Institute of International Bankers

Global Survey 2002

Regulatory and Market Developments

Banking - Securities - Insurance
Covering 43 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 fifteenth 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, 2001 to June 30, 2002 in 43 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.

The period under review was dominated by the global response to the September 11th terrorist attacks on the United States as well as the fallout from the collapse of Enron Corporation, WorldCom and other corporate and accounting scandals. At the same time, this period saw the smooth changeover to euro banknotes and coins at the beginning of 2002 in the twelve countries comprising the Economic and Monetary Union (EMU). In other major developments, a number of countries continued to modernize the regulatory structure governing their financial markets.

As described in many of the country chapters, the tragic events of September 11th were met by an international resolve to combat money laundering and the financing of terrorism. In the United States, President Bush signed the USA Patriot Act on October 26th – just 45 days after the September 11th attacks. The new law significantly expanded the authority of the U.S. government to fight money laundering, with a particular focus on money laundering effected by non-U.S. persons through U.S. correspondent banks and private banking operations. However, because of the limited available time in enacting the Act, many clarifications and exemptions needed to be sought in its implementation.

Similarly, new anti-money laundering initiatives were undertaken in a number of other countries as well as by the EU through its Second Directive on Money Laundering, adopted on December 4, 2001. In Germany, for example, various government bills were prepared in the immediate aftermath of September 11th. Under one such measure, the Act to Combat Terrorism of January 9, 2002, the Federal Office of Criminal Investigation (BKA) was given broader powers to obtain information from banks. Another measure in Germany, The Act to Combat Money Laundering, entered into force in July 2002 and is designed to combat any funding of terrorism and to implement the EU Anti-Money Laundering Directive.

Japan, likewise, implemented measures in response to the terrorist attacks on the U.S., including the freezing of assets in Japan held by Taliban connections. The government now requires financial institutions to report to the authorities transactions that they suspect are connected with the Taliban or those associated with the Taliban, as suspicious transactions according to Anti-Money Laundering measures.

The terrorist attacks also focused attention on the part the financial services industry and regulatory authorities on disaster recovery/business continuity issues, including the risk of having operations concentrated in one area. The New York Stock Exchange, which was forced to shut down for several days following the attacks on the nearby World Trade Center, plans to build a backup trading floor outside of Manhattan.

The repercussions from Enron and similar cases of corporate malfeasance are also documented in this year's global survey. The legislative response in the U.S. took the form of the Sarbanes-Oxley Act, named for the Chairmen, respectively, of the Senate Banking Committee and the House Financial Services Committee. Signed into law on July 30, 2002 by President Bush, the Act includes provisions that, among other things: create a new regulatory board with oversight over the accounting industry; restrict accounting firms from providing consulting services to their corporate auditing clients; require chief executives and chief financial officers of publicly traded companies to certify their financial results; prohibit public companies from making personal loans to their directors and executive officers; and prohibit investment banking firms from punishing research analysts that issue negative reports on firm clients. Concerns have been raised outside the U.S. about the extraterritorial reach of the Act, particularly with regard to the prohibition on loans to directors and executive officers. Regrettably, an exemption in the statute for FDIC-insured American banks to continue to make such loans under applicable banking regulations was not applied to non-U.S. banks that are also subject to their home country supervision of insider trading. At the same time, other countries undertook their own initiatives in response to the collapse of Enron. In the U.K., for example, a variety of precautionary measures were taken by Government and regulators, focussing on issues of corporate governance, auditor relationships and financial reporting.

In the U.S., Congressional inquiries into Enron, WorldCom and other corporate meltdowns – and the possible role of their banks in facilitating some of the abuses – led some to suggest a need to revisit the Gramm-Leach-Bliley Act of 1999, which repealed provisions of the Depression-era Glass-Steagall Act separating commercial from investment banking. Others have pointed out that the potential conflicts of interest and related problems apply to stand-alone securities firms that are not affiliated with banks and bank holding companies.

Meanwhile, on June 6th the House Financial Services Committee passed the Financial Services Regulatory Relief Act of 2002 (H.R. 3951), which would, among other things, ease restrictions on interstate branching and clarify merchant banking provisions of the GLB Act to ease cross-marketing restrictions. The regulatory relief bill also included an amendment proposed by the Comptroller of the Currency that would eliminate the mandatory 5% capital equivalency deposit (CED) requirement applicable to federal branches and agencies of international banks in favor of a risk-focused approach under which the Comptroller would have the discretionary authority to impose such a requirement in appropriate circumstances. As of mid-September, the regulatory relief bill had not been voted upon by the full House of Representatives and companion legislation had not been introduced in the Senate. At the state level, the New York Banking Department proposed revisions to its asset pledge requirement, which would greatly reduce the approximately $35 billion of collateral currently pledged by New York-licensed branches and agencies of international banks. Asset pledge reform initiatives were also completed in Connecticut, which lowered the requirement to 2 percent of third-party liabilities from 3 percent and capped the maximum requirement for qualified institutions at $100 million.

As found in the 2000 Global Survey, only one country other than the United States applies asset pledge requirements to branches of non-domestic banking organizations.

In other major developments during the period under review, a number of countries implemented sweeping supervisory reform measures. On April 1, 2002 the Austrian Financial Market Authority (FMA) assumed its powers and responsibilities under the Financial Market Supervision Act. The Austrian approach to financial system supervision concentrates on the core functions performed by the financial system, rather than on institutions or sectors and is in line with a functional approach to supervision.

Also in April 2002, The Kingdom of Bahrain announced the creation of a single integrated financial sector regulator within the central bank, the Bahrain Monetary Agency. Responsibilities for the regulation and supervision of the Stock Exchange and the insurance sector were in the process of being transferred to the Agency, banking supervision already being a key function of the Agency since its creation in 1973.

In spring 2002, the German parliament passed the Act on the Integrated Supervision of Financial Services, radically reforming the institutional framework for financial services supervision in Germany. Germany's three separate supervisory offices for banking, insurance and securities trading have been combined since May 1, 2002 into a single agency, the Federal Financial Supervisory Agency (BAFin), which is overseen legally and professionally by the Federal Ministry of Finance. The restructuring mirrors changes made in several other European countries to establish single financial supervisory authorities.

Under new financial sector reform measures in Canada, regulated, non-operating holding companies will be permitted for the first time, offering financial institutions the potential for greater operational efficiency and lighter regulation. For example, the holding company structure would allow banks the choice of moving certain activities that are currently conducted in-house by a bank to an entity that is subject to lighter regulation than the bank. A broader range of investments will be permitted for both holding company and parent-subsidiary structures and is expected to include, for example, expanded opportunities for investment in the area of e-commerce. As a general principle, any activity carried out by a financial institution would now be permitted to be carried out through a subsidiary of the financial institution or of its holding company. This would give banks and insurance companies greater choice and flexibility in the way they structure their operations. Trust companies would also be permitted to have a broader range of investments.

In February 2001, the Government of Ireland announced a new structure for the regulation of financial services. The Central Bank and Financial Services Authority of Ireland Bill was published in April 2002. The Bill allows for the restructuring of the Central Bank of Ireland to include a new regulatory authority with extended supervisory responsibilities including the insurance sector. The proposed new legislation will ensure that the system of prudential regulation and co-ordination of financial stability will further enhance the regulatory system. The considerable role given to consumer issues in these new proposals will also lead to increased protection to the customers of financial services and promoting greater consumer awareness and education. An interim board has been appointed to manage the transition to the new regulatory arrangements.

A matter selected for special attention in this year's Global Survey concerns the approach countries take to consolidated supervision of the operations of domestic and non-domestic financial groups. As indicated in the table on page 1, the survey found a variety of approaches to this issue around the world. At one end of the spectrum are the United States and 13 other countries that provide umbrella supervision to both branches and bank subsidiaries of non-domestic banking organizations as well as to their various affiliates. Other countries do not seek to provide umbrella supervision for either branches or bank subsidiaries of non-domestic financial groups as well as their various affiliates.

As in past years, the Survey also 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 endowment/dotational capital requirements for branches of non-domestic banking organizations, applicability of asset pledge requirements to branches of non-domestic banking organizations operating in a host country, availability of central bank "daylight overdraft" credit, the permissibility of merchant banking activities, host country supervision of non-domestic banks' branches, and market risk capital requirements.

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.

Readers are encouraged to contact the Institute with any thoughts or suggestions regarding the Survey.

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

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Brazil Canada[1] France Indonesia Ireland Italy Japan Luxembourg The Netherlands Philippines Spain[2] Sweden[3] Switzerland[4] United States[5]	Australia Austria[6] Belgium Bermuda[7] Finland Hong Kong Latvia Poland Singapore[8] United Kingdom	Czech Republic Denmark[9] Germany Korea Norway	Israel

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

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

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

[4] Swiss Banking law requires the Swiss Federal Banking Commission (SFBC) to exercise consolidated supervision over bank subsidiaries and affiliates of domestic financial groups. Bank subsidiaries and affiliates of non-domestic financial groups and unincorporated branches/agencies of non-domestic financial groups are only allowed in Switzerland if they are subject to consolidated supervision by their home country banking authority.

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

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

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

[8] The Monetary Authority of Singapore (MAS) supervises Singapore-incorporated banks on a consolidated basis, taking into account the operations of their domestic and overseas branches and subsidiaries. MAS does not supervise on a consolidated basis unincorporated branches, agencies and affiliates of non-domestic financial groups but takes into account, among other things, the adequacy of consolidated supervision exercised by parent supervisors in assessing foreign banks’ applications to set up operations in Singapore.

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

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

Host Country Applies Such A Capital Requirement[2]	Host Country Does Not Apply Such A Capital Requirement
Argentina	Australia
Austria	Bahrain
Belgium	Canada[8]
Czech Republic	Cayman Islands
Denmark	Finland
France	Hong Kong
Germany[3]	Ireland
Indonesia[4]	Japan
Italy	Latvia
Korea	Norway
Luxembourg	Sweden
The Netherlands	Switzerland
Panama	United Kingdom
Philippines	United States[9]
Portugal[5]	
Romania	
Singapore[6]	
South Africa[7]	
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] Under a 1994 regulation of the German Federal Ministry of Finance, the dotational capital requirement for German branches of U.S. banks that are supervised by the Board of Governors of the Federal Reserve System or the Office of the Comptroller of the Currency has been capped at the legal minimum amount of 5 m euros.

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

[5] Funds must be invested in Portugal.

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

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

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

[9] 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
	Czech Republic	Panama
	Denmark	Philippines
	Finland	Poland
	France	Portugal
	Germany	Romania
	Hong Kong	Singapore
	India	Spain
	Ireland	Sweden
	Italy	Turkey
	Japan	United Kingdom

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

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

AVAILABILITY OF CENTRAL BANK "DAYLIGHT OVERDRAFT" CREDIT

Central Bank Daylight Overdraft Credit Is Not Available to Domestic and Non-Domestic Banks	Central Bank Daylight Overdraft Credit Is Available Equally to Domestic and Non-Domestic Banks But Only on a Fully Collateralized Basis	Central Bank Daylight Overdraft Credit Is Available to Domestic and Non-Domestic Banks on an Uncollateralized Basis But Stricter Limits Apply to Non-Domestic Banks
Australia[1] Bahrain Czech Republic Hong Kong[1] Philippines[1] Singapore Switzerland[1]	Austria Belgium Denmark Finland Germany Ireland Israel Italy Japan Korea Latvia Netherlands 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.

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. A universal bank may further invest in non-allied undertakings subject to prior approval of the 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.

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

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

[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.

MARKET RISK CAPITAL REQUIREMENTS

Banks subject to Risk-based capital Requirements for market risk	Nonbank financial institutions (such as securities Or insurance firms) subject to risk-based capital requirements for market risk	Banks permitted to use Internal models to Measure market risk for risk-based capital adequacy requirements
Argentina	Australia (securities and insurance firms)	Australia
Austria	Austria (securities firms)	Austria
Australia	Belgium (securities firms)	Bahrain
Bahrain	Bermuda (securities and insurance firms)	Belgium
Belgium	Brazil (securities firms)	Canada
Bermuda	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[5]
Czech Republic	Greece (securities firms)	European Union[6]
Denmark	Ireland (securities firms)	Finland
Estonia	Italy (securities firms)	France
European Union	Korea (securities firms)	Germany
Finland	Latvia (securities firms)	Hong Kong
France	Luxembourg (securities firms)	Indonesia
Germany	Mexico (securities firms)	Ireland
Greece	Norway (securities firms)	Israel
Hong Kong	Philippines[2]	Italy
Indonesia	Poland (securities firms)	Japan
Ireland	Portugal (securities firms)	Korea
Israel	Singapore (securities firms; futures brokers)	Latvia[7]
Italy	South Africa (securities firms)	Luxembourg
Japan	Spain (securities firms)	Netherlands
Korea	Sweden (securities firms)	Norway
Latvia[1]	Switzerland (securities firms)	Pakistan
Luxembourg	United Kingdom (securities firms)	Poland
Mexico	Venezuela (securities firms)	Singapore
Netherlands		South Africa[8]
Norway		Spain
Peru		Sweden
Philippines[2]		Switzerland
Poland		Turkey
Portugal		United Kingdom
Romania[3]		United States
Singapore		
South Africa		
Spain		
Sweden		
Switzerland		
Turkey[4]		
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] In Romania, market risk capital requirements apply only to foreign exchange risk at present. The issuance of rules on capital adequacy of credit institutions is one of the short-term objectives of the National Bank of Romania. Rules on financial derivative instruments will be issued soon, but these elements will be treated only as concerns the credit risk.

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

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

[6] 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.

[7] 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.

[8] 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 signaled a willingness to consider an association between a bank and a non-financial company where a sound case can be presented. This policy will be applied conservatively.
Austria	Permitted	Permitted through subsidiaries	Permitted	Permitted, 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	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 capital and other regulatory requirements	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. Acquisitions of shares in excess of 5% must be filed and shares equal or in excess of 20% subject to regulatory approval
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 10% of the bank's capital, but subject to prior approval based on suitability of the shareholder
Latvia	Permitted	Permitted through subsidiaries	Permitted; together with the investments in industrial firms must not be more than full amount of the bank's capital	Permitted, but limited to 15% of bank's capital; in the aggregate limited to 60% of the bank's capital	Subject to regulatory approval for acquisitions of voting shares equal to or in excess of 10, 20, 33 and 50%

[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; universal banks may engage in securities activities directly or through a subsidiary with limitations; regular commercial banks may engage in securities activities only through subsidiaries with limitations	Insurance companies/ insurance agency and brokerage permitted for universal banks through subsidiaries with limitations; insurance agency and brokerage permitted for regular commercial banks through subsidiaries with limitations	Permitted for universal banks through subsidiaries with limitations	Permitted for universal banks through subsidiaries with limitations	Permitted with limitations on foreign and/or corporate ownership

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Poland	Permitted; dealing in publicly traded securities through subsidiaries	Permitted	Permitted	Permitted up to 25% of the bank's capital	Permitted
Portugal	Permitted; mutual funds only through subsidiaries	Permitted through subsidiaries	Generally limited to holding bank premises	Permitted up to 15% of bank's own funds (but not to exceed 25% of the voting rights of the company) and such investments may not in the aggregate exceed 60% of the bank's own funds	Subject to regulatory approval for acquisitions of voting shares equal to or in excess of 20, 33 and 50%
Romania	Banks 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
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

Argentine Financial System

Since the beginning of 2001, banks have been suffering a deposit run. Until November, the system faced withdrawals of US$15 billion, financed with its liquid reserves and with the assistance of the Central Bank in an amount of US$5.5 billion.

On December 3, 2001, the Government imposed temporary restrictions on the conversion of cash deposits (“Corralito”) and on the transfer of funds to foreign countries. The unstable financial condition has forced the maintenance of these restrictions to date with no major modifications.

On December 28, 2001, the public sector declared it was unable to pay its debts as they became due and a week later the Congress enacted an Emergency Act by means of which the Executive was authorized to modify the foreign exchange system. At the beginning of January 2002, the peso was devaluated. Initially, there was a double market and, as of February, there was a single foreign exchange market. Some days later, the Government introduced a compulsory rescheduling of fixed-term deposits and part of sight deposits, creating what today is called the “Corralón” as opposed to the “Corralito”; a term that was restricted to sight deposits.

During December and January, some depositors resorted to the Courts by means of summary proceedings to guarantee constitutional rights (-*amparos*-) and were granted preliminary injunctions through which banks were forced to reimburse deposits against the provisions of the Executive.

On December 31, the Supreme Court of Justice rendered a judgment stating that the measures introduced by the Executive as of December 3, 2001 violated the constitutional property right. Under the protection of this judgment, the number of depositors that resorted to the Courts rapidly increased.

At the beginning of February, the Government converted bank loans to the private sector and bank deposits to pesos at the exchange rate of $1 and $1.40 per dollar, respectively. Likewise, it introduced the inflation adjustment index (CER) for both items. In March, the public debt of banks was also pesified and two optional systems were introduced. By virtue of the first system, depositors were given the possibility to de-schedule their deposits in order to purchase new real property or automobiles, and by virtue of the second one (Decree 494/02) the option to swap such deposits for Treasury bonds was launched. Towards the end of April, it was evident that this option had failed as the withdrawal of deposits ordered by the Courts was booming.

