trading may need to have a smaller capital sum than that required previously.

The SGX also took several initiatives to introduce new products and to improve its services:

- It intends to list single stock futures contracts on its derivatives market, SGX Derivatives Trading Ltd (SGX-DT), scheduled for the third quarter of 2001. Initially, these futures contracts will be based on selected, locally listed blue chip companies that attract global trading interest with their large capitalization and their inclusion in major indexes. At a later stage, the SGX also plans to introduce single stock futures on other regional and global stocks.

- In partnership with the American Stock Exchange (Amex), the SGX has begun listing and trading Amex-listed exchange-traded funds (ETFs) on SGX-Xtranet, the new SGX Securities Trading board for structured products, from May 4, 2001. (ETFs are funds that invest in a portfolio of stocks that trade throughout the day on an exchange in the same way as individual stocks.) Through this arrangement an investor can buy an ETF in Singapore and sell it in the US and vice versa.

- The SGX has embarked on an initiative to bring the Singapore securities market to a Straight-Through-Processing (STP) environment, from trade execution to final settlement. SGX's STP initiative will rationalize and streamline the process for post-trade matching of transaction details, thereby increasing settlement efficiency and reducing errors.

- The SGX plans to provide multiple bid levels to its information data vendors. Many retail investors would find this useful, especially those who trade online. With live access to the best five bids and offers for each counter, instead of just the current top bid and offer, investors would be in a better position to gauge the demand and supply for a stock.

- The recommendations by the Corporate Governance Committee in relation to disclosure of corporate governance practices have been accepted by the SGX. It has amended the listing rules accordingly. Clause 912(4) of the Listing Manual will require disclosure of corporate governance practices and non-compliance with any aspect of the Code of Corporate Governance in the companies' annual reports from 2003 onwards. Where there is non-compliance an appropriate explanation for it will need to accompany the disclosure.

- The SGX has launched SGXAccess, an open interface technology which allows SGX member firms to trade in Singapore's securities market from anywhere in the world, through their own trading terminals. At least twelve member firms have signed Memorandums of Intent to adopt SGXAccess by the end of 2001.

- The SGX announced that it would allow dual membership by permitting a single legal entity to be a member in both its stock and derivatives exchanges. There are two types of dual membership. One is as a clearing member company of the stock exchange and corporate clearing member of the derivatives exchange. The other is as a clearing member of the stock exchange and corporate non-clearing member of the derivatives exchange. Meanwhile, the SGX wants to attract Internet brokers to become members. It has opened up membership in its securities trading arm and is encouraging Internet brokers with good controls and who meet the exchange's standards, to become members.

- An electronic linkage between the SGX and Australian Stock Exchange (ASX) will be established by September 2001. The linkage will enable Singapore-based investors to trade in Australian shares by calling up their local brokers, who will be able to view Australian stock quotes live on their screens. The same applies to Australian investors interested in trading Singapore stocks. Initially, about 30 stocks from each exchange, meeting pre-determined criteria, will be available for trading through the linkage. Trades will be cleared through the home exchange's clearing system.

- In April 2001, SGX-DT announced that it has made derivatives contracts on its electronic trading system, SGX ETS, accessible via the Internet and Bloomberg terminals. With these enhancements, a low-cost alternative to leased lines and dedicated terminals for order routing is now available. Through the Internet and Bloomberg terminals, SGX-DT's members can offer their clients instant, cost-effective access to various SGX-DT contracts, including Euroyen futures, Japanese government bond futures, Nikkei 225 futures, selected MSCI index futures, and Straits Times index futures.

- The proposed Securities & Futures Act and the Financial Advisers Act will affect securities and derivatives trading in Singapore. These two proposed Acts will also consolidate and rationalize existing legislation and are dealt with in the section on Banking, above.

Developments in Fund Management

The fund management industry has grown apace as a result of the government's efforts to promote the local fund management industry. According to the latest statistics available from a 1999 MAS asset management survey, total assets under management in Singapore stood at S$246.2 billion at year-end 1999. This represented a 63% increase from the S$150.6 billion managed at year-end 1998. Of the $246.2 billion, over 70% were discretionary funds, which the fund manager could invest at his discretion. Of the S$181.8 billion discretionary assets managed in Singapore, almost a third – or 31% - came from Europe, 25% from Singapore and 21% from North America. The funds sourced from Singapore grew by 54% to S$44.8 billion in 1999.

The bulk of the discretionary assets were invested in Asia – S$51.8 billion in Singapore (28%), S$19.2 billion in Japan (11%) and S$76.2 billion in the rest of the region (43%). Fund managers continued to place discretionary assets mostly in equities (69%) while bonds continued to represent about 15% of total discretionary assets, according to the survey. In absolute terms, equity investments rose 75% to S$124.8 billion, while bond investments went up 53% to S$26.9 billion. The unit trust industry also saw significant growth, with 60 new unit trusts launched in 1999, bringing the total in Singapore to 187. Assets under management more than doubled to S$6.8 billion in the year, and net subscriptions to unit trusts grew more than three-fold to S$1.5 billion, from S$443 million in 1998.

By the end of 2001, the Singapore government will have placed out the total of S$35 billion it had earmarked in mid-1998 for external management. The money comes from the MAS as well as Singapore's Government Investment Corporation (GIC), which are expected to place out S$10 billion and S$25 billion respectively. Out of the S$10 billion to be placed by MAS, managers were earmarked for S$9.4 billion as at the end of June 2001.

Meanwhile, the government has proposed to license Approved Fund Managers (AFMs). Currently, under the Securities Industry Act (SI Act) – which will be superseded by the proposed Securities & Futures Act – fund managers are required to hold Investment Adviser's Licenses. However, AFMs under the Tax Exemption Scheme for Fund Management are currently exempted from being licensed as Investment Advisers. These AFMs are reputable institutions of international standing whose business is conducted mainly with non-resident clients. However, territorial distinctions have become less relevant with increasing electronic delivery of services. Given the international trend towards cross-border trading conducted in cyberspace, the government has proposed that AFMs, like all other fund managers, be licensed.

Developments in the Insurance Industry

Following the move by MAS in March 2000 to liberalize the insurance sector, attention turned to the life insurance industry. In the same month, MAS appointed a Committee on Efficient Distribution of Life Insurance (CEDLI), comprising senior insurance practitioners, to come up with proposed changes to raise standards, transparency and efficiency in the distribution of life insurance products. CEDLI produced its main report in August 2000, with recommendations to enhance the sales advisory process, product disclosure, and the professional training requirements for intermediaries selling life insurance products. MAS accepted all the recommendations in the main report. It said that the proposed changes to the sales advisory process and training requirements would raise standards of service in the life insurance industry. Also, enhanced disclosure of information on information costs, charges and total expenses would help policyholders to compare product offerings, either from the same firm or across insurance companies. Two key recommendations by CEDLI were a) use of a "fact-find" document for needs analysis and product recommendation in the sales process and b) a minimum number of training hours for entry level agents and the continuing professional development of others. The first requirement was implemented with effect from January 1, 2001, while the latter was implemented with effect from April 1, 2001.

Towards the end of the year 2000, CEDLI also produced a supplementary report covering three areas: the agency structure, the roles and responsibilities of sales advisers and their supervisors and the development of alternative distribution channels for life insurance distribution. MAS accepted and implemented many of the recommendations in the supplementary report. For instance, CEDLI proposed that existing regulatory limits on agency size and new recruits should be replaced by a best-practice standard of control and that agency supervisors should take on a greater role in grooming their sales advisers. These changes were implemented in April 2001. The committee also proposed that existing regulatory limits on commissions and agency costs be lifted. This would be implemented on January 1, 2002, six months after the requirement on agents to make full disclosure of distribution costs, charges and expenses is imposed on July 1, 2001.

However, MAS said it was still considering whether to accept CEDLI's recommendations on the development of alternative distribution channels for life insurance. These include:

- allowing finance companies to sell insurance;
- allowing referral arrangements where professional firms such as legal practices are permitted to introduce clients to product providers;
- allowing network or franchise structures for life insurance brokerages;
- licensing Internet companies to provide recommendations; and
- requiring financial institutions to define their status as tied agents or independent brokers to distribute life insurance.

The Singapore Interbank Payment System

The MAS Electronic Payment System (MEPS) is a Real Time Gross Settlement (RTGS) system for large-value Singapore dollar interbank funds transfers. Based on this system, interbank funds transfer instructions are immediately effected and irrevocably settled if the participating bank has sufficient funds in its RTGS account. Being a RTGS system, the participating bank is not permitted to incur daylight overdraft in its RTGS account. Where participating banks have insufficient funds in their RTGS account, they can borrow from other banks to fund their accounts. MAS also provides an end-of-day liquidity facility as an additional source of funding for banks to meet their liquidity needs. Under this facility, banks may borrow funds from MAS via overnight repos of SGS. In addition, the MEPS is also able to provide Delivery-versus-Payment settlement for scripless Singapore Government Securities transactions. All banks in Singapore are eligible to participate directly in the MEPS. The RTGS system currently operates between 9.00am and 6.30pm.

SOUTH AFRICA

Debate on the Regulatory Architecture

In March 1999, the Minister of Finance invited relevant stakeholders and four international consultants to consider whether South Africa should follow the route taken by the United Kingdom and Australia to establish a single financial regulator outside the central bank. The theoretical conclusion was that this was inevitable in light of the blurring of traditional boundaries between the various categories of financial institutions. Because of the risks inherent in such a change, no final decision was taken and the Policy Board for Financial Services & Regulation has continued the debate as part of its ongoing concern with the overall structuring and stability of the financial markets.

One of the key considerations is whether the Bank Supervision Department is best placed within the central bank, or whether significant economies of scale would be gained if this function were to be transferred to a new regulatory agency with exclusive responsibility for the prudential supervision of all financial institutions. In order for the central bank to properly exercise its powers as a systemic regulator, a smooth interaction between monetary supervision and micro- and macro-prudential supervision is essential.

An important regulatory issue that has to be addressed is the supervision of complex groups. In this regard, South Africa is unique in the sense that insurers, rather than bank holding companies, typically control major banking groups in South Africa.

The central bank is of the view that there is no single correct model and that the reasons for moving to a single regulator are less compelling in emerging countries. Typically, even when such countries have a sophisticated financial sector, their banks tend to be less complex. Other considerations, such as country risk, liquidity pressures, less developed securities markets, etc, however, have to be taken into account.

The problems to be addressed by the single-regulator model can also be addressed in other ways, without reducing the effectiveness of banking supervision. Furthermore, the close interaction between monetary stability information, policy and instruments on the one hand, and regulatory information, standards and tools, on the other hand, strongly favor the retention of bank regulation and supervision within the central bank. In the final analysis, however, integration, information flows and co-ordination arrangements are more important than the institutional arrangements. Any regulatory architecture is possible, provided that the co-ordination and risks of the change process are properly managed.

The Department is also of the view that as long as there is no other agency competent to supervise banks, all banks should be considered to be systemically significant. In these circumstances, even institutional prudential supervision should be retained within the central bank. If the decision were ultimately for a single mega-regulator, the responsibility for supervising individual banks should gradually be transferred to such an agency only once a competent separate prudential-supervisory agency has been established. Ultimately, aspects of the prudential supervision of systemically significant banks may be transferred, provided that effective, structured arrangements with regard to co-operation in the supervision of complex groups and emergency liquidity assistance have been established.

Deposit Insurance

During 2000, the Bank Supervision Department, in collaboration with the National Treasury, commenced a project to establish an explicit, limited, mandatory deposit insurance scheme for South Africa.

The primary objective of the scheme is to protect small depositors. Improved stability through enhanced confidence in the banking system is secondary. The scheme will be based on the latest international best practice, as formulated by the Financial Stability Forum. The scheme will be a “payout-box” such as that in the United Kingdom, and will not use a full “risk-reduction” approach, such as that of the Federal Deposit Insurance Corporation in the United States. The scheme is likely to be compulsory, pre-funded and limited to an amount of perhaps the first R50,000 of a deposit. Furthermore, the scheme is likely to have a co-insurance element, in that it will not provide cover for the full value of the deposit.

Consolidated Supervision

Proactive, effective and efficient consolidated supervision of the financial condition and activities of bank controlling companies and their affiliates is vital to the safety and soundness of individual banks and the banking system as a whole. In the opinion of the Bank Supervision Department, consolidated supervision will continue to gain in importance and will become an effective supervisory tool. It will, however, have to be responsive to changes in the continually evolving banking industry and financial environment.

The amended Regulations Relating to Banks, implemented on January 1, 2001 will help the Department to implement a supervisory process that will ensure the effective application of consolidated supervision, thereby helping to improve and strengthen the financial system. The Department will also comply with best international practice.

Market and Operational Risk of Trading Banks

During the year under review, the Bank Supervision Department continued to focus on on-site evaluations of trading banks' risk-management practices and the daily monitoring of their capital adequacy figures. The Department has also increased its focus on fully-fledged surveillance of trading banks' activities, including the use of new financial products.

Calculation of Capital Adequacy Requirements

In terms of the Regulations relating to capital adequacy requirements (CAR) for banks' trading activities in financial instruments, trading banks have been required as of May 1999 to calculate CAR on a daily basis and to report the relevant CAR values to the Bank Supervision Department. In order to ensure that all banks were calculating CAR on a consistent basis, the regulator constructed a dummy portfolio, consisting of a number of positions in different financial instruments. During June 2000, all trading banks in South Africa were requested to calculate the required capital based on the positions held in the dummy portfolio.

Approval of Trading Banks' Internal Models

In terms of regulation 24 of the above-mentioned CAR requirements (this regulation establishes general criteria for use of internal models), approval may be granted to a trading bank to use an internal model in order to calculate its capital adequacy requirements, subject to certain stringent conditions. During 2000, the regulator granted one such approval. Several banks have indicated, however, that they would apply during 2001 for approval of their internal models.

Surveillance

As indicated above, the Bank Supervision Department increased its focus on the surveillance of trading banks' activities during 2000. This surveillance included activities such as:

- *ad hoc* visits to the treasury divisions of trading banks;
- on-site monitoring of banks' trading positions and daily analysis of banks' capital-adequacy requirements and value at risk;
- continued evaluation, both on and off site, of trading banks' risk-management procedures and internal controls; and
- monitoring of banks' implementation of new financial products, such as credit derivatives, in their treasury divisions.

During 2001, the Department will continue the above-mentioned activities, but will place even more emphasis on the surveillance of new financial products, such as credit derivatives and securitized assets.

Credit Derivatives

Credit derivatives are off-balance sheet financial instruments that are used to assume or mitigate the credit risk of loans and other assets. Institutions may use these products either as end-users, in order to purchase credit protection or acquire credit exposure from third parties, or as dealers, to intermediate credit risk between buyers and sellers.

In line with international trends, and as part of its supervisory program, the regulator investigated the extent of the use of credit derivatives in the South Africa. The investigation not only covered banks' current involvement in credit derivatives, but also tried to establish the banks' possible future involvement. The investigation focused on, among other aspects, the types of credit derivatives and reference assets, maturity structures and accounting procedures.

Having analysed the results of the above-mentioned investigation, the Department will introduce guidelines for the capital adequacy treatment of credit derivatives during 2001.

Banking Mergers and Acquisitions

Amendments to the Competition Act in 2000 have resulted in the Competition Commission effectively having concurrent jurisdiction with the Registrar of Banks and the Minister of Finance.

It would appear to be international best practice for banking stability issues to be regarded as more important than competition issues. Share acquisitions and bank mergers are often effected in order to assist an ailing bank and are therefore in the interest of banking stability. These stability considerations may not be the same as the public interest criteria applied by the Competition Commission.

The amendments to the Competition Act afford the Minister of Finance the power to exclude the Competition Commission's jurisdiction by issuing a notice. The issuing of such a notice would effectively disregard competition issues altogether and would afford the Minister sole discretion in matters relating to banks.

Issues Receiving Particular Attention During 2001

During 2001, the Bank Supervision Department and the Financial Stability Unit are focusing on the following issues:

- financial stability;
- further research on contingency planning for the handling of distress situations;
- ongoing monitoring of a wide range of indicators identified as warning signals of distress in banks;
- monitoring of the implications of the proposed new Capital Accord;

- further refinement of the approach to consolidated supervision;
- on-site reviews of banks' asset quality, including follow-up assessments of banks previously reviewed;
- further investigation of alternative methods of financing small, medium and micro enterprises;
- investigation into the establishment of a public credit registry in South Africa;
- deposit insurance;
- combating of illegal deposit-taking schemes, underpinned by continued investor-education initiatives;
- anti-money laundering measures;
- continued monitoring of banks' liquidity profiles;
- continued evaluation of trading banks' capital adequacy calculations and of the models used for this purpose;
- greater emphasis on the surveillance of products such as credit derivatives and asset securitizations;
- research on solutions to the regulatory problems and risks associated with virtual banks and internet banking, as well as the implications of electronic commerce for the banking regulatory framework and the banking sector;
- ongoing review of banking legislation to ensure that it keeps pace with local and international developments and standards pertaining to banks;
- monitoring of preference-share investment structures; and
- amendment of the legislation on asset securitization and the issuing of commercial paper.

SPAIN

The most significant change in Spanish banking regulations during the period covered by this report (July 2000 – June 2001) was the creation of what is called the insolvency statistical coverage fund, which Spanish banks began to include in their provisions in the second quarter of 2000, in compliance with Bank of Spain Circular 4/2000. The idea behind this fund is to accumulate additional resources during healthy economic periods to be used in the worst periods of the cycle, tending towards a more flattened evolution of bank results. The amount of the allowances applied to the fund depends on the type of assets held by each institution, regardless of the actual default rate, and is determined by individual historical default models approved by the Bank of Spain. The fund is limited to 3% of each institution's risk assets.

Another issue of interest was a legal modification that will make the demutualization of the Spanish stock exchanges possible. In other words, they will be able to have shareholders other than their members (the brokers and banks that take part in the trading), so that in the future it may be decided that the stock exchanges themselves will trade, as is already the case in other European countries.