In May, the Congress enacted an Act by means of which the judicial protection was restricted to certain classes of depositors (elderly and ill people at risk). At the same time, the Government ordered the banks to replace the inflation adjustment index (CER) applied to personal loans according to the salary variation index (CVS). This measure affects an important portion of bank assets.

The last initiative taken by the authorities was Decree 905/02, which instituted a new voluntary swap of deposits for public bonds (Boden). This plan would allow depositors to reestablish the value of their assets in dollars, and the Government to rescue an equivalent amount of public debt below par value. This decree also regulated the compensation granted to the banks (in public bonds) due to the pesification of assets and liabilities at asymmetric exchange rates and in order to balance their positions in foreign currency.

AUSTRALIA

Regulation and Supervision of Banks

In August 2001, the Australian Prudential Regulation Authority (APRA) released a new draft standard on Board Composition (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. This marked the commencement of Stage II of the ADI standards-making process, with a focus on giving effect to APRA's policies for the supervision of conglomerate groups containing ADIs. (Stage I was completed with the issuance of the set of harmonized prudential standards for all ADIs in September 2000.)

When finalized, the standard will replace the Prudential Statement on Ownership and Control of Banks (PS B1) for banks and subsection 237(2) of the former Financial Institutions Code for building societies and credit unions. The draft standard retains most of the prudential requirements set out in PS B1 with respect to the composition of the board of directors of a bank. It also incorporates some of the key principles in APRA's conglomerate policy framework announced in April 2000 (available on APRA's web site) relating to the composition of an ADI Board (including the application of fit and proper requirements to directors of ADIs).
Further to its April 2000 paper, APRA released a Policy Discussion Paper (available on APRA's web site) in October 2001 finalizing its comprehensive framework for the prudential supervision of conglomerate groups that include an ADI in respect of APRA's proposals on large exposure limits (both intra-group and external) and the measurement of capital adequacy in conglomerate groups.

Reflecting the growing importance of outsourcing in the financial services industry, APRA released a new draft standard on Outsourcing by ADIs in November 2001. The standard, which was finalized in May 2002 (available on APRA's web site) and will be effective from July 1, 2002, aims to ensure that the Board and senior management of ADIs have policies and procedures to manage effectively the risks arising from outsourcing material business activities. As outsourcing is a common activity across all industry sectors, APRA intends to introduce similar standards for all regulated institutions.

To give effect to its policy framework for the supervision of conglomerate groups that include an ADI, APRA released four draft revised Prudential Standards (including their related Guidance Notes) for ADIs in December 2001 (available on APRA's web site). They are APS 110 – Capital Adequacy; APS 111 – Capital Adequacy: Measurement of Capital; APS 221 – Large Exposures; and APS 222 – Equity Associations (with a new title "Associations with Related Entities"). These draft revised ADI Standards (and their related Guidance Notes)

incorporate APRA's policy proposals on risk management and group relations (such as common badging, distribution of products and shared premises) as well as large exposure limits (both intra-group and external) and the measurement of capital adequacy in conglomerate groups, as set out in the April 2000 and October 2001 papers respectively. APRA expects all these conglomerate-related Prudential Standards to be finalized in the second half of 2002.
On a separate track, the drafting of new Prudential Standards for authorized non-operating holding companies (NOHCs) of ADIs has been started. These draft standards will incorporate all the prudential requirements for authorized NOHCs covered in the April 2000 and October 2001 papers (such as board composition, fit and proper test for directors and senior management, group risk management, organizational structures and permissible activities). The draft NOHC Standards will be released for industry comment in the second half of 2002.
In June 2002, the Financial Sector Legislation Amendment Bill (No.2) 2002 was introduced into Parliament and is expected to be debated in the Spring sittings. Among other things, the Bill (available on the Parliament of Australia web site www.aph.gov.au) proposes the following amendments to the *Banking Act 1959*:

- allow APRA to apply a fit and proper test to directors and senior managers of ADIs and authorized NOHCs;

- allow APRA to remove auditors of ADIs;

- require an ADI, an authorized NOHC of an ADI and their subsidiaries to notify APRA immediately of breaches of prudential requirements and any material adverse developments;

- allow APRA to apply prudential standards on a consolidated group basis, and to investigate and obtain information from related parties of an ADI;

- allow APRA to revoke ADI and NOHC authorities where false or misleading information had been provided in applications; and

- bring APRA's indemnity in relation to ADI supervision up to the strength of the indemnity for supervision of other industries.

These amendments would bring Australia into closer compliance with the Basel Core Principles for Effective Banking Supervision. The first four provisions are also necessary to give effect to the policy framework for supervision of conglomerate groups containing ADIs, as set out in the April 2000 Policy Information Paper.

The "fit and proper test" and "removal of auditors" provisions are similar to those in the reformed General Insurance Act. Their adoption would represent a further step in APRA's program to align supervisory approaches across industries where appropriate.

Regulation and Supervision of Life Insurance Companies

In April 2002, the Life Insurance Actuarial Standards Board released a set of new actuarial standards as part of its harmonization process. These standards came into effect on June 30, 2002.

In June 2002, APRA issued a new prudential standard prescribing a minimum capital requirement for life insurance companies (available on APRA's web site). The standard seeks to preserve the minimum capital requirement of $10 million applicable to life insurance companies (other than friendly societies) under actuarial standard AS6.01 which was replaced by a new risk based actuarial standard (AS6.02) that harmonizes management capital requirements for life insurers and friendly societies.

Regulatory Reform of General Insurers

Amendments to the *Insurance Act 1973* to give effect to APRA's new prudential supervision framework for general insurance were passed by Parliament in late August 2001. The new prudential regime will come into force on July 1, 2002.

In February 2002, APRA finalized six new Prudential Standards for general insurance companies operating in Australia (available on APRA's web site). They cover capital adequacy, liability valuation, reinsurance arrangements, risk management, assets in Australia and transfers of business. The new Standards, which represent the complete set of prudential requirements that general insurers will need to meet under the new regime, are scheduled to come into effect from July 1, 2002 in conjunction with amendments to the *Insurance Act 1973*.

The amending legislation have required every general insurer wishing to operate after June 30, 2002 (around 150 in total) to apply for reauthorization. APRA has reauthorized most general insurance companies under the *General Insurance Reform Act 2001*. These general insurers, who have successfully met the new requirements, will continue to be able to underwrite insurance business in Australia. A small number of general insurers that are inadequately capitalized or were otherwise unable to satisfy APRA's reauthorization criteria have gone into run-off (i.e. no longer writing new policies or renewing existing policies) as a result of this process. APRA will supervise the orderly run-off of policies these insurers have in force.

Regulation of the Financial Services Industry

The *Financial Services Reform Act 2001* (FSR Act) commenced on March 11, 2002. The three key features of the new regime are to provide:

- a harmonized approach to licensing of financial service providers, including a disclosure and conduct framework;
- a single statutory regime for financial product disclosure; and
- the licensing of financial markets and clearing and settlement facilities.

As the regulatory body responsible for administering the new legislative provisions, the Australian Securities and Investments Commission (ASIC) has developed nine policies and three guidance papers dealing mainly with the licensing and disclosure provisions and codes of conduct (available on ASIC's web site www.asic.gov.au). ASIC also released an e-licensing system as part of the implementation of the FSR Act. It provides a fast and efficient on-line method for industry to apply for an AFS license.

The FSR Act empowers ASIC to seek civil penalties for market misconduct matters, including breaches of the continuous disclosure provisions.

New Federal Corporations Legislation

A new federal corporations legislation came into effect on July 15, 2001, when the States and Territory referred their corporations law powers to the Commonwealth in relation to the registration and regulation of companies. The Australian Corporations Law was replaced with the *Corporations Act 2001*.

Regulation of Dual Listed Companies

There have been a number of Australian companies that have wished to expand their international presence without giving up their Australian domicile. Dual listed companies (DLCs) typically bring two listed companies together – one from Australia and one from off-shore – in an arrangement under which neither company acquires shares in the other. ASIC is therefore keen to ensure that modifications and exemptions granted to facilitate DLCs could be reconciled with continuing obligations applicable to corporations in Australia. (In late 1991, ASIC developed a policy that outlined its views as to the appropriate accounting treatment to be adopted by Australian entities in DLC arrangements while being harmonious with international regulatory rules.)

Developments Relating to Payment Systems, Electronic Commerce and Banking

In December 2001, the Reserve Bank of Australia (RBA) released its Consultation Document outlining proposed reforms to credit card schemes in Australia for public discussion. The proposed reforms include draft standards on the setting of interchange fees and merchant pricing and a draft access regime for the designated credit card schemes (Bankcard, MasterCard and Visa). Submissions in response to the Consultation Document were received in March 2002. The RBA is currently consulting with a range of interested parties on the draft measures before they are finalized. Copies of the Consultation Document and public versions of the submissions are available on the RBA web site (www.rba.gov.au).

In April 2002, the Electronic Funds Transfer Code of Conduct (EFT Code) was expanded to cover internet and telephone transactions, as well as transactions undertaken using ATMs and EFTPOS. Since its release in April 2001, 205 financial institutions have adopted ASIC's EFT Code.

In March 2002, ASIC released its annual monitoring report on compliance with the Banking, Credit Union and Building Society Codes of Practice and the EFT Code (available on

ASIC's web site). The report showed that there was a general increase in complaints mainly relating to system malfunctions (such as shortfalls in the amount of cash given out at an ATM). In September 2001, the Sydney Futures Exchange Clearing Corporation (SFECC – a wholly owned subsidiary of SFE Corporation Ltd) introduced Bond and Repo Clear (BRC), an optional central counterparty service for transactions in Commonwealth Government securities and State government securities. The SFECC matches and novates each eligible trade and interposes itself between the buyer and the seller (i.e. it becomes the buyer to every seller and the seller to every buyer). The SFECC multilaterally nets members' cash and securities positions.

During the later half of 2001, the Australian Payments Clearing Association (APCA) set up a fifth clearing stream. The Australian Cash Distribution and Exchange System (ACDES) provides a formal system for participating members to undertake exchanges of cash in an orderly and secure manner. Notes and coins not in circulation are now owned and managed by five Australian banks, rather than the RBA. ACDES's objective is to minimise the overall quantity of cash – because of its carry cost – while at the same time ensuring that the right amounts and denominations of cash are in the right place at the right time.

In late 2001, the Australian Stock Exchange (ASX) reactivated its futures licence, and trading began on the ASX Futures Market (ASXF) on January 30, 2002. The Options Clearing House (OCH) is the clearing house for all trades completed on the ASXF. It provides a guarantee of performance for all trades novated to it.

In February 2002, the settlement of Commonwealth Government securities (CGS) was transferred from the Reserve Bank Information and Transfer System (RITS) to the Austraclear system. This was done following the strong support of market participants, based on the potential for increased efficiency; participants now need to maintain access to only one system to settle all of their debt securities transactions.

In May 2002, live testing of Continuous Linked Settlement (CLS) began. The Australian Dollar is included in the first wave of CLS eligible currencies.

Approach to Consolidated Supervision

Domestic Financial Groups

Australia generally adopts a consolidated approach to its supervision of ADIs.

APRA supervises the capital adequacy of a locally incorporated ADI on both a stand-alone and consolidated group basis, covering the global operations of the ADI and its subsidiaries. Generally, an ADI should consolidate all its subsidiaries in accordance with Australian Accounting Standards for capital adequacy purposes. Exceptions to this approach will be considered where consolidation of all subsidiaries of an ADI is not judged appropriate and/or where the non-consolidated subsidiary is subject to a different capital adequacy regime by APRA or approved by APRA. Life and general insurance subsidiaries come under this category.

Apart from capital requirements, locally incorporated ADIs are expected to have group risk management policies and procedures covering the ADI and its subsidiaries. Specifically, there should be limits covering large exposures, both to third parties and related entities, and systems and controls for monitoring and managing the risks arising from the activities of, and dealings with, subsidiaries and associates.

Information is collected from locally incorporated ADIs on a global consolidated basis, i.e. covering all banking operations in Australia and abroad (including any held through an intermediate holding company), as well as non-ADI subsidiaries. This information is subject to verification by ADIs' external auditors. As a general rule, prudential data are not collected from individual non-ADI subsidiaries. However, details of ADIs' large exposures to their affiliates are collected.

APRA may conduct on-site credit, market and operational risk review of some of the more significant overseas operations of Australian ADIs. Senior APRA officers may also visit ADIs' foreign establishments for general discussions on strategy and performance with the local management.

Non-Domestic Financial Groups

Foreign owned financial groups can operate as ADIs in Australia either as subsidiaries or branches. In assessing whether to allow a foreign applicant to operate as an ADI in Australia, APRA must satisfy itself that the foreign applicant is subject to adequate prudential supervision in its home country. In considering the standard of supervision exercised by the home supervisor, APRA will have regard to the Core Principles of Banking Supervision promulgated by the Basel Committee on Banking Supervision. This includes whether the home supervisor supervises the foreign bank applicant on a consolidated basis in accordance with the principles contained in the Basel Concordat, and is prepared to co-operate (in terms of the Concordat) with APRA in the supervision of the ADI in Australia. While we would generally expect reporting by foreign owned ADIs to cover operations in Australia, we would have undertakings from the foreign parent to keep APRA informed of any significant developments adversely affecting its financial soundness and/or reputation globally, and to provide promptly to APRA copies of its published financial accounts and any significant media releases (with translations where appropriate).

The consolidation approach for a locally incorporated ADI mentioned above would apply to a foreign owned subsidiary ADI and its subsidiaries in Australia. Branch ADIs are, however, not subject to capital or large exposure requirements.

AUSTRIA

Financial Market Authority

On April 1, 2002 the Austrian Financial Market Authority (FMA) assumed its powers and responsibilities under the Financial Market Supervision Act, marking the most significant development with regard to banking supervision in Austria during the period under review.

All supervisory tasks and resources are transferred from the Federal Ministry of Finance (banking, insurance and pension funds) and the Austrian Securities Authority - Bundes-

Wertpapier-Aufsicht (securities supervision) to the new supervisory body. The reform has established the FMA as an institution under public law, and its independence is secured by constitutional provision. The FMA is now the single statutory supervisory body directly responsible for banking, insurance and pension funds, securities and stock exchange supervision.

The Austrian approach to financial system supervision concentrates on the core functions performed by the financial system, rather than on institutions or sectors and is in line with a functional approach to supervision. The new, single financial supervision system overcomes the institutional segmentation of the old system. It is sector neutral and ensures a level playing field for all financial institutions doing business in Austria. To enhance the enforceability of supervisory measures, the FMA will be vested with administrative penal power and the power to enforce its supervisory rulings. Moreover, the FMA has the power to issue ordinances. No appeal of any kind is possible against rulings issued by the FMA (with the exception of administrative penal rulings).

Despite the establishment of the FMA as the single, statutory supervisory body, there is a far reaching and extended operational involvement of the OeNB, the Austrian central bank, in the supervision of the banking system. By law, the OeNB must be entrusted with on site inspections and the examination of credit and market risk of banks. The Banking Act anticipates the extension of auditing responsibilities to other financial institutions. A formal consultation process assures strong institutional cooperation between the FMA and OeNB (participation of FMA and OeNB members at on-site inspections is possible), and OeNB's position in international supervisory cooperation is enhanced. The OeNB's rights to be consulted (e.g. prior to the granting of a license or issuance of an ordinance), which are established in the Banking Act, remain untouched. The OeNB will continue to collect and process money and banking statistics (e.g. monthly returns, quarterly reports, major loans) on behalf of the FMA.

Money Laundering

An amendment to the Austrian Penal Code (Strafrechtsänderungsgesetz 2002) brought the Austrian Penal Law in line with the respective international initiatives. The scope of money laundering to be punishable by the Penal Code was broadened to cover fully the requirements of the UN Convention on Organized Crime including the financing of terrorism.
An amendment to the Austrian Penal Code provides that banking secrecy shall not exist according to the obligations of the European Union Protocol to the Convention on Mutual Assistance in Criminal Matters. The protocol stipulates an obligation for the credit industry to trace and to identify accounts which are used for the financing of terrorist or criminal activities and the monitoring of banking transactions.

In October 2001 the Austrian Banking industry issued a declaration to prevent financial transactions related to terrorism.

Consolidated Supervision

A group of credit institutions exists if a superordinate institution (credit institution or financial holding company) having its corporate seat in Austria

- maintains a direct or indirect majority holding;
- holds the majority of voting rights of the shareholders;
- has the right to appoint or recall the majority of the members of the administrative, managing or supervisory organs;
- has the right to exercise a controlling influence;
- effectively exercises a controlling influence;
- by virtue of an agreement with one or more shareholders of the subsidiary has the right to decide how shareholder voting rights, to the extent that these are needed together with the institution's own voting rights to reach a majority of all votes, shall be exercised in case of appointment or recall of the majority of the members of the managing or supervisory organ; or
- either directly or indirectly holds at least 20% of the voting rights or the capital of the subordinated institution and this participation is managed by a company belonging to the same group together with one or more companies not belonging to the group of credit institutions.

In addition, a group of credit institutions exists if a financial holding company has its corporate seat in another Member State of the European Union and if at least one credit institution having its corporate seat in Austria is subordinated to this financial holding company; in the country of the incorporation of the financial holding company no credit institution is subordinated and the credit institution in Austria has a higher annual balance sheet total than any other credit institution of the group admitted in a EU Member State.

The superordinate credit institution is responsible for compliance with the provisions of the Austrian Banking Act that are applicable to the group of credit institutions.
The institutions belonging to the group of credit institutions shall establish adequate internal control procedures and provide the superordinate credit institution with all data and information required for consolidation.