The new regulation on transfers between European Union Member States for 50,000 euros or less was completed. According to the new ruling, these transfers must be completed within a certain time limit, with specified customer information requirements and without applying double fees (it establishes that unless otherwise expressly indicated, all expenses will be for the transferor's account).

Finally, with regard to daylight overdrafts in banks' accounts in connection with payments made through the central bank, all of the banks established in Spain, including foreign-owned banks and branches of non-domestic banks, are subject to the same rules. Overdrafts are permitted, providing that the bank concerned sets up guarantees, with specified margins, for the Bank of Spain on an individual basis or on a pool basis. As for the securities or assets eligible as collateral, there is a broad criterion, but always within the limits established by the European Central Bank.

SWEDEN

Legislative and Regulatory Developments

The Swedish Parliament approved new legislation in March 2001 concerning mortgage-backed securities, which will improve the conditions for the funding of Swedish credit institutions. The new legislation became effective on June 1, 2001.

As of January 1, 2001, rules concerning insider trading were also tightened. In one of the changes, the time for reporting of shareholdings by insiders has been shortened from two weeks to five days.

From the same date, the anti-money laundering legislation has been extended to include all companies with commercial activities in payment services.

The European Union Directive 1999/93 on a framework for electronic signatures has been incorporated into Swedish law as of January 1, 2001. The purpose of the rules is to facilitate the use of electronic signatures and to contribute to their legal recognition.

Market Developments

The most important market development is the proposed merger between Skandinaviska Enskilda Banken (SEB) and Swedbank (FöreningsSparbanken) into the new bank SEB Swedbank. The new group will, alongside the Nordea Group, be the largest financial group in the Nordic region and one of the 25 largest banks in Europe. The merger is conditional upon approval from the appropriate authorities, including the EU. Depending on whether the EU decides to simply review or thoroughly investigate the merger, a decision will be announced either in late June or in November 2001.

At the end of 2000, the Norwegian bank Christiania Bank og Kreditkasse became part of the Nordic financial group Nordea. Nordea is the leading financial group in the Nordic and Baltic Sea region and consists now of Christiania Bank, the Swedish bank Nordbanken, the Finnish Merita Bank and the Danish Unibank.

During the period Svenska Handelsbanken acquired SPP Liv, which is a leading company in the occupational pension area, and has also made an offer for the Danish bank Midtbank.

Electronic Banking

Swedish banks have a leading position in electronic and Internet banking. The number of customers using the banks' Internet services has increased very fast since the introduction in 1996. In the beginning of 2001 about 30% of all Swedes were using their banks' Internet services on a regular basis.

Some examples: in one of the large Swedish banks, 55% of all private payments are made via the Internet; and in one of the large mortgage credit institutions, 60% of all mortgage loans are in response to online loan applications.

SWITZERLAND

Amendments to the SBA Portfolio Management Guidelines

In 2000, the Swiss Bankers Association (SBA) amended its Portfolio Management Guidelines, applicable mainly to private customers. On the one hand, the amendments clarify the notion of "common bank investment instruments", to which the Guidelines limit investment. Investment companies are now "common" in that sense only if "they on their part invest in common bank investment instruments" (e.g., deposits, precious metals, shares, bonds, notes, loan stock rights, certificates of investment funds and the like) or in real estate. This has the effect of excluding private equity from asset management mandates - except for the written consent of the customer. On the other hand, hedge funds are now admitted as "common" investments if either they are themselves "invested in several legally independent funds" (so-called "Funds of Funds") or their "investment is made in one single fund but is administered according to the Multi-Manager Principle".

Amendments to the Federal Banking Act to be Proposed

An experts' panel, chaired by Dr. Barbara Schaerer of the Federal Department of Finance, has proposed amendments to the Federal Banking Act concerning the reorganization and liquidation of banks (a kind of Swiss "chapter eleven") as well as depositor protection. The proposals have been published for comment in February 2001, and will be submitted in one or the other form to Parliament by the Government. They focus on three topics:

- Liquidation of banks will be more efficient and less time-consuming in the depositors' interest. Thus far, important decisions, such as the opening of bankruptcy proceedings and the granting of moratoriums, will be entrusted exclusively to the Swiss Federal Banking Commission.

- There will be a special reorganization procedure, allowing to cut into creditors' rights as far as protected depositors would not suffer a disadvantage.

- Finally, the current solution for depositor protection will be continued in principle but improved in detail (i.e., the combination of a bankruptcy privilege with timely distribution to creditors under the banks' self-regulation).

Risk Disclosure Statements for Securities Trading

The SBA's Risk Disclosure Statements, available to the banks for the information of their customers, have been thoroughly revised. They will be published in late 2001 in a more encompassing, better readable version than to date. Its contents have not changed in substance, but the text is more aptly designed for the "lay" customer. Besides information about options, futures, and structured transactions there is new information about hedge funds and investments in emerging markets.

Experts' Report on "Financial Market Regulation"

In 1998, the Federal Department of Finance commissioned a group of experts to carry out a critical examination of financial market regulation and supervision in Switzerland. The group was lead by Professor Jean-Baptiste Zufferey of the University of Fribourg and its members consisted of experts drawn from Switzerland's academic, banking and financial worlds. The group gave its assessment in its final report (the "Zufferey Report") published in November 2000.

After analyzing the strengths and weaknesses of Swiss financial market regulation and supervision, and after making international comparisons, the Zufferey Report puts forward certain recommendations concerning the supervision of banks, insurance firms and financial conglomerates, as well as the supervision of those financial intermediaries which have so far not been subject to regulation. The Federal Department of Finance asked for comments to be made on the Zufferey Report by the end of January 2001, and now different positions are being evaluated in anticipation of possible legislation over the next few years.

One of the Zufferey Report's main recommendations is the creation of an integrated system of banking and insurance supervision in Switzerland, i.e. that the Swiss Federal Banking Commission (SFBC) and the Federal Office of Private Insurance should be fused into a single integrated financial market supervisory authority. In the light of current international developments in this area, the SBA basically welcomes this recommendation. With regard to the regulation and supervision of financial conglomerates, the SBA believes that enhanced cooperation between banking and insurance supervision will produce valuable synergies.

Secondly, the Zufferey Report recommends placing securities brokers, foreign exchange dealers and introducing brokers under adequate regulation. The SBA also supports this proposal in principle. Including those categories of financial intermediaries which have so far escaped regulation in an appropriate regulatory framework will undoubtedly enhance both the quality and reputation of the Swiss financial sector.

Thirdly, the Zufferey Report emphasizes the importance of simplifying and differentiating banking and financial regulation so that the differences between different banking groups and institutions in Switzerland can be adequately taken into account. In this respect, the SBA also welcomes the Report's recommendation that careful cost-benefit analyses should be carried out before any major regulatory changes are undertaken.

In addition, the Report

- acknowledges the fundamental importance of an economic rationale for the regulation of financial services companies in order to protect creditors as well as the financial system as a whole;

- suggests that the objectives pursued by means of financial market regulation be explicitly embodied in law;

- argues in favor of maintaining the existing dualistic (or indirect) system of banking supervision where recognized auditors are entrusted with the task of assessment; and

- emphasizes the vital importance of self-regulation in the Swiss financial sector.

As mentioned above, the Federal Department of Finance is currently analyzing the different views expressed following the Report's publication. At the present moment it is difficult to forecast which, if any, of the Report's recommendations will be put into practice.

Payments System Risk Policies

Daylight overdrafts on the accounts with the Swiss National Bank (SNB) are not allowed since intra-day liquidity is granted by means of intra-day repos. All domestic and remote participants of the Swiss Interbank Clearing System (SIC) can borrow interest-free but collateralized intra-day credits from the SNB.

TURKEY

Developments in Restructuring of the Banking System

Restructuring the banking system is a priority under Turkey's economic program. The restructuring efforts are focused on three groups: state-owned banks; banks under the Savings Deposit Insurance Fund (SDIF); and private banks.

Privatization of State-Owned Commercial Banks

In November 2000, the parliament passed a new law concerning the state-owned banks, which aims at strengthening their financial and administrative structure and making necessary preparations for the privatization process.

Under the law, the state may not assign duties to any of the three state-owned banks before providing the necessary funds. It further states that the Treasury within the schedule outlined in the restructuring program will cover any losses relating to such assigned duties.

Provisions of the law, which is to stay in effect until the government stake in the banks is reduced to below 50%, shall be executed by the Council of Ministers.

Within the context of restructuring of state-owned banks, a joint board of directors is constituted for the banks, and professional bankers are appointed to this board.

The Treasury will issue marketable domestic debt instruments to pay for the aforementioned duty losses of the state-owned banks. Later, the balance sheets of these banks will be significantly scaled down by converting securities issued in lieu of duty losses into cash. Any kind of financing that might be secured from abroad will be committed to this end.

In this restructuring process, every effort will be made to support the most efficient operation of the economy and especially of small and medium scale private enterprises. The key objective is the competitive and efficient functioning of the whole financial sector.

The operation of the state-owned banks on the basis of market rules and profitability is one of the fundamentals. To this end, all excess branches will be closed and staff eligible for retirement will do so.

Law No. 4684 making amendments in a number of Laws and Decrees, was published in the Official Gazette dated June 20, 2001. This Law made amendments in and added a number of provisional articles to the Law No. 4603 on the privatization of state-commercial banks. Within this context, the banking license of Türkiye Emlak Bankası A.Ş. was cancelled in accordance with the provisional article 3 of the Law No.4603, which was added by the article 2 of the Law No: 4684. As of July 9, 2001 the head office and all branches of Türkiye Emlak Bankası A.Ş. will continue to operate under the title of T.C. Ziraat Bankası A.Ş.

Banks Under the Savings Deposit Insurance Fund (SDIF)

There were nine commercial banks under the management of the SDIF as of May 15, 2001. Measures to be taken for restructuring of banks in the SDIF during 2001 are as follows:

- Liquidity requirements of the banks in the SDIF will be met by an approach similar to that for state-owned banks, and the short-term liabilities of these banks will be liquidated.

- While carrying out any kind of decisions on SDIF banks, all deposits and creditors of the SDIF banks will continue to be under the full guarantee of the Government, as announced in December 2000.

- The bad assets of the banks in the SDIF will be managed by the Asset Management Unit.

Private Banks

The Banking Regulation and Supervision Agency (BRSA), which is authorized to issue regulations and official communiques in respect of the application of the Banking Law, has been making agreements with private banks on capital increases and restructuring plans. This process will be accelerated.

Changes in Banking Law No.4389

In May 2001, the Government approved important changes in the Banking Law No. 4389, including the following:

- Own funds of banks is redefined as an amount calculated by deducting defined assets from the total of main capital and supplementary capital, based on principles, components and rates determined by the Banking Regulation and Supervision Board (BRSB), which is the decision-making body of the BRSA.

- The definition of credit is broadened to include banks' partnership shares, forward transactions, options contracts and other similar contracts. The ratio of these items taken into account in calculation of credit limits shall be determined by the BRSB.

- Banks' provisions for losses will be treated as expenditures in the calculation of the corporate income tax base in the year in which they are set aside.

- Parallel to the EU directive, a bank may acquire shares of a company other than a financial institution, in an amount up to 15% of its own funds. The total sum of investments in these companies may not exceed 60% of the bank's own funds.

- Banks and special finance institutions are required to decrease the amount of their participations based on periods and rates to be determined by the BRSA until December 31, 2009.

- With regard to permission required for any acquisition or assignment of a bank's shares, paid up capital of that bank shall be increased to the amount of capital defined in the banking law in a year starting from the date of permission.

- Receivables of banks taken over by the SDIF will be collected in accordance with the Act on Procedures for the Collection of Public Receivables.

- Special finance institutions are required to establish an association, which will create a fund to guarantee deposits in such institutions.

Regulation on Internal Control and Risk Management Systems of Banks

As required by Banking Law No. 4389 approved in June 1999, the Banking Regulation and Supervision Agency (BRSA) issued a new regulation on internal control and risk management systems of banks.

This regulation requires banks to set up appropriate internal inspections and risk management systems by January 1, 2002. The transition period could be extended one time for six months in exceptional cases.

The BRSA is authorized to supervise banks' internal inspection and risk management units and shall take necessary actions, including restrictions on banking activities, in the absence of a competent and effective system.

The regulation defines ways to manage basic risks faced by banks, including credit, market, liquidity and operational risks.

Starting from July 1, 2001, banks will begin reporting developments concerning internal inspection and risk management units on a consolidated basis at the end of every quarter. Banks shall submit a written risk assessment report to the BRSA within two months after the assessment is completed. Risk assessments shall take into account consolidated risks faced by the group comprising the bank and its affiliates.

Regulation on Measurement and Assessment of Capital Adequacy

The BRSA issued a new regulation on the measurement and assessment of capital adequacy on a consolidated basis, published in the Official Gazette dated February 10, 2001. This regulation superseded previous regulations on the same matter.

The new regulation sets out provisions and procedures related to the calculation of the standard capital adequacy ratio of banks both on a consolidated and unconsolidated basis with a view to ensure that they maintain an adequate amount of capital against losses which may result from existing and potential risks.

This Regulation is applicable to domestic banks and Turkish branches of foreign banks, which are treated as separate legal entities). Any bank shall achieve and maintain a minimum 8 % standard capital adequacy ratio, and report quarterly both on an unconsolidated and consolidated basis.

Market risk shall also be included in the calculation of the standard capital adequacy ratio on both a consolidated and unconsolidated basis in accordance with provisions and procedures set out in the annexes of the regulation.

Amounts which are exposed to market risk will be calculated on an unconsolidated basis and included in the standard capital adequacy ratio by banks as from January 1, 2002, and on a consolidated basis as from July 1, 2002.

Reserve and Liquidity Requirements

Pursuant to an amendment on the application of liquidity and reserve requirements made in November 2000, the reserve requirement ratio for TL (Turkish lira) deposits is reduced by two percentage points to 4%, and the liquidity requirement ratio for non-deposit TL accounts of banks was decreased to 6% from 8%, which shall be maintained as TL free deposits with the Central Bank.

Deposit Insurance Scheme

The decision on savings deposits subject to insurance and premiums to be collected by the Saving Deposits Insurance Fund No.2000/682 was published in the Official Gazette dated June 1, 2000. According to the decision, Turkish lira and foreign currency deposit accounts being of the nature of savings deposits opened by both residents and non-residents with domestic branches of banks operating in Turkey and authorized to accept deposits are subject to the deposit insurance.

With the decision, the level of coverage on savings deposit accounts opened and/or renewed after the publication of this decision was changed. Up to 100 billion TL per account will be covered until December 31, 2000, and up to 50 billion TL as from January 1, 2001. However, the fund still covers 100 percent of saving deposit accounts opened before the decision.

The premium rate shall be as follows on the basis of the quarterly totals of the Turkish lira savings deposits and foreign currency deposits:

- for banks who fulfill all of the prudential ratios, 25 TL per ten thousand of such deposits; and
- for banks who fulfill all of the prudential ratios except one, 26 TL per ten thousand of such deposits.

However, in light of the recent turmoil in the financial system in late November and in December 2000, the Government made an announcement regarding a temporary full guarantee of depositors' and other creditors' claims on Turkish deposit-taking banks on December 6, 2000.

Regulation on Investor Protection Fund

The regulation on the Investor Protection Fund was published in the Official Gazette on June 21, 2001. The Fund is a legal entity established to meet the liquidation expenses and liabilities of intermediary institutions which are bankrupt or in liquidation relating to cash payments or delivery of shares.

Implementation of Tax Identification Numbers

A Decree published in the Official Gazette on June 19, 2001 provides for implementation of a tax identification number system in banking transactions commencing September 1, 2001. All banks (including their offshore branches), intermediary institutions, special finance houses, leasing and factoring companies, insurance and reinsurance companies are required to determine the customer's tax ID number relating to financial transactions covered by the Decree.

Withholding Tax Rates

Pursuant to the Decision of the Council of Ministers No.1712/2000, which was published in the Official Gazette dated December 20, 2000, the withholding tax rates on deposits, dividends and interest from repo transactions were increased to the same level. The decision, which will be applied as of January 1, 2001 implies that:

- the withholding tax rate on the Turkish lira deposits, and dividends paid by the special finance houses, was increased to 16% from 15%; and
- the withholding tax rate on interest from repo transactions was increased to 16% from 14%.

Market Developments

During the period under review, the banking licenses of two banks were revoked. One was a foreign bank with a branch in Turkey (Kıbrıs Kredi Bankası) and the other was a privately-owned development and investment bank (Park Yatırım Bankası).

At the same time, five privately-owned commercial banks, namely Etibank, Demirbank, Bank Kapital, İktisat Bankası and Ulusal Bank, were taken into the Savings Deposit Insurance Fund (SDIF).

However, the banking licenses of four of the banks in the Fund (Egebank, Yurt Ticaret & Kredi Bankası, Tütüncüler Bankası and Kapital Bank) were removed by February 18, 2000, since they were merged under the structure of Sümerbank, which was another bank under the SDIF's management. Hence, the number of banks in the SDIF was 9 as of May 15, 2001.

Excluding the Central Bank of Turkey, the number of banks operating in Turkey decreased to 75. Of that amount, 57 are commercial banks and 18 are development and investment banks.

Payments System Developments

After initiation of the first generation RTGS system, named TIC-RTGS, in April 1992, it was renewed in April 2000 with additional functions, including a central queuing mechanism. TIC-RTGS is now running with the participation of 85 banks and with a daily average value of US$13 billion and volume of 100,000 payment messages.

The new Securities Settlement System, called ESTS-Electronic Securities Transfer and Settlement System, started on October 30, 2000. The ESTS is processing the primary and secondary market operations of government bonds and bills.

The ESTS System is integrated with the TIC-RTGS, working in real time. Once the buy and sell transactions are matched in the system, funds and securities are settled simultaneously.

The ESTS is also integrated with the Istanbul Stock Exchange (ISE) through the ISE's settlement bank (Takasbank), providing final settlement of funds and securities.