The superordinate credit institution has to ensure that the subordinated institutions and superordinate financial holding company communicate and provide all necessary information. Subsidiaries situated in Austria subject to a duty to consolidate vis-á-vis financial holding companies, credit institutions, investment firms, financial institutions or mixed-activity companies as parent companies situated abroad shall provide all information and communicate to the parent institution all documents necessary for consolidation.

KINGDOM OF BAHRAIN

Financial Sector Regulation

The major development during the period under review occurred in April 2002, when the government announced the creation of a single integrated financial sector regulator within the central bank, the Bahrain Monetary Agency. At the time of writing, responsibilities for the regulation and supervision of the Stock Exchange and the insurance sector were in the process of being transferred to the Agency, banking supervision already being a key function of the Agency since its creation in 1973.

It is expected that later in 2002 a new, unified law will be enacted, which will bring together existing provisions regarding the BMA and the regulation of different sectors of activity. The new law will update and rationalize the existing regulatory framework, as part of a broader effort to enhance Bahrain's standing and attractiveness as an international financial center.

The period also saw an important initiative by the Bahrain Monetary Agency to implement a sound prudential framework adapted to Bahrain's increasing number of Islamic banks and financial institutions. At the time of writing, 23 pure Islamic banks were licensed in Bahrain, representing the largest such concentration in the Middle East. With effect from end-March 2002, a comprehensive new framework of prudential regulations has applied to Islamic banks, which reflect standards issued by the Basel Committee and the Accounting and Auditing Organization for Islamic Financial Institutions (AAIOFI), as well as International Accounting Standards.

Anti-Money Laundering Developments

In October 2001 the BMA issued an extensive anti-money laundering regulation, applicable to its licensees, which complemented the Kingdom of Bahrain's January 2001 money laundering law. A further BMA circular issued in January 2002 implemented the Financial Action Task Force's recommendations regarding terrorist financing. The BMA also played a full part in international efforts regarding the freezing of assets of suspected terrorists or terrorist organizations. The Agency has created a dedicated anti-money laundering unit and has focused much supervisory effort on tackling financial crime and maintaining Bahrain's positive reputation in this area.

Other Developments

During the period under review, a number of other regulatory initiatives were taken. A new framework for the monitoring and control of large exposures was issued in November 2001, and the reporting burden on banks reduced. New computerized monthly, quarterly and annual returns were introduced for moneychangers. Additional regulations regarding the marketing of collective investment schemes are in the course of preparation, reflecting the significant growth in this sector. At the time of writing, approvals have been granted to 42 banks to establish and market in or from Bahrain 1,272 schemes. Lastly, regulations setting the framework for the operation of internet banks have been drafted, pending the enactment of enabling legislation in the field of e-commerce.

In terms of supervisory processes, the BMA also undertook during this period a major project to develop a risk-profiling framework, which assesses licensees according to the risks they pose to the supervisory objectives set for the Agency. This framework, which will be piloted in the fourth quarter of 2002 and rolled out in 2003, will enhance the Agency's ability to apply risk-based supervision, which focuses resources on areas of greatest risk and is forward looking, while providing incentives to licensees to improve the quality of their risk management. As part of this project, the Agency has been developing the approach and tools used by its on-site examiners; its off-site supervisors are shortly to embark on a similar review.

BELGIUM

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

Central Bank

In order to make essential improvements to the statistical information available for the fulfilment of the tasks of the European System of Central Banks and of the ECB, in particular, the task of defining and implementing the single monetary policy, a number of important innovations have been added to the system of bank reporting which specifically pertain to:

- the collection of data on the write-off/write-down of loans and the revaluation of securities needed to compile flow statistics of an acceptable quality for credit; and

- statistics on interest rates applied by monetary financial institutions (MFIs) to deposits and loans vis-à-vis households and non-financial corporations.

Reform of the Supervision of the Financial Sector and the Financial Services

A law on the reform of the supervision of the financial sector and the financial services, adopted by Parliament on July 18th, holds four main principles:

- reorganization of the financial markets in Belgium;

- changes in the decision-taking procedures within the prudential control authorities;

- closer co-operation between the Banking and Finance Commission (BFC), the Insurance Supervision Office (OCA/CDV) and the National Bank of Belgium (NBB); and

- streamlining the procedures for lodging an appeal against decisions taken by the Banking and Finance Commission and the Insurance Supervision Office.

Reorganization of the Financial Markets in Belgium and of their Supervision

Given the fact that the regulated markets have now turned into private companies and due to the various far-reaching changes in the financial regulations at the European level, there was a need for reorganizing the Belgian regulations.

First, it should be pointed out that the new structure differentiates between provisions of public order and those which are purely of a contractual nature. The former have been included into the legal framework, whereas the latter are the subject of the rules established by the market companies and the clearing and settlement institutions.

The chapter on the financial markets in the draft law deals with the following main topics:

a) Setting up a new market structure in compliance with the draft Investment Services Directive. More particularly, this involves creating the possibility to leave the concentration rule (which provides that all transactions must be executed on a regulated market) behind and to allow financial intermediaries to internalize transactions. In addition to the rules for the functioning of market companies, a number of provisions deal with the rules governing the functioning of the clearing and settlement institutions.

b) The rules imposing penalties in the case of market abuse become more stringent under the influence of the European Directive in this field. The draft law imposes administrative penalties on the one hand and penalties pertaining to criminal law on the other. As for the latter, there must be proof of an intentional factor on behalf of the trespasser.

c) The rules of conduct applying to the intermediaries are extended in preparation of the full introduction of the conduct of business rules (COB-rules) laid down by the Committee of European Securities Regulators (CESR). The definitive COB-rules will be laid down by Royal Decree and it will be possible to distinguish between services provided to retail investors, professional investors or eligible counterparties. A distinction will also be made between ‘execution only’ and other kinds of investment services.

d) As for Alternative Trading Systems, a legal basis has been laid down for the introduction of the European rules.

Decision Taking Within the Prudential Control Authorities

The system has been adapted according to the pricniples of corporate governance and following the cooperation between the concerned authorities as explained hereafter.

Closer Cooperation Between the Banking and Finance Commission, the Insurance Supervision Office and the National Bank of Belgium

Belgium has opted for a gradual integration of the supervision of banks, financial markets and insurance companies. The Central Bank will act as head organization, the Banking and Finance Commission and the Insurance Supervision Office keeping their status of separate entities within this overall structure headed by the Central Bank.

Various cooperation bodies will be created depending on the topics (e.g. a Committee on Financial Stability). Some of them will organize a consultation of all interested parties on the provisions which will be planned in the future by the supervisory authorities.

Streamlining the Procedures for Lodging an Appeal Against Decisions Taken by the Banking and Finance Commission and the Insurance Supervision Office

Up to now, several kinds of appeal could be lodged with the appropriate supervisory Minister against some of the decisions taken by the Banking and Finance Commission and the Insurance Supervision Office. However, the Ministers concerned do not have the ideal means at their disposal for dealing with these appeals. Moreover, the specific competence of the Banking and Finance Commission and the Insurance Supervision Office has been extended by this law. Supervision must be put into the hands of a judicial body given this new scope for intervention on behalf of the institutions and the sanctioning power which has been given to the Banking and Finance Commission.

In order to ensure the proper functioning of the judiciary, the decision has been taken to bring all cases before the Brussels Court of Appeal, except for the whole of appeals concerning the administrative supervision, for which the Council of State is the competent authority. This has been done with the following purposes in mind:

- a unification of the jurisprudence applying to the financxial sector; and
- a simplification of the legal grounds in this matter.

Introducing the Provisions of the Law

The law will be applied progressively in order to take into account the adoption of the future European rules which are still under discussion in these fields.

Regulation and Supervision of Banks

Capital Adequacy Requirements

There are no new rules, but the provisions to be taken in view of the future Basel Accord are under careful scrutiny (asking the banking industry to give its point of view about the Basel Committee's working documents and consultation of the Belgian national authority) and asking the banks to prepare the adoption period of three years between 2003 and 2006.

Internal Control and Audit Procedures

An organizational standard for the *compliance* function as for the external and internal rules (nature, organization, responsibility involved in the function) was introduced in December 2001.

Regulation Concerning Derivatives and Securities Products

The draft Directive concerning the prospectus, which had been severely criticised by the professionals, was discussed at the Ecofin Council Meeting on June 4, 2002 after a whole series of positive changes had been made.

The European banking sector is fully in favor of introducing a single European passport for issuers in order to enhance the unification of the European capital market. The sector has welcomed the extensive efforts made by the Belgian and Spanish presidency in order to reach an agreement on this proposal for a Directive, although it has made several points discussed below. Regulations which are too rigid with respect to the competent market authority or the format of the prospectus would be detrimental to all of the investors, be they professional or private investors. As for choosing the competent authority, it is inappropriate to oblige the issuer to have his prospectus approved by the national authority, without taking into account the place where the issuer wants to offer securities to the public or obtain admission to stock exchange listing. At present, a choice can be made as for the competent authority and giving up this possibility would be a setback for the unification of the European financial markets. This would bring about a renationalization and increased segmentation of the markets, something which would run counter to the purpose of the Directive.

The sector also considers it to be vitally important to maintain the possibility of choosing the format of the prospectus, for shares as well as for bonds (optional shelf registration). Indeed, this optional shelf registration is believed to have the support of the European Parliament and the European regulators (Committee of European Securities).

The substantial costs and the lack of flexibility as for the choice of the most adequate format of the prospectus could cause an exodus of European and non-European issuers towards markets outside the European Union.

Anti-Money Laundering Developments

In addition to the different measures which have been taken within the framework of the fight against terrorism (financial penalties, embargoes) and which also have an influence on the fight against money laundering (the Law against money laundering also applies to offences linked to terrorism), a Law (of May 3, 2002) has modified the Law of January 11, 1993 in order to adapt the provisions aimed at preventing money laundering to the measures taken against non-co-operating countries and territories (list established by the GAFI) in which the fight against money laundering is suffering from major shortcomings. According to a new provision, the obligation to communicate information (declaration to be made to the FIU) can be extended, on the advice of the FIU, to transactions and facts concerning natural or artificial persons living, registered or established in a State or territory where regulations are deemed to be insufficient or where practice is considered to be an obstacle for the fight against money laundering by a competent advisory or co-ordinating institution on the international level. The kind of transactions and facts concerned as well as the minimum amount can be specified by Royal Decree. For the moment, this obligation applies only to Nauru according to the Royal Decree of 10 June 2002.

Furthermore, Parliament is currently discussing a draft law aimed at transposing the new European Directive 2001/97/EC.

Market Developments

Major Merger

On April 1, 2002, Dexia Bank and Artesia Banking Corporation were combined into one entity under the name of Dexia Bank Belgium. This new entity is the second largest bancassurance group in Belgium after Fortis.

Payment Systems, Electronic Commerce and Banking

In the field of payment systems, electronic commerce and banking, the following significant market developments are taking place:

- The introduction of the euro currency on January 1, 2002 has led to a substantial increase of the use of Proton e-purses.

- The approval of a regulation on cross-border payments in euro by the European Commission at the end of December 2001. The chief aim of this regulation is to get the cost of cross-border payments within the EU in line with that of payments at the domestic level (this applies to electronic payments and money withdrawals as well as to credit transfers).

- As a consequence of the introduction of the euro and of the European initiatives in the field of regulation, the European banking industry had to make an analysis of how to implement a truly Single European Payment Area.

- The cancellation of the Eurocheque guarantee on January 1, 2002, which should have as a consequence that almost all of the checks used by Belgian customers will disappear.

- Initiatives in the field of regulation at the Belgian level concerning electronic funds transfers, social bank account, universal banking service, etc.

- Isabel, the interbank network, has launched a project in the field of e-invoicing; electronically generated invoices enjoy a tax advantage and can easily be integrated into corporate accountancy systems.

Consolidated Supervision

Consolidated Supervision of Domestic Financial Groups

Banking groups (having a bank at their head) and financial groups (consisting of at least one bank, but with a non-bank financial company at their head) are subject to the same kind of consolidated supervision. This supervision on a consolidated basis is identical to individual bank supervision. There is some kind of flexibility as for the individual supervision of the bank at the head of the group or subgroup. As for financial groups, this supervision is carried out on the basis of the situation of the bank which is part of the group, but this situation is consolidated at the level of the financial group as a whole.

If the head company of the group is a mixed company (a company which is not a credit institution nor a financial company and which owns non-financial subsidiaries), the group will be subject to a form of supervision which is rather similar as for its nature and purposes, but this supervision requires a smaller number of detailed and systematic data than the bank supervision in itself. All this complies with the European rules. For that kind of consolidated control, insurance companies are considered as financial institutions.

Consolidated Supervision of Non-Domestic Financial Groups

If the group is established in another Member State of the European Union, supervision will be similar to that discussed above and may be organized and shared together with the competent authority in the home country. If the bank or banks belonging to the group is/are established in the home country, supervision will be done by this country alone.

If the home country lies outside the EU, a similar system can be set up together with the home country authorities, provided the quality of this supervision is at a level which is at least comparable to the supervision laid down in the European Directives. If not, the Belgian authority must organize the full consolidated control of the group, as much as possible in cooperation with the (sufficiently qualified) authorities of other countries in which the group is estabished.

Belgian Supervision of Different Kinds of Financial Companies Individually Established in Belgium While Belonging to the Same Foreign Group

The system works in the way described above, depending on where the banks within the group are established. If the bank is represented in Belgium only through a branch, the supervision will not be consolidated, but a similar supervision system is created, if possible in cooperation with the home country authorities and also, when necessary, together with those in the other countries in which this bank has branches.

Supervision of Different Kinds of Activities in Belgium Carried out by Foreign Financial Groups

The responsibility is spread over the Belgian supervisory authorities in the same way as for the Belgian companies under supervision. There is a specific supervision for banks (by the Banking and Finance Commission), stockbroking firms (in that case, the Banking and Finance Commission is partially involved), the other investment companies (by the Banking and Finance Commission), insurance companies (by the Insurance Supervision Office), etc.

Examination by the Belgian Authorities of the Consolidated Situation of Foreign Groups Established in Belgium

Belgian authorities must have a clear idea of the structure of the group, its shareholding, solidity, organisation, etc., if possible in cooperation with the home country authorities.

However, if the home country supervisory authority cannot ensure a sufficient quality of supervision, the presence of the bank in Belgium will be subject to Belgian supervision.

Supervision by the Belgian Authorities of Global Transactions Carried out by Foreign Groups

This kind of supervision does not have to be organized systematically by the competent Belgian authority, but the latter is entitled to take an interest in it, mainly through a co-operation with reliable supervisory authorities abroad.

BERMUDA

Regulatory Developments

Regulatory responsibility for Bermuda's insurance industry was transferred to the Bermuda Monetary Authority from the Ministry of Finance, effective January 1, 2002, establishing the BMA as the independent regulatory body for the financial services sector.

The process of updating Bermuda's financial regulatory legislation remains a key priority for the country, and the BMA has continued to devote considerable resources to this project in support of the Ministry of Finance. In particular, 2001 saw the enactment of a new Trusts (Regulation of Trust Business) Act which came into force on January 25, 2002, and which repealed and replaced the Trust Companies Act 1991. The new statute widens the previous basis for regulating trust business. It creates two types of licenses, one for trust companies and a restricted license for individuals and partnerships. It also provides a full range of intervention powers for the BMA in dealing with any regulatory concerns.

Additional amendments to the Bermuda Monetary Authority Act 1969 and the Insurance Act 1978 were also implemented in 2001, enabling the BMA to require information from licensed entities in order to assist an overseas regulator. In addition, the Proceeds of Crime Act was amended to extend the scope to cover the proceeds of all indictable offenses. The latter amendment also established a Confiscated Assets Fund. Further changes to the Act, Regulations and Guidance Notes are under consideration, following a consultation process initiated in late 2001 by the National Anti-Money Laundering Committee, and having regard to the current review by the Financial Action Task Force (FATF) of the 40 recommendations as well as other developments internationally in know-your-customer standards. As part of this Bermuda, in common with most other countries, is also reviewing the existing provisions in order to ensure it can deal fully with the issue of terrorist financing.

Further elements of the regulatory framework scheduled to be updated include:

- the Investment Business Act 1998 (where amendments will clarify certain existing provisions as well as extending the scope of the Act to cover custody services and dealing with a number of weaknesses in current information and intervention powers);

- a new Collective Investment Schemes Act (which will include provision for licensing fund administrators) and amended Classification Regulations; and
- a new Act criminalizing insider trading and unfair price manipulation in securities markets.

The Government has also undertaken to introduce anti-terrorism legislation.

Consolidated Supervision of Domestic Financial Groups

Financial services groups headquartered in Bermuda are subject to consolidated supervision by the BMA. The methodology normally includes a full accounting consolidation of financial companies within the group. But, where an accounting consolidation is not an effective tool because of the nature of the particular business, supervision involves a more qualitative assessment of the risks to the licensed entities posed by the particular businesses that are not subject to an accounting consolidation. The BMA normally requires both solo and consolidated prudential reporting, with the scope of consolidation agreed upon with the licensed entity in light of the above considerations.