The Central Bank Act

The Turkish parliament has approved a law (published in the Official Gazette dated May 5, 2001) which gives the Central Bank more autonomy and protection from political interference. The primary goal of the Bank, which is to achieve and maintain price stability, is definitively stated in the Central Bank Law. Thus, the Bank will determine in its own discretion the monetary policy that it will implement and the monetary policy instruments that it is going to use in order to achieve and maintain price stability.

With the new law, the Bank is prohibited from granting advances and extending credit to the Treasury and to public establishments and institutions, and from purchasing debt instruments issued by the Treasury and public establishments and institutions in the primary market.

A new paragraph on the establishment of the Monetary Policy Committee, which is to be one of the governing bodies of the Bank, and a subsection related to duties and powers assigned to the Committee, were added to the Law.

The term of office for vice governors is extended from 3 years to 5 years, similar to that of governor.

Intra-Day Credits

In order to keep TIC-RTGS (the national real-time gross settlement system in Turkey) operating smoothly and provide liquidity so as to enable the banking system to perform time-limited payments in advance, in July 1999 the Central Bank started providing interest-free daylight overdrafts to the banks against collateral within their interbank borrowing limits. The overdraft has to be covered by the end of the day, otherwise it will be converted into a penalized overnight credit. The same rules are applied to both domestic and non-domestic banks.

UNITED KINGDOM

The last twelve months have seen a challenging environment for UK financial services despite growing business volumes and strong overseas earnings. For the banking sector in particular, growing political scrutiny and ever increasing competitive pressures have been key features. The period has also been characterized by moves towards greater consolidation. Following last year's take-over of National Westminster by the Royal Bank of Scotland, there have been a number of further initiatives, most recently the announcement of the proposed merger between the Halifax and the Bank of Scotland.

On the regulatory front also there has been considerable activity. In addition to a variety of important EU initiatives and the pending modifications to the Basel Capital Accord, the UK financial services industry has had to prepare for major changes to the domestic regulatory framework.

Regulatory Developments

Over the past year there have been intensive preparations for the new regulatory framework when the Financial Services Authority (FSA) will assume its powers under the Financial Services and Markets Act 2000. The Government recently announced that N2, the date when the legislation will be implemented, will not be later than end November 2001.

The FSA was granted its legislative powers under the Act on June 18, 2001 and shortly afterwards formally made the first part of its rules and guidance (known collectively as the Handbook). Elements include:

- High Level Standards – including Principles for Business, the Approved Persons regime and Senior Management Arrangements, Systems and Controls.
- Business Standards – including the Money Laundering Sourcebook (see below), the Interim Prudential Sourcebooks, the Conduct of Business Sourcebook and the Code of Market Conduct.
- Regulatory Processes – including the Authorization, Supervision and Enforcement Manuals.
- Specialist Sourcebooks – including Collective Investment Schemes and Recognized Investment Exchanges/Clearing Houses.

Also included in the Handbook is material on the Compensation Scheme and the fees payable by financial services firms to the FSA. All parts of the Handbook have been the subject of extensive industry consultation.

Whilst the Financial Services and Markets Act creates the framework for the new single financial services regulator, this has had to be supplemented by a broad range of secondary legislation. Again with industry consultation, statutory instruments covering commencement orders (orders formally commencing the relevant provisions of the Act), scope orders (determining the scope of regulation under the Act such as the Regulated Activities Order), other regulatory instruments and supplemental orders (containing repeals, transfers of functions, consequential amendments and transitional provisions) have been progressed.

A further important element of preparations for N2 concerns 'grandfathering'. This is the process, essential for a smooth transition to the new regime, whereby firms already having authorization to conduct certain regulated activities will automatically be able to continue undertaking those activities following N2 without further application to the FSA. A similar process is being invoked for individuals requiring FSA approval to conduct specified controlled functions under the Act, for regulated products and for entities such as exchanges and clearing houses. With regard to regulated activities, the FSA plans to send each firm a provisional list of the activities for which it is authorized. The objective is to agree these lists with as many firms as possible before N2.

Further particulars have been forthcoming over recent months on the FSA's risk-based approach to regulation, including the risk model to be used for assessing individual firms. The latter will involve an assessment of the potential impact of an institution on the FSA's statutory objectives (maintaining confidence in the UK financial system, promoting public understanding of the financial system, securing an appropriate degree of consumer protection and reducing the scope for financial crime) and of the probability of a firm specific “event” materializing that would have a negative effect on the achievement of those objectives. On the basis of these two “scores”, each institution will be allocated to one of four regulatory categories A, B, C or D – which summarise FSA's assessment of the risk which the regulator considers the institution poses to its objectives and indicates the nature of the relationship which the FSA expects to have with the institution. So while FSA will maintain a close and continuous relationship with category A (“high risk”) institutions, at the other end of the spectrum regulatory oversight of category D firms will be based mainly on remote monitoring. Additional detail on FSA's risk based approach is expected to appear later in the year.

A wide variety of other work is being taken forward by the regulator. This includes a consultation on an integrated prudential sourcebook which would apply prudential rules on a cross-sector basis. This is not for introduction of N2 but at a later date to coincide with implementation of the new Basel Accord. Consultations are also being undertaken on the use of skilled persons in the supervisory process and on the possibility of having a relatively lighter regulatory regime for banks that do not accept deposits from retail customers.

Notwithstanding the importance of N2, it is important to note that the FSA will assume certain powers after that date. For example, it is expected that the new regulatory regime for mortgage lending will be implemented in January 2002 and that for credit unions in the middle of 2002. More generally, it is expected that the UK regulatory framework will continue to evolve for a period of years.

Anti-Money Laundering Developments

Financial Services Authority's Money Laundering Rules

In January 2001, after an extensive consultation, the Financial Services Authority published the text of its Money Laundering Rules. The Rules will officially come into force later in the year, will run parallel to the 1993 Money Laundering Regulations and will concentrate on the systems and controls within regulated businesses. The Rules are set out in an FSA Policy Statement (see www.fsa.gov.uk).

The FSA Rules will apply to UK financial institutions and to incoming firms that set up a branch in the UK.

The Rules cover the need for institutions to appoint a senior level Money Laundering Reporting Officer to oversee training, systems and practices within the organization. The MLRO is required to write an annual report to senior management and to have access to all relevant customer information.

The initial draft of the Rules set out detailed customer identification procedures. These have been omitted in favour of references to the content of the Financial Sector Money Laundering Guidance Notes published by the industry-based Joint Money Laundering Steering Group. A new edition of the Guidance notes was published in February 2001 and can be purchased from the British Bankers' Association (see www.JMLSG.org.uk for details).

Draft Proceeds of Crime Bill

In February 2001, the Home Office published draft legislation for a "Proceeds of Crime Bill." The final proposals are expected to come before Parliament later in the year. The main aim of the Bill is to set up a National Confiscation Agency that will have powers to confiscate the funds of criminals. The Bill will also include some rationalization of the money laundering offences under the 1993 regulations. The offence of not reporting a suspicion of money laundering will be extended to include cases of wilful default or negligence. The draft Bill is available as part of a consultation paper on www.homeoffice.gov.uk .

Financial Services Authority – Money Laundering Theme Project

In July 2001, the FSA published a paper on know your customer practices. This followed a questionnaire that was sent to many financial institutions.

Taxation

The Finance Act 2000 required UK banks and other such institutions to report annual details of interest paid to non-UK resident individuals. It also required banks to report details of non-UK source dividends and interest dividends collected for individuals. The changes apply to income collected or paid from April 2001. Detailed regulations were published in February 2000 together with helpful Inland Revenue Guidance Notes (available on www.inlandrevenue.gov.uk/s17guidance/index.htm.). As a result of lobbying, it will only be necessary to report payments to individuals with addresses in a limited number of countries (EU member states, USA, Japan, South Korea, Australia, Norway, New Zealand and UK dependent territories).

Information collected by the Inland Revenue will be made available to the tax authorities of other countries but only if there is a reciprocal agreement for similar information to be supplied by the foreign tax authority. Currently there is only likely to be an exchange of information with 15 of the listed countries.

From 2002, the income reported may be extended to include the proceeds on sale or maturity of interest bearing securities and distributions from foreign bond funds. The details will depend on the result of continuing discussions about an EU savings tax directive.

Payment Systems Issues

Following the publication in March 2000 of the report *Competition in UK Banking* by Mr Don Cruickshank for the Chancellor of the Exchequer, HM Government responded in August and followed this response with a Consultation Document in December.

This document confirmed the Government's intention to establish a new competition regime for payments. It stated its intention to give the Office of Fair Trading (OFT) new powers aimed at promoting effective competition in payment systems for the benefit of consumers. This approach, considered by some observers to be a partial rejection of Cruickshank's recommendation for the establishment of a totally new regulator, was seen as a satisfactory and pragmatic outcome by practitioners. Nevertheless, despite the powers which will be vested in the OFT, once legislation has been secured, other regulators will continue to have an involvement and whilst the OFT will deal with competition issues associated with payment systems, the Bank of England will continue to have responsibility for the general oversight of payment systems from a financial stability perspective, whilst the Financial Services Authority will continue with its roles in prudential supervision of financial institutions and consumer protection. Redress will continue to be dealt with by the Financial Ombudsman's Service, which will continue to deal with customers' complaints.