Consolidated Supervision of Non-Domestic Financial Groups

The BMA is responsible as host country supervisor for the supervision and regulation of financial institutions incorporated or registered in Bermuda. Where entities within Bermuda are part of a group headquartered in another jurisdiction, the BMA's responsibility normally relates to solo supervision of the Bermuda entity. BMA reporting requirements for such entities are likewise solo. In such cases the BMA liaises routinely with the home country supervisor responsible for consolidated supervision. When an application is received from an overseas financial group wishing to establish an institution in Bermuda, the BMA liaises with the home country supervisor. Most regulated financial institutions establishing in Bermuda do so in the form of subsidiary companies incorporated in Bermuda rather than via branches. Where, exceptionally, branches are involved, the BMA reviews the capital adequacy of the institution as a whole as well as the nature and quality of financial regulation to which the entity is subject.

BRAZIL

Brazil and its banking sector are undergoing a deep transformation. New rules, foreign competition, globalization, technological advances, and economic changes are reshaping banking. At the same time, banking has as its utmost challenge the financing of development to help improve the lives of all Brazilians.

The volume of service is increasing at a lower price, in spite of the economic turmoil Brazil faced during the period under review. The main actions dealt with the payment system, financial transactions tax, money laundering, corporations law, new civil code, house financing, digital certification and credit derivatives.

Payment System

The Central Bank, Febraban and the banking system set up a new payment system, SPB – Sistema de Pagamentos Brasileiro. It is a RTGS – Real Time Gross Settlement System – that will operate through five new clearings. The new system adds efficiency and stability to the Brazilian banking network. The banking system developed a new network and five new clearings to process payments in the new system.

The system started operations on April 22, 2002, with a floor of R$ 5 million (≈ US$ 2 million) per transaction, and through three clearings. As the reliability of the system increased the floor was gradually lowered, and the remaining two clearings started operating. Besides the clearings, the Central Bank of Brazil developed the STR – Sistema de Transferência de Reservas – that transfers funds among banks.

Financial Transactions Tax

Constitutional Amendment nº 37 enacted on June 12, 2002, prorogated the financial transactions tax (CPMF – Contribuição Provisória sobre Movimentações Financeiras) until December 31, 2004. The Amendment also exempted stock market and foreign currency transactions from the financial transactions tax (CPMF) as from July 15, 2001.

Money Laundering

Money laundering detection and punishment is being enhanced through Law nº 10.467, enacted on June 11, 2002, which introduced and defined the crime against foreign public administration in the Penal Code and in the Anti-Money Laundering Law allowing a prompt action against violators.

Corporations Law

The corporations law – Law 6404 of December 7, 1976 – was updated by Law nº 10.303, of October 31, 2001. The new law was regulated by the Executive Order nº 3.995, of October 31, 2001 and regulates corporations (Sociedades Anônimas) operations, disclosure, legal formalities, issuing of shares and voting rights.

New Civil Code

An important legal change during the period under review was the enactment of the New Civil Code that is going to be obligatory as from January 11, 2003, and is going to rule civil relations in the Brazilian society. Febraban has a task force studying the changes and effects of the New Civil Code in the banking legal environment.

House Financing

Some steps were taken to promote house financing in Brazil. Provisional Decree (MP) nº 2.223, of September 4, 2001, regulated housing-financing notes and mortgage notes, permitting more secure and speedier house credit operations.

Digital Certification

Provisional Decree (MP) nº 2.200, of August 24, 2001, established the ICP-Brasil – the Brazilian public keys infrastructure - to certify the authenticity, integrity and legitimacy of electronic documents and transactions.

Credit Derivatives

Central Bank Resolution 2.933 and Circular 3.106 regulated the use of credit default swaps in Brazil, an instrument that will increase efficiency in credit markets, enhancing transparency of spreads, permitting hedging of portfolios and arbitrage of price distortions.

CANADA

Executive Summary

During the period under review, Canada has passed significant reforms of its federal financial sector legislation. In addition, on a voluntary basis, banks, insurance companies and other financial services institutions have developed a comprehensive ombudsman system to deal with consumer complaints. There have also been anti-money laundering measures implemented, which were supplemented by anti-terrorist actions in response to the events of September 11, 2001.

Federal Financial Sector Reform

This year has seen the passage of significant reforms to the federal financial sector legislation. The amendments have three main objectives:

- Promote efficiency and growth in the financial sector
- Foster greater domestic competition
- Empower and protect consumers

Among the measures are changes to the "widely held" definition, allowing "holding companies", expansion of permitted investments and changes to the foreign bank entry rules.

For financial institutions with $5 billion or more in equity, there is now a new definition of widely held that permits an investor to own up to 20 percent of any class of voting shares and 30 percent of any class of non-voting shares subject to ministerial approval and a "fit and proper" test designed to evaluate the applicant's character and suitability. This would allow these institutions to enter into substantial share exchanges, including the ability to enter into strategic alliances and joint ventures.

Essentially, there will be three classes of banks, based on equity size: "large" (C$5 billion or greater), "medium" (C$1 billion to C$5 billion) and "small" (less than C$1 billion). The Bank Act continues to prohibit control of a large financial institution by any single shareholder, or group of shareholders, under the new ownership regime. The federal government has worked with the financial institution industry to develop control guidelines.

For the first time, regulated, non-operating holding companies will be permitted that offer financial institutions the potential for greater operational efficiency and lighter regulation. For example, the holding company structure would allow banks the choice of moving certain activities that are currently conducted in-house by a bank to an entity that is subject to lighter regulation than the bank. The holding company option would also provide financial institutions with a mechanism to come together to compete with larger institutions. This would provide greater structural flexibility to compete with highly specialized or unregulated firms.

A broader range of investments will be permitted for both holding company and parent-subsidiary structures and is expected to include, for example, expanded opportunities for investment in the area of e-commerce. As a general principle, any activity carried out by a financial institution would now be permitted to be carried out through a subsidiary of the financial institution or of its holding company. This would give banks and insurance companies greater choice and flexibility in the way they structure their operations. Trust companies would also be permitted to have a broader range of investments.

Access has been expanded to the payment system to accommodate the entry of the life insurance companies, securities dealers and money market mutual funds. Permitting these new types of financial institutions to join the payments system would enable them to offer a range of services to their clients, thus promoting increased competition for the consumer's business. For example, life insurance companies would be able to offer payment services that are basically similar to those provided by banks or deposit accounts.

A new agency, the Financial Consumer Agency of Canada (FCAC) has been established to enforce the consumer-oriented provisions of the federal financial institution statutes, monitor the industry's self-regulatory initiatives designed to protect the interests of consumers and small businesses, promote consumer awareness and respond to general consumer enquiries. The FCAC would have the regulatory tools necessary to promote financial institutions' compliance with the consumer-related requirements under their governing statutes, including financial penalties.

Foreign Banks in Canada

To foster greater competition in the domestic marketplace, the federal government had previously developed a framework for the entry of foreign banks into Canada. Over the course of a number of legislative initiatives, this framework has been implemented, most notably allowing "authorized foreign banks" (foreign bank branches). Foreign bank branches are permitted to offer the same products and services as domestic banks, except they cannot accept "retail" deposits (that is, deposits of less than C$150,000). Foreign banks are, however, allowed to establish a Canadian incorporated "foreign bank subsidiary" as well as a foreign bank branch. Currently, there are 17 foreign bank branches and another dozen are completing the process to establish a branch. There are also 33 foreign bank subsidiaries.

The new reforms implemented recently under the federal financial sector reform ensure that the foreign entry regime for banks is consistent with the new domestic policy framework in areas such as permitted investments and business powers. The key principles underpinning the proposed regime are to provide flexibility for foreign banks wishing to operate in Canada and to streamline regulatory approvals.

Ombudsman Proposals

Five major industries of Canada's financial services sector – banks, life and health insurers, property and casualty insurers, investment dealers and the mutual fund industry – announced on December 20, 2001 the creation of a National Financial Services Ombudservice (NFSO). This new service, now renamed the Financial Services OmbudsNetwork (FSON), which is planned to be in place by September, 2002, will provide more than 95 percent of Canada's financial services consumers with single-window access to recourse if they have concerns or complaints.

This industry-based, integrated consumer assistance service, which builds on long-established consumer redress mechanisms already in place, has at its heart a new organization, the Centre for the Financial Services OmbudsNetwork (CFSON), which will provide a central contact point (1-800 phone number, website, etc.), establish and maintain standards, undertake awareness-raising and provide reports on the new system.

The core components of these services are:

- The individual companies in the participating industries and their ongoing complaints management activities;
- Industry-level consumer recourse mechanisms which will include independent, impartial Ombudsman services for consumers whose complaints have been dealt with at the company level and wish to pursue their complaints further; and
- The new CFSON Center.

The FSON has been endorsed by the Joint Forum of Financial Market Regulators, the Canadian Council of Insurance Regulators, the Canadian Association of Pension Supervisory Authorities, Canadian Securities Administrators, and the federal Secretary of State (International Financial Institutions).

New Anti-Money Laundering and Anti-Terrorism Initiatives

Two sets of regulations aimed at combating money laundering and terrorist financing were published on May 14, 2002.

The first set of regulations, which amend the existing Proceeds of Crime (Money Laundering) Suspicious Transactions Reporting Regulations, requires financial institutions and other intermediaries to report financial transactions to the Financial Transactions and Reports Analysis Centre of Canada (FinTRAC) where there are reasonable grounds to suspect the transaction is related to terrorist financing. They will also be required to report to FinTRAC if they are in possession of terrorist assets or have knowledge of a financial transaction involving such assets. Financial institutions have been required to report "suspicious" transactions related to money laundering since 2001.

The second set of regulations, the Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations, requires financial institutions and intermediaries to report large cash transactions and international electronic fund transfers. It also outlines the requirements for enhanced record-keeping, client identification and internal compliance.

These regulations will be phased in on two separate dates. Most of the provisions in the regulatory package will come into effect on June 12, 2002, while the remainder will be implemented on November 30, 2002, to allow reporting entities additional time to make the necessary changes to their systems and train their employees.

The Canadian government is currently finalizing regulations that will require the reporting of cross-border movements of large amounts of currency and monetary instruments.

To respond to the threat from terrorism, the federal government passed legislation that made changes to various statutes, including the Criminal Code and also expanded the mandate of FinTRAC.

CAYMAN ISLANDS

During the period July 2001 to June 2002, the most significant developments in the Cayman Islands related to progress made in transforming the Monetary Authority into an independent regulatory body and the passage of the Securities and Investment Law. In addition, in response to the global war on terrorism, the Cayman Islands has endorsed the Special Recommendations issued by the FATF to deny terrorists and their supporters access to the international financial system. Prior to the tragic events of September 11th, global efforts in the fight against financial crimes focused on the use of financial transactions to disguise the proceeds of crime.

The finalization of the administrative arrangements and legislative changes are at an advanced stage to convert the Monetary Authority into an autonomous supervisory agency. In keeping with international best practices, the Authority's independence will place complete operational decision-making in the hands of the Board of Directors and senior management of the Authority. It will remove the need for the approval of the Executive Council for certain decisions, such as the approval and revocation of licences. Additionally, it will increase the power of the Authority in terms of enforcement.

The Securities Investment Business Law (SIB), 2001 has been passed and the Authority is currently working on the accompanying Regulations. The law regulates entities that engage in dealing in securities; arranging deals in securities; managing securities and advising on securities. This law places the regulation and supervision of securities business under the Monetary Authority. Subject to exemptions, only those entities licensed under the Law will be permitted to carry on or purport to carry on investment business.

In December 2001, a team from the International Monetary Fund (IMF) made a preliminary visit to the Cayman Islands. The objective of the visit was to help the authorities in Cayman and the IMF team prepare for an assessment scheduled to take place towards the end of 2002. As recommended in the Financial Stability Forum (FSF) Report on Offshore Financial Centres in 2000, the IMF has assumed the role of undertaking comprehensive assessments of financial supervision in Offshore Financial Centres, and providing advice and technical assistance therein.

The Caribbean Financial Action Task Force (CFATF) second Mutual Evaluation of the Cayman Islands took place on February 19- 22, 2002. The objective of the Mutual Evaluation Process was to provide an impartial evaluation of the implementation of the Revised 40 Recommendations of the Financial Action Task Force (FATF), the Revised 19 Recommendations of the CFATF, and the FATF 25 Point Criteria used in the Non-Cooperative Countries and Territories Exercise. The Mutual Evaluation Survey provides one of the mechanisms by which the CFATF Secretariat ensures that its members fulfil their obligations and is consequently a crucial part of the work of the CFATF. In addition, the evaluation focused on the practical implementation of the Cayman Islands' anti-money laundering framework.

The Cayman Islands is part of a Working Group on Trust and Company Services Providers. The Group was formed following a meeting of the Offshore Group of Banking Supervisors (OGBS) in June 2001. At the meeting it was proposed that members of the OGBS and relevant non-OGBS members drawn from G7 countries and international organizations, be included in a Working Group to discuss and establish international standards for the regulation of trust and company service providers.

The Working Group's objective is to review the current and/or the proposed legislation of member jurisdictions represented, thereby identifying key standards by drawing upon the existing legislation and other source documents. The Group will also consider whether these standards need to be strengthened or supplemented in compiling a statement of minimum standards for global application. The working group is currently comprised of OGBS members from the Bahamas, Bermuda, British Virgin Islands, Cayman, Cyprus, Gibraltar, Guernsey, the Isle of Man, Jersey, and G7 Financial Stability Forum Members from France, Italy, Netherlands, United Kingdom and representatives from the FATF, IMF and the OECD.

Financial Performance
Banking Sector

The number of active banking and trust company licenses at the end of March 2002 decreased to 533 from 538 in June 2001. Despite this, forty of the top fifty banks still held active banking and trust company licenses in the Cayman Islands, a symbol of confidence placed in the jurisdiction as a premier international financial center. Active licensees represented fifty-four countries, with 31% from Europe and 26% from North America.

Insurance

During the period June 2001- March 2002, the Cayman Islands maintained its position as the second largest captive insurance domicile in the world with an increase from 527 to 547 companies writing over US$2.98 billion in premiums and reporting total assets in excess of US$15.2 billion. These companies emanate mostly from the U.S. (85%), followed by the Caribbean and Latin America (4.4%) and Europe (3.7%).

Investment Services

During the period, June 2001 to March 2002, the Cayman Islands increased its dominance as the number two offshore mutual fund jurisdiction by eclipsing the 3,000 mark with assets over $210 billion. Based upon figures from the 2001 edition of The U.S. Offshore Funds Directory, Cayman now accounts for 58.9% of new offshore hedge funds. At the end of March 2002, there were 3,828 regulated funds, an increase of about 51%, reflecting the continued growth of the mutual funds industry in the Cayman Islands. In addition, the total number of mutual fund administrator licenses increased by 16 over the same period. Restricted Mutual Fund Administrator Licenses showed the largest increase, bringing the total number of mutual fund administrators to 223 from 207 in June 2001.

CHILE

Signing of the Free Trade Agreement between Chile and the European Union

Chile signed a Free Trade Agreement with the European Union, in which Financial Services was set apart as its own chapter from Services in general. In the agreement, the negotiating position of Chile was based upon the General Agreement on Trade and Services (GATS), applied to financial services.

The agreement was defined in conformity with Chilean legislation, and as a result, the government decided it was not necessary to modify the General Bank Law. However, the agreement still needs to be ratified by the Chilean Congress.

Mergers

On October 3, 2001, The Superintendency of Banks and Financial Institutions granted Chilean banks the authorization required to proceed with mergers. Subsequently, on May 16, 2002, the Superintendency of Banks and Financial Institutions, with previous authorization from the Central Bank, authorized Santiago and Santander to merge.

Provisional Voluntary Saving

The Superintendency of Banks in conjunction with the Superintendency of Administration of Pension Funds, Social Security and Prices and Securities, defined the conditional framework for the functioning of the system of provisional voluntary saving that will make it possible for competition in the capital markets. In this way, banks and financiers will be able to design and offer new alternatives for long term saving.

One Day Bank Retention

In accordance with the norms dictated by the Superintendency of Banks and Financial Institutions, from November 9, 2001 onward, all checks will have the same one-day bank retention rate.

Means of Paying High Sums

The Central Bank is developing a program to develop the payment system in Chile, within which is contemplated a business model for inter-bank payments of high sums in the national currency. The program is being developed to reduce liquidity risk, creating a system for real time high sum payments, which would bring, in practice, a use of guarantees for the functioning of a system of payments.

The introduction of an inter-bank system of payments of high sums modifies the existing inter-bank market that already separates in a clear manner the inter-bank overnight market from the intra-day market.

Interest Payment in Checking Accounts

Banks have been authorized, but not obligated, to pay interest on checking accounts, and permitted to differentiate between rates paid on accounts of individuals and legal entities.

CHINA

Regulatory Developments in the Banking Industry

On July 4, 2001, the People's Bank of China (PBOC), China's central bank, issued a provisional regulation on commercial banks' intermediary businesses. The 29-article regulation clarifies that, with the central bank's ratification, commercial banks can engage in such businesses as financial derivatives and investment banking.

On July 9, 2001, PBOC launched a provisional method for regulating on-line banking. Under the new method, domestic commercial banks, joint-venture banks, foreign-funded banks and branches of foreign banks must apply to the PBOC headquarters before opening on-line banking businesses, while city commercial banks need to be approved by local branches of the PBOC. Banks conducting on-line business must abide by State laws and regulations, and should have adequate security measures.