At present, payment systems in the United Kingdom do not fall under any direct regulatory framework. Self-regulation by participants continues to maintain high standards of integrity and reliability in the major UK payment clearings. The proposed regulatory regime is, in practice, likely to underpin the current arrangements rather than replace them.

Daylight Overdrafts

Daylight overdrafts are not permitted in the major UK payment systems which settle over Bank of England accounts. Some 95% of values transmitted in the UK are handled by the CHAPS system, which operates in real time across Bank of England accounts. Member banks are required to have funds on their Bank of England account adequate to meet all payments being transacted. In the UK, no distinction is made regarding the domicile of the settlement member of each payment system. The requirement to have adequate funds on the Bank of England account is precisely the same for all participating institutions.

The Euro

Speculation regarding UK entry into the single European currency remains intense at the time of writing (August 2001). The Labor government has stated that it will make a decision whether or not to recommend entry early in this parliament, following its re-election in June. "Early in the parliament" is stated to be during the first two years, so a decision is expected by early 2003. Both the Labor and Conservative parties have made a commitment to call a referendum to confirm any decision to enter.

The UK Treasury has continued to work on its Outline National Changeover Plan, particularly looking at whether there are lessons to be learned from the first wave of entrants about managing the transition process among smaller businesses and individuals. The results of this work are likely to have a significant influence on the way in which retail banking services would be provided following any UK entry.

Along with the other financial markets in Europe, the UK is making preparations for the end of the legacy currencies which have continued as denominations of the euro since 1999. From the beginning of next year, any remaining transactions will have to be settled in euro, and remaining accounts will be converted to euro. The BBA intends to cease publishing LIBOR rates in the legacy currencies at the end of 2001. The BBA will recommend that the successor rates should be the euro BBA LIBOR rates, to which the legacy rates have been equal since 1999.

The merger of the London and Frankfurt stock exchanges mooted last year has been abandoned and the emphasis now is on integration of the settlement systems across Europe.

Concluding Remarks

The overlay of major regulatory and structural change has posed real challenges for banks in the United Kingdom over the past year. These look set to continue in the years ahead, not least as the industry comes to terms with the policies and style of the new regulator. A major uncertainty is whether the United Kingdom will join the European Single Currency in the near to medium term, a development that would raise key logistic and strategic issues for the financial services industry.

UNITED STATES

Overview of Key Regulatory Developments

Federal banking regulators devoted considerable attention during the period under review to implementing provisions of the Gramm-Leach-Bliley (GLB) Act, the financial services modernization legislation enacted in November 1999 that enables for the first time in the United States the combination within an affiliated financial group of an entire array of financial activities ranging from commercial banking to securities underwriting and dealing, insurance underwriting and merchant banking. These actions included (i) adoption of final standards for becoming a financial holding company and, as a result, qualifying to engage in the expanded financial activities permissible under the Act; (ii) issuance of regulations under the Act's merchant banking provisions (discussed below); (iii) finalization of regulations under the so-called "CRA sunshine" provisions of the Act, which require public disclosure of written agreements which insured depository institutions enter into with nongovernmental entities or persons to help meet the needs of the institution's community under the Community Reinvestment Act (CRA) and the filing of annual reports regarding the parties' performance under these agreements; and (iv) adoption of regulations prescribing consumer protection rules relating to the sale of insurance products by depository institutions.

At the same time it issued its merchant banking regulations for public comment, the Federal Reserve Board separately proposed to apply to bank holding companies and financial holding companies a 50% capital deduction for all their equity investments, regardless of whether such investments are made in connection with merchant banking activities authorized under the GLB Act. This proposal raised significant opposition from the industry and triggered Congressional hearings regarding its appropriateness. In response to these developments, the Board issued, and still has under consideration, a revised proposal that generally would impose a capital charge that would increase in steps as a banking organization's level of concentration in equity investments increases, with a top marginal charge of 25% of Tier 1 capital for investments in excess of 25% of Tier 1 capital. These regulatory capital charges would be applied to bank holding companies and financial holding companies that are subject to the risk-based capital standards applied by the Federal Reserve under the Bank Holding Company Act. The regulatory capital of international banks would continue to be determined in accordance with applicable home country standards.

Debates on deposit insurance reform intensified, with several proposals under consideration to raise coverage limits and/or modify the application of risk-based premium criteria so that more banks would be required to pay into the fund (under the current system, more than 90% of covered banks pay no premium). At the same time, the Comptroller of the Currency raised for discussion the subject of achieving greater equity in the supervisory assessments paid by national banks vis-à-vis state-licensed banks by, for example, rebating to national banks a portion of their deposit insurance premium payments.

The significance of these, as well as other, developments to international banks operating in the United States are discussed below.

Reforming Federal and State Asset Pledge Requirements

Throughout the period under review, the Institute continued its efforts to seek significant reform of the asset pledge requirements applicable to U.S. branches and agencies of international banks under federal and state law. As discussed below, these requirements obligate branches and agencies to keep on deposit with a bank in the state in which they are licensed liquid assets such as U.S. government securities that would be readily available to the appropriate authority in the event of their liquidation.

Indicative of the significance of this issue to international banks operating in the United States, during the past year expressions of support for asset pledge reform have been voiced to the appropriate U.S. authorities by home country banking regulators and banking associations. In addition, reform of U.S. asset pledge requirements has been raised with the European Commission, which is expected to communicate its views on this subject as well.

At the federal level, the International Banking Act of 1978 (IBA) currently provides that branches and agencies licensed by the Office of the Comptroller of the Currency (OCC) must at all times pledge assets in an amount equal to at least 5 percent of their total third-party liabilities. The OCC has proposed that the IBA be amended to replace this rigid statutory requirement with a flexible standard that the OCC may apply in the exercise of its supervisory discretion, similar to the approach that has been taken in Illinois and that is within the discretion of other state banking regulators under their existing statutory law. The Institute supports such an amendment and has met with senior policymakers in Washington to promote the necessary legislation.

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" and in such amount as the Commissioner deems "necessary for the protection of depositors or the costs of taking possession and control" of a branch or agency. For these purposes, the Commissioner has developed guidelines which base asset pledge requirements on the level of supervisory concern associated with a particular branch or agency. A very different approach is taken in New York, where all New York-licensed uninsured branches and agencies are subject to an asset pledge requirement equal to 5 percent of their third-party liabilities (other than liabilities arising from repurchase transactions) regardless of the level of supervisory concern. For many banks, this requirement results in the pledge of hundreds of millions of dollars (and, in a number of instances, several billion dollars) of assets. The New York Banking Department is considering ways in which this requirement might be modified.

The Institute has proposed that asset pledge requirements be reformed by utilizing a "risk matrix" approach to determine whether a branch or agency should be required to pledge assets and, if so, the amount of the pledge. The Institute believes that a properly administered, risk-focused approach would greatly diminish the amount of assets required to be pledged by well-rated institutions to an amount that would ensure coverage of potential costs of liquidation while preserving supervisory discretion to require larger amounts in remedial situations.

The following considerations strongly support asset pledge reform:

- With the widespread acceptance of internationally agreed upon capital standards and the enhanced, risk-based supervisory oversight of internationally active banking organizations on a consolidated basis, asset pledge requirements are not necessary for financially strong and soundly managed banks from countries that adhere to international capital and supervisory standards.

- As indicated above in the table at page 2, no other country (except Canada) applies asset pledge requirements to American and other non-domestic institutions as host country regulator.

- While a number of countries do require local capital for branches (which is achieved by bringing in head office funding so that total assets exceed local liabilities), asset pledge requirements represent the only situation in which capital funds must be invested in particular types of lower interest-paying instruments rather than being freely available for whatever assets an institution may wish to acquire.

- There is a whole array of supervisory tools available to the host country regulator to achieve safety and soundness, including in particular the examination and supervision of branches so as to maintain sufficient assets to pay off depositors and other liabilities.

- In light of the tremendous costs and burdens associated with the asset pledge (the investment returns on eligible assets under this requirement are frequently below an international bank's cost of funds or otherwise result in significant opportunity costs of 40 to 50 basis points and even higher for some institutions), it should be a discretionary tool for use in remedial situations, rather than an across-the-board requirement.

- American and non-domestic banks operating here have to meet Basel capital standards for their global operations. To impose an asset pledge requirement on non-domestic banks' major operations in the U.S. is a significant additional burden beyond the existing global capital requirements.

Implementation of the Gramm-Leach-Bliley Act and Its Implications for International Banks

Treatment of International Banks as Financial Holding Companies under the GLB Act

The GLB Act authorizes bank holding companies that qualify as "financial holding companies" to engage through nonbank subsidiaries in a wide array of expanded financial activities, including securities underwriting and dealing, insurance underwriting, merchant banking and insurance company investment activities. For a bank holding company to qualify as a financial holding company, each of its depository institution subsidiaries must be (and remain) "well capitalized" and "well managed". For these purposes, a depository institution subsidiary is "well capitalized" if it has a minimum Tier 1 and total risk-based capital ratio of 6% and 10%, respectively, and a minimum leverage ratio (Tier 1 capital to total assets unadjusted for risk) of 5%.