On August 20, 2001, PBOC issued guidelines for the operations of overseas branches of Chinese commercial banks. The guidelines state that all commercial banks must apply to the PBOC before they set up or purchase overseas branches, upgrade them or make other changes such as adding or reducing capital or operating funds and adjusting their equity structure. According to the guidelines, commercial banks are required to build up internal control systems concerning the management of overseas branches, and upgrade the systems in accordance with changes in supervision regulations and the growth of their own operations. In addition, commercial banks must strengthen the management of overseas branches, improve reporting systems, strictly punish acts in excess of authority, and guarantee that all services of overseas branches be authorized. The guidelines state that commercial banks, together with overseas branches, must build up risk-management systems to ensure the security of parent banks by supervising, evaluating and managing effectively all risks, including credit risks, market risks, liquidity risks and operating risks of overseas branches.

On December 29, 2001, China's State Council issued a new set of governing regulations for overseas financial institutions. The regulations provide systematic explanations and requirements regarding the registration, business scope, supervision, liquidation and liabilities for overseas financial institutions. According to the regulations, solely-funded foreign banks, branches of foreign banks, and jointly funded banks will be entitled to engage in a variety of businesses approved by the People's Bank of China. The regulations also designate the detailed requirements for overseas financial institutions that want to run RMB businesses in China.

On May 21, 2002, PBOC published provisional regulations for the release of commercial bank information. Under the provisional measures, the information banks are required to release includes financial accounting reports, various risk management conditions, corporate governance information and major events within the fiscal year. The measures stress that commercial banks must ensure that information is genuine, accurate, complete and comparable. The annual financial accounting report must be audited by licensed accounting firms. Commercial banks should release related information in their annual reports before the end of April every year. The measures are applicable to all commercial banks operating in China, including foreign banks.

To date, PBOC has given licenses to four foreign banks to conduct RMB currency business with foreign firms and individuals in Tianjin, in line with its WTO commitments. The four foreign banks are Japan's UFJ Bank, Korea Exchange Bank, Chohung Bank and Industrial Bank of Korea.

Regulatory Developments in the Securities Industry

On March 12, 2002, a revised Foreign Investment Industrial Guidance Catalogue was released by the State Development Planning Commission, the State Economic and Trade Commission and the Ministry of Foreign Trade and Economic Cooperation. Under the guidance catalogue, foreign securities companies are listed under the category of industries with restriction on foreign investment. Foreign investment in securities companies will be allowed no later than December 11, 2004 and the foreign stake will account for up one-third. Foreign capital can take a stake of up to 33 percent in securities investment management companies and up to 49 percent no later than December 11, 2004.

China Securities Regulatory Commission (CSRC) has finalized the disclosure rule for foreign companies seeking to list their China operations on the mainland bourses. Aside from the regular corporate information, foreign companies must disclose risks involved in their overseas raw material procurement process, technology transfer, and possible changes in preferential tax policies in China. The listing candidates must also provide information regarding their transactions with their parent company over the past three years.

Regulatory Developments in the Insurance Industry

On December 23, 2001, China's State Council issued Regulations for the management of overseas-funded insurance companies. The regulations came into effect on February 1, 2002. According to the regulations, all overseas-funded companies should seek the approval of the China Insurance Regulatory Commission before their being established in China. The overseas insurance companies are allowed to deal in property, liability, credit, personal, life, health and accident insurance. The regulations are applicable to overseas-funded insurance agencies that are set up in Hong Kong, Macao and Taiwan.

Future Development

Five years after China enters the World Trade Organization (WTO), overseas-funded banks in China will receive the same treatment as Chinese domestic banks, according to Dai Xianglong, governor of the People's Bank of China, who made the announcement on September 19, 2001 at the Sixth World Chinese Entrepreneurs Convention. In the year of China's entry into the WTO, overseas-funded banks in China will be permitted to handle business services of foreign currencies for Chinese enterprises and individuals. In two years, they will be allowed to deal with RMB business for Chinese enterprise. In five years, the banks will be able to carry out RMB business for Chinese individuals.

CZECH REPUBLIC

The following amendments and completely new laws affecting the banking sector were adopted during the period under review:

- "Harmonization amendment" to the Law on Banks (No.126/2002 Coll., effective from May 1, 2002).
- Amendment to the Law on the Czech National Bank (No. 127/2002 Coll., effective from May 1, 2002).
- Amendment to the Foreign Exchange Act (No. 482/2001 Coll., effective from January 1, 2002).
- Law on credit transfers, electronic payment instruments and payment systems (Nos. 124 and 125/2002 Coll., effective from January 1, 2003).
- Law on some conditions of consumer credit (No. 321/2001 Coll., effective from January 1, 2002).

The amendment to the Law on Banks is of key importance. The amendment does not alter the existing essential regulatory framework for banking - i.e. the regulatory and supervisory role of the central bank, the concept of universal banks, the conditions for establishing banks or branches of foreign banks, ownership and control rules, principles of due diligence and prudence in banks etc. The harmonization amendment provides, however, for the following:

- Full adjustment to the principles of the EU banking directives: <u>single banking licence, freedom of establishment, freedom to provide services, home country supervision</u>; the entry into force of these provisions is postponed to the day of full membership of the Czech Republic in the EU.

- The principles of bank supervision on a consolidated basis.
- An enhancement of the deposit protection scheme, adjusting it fully to the EU requirements: both local currency and foreign currency deposits are equally protected; the compensation ceiling has been elevated to 25,000 euro; the obligatory contribution of banks to the deposit protection fund has been lowered from 0.3 percent to 0.1 percent of the annual average amount of protected deposits, starting with contributions for the year 2002, due in January, 2003; similarly, the contribution of home building saving banks was reduced from 0.1 percent to 0.05 percent; the state is fully excluded from the system; the branches of foreign banks may refer to their homeland deposit protection schemes, if these offer at least the same level of protection as the Czech system does.
- Partial alleviation of the constraints on personal interlocks among banks, foreign banks and financial institutions (under the condition that there is ownership-control relationship between institutions in question).

The Law on Banks also includes rules for liquidation of bearer savings books - which were the only remaining form of anonymous bank accounts. The possibility to open these savings accounts was abolished already by the Law No. 367/2000 Coll.(amendment to the Civil Code), in force from January 1, 2001. Now, Article III of the Law on banks determines the expiration date of bearer savings books on December 31, 2002.

Finally, the amendment to the Law on Banks establishes rules enabling the central credit registry of legal persons, administered by the Czech National Bank and a similar scheme for natural persons (Czech Credit Bureau), to start operations and the banks to participate.

The amendment to the Law on the Czech National Bank has also been motivated by fuller adjustment to the EU legislation on central banks and provides for a deeper autonomy of the central bank from other supreme bodies of the State. It recovers full autonomy of the Bank Board in approving the budget of the Czech National Bank, it reconfirms a full independence and responsibility of the Czech National Bank in fulfilment of its central objective - monetary stability (the CNB is not permitted to accept and/or request directives from the President, the Parliament, the Government or any other person in this respect). The amendment also includes several provisions, qualifying the Czech National Bank as a part of the European System of Central Banks in accordance with the respective EU Protocol, effective from the day of full accession of the Czech Republic to the EU.

The adoption of an essentially new Law on credit transfers, electronic payment instruments and payment systems responds to the requirements of the respective EU directives and recommendations. It introduces minimum conditions, sanctioned by the law, as to the maximum time needed for transfer, responsibility of the institution, carrying out the transfer, for the delayed and/or failed transfer etc. Entry into force of the law is envisaged from January 1, 2003. A further law providing for an institutional framework required by the EU rules, - i.e. establishing an authority for the settlement of disputes between the payment originator and institution, carrying out transfer between the payment beneficiary and the institution (labelled Law on financial arbiter) - is still in the hands of the Parliament.

The Law on some conditions of consumer credit adjusted legal rules to the requirements of the respective EU directive in accordance with consumer protection. The provisions of this law apply to consumer credit from 5,000 to 800,000 Czech koruna (approx. 166 euro to 26,000 euro) and include minimum standard conditions of a consumer-credit contract, transparency rules on the cost (interest) of consumer credit, supervisory authority etc.

Some significant novelties in the legal framework of the banking sector have been introduced by amendments to the Civil Code and by laws, other than those in the sphere of financial legislation.

Thus, a centralized registry of pledged chattels has been introduced by an amendment to the Civil Code No. 367/2000 Coll. and by a further amendment No. 317/2001 Coll., starting from January 1, 2002. The scheme is operated by the Chamber of Notaries.
The Law on Court Executors (Executory Order), effective from May 1, 2001 together with the amendments to the Bankruptcy and Settlements Act and with the Law on Out-of-Court Seizures should enhance the creditor position in the process of realization of pledges. The legal provisions concerning pledges were transferred from the Commercial Code to the Civil Code, as a part of a wider concept to strengthen the role and the scope of the Civil Code as a dominant legal norm, marginally supplemented by the Commercial Code, governing the business relations between primarily legal persons.

Several other drafts, concerning the financial sphere, are either still in the hands of the Government and being debated or are pending approval by Parliament. In addition to the Law on financial arbiter, needed for a full fledged application of the legal regime of credit transfers etc., these relate mostly to the capital market sphere. Still in the process of preparation is a fundamental amendment to the Securities Act, Act on Securities Commission and a Draft Bill on Capital Market Undertakings. The most intensively discussed issues are those concerning the protection of client assets held by securities traders (brokers) – the so-called Guarantee Fund, the powers of the Securities Commission, dual supervision over banks that are engaged in securities trading (by the central bank for general banking activities and by the Securities Commission for activities related to the capital market), control responsibilities over securities traders imposed on banks performing depository duties, etc. These circumstances obviously contributed to the revival of former efforts to outline and submit an umbrella law on financial activities.

A so called Euro-amendment to the Commercial Code - also in the process of drafting - introduces the rule of the Directive 2000/35/ EC on sanctions against delayed payments in business transactions.

The "harmonization amendment" to the Law on Banks introduced a completely new Chapter 8, concerning supervision by the central bank on consolidated basis. In the wording of the law this means monitoring and regulation of risk in consolidated entities, a component of which is a bank, with an objective to reduce risk for the bank. The essential principles and rules, stipulated in the Law, include the following:

- Consolidated supervision does not replace bank supervision under the Law on Banks or the supervision of financial institution under provisions of a separate law.

- The central bank performs supervision on a consolidated basis in co-operation with the bodies responsible for supervision over financial institutions in the Czech Republic and with the bodies responsible for supervision over banks and financial institutions in foreign countries, and is entitled to exchange information with these bodies; this principle applies to non-domestic financial groups as well.
- Persons in control of consolidated entities are subject to prudential rules.

DENMARK

Financial Reporting by Banks

On January 1, 2002 the new Danish Financial Statement Act took effect. The Act is a major revision of the previous Danish Company Accounts Act. For instance, future financial statements will to a greater extent be valued-based (fair value reporting) rather than transaction-based. Financial reporting by banks is not governed by this Act, but by the new Act on Financial Undertakings, which provides the overall framework for financial reporting. There are substantial similarities between the two Acts.

Payment Cards

In the past year, the financial sector has retained its strong focus on the payment card area. Following an amendment to the Danish Payment Cards Act in 1999, Danish banks have been striving to comply with the four requirements laid down by the Danish government for repealing section 14 of the Payment Cards Act, which prohibits the collection of fees from retailers receiving card payments. The provision was designed to protect consumers who wanted to pay cash in the shops. Legislators were concerned that retailers would pass on the expenses associated with cardholders' use of payment cards to cash-paying customers in the form of higher retail prices.

The sector has been working to satisfy the requirements by the Competition Authority. It is now up to the government to make a final decision on repeal of Section 14.

Consumer Legislation

On September 14, 2001, the Danish Consumer Council and the Danish Bankers Association (DBA) adopted a common position on personal guarantees. The issue of protection of personal guarantors has been discussed by the Danish Consumer Council and the DBA for some time.

The basic intention of the elements contained in the agreement between the Consumer Council and the DBA is to ensure that guarantors are thoroughly informed of the meaning of the guarantee commitment and its possible implications for their personal finances. The agreement embraces elements, which the DBA has recommended that its members should follow for contracts of guarantee made from and including January 1, 2002.

In October 2001, the DBA launched a new electronic search system for rulings by the Financial Services Complaints Board. The system is made available to the public free of charge on the website www.finansnettet.dk The search system contains all rulings by the Financial Services Complaints Board – currently 5000, since its formation in 1998.

Money Laundering and Combating Terrorism

On May 31, 2002 the Parliament adopted a Bill amending the Money Laundering Act with regard to implementing the EU-Council Directive of December 4, 2001 on Money Laundering amending Directive 91/308, the UN Convention of December 9, 1999 against financing of terrorism and the Security Council Resolution no 1373 of September 28, 2001 on combating terrorism.

Consolidated Supervision

Bank groups are subject to consolidated supervision. Where a bank or another credit institution is the parent company, consolidation of the parent and its subsidiaries is prescribed according to the EU-directive 1992/30/EC on the supervision of credit institutions on a consolidated basis. In this case, the consolidation includes all the credit institutions and financial institutions.

Insurance companies and their subsidiaries and undertakings are not included in the consolidation for technical reasons.

Where the parent of the bank is a financial holding company, the consolidation of the bank group is extended to include the parent. In addition, the financial holding company is considered as being a bank and accordingly it has to comply with the capital adequacy and solvency rules of banks.

The parent company is responsible for drawing up the consolidated accounts of the whole group. Within a consolidated group, capital requirements, solvency ratios and large exposure limits are applied not only by the member of the group that is a bank, but also to the group as a whole.

The consolidation provisions are only applicable to bank groups subject to Danish legislation. If the parent company is located abroad only the subgroup is encompassed by the consolidation provisions.

Financial groups are supervised by one single authority, The Danish Financial Supervisory Authority, which is responsible for the supervision of all financial undertakings subject to supervision, i.e. banks, mortgage banks and insurance undertakings etc.

EGYPT

Due to the strong relationship between the Egyptian and the global economy, the impact of September 11th adversely affected the exchange rate as well as the balance of payments in Egypt.

During the period under review, there were also several financial and monetary developments as the government continued its tight financial policy aimed at overcoming inflation and budget deficits in view of the economic reform program and realizing financial and monetary stability, mainly through the following:

- Signing an agreement of partnership with the European Union to push forward the economic and technological cooperation between Egypt and the European Union.

- Issuing sovereign Eurodollar bonds in the international market in an amount of US$ 1.5 billion to give the private sector the opportunity to obtain foreign currency based on benchmark.

- Introducing a 25 percent to 50 percent cut in foreign currency purchases of ministries and government organizations up to the end of 2001, with a view to alleviating the demand on foreign currency.

- At the latest Donor Countries Conference, held in Sharm El Sheikh with the participation of the IMF and World Bank Donors, it was decided to provide Egypt with the sum of US$ 10.3 billion over the coming 3 years. The Egyptian government decided to disburse US$ 2 billion this year to face the effects of September 11th events on the Egyptian economy.

- Limiting the government's initiation of new projects, pending the completion of the existing ones, together with granting the private sector a greater role in the development process during the coming period.

- Setting the necessary controls on B.O.T. projects and future gas agreements to maintain the balance of foreign currency, particularly in the current conditions.

- Issuing an employment program, which offers 800,000 job opportunities to new graduates.

- Issuing a new mechanism to organize the foreign exchange operations to be more realistic in view of the economic liberalization process. This mechanism includes devaluation of the Egyptian pound against the US dollar by 30 percent to give a competitive advantage to the Egyptian exports in the international markets, encourage foreign investments and reduce imports.

- The Egyptian stock exchange witnessed significant amendments of the executive regulations of Capital Market Law to facilitate share swaps according to certain rules.

The government also proceeded with its conservative monetary expansion policy by the following:

- Adopting a national program to modernize the Egyptian industry.

- Applying the second and third stages of the sales tax to fully define tax community and increase tax revenues.

- Preparing the draft of the new income tax law to impose fair taxes and alleviate burdens on low-income brackets.

- Transforming the supervision on the National Investment Bank to the Ministry of Finance.

- Abolishing subordination of the Central Bank of Egypt to the Ministry of Economy to enable the CBE implement the monetary policy and its relative duties.

- New customs tariffs were imposed on imported clothes to protect the national industry.

The CBE exerted efforts to activate the market through the following:

- Offering soft loans to the low-income sectors to purchase Egyptian products.

- Issuing the Real Estate Mortgage Law and its executive regulations to confront the housing problem and activate the real estate market.

- The draft of "Anti-Money Laundering" law is ready and about to be approved by the parliament.

- Establishing a national system to control credit cards and their risks.

- Taking the necessary steps to establish a fully automated Clearing House system.

- Issuing a number of fundamental decisions and amendments relating to liquidity ratios and the monetary reserve deposited, in addition to reducing the discount rate to overcome recession, monopoly and shortage of liquidity.

- New euro saving pools were issued by Egyptian banks in order to enhance the demand on said currency in the future.
- Applying a new system for transferring funds, based on SWIFT, with the aim of ensuring banks' immediate access to their balances either with CBE or other banks.

On another front, the executive regulations of the insurance Supervision Law were also amended in order to control insurance activities in view of foreign competition.

EUROPEAN UNION

The period from July 2001 to June 2002 saw the successful introduction of the euro in fiduciary form in the twelve countries of the EMU. The preparations for the distribution of the new notes and coins constituted a major activity for the Federation. The smooth success of the process was to a large degree the result of the enormous efforts of the European banks. The period also saw the continued development of the Single Market in financial services, with notable developments such as the establishment of a new more flexible legislative framework for the financial markets following the proposals of Baron Lamfalussy.