International banks that operate U.S. branches or agencies are eligible under the GLB Act to be treated as financial holding companies, and thus engage in the expanded financial activities permissible for financial holding companies, subject to capital and management standards "comparable" to those required for domestic institutions. The GLB Act directs that these standards be applied by the Federal Reserve Board (the "Board"), "giving due regard to the principle of national treatment and equality of competitive opportunity."

In its exercise of this authority, the Board in January 2000 adopted an interim rule setting forth two procedures for determining whether an international bank satisfies the "well capitalized" standard applicable to financial holding companies under the GLB Act. The first procedure involved the application of numerical criteria – minimum Tier 1 and total risk-based capital ratios of at least 6% and 10%, respectively, and a leverage ratio (Tier 1 capital to total assets unadjusted for risk) of at least 3% – as well as a finding by the Board that the capital of the bank is "comparable to the capital required for a U.S. bank owned by a financial holding company." The second approach provides a "pre-clearance" procedure by which banks that do not qualify under the first procedure may obtain a determination from the Board that its capital is "otherwise comparable to the capital of a U.S. bank owned by a financial holding company."

In response to the serious concerns with the interim rule raised by the Institute and others, the Board adopted a final rule which made several significant revisions. These revisions, which were effective February 2, 2001, include the following:

- **Leverage.** The Institute, the European Commission and others strongly objected to the inclusion of a numerical leverage test under the comparable "well capitalized" standard, arguing that this standard should instead be applied solely on the basis of Basel risk-based capital standards. In the final rule, the Board removed the numerical leverage test, but preserved the 6%/10% risk-based tests (as well as the pre-clearance procedure), and indicated that leverage instead is one of several other factors (*e.g.*, the composition of a bank's capital, its long-term debt ratings, accounting standards, its anti-money laundering procedures and, as discussed below, whether a bank meets the Board's "comprehensive consolidated supervision" (CCS) standard) the Board considers in determining whether an international bank satisfies the capital and management standards.

- **"Well Managed": U.S. Banking Operations.** The Board responded favorable to a suggestion by the Institute by revising the comparable "well managed" standard to require an international bank to have a satisfactory composite rating for its U.S. branches and agencies as a whole, rather than requiring each office individually to have a satisfactory rating.

- **"Well Managed": Home Country Assessments.** Whereas the interim rule included in the well managed test a requirement that a bank's home country supervisor considers the overall operations of the bank to be satisfactory or better, the final rule removed this requirement in favor of a requirement that the bank's home country supervisor consents to the bank's expanding its U.S. activities to include those permissible for financial holding companies.

- **Treatment of Subsidiary International Banks with U.S. Branches or Agencies.** The Institute also raised concerns regarding the Board's requirement that the capital and management standards apply not only to an international bank seeking to qualify as a financial holding company, but also any international bank subsidiary of such bank that has its own U.S. branch or agency regardless of whether that subsidiary also seeks financial holding company status. The Board retained this requirement in the final rule, but stated that "[t]here may be limited situations involving strategic minority investments between foreign banks where some relief from this requirement by be justified." It further stated, however, that it anticipates that such relief would be granted "only in limited circumstances where the foreign bank can clearly demonstrate that it has no ability to control the other foreign bank." The Board indicated that such situations would be addressed through the pre-clearance procedure.

- **CCS Considerations.** The Board also modified the interim rule to give added weight to whether an international bank meets the Board's CCS standard in determining whether it should be considered well capitalized and well managed. Specifically, the rule has been revised to indicate that a bank that does not meet the CCS standard generally will *not* be eligible to qualify as a financial holding company unless its home country has made "significant progress" in establishing arrangements that meet the CCS standard *and* the bank is in a "strong financial condition as demonstrated, for example, by capital levels that significantly exceed the minimum levels that are required for a well capitalized determination and strong asset quality." In the preamble to the final rule, the Board states that it anticipates granting financial holding company status to international banks that do not meet the CCS standard "only in rare instances".

Merchant Banking Activities

On March 17, 2000, the Board and the Treasury Department jointly adopted an interim rule on merchant banking, which, among other things, (i) limited the aggregate amount of a financial holding company's merchant banking investments, (ii) prescribed a maximum holding period for merchant banking investments and (iii) applied Sections 23A and 23B of the Federal Reserve Act (see below) to transactions between a U.S. branch of an international bank that qualifies as a financial holding company and any U.S. affiliate engaged in merchant banking activities and any company that is controlled by such bank through the exercise of its merchant banking authority under the GLB Act.

The Institute sought revisions to the interim rule to provide greater flexibility in its application and took the position that restrictions under Sections 23A and 23B should not be applied to U.S. branches and agencies. On January 10, 2001, the Board and Treasury Department announced important revisions to the merchant banking rules, effective February 15, 2001. In general, the revisions make the final rule less restrictive than the interim rule. However, the final rule retains the provisions of the interim rule applying Sections 23A and 23B to transactions by U.S. branches and agencies with merchant banking affiliates.

Among the more significant revisions to the interim rule are the following:

- Elimination of the dollar-based threshold for the review of a financial holding company's merchant banking activities and adoption of a sunset provision for the remaining capital-based threshold, which requires prior Board approval to make any merchant banking investment if the aggregate carrying value of all merchant banking investments exceeds (i)

30% of a financial holding company's Tier 1 capital or (ii) excluding investments in private equity funds, 20% of its Tier 1 capital (for international banks, Tier 1 capital is determined in accordance with the appropriate home country standards).

- The sunset provision will be effective upon the effectiveness of final rules regarding the appropriate regulatory capital treatment of merchant banking and other equity investments (see above).

- Revision of the restrictions that apply to merchant banking investment held beyond the permissible holding period (which, as under the interim rule, is generally 10 years) in ways that make them less burdensome.

Proposed Regulation W and the Applicability of Sections 23A/23B of the Federal Reserve Act to Transactions by U.S. Branches and Agencies of International Banks with their U.S. Affiliates

In general, Sections 23A/23B restrict "covered transactions" between insured depository institutions and their nonbank affiliates by (i) limiting them to a percentage of the depository institution's capital (10% for any one affiliate and 20% in the aggregate), (ii) requiring collateralization of extensions of credit to affiliates and (iii) imposing "market terms" dealing requirements on covered transactions. The Board did not apply Sections 23A/23B to U.S. branches and agencies prior to the GLB Act, except with respect to their transactions with "Section 20" securities underwriting/dealing affiliates. Subsequent to enactment of the GLB Act, the Board adopted regulations applying Sections 23A/23B to transactions between U.S. branches and agencies and their U.S. affiliates engaged in securities underwriting/dealing and, as discussed above, merchant banking activities authorized under the GLB Act.

On May 4, 2001, the Board issued proposed "Regulation W" providing for the comprehensive implementation of Sections 23A/23B. Subpart G of proposed Regulation W would apply Sections 23A/23B to transactions between U.S. branches and agencies of international banks and affiliates engaged in the United States in (i) insurance underwriting, securities underwriting/dealing/market making, merchant banking or insurance company investment activities permissible for financial holding companies under the GLB Act or (ii) "any other activity designated by the Board". The proposal would *not* apply Sections 23A/23B requirements to transactions between a U.S. branch or agency and its non-U.S. affiliates or to transactions between the international bank's non-U.S. offices and its U.S. affiliates, and the Board has stated that it "does not believe that it is appropriate or necessary at this time" to apply such requirements to transactions involving U.S. affiliates engaged in activities that were permissible prior to the GLB Act (*e.g.*, commercial finance and leasing), except for "Section 20" securities activities.

The Board has proposed Subpart G pursuant to its authority under Section 114 of the GLB Act, which, as applied to international banks, provides the Board authority to impose restrictions on relationships or transactions between a *U.S.* branch or agency and any *U.S.* affiliate of an international bank that it finds are appropriate to avoid "decreased or unfair competition", among other specified adverse affects. Explaining its rationale under Section 114, the Board has stated that it believes Subpart G "may help ensure competitive equity between foreign banks and U.S. banking organizations in the funding of certain of their U.S. nonbank operations." The Institute submitted a comment letter on the proposal raising significant statutory and policy concerns about the proposal and urging the Board to withdraw Subpart G.

At the same time it issued Regulation W for comment, the Board issued a separate proposal seeking comment on the appropriate treatment under Sections 23A/23B of (i) credit exposures arising out of derivative transactions between FDIC-insured banks and thrifts and their affiliates and (ii) intraday extensions of credit by FDIC-insured banks and thrifts to their affiliates. Both proposals remain under consideration as of September 2001.