Economic and Monetary Union

To support the preparations for the introduction of euro notes and coins the Federation issued a series of practical recommendations to help the banks. These related to the conversion of customer and nostro accounts into euro; to the processing of cross-border checks in legacy currency; to the processing of travellers checks and finally to communication with customers with regard to the cross-border checks in euro.

Review of the Basel Capital Accord

The European Banking Federation has from the start of the process strongly supported the general framework and evolutionary structure of the proposed new Accord. The Federation has presented the opinion of the European banking industry to the Basel Committee and welcomes the open and transparent approach adopted by the Basel Committee.

The Federation therefore welcomed the Basel Committee announcement, on December 13, 2001, that an additional review to assess the overall impact of the proposals on the banks and banking system would take place before releasing its third consultation document. The Basel Committee acknowledged that there had to be a balance between risk-sensitivity and flexibility to allow the Accord to be effectively implemented. Moreover, the impact of the proposal on small and medium sized enterprises, which is a major concern for the European banking sector, had to be considered. Finally, the Basel Committee decided to run a final calibration study to be completed prior to the release of the final consultation document. This third Qualitative Impact Study will not be released to the banks before October 1, 2002, therefore, the initial timing of the final consultation document, initially early 2002, has had to be put back towards the early summer of 2003. This will make the EU legislative timetable extremely tight if the 2006 deadline for implementation is to be met in all EU Members States.

European Union Proposal for a Directive on the Supplementary Supervision of Financial Conglomerates

In April 2001 the Commission had published a proposal for a Directive on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate. The proposal aims at establishing common prudential standards for the supervision of financial conglomerates.

The Federation published a position paper on October 3, 2001, the core elements of which are as follows:

- Only groups that might reasonably be deemed a threat to financial stability should fall under the scope of application of the proposed Directive.

- Effective supplementary supervision of regulated entities in a financial conglomerate can be best achieved by setting qualitative organizational, control and reporting requirements.

- It should be mentioned explicitly that the coordinator is to ensure that duplication of reporting is avoided.

- The timing of the proposed Directive is inappropriate as far as the introduction of new capital adequacy requirements for financial conglomerates is concerned. This is so given the current revision of the Basel Capital Accord.

- The proposed quantitative measures are not justified from a prudential viewpoint. In particular, the envisaged deduction of bank's equity holdings in insurance undertakings is questionable given the lack of any significant positive correlation between banking and insurance risks.

- In any case, the choice of the method to calculate the solvency position at the level of the financial conglomerate should rest with the financial conglomerate and not with the supervisors.

The co-decision process entered into its final stage with the Council reaching a political agreement on May 7, 2002 and a second reading in the European Parliament being scheduled in September 2002.

Establishment of the Lamfalussy Framework

The European Banking Federation participated in a joint industry meeting with the Commission and the Committee of European Securities Regulators (CESR), set up under the Lamfalussy framework, to discuss the subject of consultation and transparency under the new framework. The statement on consultation practices published by CESR in December 2001 endorses the principles put forward by the Federation. The FBE publicly welcomed the conclusion of an inter-institutional agreement on the Lamfalussy framework (pursuant to the Parliament vote in February 2002).In March, CESR launched its "pre-consultation" for an implementing measure on the Market Abuse Directive and convened a panel of experts on the subject.

Consultation on the Revision of the ISD

Having launched the consultation on revision of the Investment Services Directive (ISD), at the start of 2001, an official hearing on the ISD consultation document was held by the European Commission on September 18-19, 2001, attended by the FBE. The FBE subsequently submitted a written response to the Commission's consultation document in November 2001.

Following the first consultation, the Commission issued a new document in March 2002, which incorporates, inter alia, the following changes supported by the Federation:

- Deletion of the "organized market" concept and no monopoly for regulated markets in instruments admitted to trading on those exchanges.
- A more flexible approach for alternative trading systems (ATSs), with regime limited to multilateral ATSs (as in the underlying CESR work).
- No unfair advantage for firms that provide independent investment advice over non-independent advisers.
- Deletion of the proposed quarterly justification of execution venues.
- Post-trade transparency requirements for off-market trades limited to equities.

The comments on this final round of consultation were due June 2002; the FBE submitted a response that called for a light regulatory regime for in-house matching.

The Federation has also been very active in other areas that will form a part of the new ISD regime, either in the Directive itself or in the form of "Level 2" legislation.

A key element of the ISD is the categorization of investors for the purpose of applying (old) article 11 of the ISD and the rules that will apply to retail and professional investors. The Federation was one of the associations that insisted that the two questions of investor protection rules and the categorization of investors were linked, and that the categorization question had therefore not yet been settled satisfactorily. The Federation proposed an alternative categorization to the European Commission and FESCO in July 2001. CESR decided to re-open this issue and launch a second round of consultation for the two papers together in October 2001.

The Federation attended the November hearing organized by CESR on this paper in Paris as a delegation, hosted by the French Banking Association. The final response was submitted in December 2001 to CESR and the Commission. CESR published the conduct of business rules paper in March 2002, but decided to continue its work on the categorization of investors until June 2002.

On the regime for ATSs, the predecessor of CESR, FESCO, had issued a consultation paper in the summer of 2001. The Federation sent its written response to this consultation paper in September 2001. A second consultation paper on the subject was issued in January 2002; the FBE sent its response in March 2002. The second consultation paper incorporates the main idea supported by the Federation - a narrower definition of ATSs limited to multilateral systems.

European Union Proposal for a Directive on Market Abuse

In September 2001, the Federation sent a written position paper to the Commission in response to the proposal for a Directive on insider dealing and market. The European Parliament

First Reading was concluded on March 14, 2002; the Council reached political agreement on the proposal in the EcoFin Council of May 7, 2002.

Proposal for a Directive on Prospectuses

The proposal on prospectuses, along with the Market Abuse Directive, are seen as the first examples of a "Lamfalussy Directive". The Federation issued a position paper in October 2001. The Federation worked as part of a coalition on this Directive and was an active member of the industry delegations that met with the Commission, the Belgian Presidency, and the Parliament representatives. The Federation also attended the Parliament Hearing on Market Abuse/Prospectuses in mid-October 2001. Following the Parliament First Reading on March 14, 2002, which was responsive to many of the industry's concerns, the proposal is continuing to be discussed in the Council, with a possible political agreement in the fall of 2002.

Euribor and Eonia

Euribor and Eonia have become firmly established as the benchmarks for the euro-denominated interbank market.

The panel of contributing banks now consists of 49 banks due to merger activity and the discontinuation of the rotation systems.

The range of the Euribor quoted maturities was extended, with the successful introduction of the two- and three- week fixings on October 15, 2001.

Historic Euribor data has been posted on the Euribor website to help users and academics.

Eurepo

Since the introduction of the Euro, the European repo markets have developed significantly, with more and more emphasis on cross border financing trades. This has led to an increasingly homogenous Euro-denominated General Collateral (GC) market so that the market is now ready for a representative benchmark.

Consequently, the Federation and the European Repo Council have decided to come together and, in co-operation with the other European credit sector associations representing the savings and the co-operative banks, to create Eurepo.

Eurepo is the rate at which one prime bank offers funds in Euro to another prime bank if, in exchange, the lending bank receives from the borrowing bank Eurepo GC, as defined in the agreement, as collateral.

A panel of 38 banks has been selected to contribute to the fixing of Eurepo. All panel banks are active in cross border Eurepo GC repo trading and/or represent a particular market segment in the Eurepo GC repo market.

Eurepo was launched on Monday, March 4, 2002, following a rigorous testing program carried out by Moneyline Telerate, the screen service provider. Eurepo is the successor rate to the British Bankers' Association euro repo benchmark. More information is available on www.eurepo.org.

Retail Cross-Border Payment in Euro

A Regulation proposed by the Commission, was adopted by the Council and the European Parliament, which aims, by force of law, to fix prices for cross-border payments in euro at the same level as those applied to corresponding domestic transactions in Member States. However the strong lobbying of the Federation and the member associations has borne some positive results, and has reduced the damage. If the text adopted by the Council is compared with the one originally proposed by the Commission on July 25, 2001, important changes can be observed as follows:

- The entry into force of the regulation is delayed by 6 months both for electronic payments (January 1, 2002 to July 1, 2002) and credit transfers (January 1, 2003 to July 1, 2003).
- The maximum amount of the payments falling under the Regulation is reduced from 50,000 to 12,500 euros. Starting January 1, 2006 (instead of January 1, 2004), the maximum amount will be raised to 50,000 euros.
- Paper checks are excluded from the scope of the Regulation, at least for what concerns charges.
- The Regulation does not affect the possibility for institutions to offer an all-inclusive fee for different payment services, provided that this does not discriminate between cross-border and national payments.
- If the customer does not provide full STP information (IBAN+BIC), additional charges may be levied on him by the institution.

A Blueprint for a Single Euro Payment Area

Obviously, a price regulation adopted by the EU cannot solve the real issues that make cross-border transfers expensive. These issues include the need for a new European cross-border payments infrastructure and the development of automated payments. This is the subject of a document called "Blueprint towards a single euro payment area", which has been approved by the Board and the Executive Committee of the FBE. The ultimate objective of the Blueprint is to outline the measures necessary to establish a single euro payments area, over the coming 5 to 7 years, to the benefit of banks and their customers.

The implementation of the actions identified in the Blueprint are distributed over the short, medium and longer terms. In the short-term plan, several important actions were promoted by the Federation during 2001:

- Europe-wide implementation of standards and best practices to increase STP (Straight-through processing) rates e.g. through the issuance of "Guidance on IBAN + BIC implementation and MT 103 Best Practices".

- Definition of a "Eurocred" standard, as a standard for the efficient and low-cost processing of euro retail cross-border credit transfers.

Environmental Liability

The European Commission presented in January 2002 a proposal for a Directive on environmental liability with regard to the prevention and remedying of environmental damage.

The proposal aims to establish a framework whereby environmental damage would be prevented or remedied. The principle, according to which the polluter should pay, is at the root of Community environmental policy. The drafting of this Commission proposal to finally see this principle securely applied in the EU under strict legal conditions has been a long time in the making and dates back to the 1993 Green Paper on Environmental Liability, Parliamentary resolutions and the 2000 White Paper on Environmental Liability.

On the occasion of the publication of this new proposal, the Federation reiterated the concerns of the banking sector. In managing their own business, European banks are still conscious of the needs of the communities and the environment in which they operate. They also wish to be able to continue to provide finance for environmentally beneficial projects.

The greatest concern for banks still relates to lender liability and legal certainty. It is essential that the chain of liability is clearly understood and a workable framework of safeguards put in place. Without this, ability of lenders to provide funding in certain sectors, where risks are perceived to be high, could inevitably be compromised. In any case, banks take their share of responsibility as they conduct their own risk assessment. However, they should not bear the responsibility that actually falls under the operator's obligations.

In the proposed legal framework, the definition of a key concept, "operator", as "any person who directs the operation of an activity covered by the Directive including the holder of a permit or authorisation for such an activity and/or the person registering or notifying such an activity " is welcome. Such a definition as well as the deletion of any reference to a legal person controlling the activity is a positive step to ensure legal certainty. Specific concern such as joint and several liability has also been raised: in any situation where a bank could be held jointly and severally liable, there will always be the temptation to go after the bank on the "deep pocket" principle.

Generally speaking, the Federation welcomes the initiatives of the Commission in that field, which are positive and necessary and is keen to positively contribute to the current work made for the adoption of a Directive on environmental liability in the course of 2002.

Revision of the FATF 40 Recommendations

After preliminary debates in 2001, the FATF published on 30 May 2002 a consultation paper, whose aim is to provide a broad review of the FATF 40 Recommendations.

The contents of the paper can roughly be divided into the following areas:

- "Know your customer" (KYC) rules;
- customer due diligence;
- suspicious transaction reporting;
- supervision;
- regulation of corporate vehicles (including rules on bearer shares and other bearer instruments); and
- the inclusion of non-financial professions under the scope of the 40 Recommendations.

An FBE ad-hoc Working Group met on 24 June 2002 in order to draft some preliminary comments which must be addressed to the FATF in August 2002.

Competition

In September 2000 the Commission issued a proposal on the implementation of the rules on competition laid down in Articles 81 and 82, which set out the EU competition rules applicable to restrictive practices between business and abuses of dominant positions committed by them.

The Commission proposed to create a new enforcement system referred to as a "directly applicable exception system". In such a system, both the prohibition rules set out in Article 81(1) and the exception rules contained in Article 81(3) can be directly applied by not only the Commission but also national courts and national competition authorities. This implies, among other things, increased powers of investigation of the Commission and the setting-up of strengthened co-operation mechanisms among courts, national competition authorities and the Commission.

As a matter of principle, the Federation reiterated its reservations about the proposed switchover from a notification system to a directly applicable exception system. Although the notification system places a significant administrative burden on undertakings, the transition to a directly applicable exception system will entail considerable legal uncertainty, particularly as the responsibility –in some cases complex- for the assessment of whether certain practices are compatible with competition law will rest solely on the undertakings themselves.

Notwithstanding this strong reservation and the massive support from the MEPs for the proposed system, the Federation welcomed the amendments adopted by the Parliament, which improved the Commission reform and ensure a more workable and effective competition regime in Europe. The Parliament declined the Commission proposal in favor of a registration system for types of agreements which are not covered by block exemptions. Some other amendments were welcomed which seek to introduce an element of harmonisation as far as the fines are concerned and a clearer definition of public interest. The Federation also supported the one which aims to limit the right to interview staff in an investigation of representatives in order not to jeopardise the individual's position in the company.

In September 2001 the European Parliament voted in favour of the Commission proposal. In the aftermath of the vote, the Council held a debate on major points of the proposal for a Regulation and the Barcelona European Council of 15 and 16 March 2002 gave absolute priority to proceedings on this issue and called on the Council to adopt the new legislative framework by the end of 2002.

Proposal for a Directive on Financial Collateral Arrangements

A political agreement on the proposal aiming at harmonising the legal framework for collateral was reached in December 2001. The Federation has carried out very active lobbying in order to have such a political agreement in place. Several joint efforts were made together with ISDA. One particular issue of concern related to the scope of the Directive: the Federation pleaded for the inclusion of all corporates, including non-financial corporates in order to give the Directive maximum boost to EU financial markets.

Second Directive on Money Laundering

The Second Directive on Money Laundering (amending the first Directive of 1991) was adopted on December 4, 2001. It contains a wide extension of the offences covered by the Directive (including minor ones). In view of the very sensitive political context following the September 11 attacks, it became more and more difficult to convince the authorities that a too wide extension of the definition of "money laundering" could lead to a large increase of notifications of suspicious transactions and therefore could render the preventive fight against money laundering less efficient.

Concerning identification at a distance, the Federation successfully sought some flexibility for banks concerning the choice of the best methods of identification.

Fight Against Financing of Terrorism

In the aftermath of the 11th of September, the European Union agreed on an Action Plan to combat terrorism. The measures and initiatives taken at EU level focus on a few areas where they can provide added value over and above what each Member State is doing:

- police and judicial co-operation;
- bilateral relations with third countries and regions;
- air transport security;
- economic and financial measures.

In the field of financial sanctions, the key aim of the European Union is to dry up the sources of terrorist funding. The 19 October 2001 European Council in Ghent reiterated the importance of effective measures to combat the funding of terrorism by final adoption of the Directive on money laundering and by calling the swift ratification by all Member States of the United Nations Convention for the Suppression of the Financing of Terrorism.

All along the legislative process, the European banking industry has closely co-operated with the EU authorities in implementing embargo regulations and improving their contents in order to make them workable and applicable by banks. A few major concerns have been raised by the European banking sector in this respect:

- the promotion of proportionate requirements;
- the accommodation of financial sanctions against black-listed persons to the needs of banking practice (possibility to debit and credit their accounts);
- the need to exempt banks and banks' staff from liability in such cases;
- the need for a clear list of reference of targeted people (the principle of a common list should be encouraged at EU and international levels);
- the promotion of an electronic "black list" which would enable banks to implement financial sanctions much more rapidly and efficiently;
- the need for better identifiable entries in the lists of sanctioned persons and organisations which are in circulation: the information concerning targeted persons and embargoed organisations should be as complete as possible.

The Federation published some Recommendations on Drafting, Interpreting and Implementing the Financial Sanctions Regulations in January 2002.

Taxation of Savings

At the ECOFIN Council meeting in November 2000, the 15 Finance Ministers reached an agreement on the substantial content of a Directive. Accordingly, the Commission adopted, in July 2001, a new proposal for a Directive.

At its meeting of December 13, 2001, the ECOFIN Council stated that the proposed text of the Directive represented the provisions necessary for the negotiations with key third countries in 2002. When the Member States would have ascertained the "reassurances" included in the Feira agreement regarding the adoption of "equivalent measures" by key third countries and "the same measures" by dependant or associated territories, the Council, voting unanimously, will decide, on the basis of a report presenting the results of negotiations, on a final text of the Directive, by December 31, 2002 at the very latest.

As from the start, the Federation has stressed, in its representations, the fundamental need to preserve the competitiveness of European financial markets. This primarily requires the administrative burden on paying agents of the EU to be as light as possible. Secondly, a level playing field must be reached inside and outside the EU. Before the adoption of a proposal for a Directive, the Federation had submitted its observations to the Commission. During the Belgian Presidency, the Federation met representatives of the Council and the Commission and submitted two position papers.