Securities "Push Out" Provisions

The GLB Act requires that banks, including the U.S. branches and agencies of international banks, transfer to SEC-registered broker-dealers all of their securities activities except those specifically identified in the Act as being permissible for banks to continue to conduct directly. These "push-out" provisions were effective May 12, 2001. On May 11, 2001, the Securities and Exchange Commission (SEC) adopted and requested comment on "interim final rules" providing interpretive guidance on the applicability of the exceptions to the push-out provisions. To give banks additional time to bring their operations into compliance with the statutory requirements, as interpreted by the rules, the SEC also adopted a temporary, "blanket" exemption from the push-out provisions.

Comments on the interim final rules by the Institute and others, including in particular the federal bank regulatory agencies, which submitted a lengthy joint comment that was highly critical of the interim final rules, raised very serious concerns regarding their requirements. In response, the SEC on July 18th announced its intention to amend the interim final rules it adopted on May 11th, although it gave no indication of how it ultimately intends to revise them. At the same time, the SEC extended the "blanket" temporary exemption from the push-out provisions from October 1, 2001 until at least May 12, 2002 and stated that it does not expect banks to develop compliance systems for the push-out provisions until the rules have been adopted in final form.

Other Regulatory and Supervisory Developments

Revisions to the FBO Supervision Program

In cooperation and coordination with the other federal and state banking authorities involved in supervising the U.S. operations of international banks, the Federal Reserve Board on October 23, 2000 announced a number of steps to enhance the FBO Supervision Program. The changes to the Program are intended to make the "strength of support assessment" (SOSA) a more flexible and robust supervisory resource for the Federal Reserve, promote further cooperation with home country supervisors, and provide international banks more meaningful information regarding supervisory assessments of their U.S. operations (SOSA evaluates an international bank on a global basis, including consideration of the system of supervision in the bank's home country the record of home country governmental support of its banking system and transfer risks).

In a very significant change from prior practice, an international bank's SOSA ranking, as well as the rationale for the ranking, will be shared with the bank's senior management and home country supervisor. Among other significant changes, a new composite rating of all of an international bank's U.S. branches and agencies will be given in addition to ROCA ratings for individual offices and will be factored into the bank's Combined U.S. Operations Rating.

Increased Daylight Overdraft Limits for U.S Branches and Agencies of International Banks

On May 30, 2001, the Federal Reserve Board proposed changes to its payments system risk policy, including significant modifications to the calculation of daylight overdraft limits for U.S. branches and agencies of international banks. The proposal provides as follows:

- in place of the Basel Capital Accord criteria the Board applies under its current policy, daylight overdraft limits for international banks would be calculated on the basis of a bank's SOSA rating and whether it has qualified as a financial holding company under the GLB Act; and

- whereas under current policy daylight overdraft limits are calculated on the basis of not more than 10% of an international bank's capital, the Board proposes that for international banks that are classified as financial holding companies the percentage be increased to 35%, while for international banks that are not financial holding companies but have a SOSA rating of "1" the figure would be 25%.

Concurrently with its proposal, the Board adopted an interim policy that allows depository institutions, including U.S. branches and agencies of international banks, that calculate their daylight overdraft limits on a self-assessment basis to gain access to daylight credit in excess of their limit by collateralizing the amount of any such excess.

The Institute submitted a comment letter in support of the Board's proposal. In its letter, the Institute noted that while the Board's proposal would narrow the gap between daylight overdraft limits permissible for international banks vis-à-vis domestic banks, it would preserve the fundamental lack of parity with domestic banks that characterizes the Board's existing policy. The letter urges the Board to remain flexible in its approach to daylight overdraft limits for international banks and continue to consider actions that over time will further diminish the disparity between international banks and domestic banks.

Anti-Money Laundering Initiatives

In connection with the development of a national strategy to combat money laundering, an inter-agency working group comprised of representatives from the Treasury Department, the federal banking agencies and the Department of State on January 16, 2001 released guidance relating to financial dealings with foreign political figures. The guidance provides advice to assist banks and other financial institutions in applying enhanced scrutiny to transactions by senior foreign political figures and closely related persons and entities, so that the institutions may more effectively detect and deter transactions involving the proceeds of foreign corruption and protect themselves against being used as conduits for such transactions. It is contemplated that institutions will apply the guidance to their private banking activities, and the guidance suggests that institutions may wish to apply the guidance as well to high-dollar accounts in other areas of their operations.

Tax Matters

New Withholding Regulations and Qualified Intermediary (QI) Rules Become Effective

New regulations relating to withholding taxes and information reporting requirements on payments (including interest and dividends) made from U.S. sources to non-U.S. persons became effective on January 1, 2001. These regulations include special rules applicable to non-U.S. financial intermediaries that enter into QI agreements with the Internal Revenue Service (IRS), which are intended to reduce in certain important respects the information gathering and reporting burdens that non-U.S. financial intermediaries and their customers would otherwise bear under the new regulations. The transition to the new rules has been eased somewhat under relief issued by the IRS in December 2001 that responded to an Institute submission urging transitional relief.

The Institute has urged the IRS to act promptly to issue workable guidelines for the external audits of QIs that are required under the terms of QI agreements entered into by non-U.S. financial intermediaries pursuant to the new regulations and has submitted a letter to the IRS outlining its views regarding the principles that should guide the IRS in developing such guidelines.

The Institute has highlighted the following additional areas of concern under the new regulations:

- The requirement that QIs obtain satisfactory documentation regarding beneficial owners of accounts that were opened prior to the effective date of the applicable "know-your-customer" rules (generally pre-1993 accounts).

- The complexity of the rules relating to QIs handling non-QI accounts and the absence of workable rules relating to partnerships, trusts and other collective investment vehicles.

OECD Discussion Draft on the Taxation of Bank Branches

In February 2001, the Organization for Economic Cooperation and Development (OECD) released for public comment a "Discussion Draft" of a proposal that could have a major impact on the manner in which banks are taxed. In particular, the "discussion draft" document proposes a new, comprehensive framework for determining the amount of profits that should be attributed to the various branches of a multinational bank. Significantly, the document proposes to allocate equity capital to each branch (for purposes of determining its deductible interest expense) based on the risk-weighted assets (and off-balance sheet exposures) of the branch, utilizing the risk-weighted capital standards that are applied under the Basel Accord for bank regulatory purposes.

The Institute is very concerned that if adopted the Discussion Draft's proposed approach to allocating capital could have a significant adverse impact on the worldwide tax position of many multinational banks. On June 28, 2001, the Institute submitted to the OECD a lengthy and comprehensive paper commenting on the Discussion Draft. The Institute's paper argues that key features of the Discussion Draft are flawed on technical, practical and policy grounds. In particular, the paper expresses the serious concern that the use for tax purposes of the same capital allocation method that is used for regulatory purposes would raise significant administrative and practical complications and would produce distorted results. Also, the Discussion Draft would impose unnecessary complexities and burdens regarding the tracing of assets to particular locations and the performance of functional analyses of straightforward banking operations. Furthermore, the Discussion Draft would not achieve a sufficient level of uniformity in the treatment of multinational banks by different tax authorities.

Global Dealing Regulations

The Institute continues to emphasize the critical need to finalize, as soon as possible, the proposed regulations, issued in March 1998, concerning cross-border dealing operations in foreign currencies, securities and derivatives. In addition, the Institute continues to urge that international banks and their affiliates be allowed to elect to apply the proposed regulations on a retroactive basis. Representatives of the Treasury Department have affirmed the Department's commitment to finalize these regulations and have noted with sympathy the Institute's request for elective retroactive relief.

One complication that has emerged in finalizing the regulations is the concern expressed by U.S.-headquartered securities firms that in the absence of relief, the new global dealing rules could result in profits of their foreign subsidiaries from global dealing activity involving the United States being subject to both U.S. and foreign tax but no relief being available for such tax when the foreign subsidiaries' profits are repatriated as taxable dividends to the U.S. parent company. To address this concern, the Institute has made a preliminary proposal that the U.S. participant in a global dealing operation should be permitted (subject to certain conditions and limitations) to report all of the U.S.-related income from that operation, including income of non-U.S. affiliates that do not otherwise file U.S. tax returns.

IRS Proposal to Require Reporting of Deposit Interest Paid to Nonresident Alien Individuals

On February 27, 2001, the Institute submitted a comment letter to the IRS strongly opposing proposed regulations (issued in January) that would impose reporting requirements for interest on bank deposits of nonresident alien individuals (NRAs). The Institute subsequently testified in opposition to the proposal at a hearing held by the IRS in June.

The proposed NRA reporting requirements are intended primarily to enable the United States to provide information, pursuant to the information exchange provisions of tax treaties, to an NRA's home country tax authority regarding the NRA's interest income from U.S. bank deposits. In its comment letter and testimony, the Institute that it would be counterproductive for the United States to act unilaterally to provide foreign governments with information on the savings income of NRAs. Many NRA individuals maintain deposits in the United States in reliance on the confidentiality of their banking relationship. Unilaterally imposing information reporting requirements with respect to interest paid on these deposits would strongly encourage NRAs to withdraw their funds and transfer them to the many jurisdictions that do not impose such requirements. The outflow of funds from the U.S. banking system that would result from the proposed rule would be harmful to depository institutions in the United States and more generally to the U.S. economy. The Institute also questioned whether the limited benefit to the United States from this proposal merits the imposition of the costs and burdens of compliance on the banking industry.