VAT and E-Commerce

In its representations vis-à-vis the OECD, the Federation reiterated its concerns about a customer authentication process, for VAT purposes, that would be based on specific payment methods. This would result in the tax chargeable event depending on whether these specific means of payment are used. Such a solution would undermine the neutrality required between digital and tangible goods and would influence customers in their choice of the payment method. In addition, the question was raised as to whether the administrative burden on banks would remain reasonable from a competitive perspective. In addition, the introduction of a customer identification method should not compromise the security and the integrity of payment systems. Moreover, the Federation stressed its concerns of privacy and confidentiality in the eventuality of a disclosure by banks to private third parties of details concerning their customers.

Therefore, the Federation welcomed the report on consumption tax aspects of electronic commerce, which was released in February 2001 by the OECD Working Party No. 9 and expressed the view that there was no immediate, comprehensive answer to the question of B-to-C jurisdictional verifications and that further study was necessary to examine technological and non-technological options. The Federation advocated in particular the option to rely on the address usually given by the customer to the supplier at the time an order is placed. Nonetheless, the Federation was concerned with the Working Party's statement that "less than perfect" options, including credit card indicia, could suffice in the interim.

EFRAG

The European Union has expressed its preference for International Accounting Standards (IAS) as the set of standards for EU listed companies. All interested parties in Europe therefore agree that the EU should invest more efforts to influence International Accounting Standards. The creation a "European Financial Reporting Advisory Group" (EFRAG) which would endeavour to reach common European views on topics discussed within International Accounting Standards Committee (IASC) and produce technical and conceptual papers supporting these views was therefore unanimously welcomed. EFRAG will also advise on the technical assessment of the IASB standards and interpretations for application in Europe. EFRAG consists of standard setters and representatives from the industry. The Federation was among the co-founders of EFRAG and is represented within the EFRAG structures.

The intention would be for EFRAG to play an important role in the European accounting standard setting process because it would be the only forum within which European technical views would be co-ordinated. To organize the endorsement of International Accounting Standards on a political level, the EU plans to set up an "Accounting Regulatory Committee" which would be composed of experts appointed by Member States and be under an obligation to deliver its opinion within a one-month timeframe. If the Committee does not agree with the view taken by EFRAG, it will be up to the EU Council of Ministers to decide.

Distance Marketing of Financial Services

The European Union agreed a Directive for the distance marketing to consumers of financial services which lays down common rules for selling financial products to consumers by phone, fax or internet.

Its main features are:

- The prohibition of abusive marketing practices seeking to oblige consumers to buy a service which they have not solicited.

- Rules to restrict other practices such as unsolicited phone calls and e-mails.
- An obligation to provide consumers with comprehensive information before a contract is concluded.
- A consumer right to withdraw from the contract during a cool-off period – except in cases where there is a risk of price fluctuations in the financial market.

The Directive will come into force two years after its publication.

Green Paper on Consumer Protection

The Green Paper focuses in fact exclusively on fair trading practices, addressing the key issues of consumer protection. It aims at stimulating a wide debate on options to improve the functioning of the business-to-consumer (B2C) Internal Market.

The Paper sets out new strategic options for the future development of EU regulation on B2C commercial practices:

- the strategy which has been adopted until now and which consists, more particularly, in pursuing harmonisation across the EU by means of a series of Directives addressing specific issues;

- a new strategy based on complementing specific legislative measures with a framework Directive covering B2C commercial practices.

The proposed new strategy would rely to a certain extent on the willingness of business and trade associations to agree on EU wide self-regulation.

The paper also seeks views on priority areas for harmonisation and on the various options for a possible framework Directive. In addition, it equally sets out options for ensuring and improving enforcement of consumer protection rules.

A Follow-up Communication to the Green Paper demonstrates the Commission's determination to develop a proposal for a framework Directive.

FINLAND

Developments in the Finnish Financial Markets

During the period under review, the Finnish economy was already in a low-growth mode prior to September 11th because the TMT (telecommunications, media and technology) sector was not as buoyant as earlier. However, the unemployment rate continued to fall steadily and the household sector held up well. The high consumer confidence and continued growth in a few major cities implied that housing loans were and still are steadily growing.

Due to the dismal development of the stock market during September and October there was a portfolio shift towards deposits and fixed income funds. From the beginning of this year, stock investments picked up again with rising stock prices. However, this development was short-lived and following international trends the stock market has performed poorly. In the longer term, changes in household savings opportunities and investment behavior provide a foundation for long- term savings growth.

Anti-Money Laundering Developments

EU financial sanctions regulations are applicable directly in Finnish law. In February, the Government issued a proposal to adopt the UN International Convention for the Suppression of the Financing of Terrorism. Furthermore, the Ministry of Interior has issued new and more stringent regulations on the identification, due diligence and reporting of transactions that relate to states which do not fulfill international requirements for the prevention of money laundering.

Other ongoing legislation includes a government proposal amending the Credit Institute Act. The proposal includes the notion of basic banking services (HE 33/2002). If approved as proposed, it could have a negative effect on anti- money laundering efforts. According to the proposal, a banking account should be made available to any customer regardless of nationality or whether the customer is a private person or a legal entity. A bank can refuse to open an account only for specific reasons, such as if it has serious reason to expect fraudulent behavior or if it can not properly identify the customer. Since new companies with clean records can easily be set up, it is very hard to refuse to open an account even if fraud is suspected. If opening an account is to be denied, the reason must be given to the customer. This is in contradiction of current anti- money laundering legislation, according to which suspicion of money laundering should not be told to customer. The Finnish Bankers' Association is strongly opposed to the proposal, and The National Bureau of Investigations, The Financial Supervision Authority, among others, have expressed their concern.

Consolidated Supervision

Domestic financial groups (groups consisting mainly of credit institutions, investment firms and other financial institutions) are subject to consolidated supervision, which is based on requirements defined in the existing EU banking directives. In addition, separate supervision requirements under legislation that came into force in February 2002 are applied to financial conglomerates (groups consisting of both financial and insurance activities).

Non-domestic financial groups are, in principle, subject to consolidated supervision to the same extent as domestic financial groups. Reporting requirements and supervisory powers are in these cases focused on the Finnish parent company. The Financial Supervision Authority may on a case-by-case basis exclude a foreign undertaking from consolidated supervision if it belongs to a group supervised by a foreign supervisory authority and corresponding solvency and other requirements are applied.

Market Structure Developments

Two brokerage firms and an insurance group have been recently granted a banking license. Additionally, a mortgage bank has applied for a banking license for its wholly-owned bank in order to collect deposits. There seems to be a general trend towards merging banking and life insurance business.

Conversely, two major banking groups operating in Finland have sold their respective non-life insurance companies, but continue to distribute non-life products through their bank network.

FRANCE

During the period under review, the French public authorities have for the most part been tackling the key issue of the euro changeover, which took effect on 1 January 2002.

Due to the hectic electoral calendar during the Spring of 2002 (presidential elections followed by the election of new National Assembly), there has been relatively little legislative and statutory activity. However, three main themes have been of particular interest to the French banking sector.

Changeover to the Euro

This period witnessed the implementation of the final raft of measures with respect to the euro changeover. These measures were effectively legal provisions in the form of Acts of Parliament (changing into euros the values of certain amounts given in French francs, manufacturing coins and notes, marking banknotes to be withdrawn from circulation with perforations, adaptation of cash dispensers etc.) and other changeover measures designed to make the switch from the franc to the euro as smooth as possible. They were implemented gradually, product by product, within each banking institution.

It should be pointed out that there was a piece of legislation (Act N° 2001-1168, dated December 11, 2001) that temporarily exonerated financial institutions from criminal responsibilities in terms of combating money laundering, to allow them to concentrate on converting francs into euros. In fact, by relaxing somewhat the legislation governing money laundering, banks were able to carry out millions of conversion transactions for their customers in a very short space of time and without any major hitches.

In fact, all measures to do with the changeover were implemented without any major difficulties, especially the loading of cash dispensers in the first few days in January. The general public took to the euro very quickly and was quite happy to say farewell to the Franc, thereby disarming the more hardened critics. It was a resounding and unprecedented success and the banks played no small part in making it work.

Combating Money Laundering and the Financing of Terrorism

Like all banks across the globe, French banks have been finding themselves confronted by wide-scale and far-reaching legislation aimed at combating money laundering activities and all forms of financing of terrorism.

This legislation, in force not just in France but also throughout Europe, consists in freezing the assets of persons or associations involved in terrorist activities. It is not always coherent either, and requires the deployment of huge amounts of resources, in terms of time, money and materials. (Just to illustrate the difficulties in implementing it, we need look no further than the European directive EC N° 467/2001, which was modified 9 times over the space of 12 months. It was finally repealed in May this year and replaced by the EC directive 881/2002, which was itself modified one week later.)

From a purely French perspective, the Law n° 2001-420 dated May 15, 2001, governing the New Economic Regulations has extended the scope for reporting suspect accounts. It also stipulates procedures for identifying customers whose transactions are suspect and sets out new obligations concerning market transactions. In addition to this piece of legislation, there is a ruling by the CRBF 2002-01 (the French Financial and Banking Regulations Committee) with respect to vigilance when processing checks. This ruling is set within the context of combating money laundering and financing of terrorism and compels financial institutions to be even more vigilant than before when handling and processing checks. It is based on three sets of measures:

- The level of diligence varies and is dependent on whether checks come from a Financial Action Task Force (FATF) member country (inspection by sampling), or from countries on the FATF blacklist (inspection of all checks), or countries belonging to neither of the above-mentioned categories (inspection of a minimum 25% of all checks).

- Developing inspection procedures with a view to detecting manifest material anomalies and for endorsement chains.

- Systematic conclusions of agreements between the relevant banks, stipulating, among other things, the duties and obligations of each party concerned.

Security Problems in Transporting Funds

In light of the extremely violent attacks on armoured vehicles used to transport funds (use of war weapons, causing the death of several security guards), the French public authorities have passed an Act of Parliament aimed at improving the safety of these transports. These measures are also forcing banks to make major alterations to the layout of their branches. These alterations must be finished by December 31, 2002.

The afore-mentioned alteration work, a costly exercise in itself, also involves carrying out alteration work on public highways. For this, planning permission by the public sector (notably from municipal councils) will have to be applied for, which will slow down considerably the decision-making process. Furthermore, the law has also examined the possibility of using other means of transporting money (the use of self-destructing carrying cases fitted with an electronic opening device, which would eliminate the need altogether for armoured vehicles and security guards). However, the public authorities do not currently favour these alternatives. It must be remembered, though, that security was high on the political agenda during the recent elections and public opinion remains particularly sensitive to the whole issue.

At the present time, half of all branches comply with the legislation mentioned above. If existing legislation is not revised, and if, above all else, the deadline for these alterations is not extended, banks will be forced to stop any cash transaction in a number of their branches as from January next year, so as to avoid the particularly harsh non-conformance penalties.

Cross-Border Payments within Europe

Most legislation governing the French banking sector has its origins in European directives. Among the latest, a test of strength can be discerned with respect to cross-border payments between the European Commission and European banks who stand accused of charging too much. This has culminated in the passing of EC n° 2560/2001 regulation, aimed at bringing costs charged for cross-border payments (transfers, credit card payments) down to the tariff charged at the national level.

Steps being taken by the European authorities are not taken in the furtherance of creating a single market. Moreover, they merely freeze the present disparities between the different member states. This will doubtlessly handicap French banking institutions that, for historical reasons, have never charged their customers for electronic transactions in France and that will find themselves obliged to extend this free service abroad.

GERMANY

Germany's banks successfully performed their key role in the changeover from deutschmark to euro banknotes and coins at the beginning of 2002. The European Commission has issued landmark rulings against anti-competitive state aid granted to Germany's public banks. Financial supervision, pension schemes, company law and securities trading law have seen important reforms, and the integration of stock exchanges and payment systems is making progress. The use of the Internet for online banking continues to increase as the security framework is further improved. Following the terrorist attacks of September 11, 2001, anti-money laundering legislation and financial sanctions have been toughened.

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 were put into circulation at the start of 2002. In Germany, the deutschmark was thus 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) entered into force, declaring the euro as the sole legal tender, while the Deutsche Bundesbank continued to 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 was not regulated by law, but, in accordance with the "joint declaration" of the banking industry and other relevant business sectors, was made possible in practice until February 28, 2002.

German legislators, the government, banks and firms thoroughly prepared the launch of the new euro currency. As a result, the exchange of deutschmark notes and coins for euros met with such a positive response from the general public that it was almost accomplished within the first two weeks of the two-month changeover period.

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

2001 saw a decisive breakthrough in the creation of a level playing field between private and public-sector banks. Up to now, German public-sector banks have benefited from state guarantees known as Anstaltslast and Gewährträgerhaftung. In December 1999, the European Banking Federation lodged a complaint with the European Commission concerning these state guarantees. Subsequently, on July 17, 2001, an understanding was reached between Brussels and Berlin on the future treatment of state guarantees for Landesbanks and savings banks. The cornerstone of the understanding is the abolishment of Gewährträgerhaftung and the replacement of Anstaltslast by a normal commercial owner relationship governed by market economy principles, like that between a private shareholder and a limited liability company. The state's unlimited liability, which has given these public-sector banks considerable rating advantages on the capital markets, will cease to apply. They will then be subject to the same insolvency risks as their competitors in the private sector. On February 28, 2002, the European Commission and the German government released their conclusions following the understanding, which spell out the elements which must be contained in revised savings bank and Landesbank laws.

Following the understanding on savings banks and Landesbanks, a similar agreement was reached on public-sector development banks on March 1, 2002. Under this agreement, Anstaltslast, Gewährträgerhaftung and/or refinancing guarantees may only be applied to certain promotional activities undertaken at the request of the state in specific, clearly-defined areas. Activities falling outside these areas must either be discontinued or spun off to legally independent companies without state support.

In July 1999, the European Commission decided 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 this state 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 at the end of 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 at the end of 2002.

Modernization of Financial Market Supervision and Reorganization of the Deutsche Bundesbank

In the spring of 2002, the German parliament passed the Act on the Integrated Supervision of Financial Services, radically reforming the institutional framework for banking supervision in Germany. Germany's three separate supervisory offices for banking, insurance and securities trading have been combined since May 1, 2002 into a single agency, the Federal Financial Supervisory Agency (BAFin), which is overseen legally and professionally by the Federal Ministry of Finance.

The BAFin's supervision covers the whole of the financial market and is therefore a major contribution towards safeguarding Germany's stability as a financial center. It takes account of the growing cross-sectoral integration of the financial markets, reduces any duplication of activities and promotes synergy by concentrating supervisory powers. It also keeps open the option of a "Europeanization" of supervisory powers in the long term, particularly as the German restructuring is likely to accelerate the Europe-wide trend towards the creation of single financial supervisory authorities.

The joint banking supervision operated so successfully in the past in Germany by the Federal Banking Supervisory Office and the Bundesbank will be maintained. In addition, the BAFin will house the already established Financial Markets Stability Forum, which will advise the new agency on questions concerning the stability of the financial system and serve to feed in the expertise of the Bundesbank.

As the quality of banking supervision is an important business location factor for the financial industry, it is particularly to be welcomed that the BAFin will be financed in the future entirely by the financial institutions under its supervision and will no longer be dependant on federal funding. This will make it much easier to recruit the highly-qualified specialists needed to perform the increasingly demanding supervisory tasks (e.g. implementation of the forthcoming Basel II rules).

With the setting-up of the European System of Central Banks (ESCB) and the introduction of the euro, the functions and tasks of the Bundesbank have changed. As a consequence, the Bundesbank Act was amended on May 1, 2002 to strengthen the head office of the Bundesbank. A board of directors replaced the central bank council and the directorate. The federal state central banks have no decision-making power of their own any more, but follow the instructions of the Bundesbank´s board of directors.

From the point of view of the German banks, this amendment of the Bundesbank Act 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.

Pension Scheme Reform

In 2001, the state-run pension scheme was reformed by means of the Pension Provisions Act. An important part of this reform is the promotion of supplementary, private pension provisions by way of government premiums or tax deductibility as special expenses up to a certain maximum amount, starting with contributions made in 2002. The funds stemming from such state-promoted contributions will be taxed on a deferred basis, i.e. at the payout stage. Besides persons contributing on a compulsory basis to the statutory pension scheme, civil servants can also take advantage of the state-promoted private pension provision arrangements introduced by the change in the law in December 2001, as cuts in their pensions are likely in the future, too. The BAFin is responsible for certifying pension products and has stated that up to 20 percent of the capital which has been saved at the start of the payout phase may be paid out flexibly.

The market for these products was slow to evolve in the first half of 2002, since their eligibility for promotion is tied to a number of conditions. This complicated set-up has evidently prevented many citizens from making use of the products on offer. The expectations in connection with company pension schemes are all the greater. The Pension Provisions Act also created the basis for pension funds. While these are similar to insurance undertakings, they offer employers and employees more scope for investing the money deposited in them. The first pension funds have now been admitted.

New Developments in Company Law

The Act regulating public offers for the purchase of securities and takeovers (Takeover Act) entered into force on January 1, 2002, replacing the Takeover Code issued by the Commission of Stock Exchange Experts in 1995. It regulates not only offers that seek to acquire a controlling interest in the target company but all offers for the purchase of securities issued by a stock corporation or a partnership limited by shares in Germany and admitted to official trading or to a regulated market in the European Economic Area. The new central financial supervisory agency, BAFin, is responsible for overseeing the Takeover Act with the help of an advisory council composed of 15 market participants.

Voluntary takeover bids are geared to acquiring a controlling interest, with legislators setting a 30 percent threshold for acquiring such a controlling interest. If a bidder has acquired this percentage of the voting rights of the target company, he must announce this and subsequently submit a bid (mandatory bid). Where mandatory bids and takeover bids seeking to obtain a controlling interest are submitted, the bidder has to offer the shareholders of the target company appropriate consideration. To do so, he can generally choose between conversion into liquid shares, cash payment in euros or a mixture of both. The takeover price is to be based on the average market price of the target company’s shares and the price at which the bidder acquires shares of the target company.

A highly controversial issue – not only at the European but also the national level – was the requirement for the supervisory board and the management board of the target company to adopt a neutral position whenever a takeover bid is made. Once the European directive failed, German legislators had a free hand on this point. This is why, after numerous amendments, the Takeover Act now allows the management board to adopt other defense strategies besides looking for a so-called “white knight” if the supervisory board has approved them and does not interfere with the powers of the shareholders’ meeting in the process.

The recommendations of the government commission “Corporate Governance: Corporate Management – Corporate Control – Modernization of Stock Corporation Law” chaired by Professor Theodor Baums, which presented its final report in July 2001, have been largely implemented in the meantime both by legislators and by an independent panel of experts set up to draft a code of best practice.

On July 25, 2002, the Corporate Transparency and Disclosure Act entered into force (with some provisions to be implemented only after December 31, 2002). This Act implements, in a first step, the more straightforward regulatory recommendations of the Baums Commission. Besides providing for a so-called "declaration of compliance" with the corporate governance code, the Act also ensures that the supervisory board is given more information and strengthens the confidentiality of its work. Various recommendations of the Baums Commission on accounting and transparency are also implemented, while its recommendations concerning a reform of the law on contesting action and liability are to be implemented in a second stage.

At the same time, the government commission "German Corporate Governance Code" set up by the Federal Ministry of Justice in February 2002 has presented its code of best practice. The code sets out the statutory German corporate governance rules already in place in a clear and transparent manner. In addition, it recommends additional standards for responsible corporate management. The code is something of an innovation in the German system of company law. While companies are free to decide whether and, if so, to what extent they implement the code, they are to be required by the clause legitimizing the code in the Corporate Transparency and Disclosure Act to report this ("comply or explain"). A positive feature is that the code is a flexible instrument which does not restrict the scope companies have for implementing and complying with good corporate governance standards. In addition, this code increases transparency, which is likely to have a positive impact on the capital market, as it satisfies the information requirements of international investors.

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. Following the introduction and almost immediate acceptance by the market of EURIBOR (Euro Interbank Offered Rate) and EONIA (Euro OverNight Index Average) as benchmarks for unsecured interbank loans in January 1999, the European Credit Sector Associations established EUREPO in March 2002 as a similar benchmark for secured interbank loans (repos) in the euro zone.

An infrastructure comprising several payment systems is available for handling large-value payments resulting from money market and foreign exchange trading in the euro. The TARGET network links the national real-time gross settlement (RTGS) systems of the euro area's central banks. In November 2001, the liquidity-saving settlement system RTGS^{plus} of the Deutsche Bundesbank replaced its Euro Access Frankfurt (EAF), a hybrid system combining gross and net settlement, and the former German RTGS system ELS (Electronic Counter, to be retained as an alternative until 2004). With its modern features, RTGS^{plus} may well serve as a model for the further integration of the TARGET network.

In addition to the English version of the 2001 European Master Agreement (EMA), German, French, Italian and Spanish versions are now available. The benefits of the EMA – standardized documentation through a single instrument of such differing products as securities lending and securities repurchase transactions and, in the medium term, financial derivatives transactions, along with flexible choice-of-law arrangements – have induced the European Central Bank (ECB) to now use the EMA for all secured transactions with its currency reserves.

New Stock Market Developments

Now that the Cedel shareholders have approved Deutsche Börse AG's takeover of the German-Luxembourg securities clearing and settlement system Clearstream, the latter will soon be providing the full range of services for the securities industry. These include trading, clearing and settlement and safe custody systems.

Deutsche Börse has postponed its plans to introduce a central counterparty until the spring of 2003. 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.

Deutsche Börse plans to add a facility by the name of Xetra-BEST to the electronic trading platform Xetra at the beginning of September 2002. Xetra-BEST will allow banks to execute customer orders against themselves under certain conditions if in this way they can obtain a better price than the market price for the customer.

New Developments in the Regulation of Securities Trading

On July 1, 2002, the Fourth Financial Market Promotion Act, further modernising German financial market and capital market law, entered into force (for the anti-money laundering provisions of this Act, see special section below).

This Act amends, for example, the Stock Exchange Act, by abolishing official price determination and the priority status of floor trading. Stock exchanges are also authorized to set more comprehensive admission requirements. A reporting requirement has also been introduced for near-stock-exchange trading systems that are supervised at the federal state level. Another important feature concerns new rules on forward trading. Whereas the old provisions of the Stock Exchange Act stipulated that failure to comply with certain formalities made a forward transaction invalid, the new rules simply state that the counterparty is entitled to claim compensation in such cases. In addition, the ad hoc reporting requirements are now worded more precisely, and investors can in the future enter a claim for compensation if these are violated. Also new is the statutory requirement to report securities transactions conducted by members of a company's management or supervisory board. The rules to combat price rigging have been made much more detailed. A requirement to disclose conflicts of interest when producing and circulating investment analyses has now also been introduced.

New Bank Regulatory Developments

In October 2001, the Federal Banking Supervisory Office recognized for prudential capital rules purposes (Principle I) both the netting of securities repurchase and securities lending transactions recorded in the trading book and netting against countervailing positions when posting collateral in the form of money or securities for swaps and other forward contracts and option rights. This means that the netting arrangements that had previously only been allowed under the prudential regulations governing large exposures and loans of 1.5 million euros or more are now also admissible in the area regulated by Principle I.

Online Banking and Electronic Commerce

Thanks to the German direct banks, which are mainly subsidiaries of the big private banks, the private banks are the clear market leaders in this field, operating half of the 20 million online accounts.

In mid-2001, the Association of German Banks, in collaboration with the research group Wahlen Telefonfeld GmbH, conducted a second representative survey of online banking and e-commerce in Germany to follow up on the August 2000 survey. It revealed that 42 percent of Germans already have Internet access. The percentage of persons using the Internet to obtain financial news as well as information on financial products and services and the stock market has risen from 14 percent to 22 percent, and the number of German Internet shoppers from 8 percent to 16 percent. While only 11 percent of Germans used the Internet for online banking in August 2000, this figure now stands at 20 percent. At least another 14 percent of Germans – namely, one in two who are currently using the Internet for other purposes only – would consider online banking as well in the future. Eight percent of the population currently takes advantage of online brokerage services. An obstacle to an even wider use of online banking may be the perceived security risk, although 86 percent of Germans who have already used online banking rate it as safe or very safe.

Customers require a high level of security when conducting online banking, and the private banks meet this requirement in a variety of ways. With HBCI (Home Banking Computer Interface), the German banking industry has created a uniform standard for online banking. This convenient and constantly available system uses only the most up-to-date security mechanisms, thus offering the greatest possible protection against abuse. The customer is identified by means of an electronic signature. The private key which the customer needs for this purpose is usually stored on a chip card connected to the computer by a smart card reader. The key for the electronic signature is normally issued by a certification authority. Germany's private banks have concluded a co-operation agreement aimed at making available to their customers bank signature cards and certificates which satisfy the requirements of the German Digital Signature Act. These signature cards will either be specially distributed or be based on certain already existing chip cards which can then be used as a security medium to create digital signatures. The bank signature card will soon be able to offer further banking services. For example, banks are currently working on a kind of "electronic bank directory" that can be used when non-cash transactions are to be "signed" with the bank signature card.

The Fight Against Money Laundering and the Financing of Terrorism

Against the background of the terrorist attacks in the United States on September 11, 2001, a number of government bills were swiftly prepared and have mostly already entered into force.

Under the Act to Combat Terrorism of January 9, 2002, the Federal Office of Criminal Investigation (BKA), as the central agency for police information and intelligence, was given broader powers to obtain information from banks. In addition, government intelligence services may obtain information under certain conditions from banks, financial services enterprises and financial institutions as well as from telecommunications companies (teleservice data). The provisions of this Act are limited to a period of five years and thus automatically cease to apply on January 11, 2007, unless they are extended by way of new legislation beforehand.

Following the terrorist attacks in the United States, the Fourth Financial Market Promotion Act, which was originally presented on September 4, 2001, was toughened significantly in the area of measures to combat money laundering. In particular, an amendment to the Banking Act introduced “automated access to account information”, giving the BAFin direct electronic access to special new bank files containing the number of a cash or securities account, the date on which the account was opened or closed, the name (where natural persons are concerned, also the date of birth) of the account holder and of any persons authorized to draw on the account and the name and address of any different beneficial owner. Furthermore, prosecution authorities will be authorized under the procedures they operate to request such information from the BAFin.

Also new is a statutory requirement for banks to perform “account screening”, although in Germany there is already an agreement between banking regulators and the central banking associations that, under the reporting requirements set by the Money Laundering Act, banks should follow up on suspicions of money laundering also by using electronic data processing facilities. This means that banks will carry out “research measures” where they have a specific reason for doing so.

The Act to Combat Money Laundering that entered into force in July 2002 amends the Money Laundering Act and the Banking Act. It is designed particularly to combat any funding of terrorism and to implement the EU Anti-Money Laundering Directive. The main aspects of the act are: establishment of the legal basis for the Financial Intelligence Unit (FIU) that Germany has lacked so far because of its federal structure. This unit is to be set up at the BKA. In addition, the German government is empowered “to define individual types of financial transactions that are suspicious ”. These powers are linked to possible future Financial Action Task Force on Money Laundering (FATF) measures directed at non-cooperating countries and territories. Such financial transactions then have to be reported by banks on the strength of this “general suspicion”.

Finally, the highly important “Special organizational duties in the payments sector” are designed to implement FATF Special Recommendation No. VII of October 31, 2001 on wire transfers. They require banks conducting giro business and accepting payment orders from their customers to establish the name, address and account number of the originator and to forward these to the beneficiary banks (and to any intermediary banks) in the message formats used for electronic payments. Intermediary banks and beneficiary banks receiving these messages are required to check the details and to complete them if possible where they are incomplete. Due to an ongoing discussion about the implementation of FATF Recommendation No. VII at European level, the scope of these special organizational duties is limited to cross-border payments to and from countries outside the EU.

German banks are currently taking part in the review of the FATF 40 Recommendations published in a consultation paper in May 2002.

Since the terrorist attacks of September 11, 2001, the German government has often stepped in with interim financial sanctions before the EU managed to implement corresponding legislation at European level.

Consolidated Supervision

In Germany, banking or financial holding groups are subject to consolidated supervision. In accordance with EU Directives 2000/12/EC and 93/6/EC, a banking group comprises a parent undertaking (bank, securities firm or financial institution domiciled in Germany which requires a license) and the subsidiary undertakings (subsidiaries domiciled in or outside Germany which are themselves banks, securities firms or financial institutions). A financial holding group exists if a financial holding company domiciled in Germany (financial undertaking whose subsidiaries are mainly or exclusively banks, securities firms or financial institutions) has at least one subsidiary bank or securities firm. Consolidated supervision covers the required capital adequacy for credit risks and market risks and the monitoring of large exposures. Insurance firms are not included in consolidated supervision. However, an EU Directive on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate is likely to be adopted towards the end of the year. If a bank forms a financial conglomerate together with an insurance firm (general threshold: a 20 percent shareholding), the financial conglomerate is to be subject to supplementary qualitative and quantitative supervision.

Under German supervisory law, anyone wishing to conduct banking business or to provide financial services in Germany commercially or on a scale which requires a commercially organized business undertaking needs a written license. This licensing requirement also applies if cross-border business with persons permanently resident in Germany is conducted. An exception is made only for banks domiciled in another country of the European Economic Area. Under EU law, these may conduct cross-border business in Germany subject to receiving a license to do so from their home country and do not therefore require a license from the German authorities. Banks or financial groups from third countries are only allowed to operate in Germany through subsidiaries or branches.

HONG KONG

Bankruptcy

Following a change to the Bankruptcy Ordinance allowing for the discharge of bankruptcies in the ordinary course after four years and a downturn in the Hong Kong economy, Hong Kong has seen a surge in personal bankruptcies, particularly those where the debtor petitions for his own bankruptcy. A number of initiatives are under way to counter this, as follows:

- Greater sharing of credit data on individual customers so as to enable banks and other financial institutions to have a wider spectrum of information available when granting credit facilities.

- A mechanism for the institutional reporting of fraud.

- A voluntary system among the banking community for promoting a non-statutory debt relief plan as an alternative to bankruptcy.

- In the longer term, a strategic review of the bankruptcy legislation.

Commercial Credit Reference Agency

The banking industry is working on the establishment of a Commercial Credit Reference Agency which will collect credit information of SME customers from banks and other financial institutions and make it available to banks and other financial institutions which have an existing borrowing relationship with the SMEs, or with whom the SMEs intend to seek a borrowing relationship. This will assist SME customers in obtaining finance and at the same time enable banks and other financial institutions to obtain a more detailed spectrum of information on these customers. The scheme will be voluntary both on the part of banks and other financial institutions and SME customers and is expected to come into being as early as 2003.

Securities Legislation

The wholesale revamping of the securities legislation, which was delayed following public consultation, has now been enacted and is expected to be brought into force after the pertinent subsidiary legislation and regulations are ready. The legislation consolidates a number of enactments and makes extensive changes following a detailed review. In tandem with this, amendments to the Banking Ordinance will be brought into effect dealing with the regulation of banks' securities business.

Check Clearing

A system is to be introduced in June 2002 under which checks in Hong Kong dollars drawn on certain banks in Guangdong province and deposited into banks in Hong Kong will be cleared efficiently through the cooperation of Hong Kong's interbank clearing house and Guangdong province's clearing houses. This extends the existing clearing of checks drawn on Hong Kong banks payable to payees in Guangdong so that now the cross border clearance of checks in Hong Kong dollars will operate on a two-way basis.

Companies Legislation

A variety of amendments have been proposed in the Companies (Amendment) Bill 2002. Many relate to procedural amendments and the more substantive proposed changes are as follows:

- companies be allowed to be incorporated by one shareholder. At present, Hong Kong companies must have a minimum of two shareholders.

- private companies be allowed to have one director. At present, a minimum of two directors are required;

- minority protection provisions be enhanced by permitting 2.5 percent of the voting rights or 50 shareholders to convene an extraordinary general meeting. At present, 5 percent of the voting rights or 100 shareholders are required.

- the provisions restricting loans to directors be extended to cover more modern forms of credit and the reporting requirements be amended accordingly; and

- companies be allowed to purchase liability insurance for officers and auditors in respect of any negligence, default, breach of duty or breach of trust (save for fraud).

Reciprocal Enforcement of Judgments between the Hong Kong SAR and the Mainland

A system is being proposed by the government whereby judgments obtained in the Hong Kong SAR courts and the Mainland courts may be enforced on a reciprocal basis. This is proposed to be limited to money judgments in commercial matters where there is a valid choice of forum clause in the underlying contract. Reciprocal enforcement is intended to be limited to judgments given by a court at the intermediate level or above.

Consolidated Supervision

Domestic Financial Groups

Banks, restricted license banks and deposit-taking companies are regulated by the Monetary Authority insofar as their banking activities are concerned.

They may also carry on securities business subject to a license obtained from the Securities and Futures Commission and if they are so licensed, their securities business will be subject to supervision of the Securities and Futures Commission.

They may also seek exemption from licensing by the Securities and Futures Commission and if this is granted they will, as regards their securities business, be supervised by the Monetary Authority by virtue of a Memorandum of Understanding between the Monetary Authority and the Securities and Futures Commission under which the Monetary Authority will apply equivalent standards of supervision as are applied by the Securities and Futures Commission in respect of licensed persons.

Banks, restricted license banks and deposit-taking companies are exempted from regulation under the Insurance Companies Ordinance in respect of certain classes of insurance carried on for the purpose of their banking or deposit taking businesses. These comprise certain types of retirement schemes, financial loss and legal expenses insurance, accident and health and credit and suretyship insurance.

If banks, restricted license banks or deposit taking companies conduct any other kinds of insurance business, they will need to obtain authorization from the Insurance Authority and be subject to regulation by that Authority.

Non-Domestic Groups

In the case of a non-domestic financial group in Hong Kong, all of its presence in Hong Kong would be subject to the supervision of different local supervisors depending on the types of businesses they are engaged in. There is no "country level consolidation" in Hong Kong, although there is close contact between Hong Kong supervisors if issues arising from a legal entity supervised by one supervisor may affect another legal entity supervised by another supervisor. If the group's major activity in Hong Kong is banking and its home supervisor is a banking supervisor, then the MA will act as the coordinator of the Hong Kong supervisors. However, if its major activity in Hong Kong is securities and its home supervisor is a security supervisor, it will be the SFC that will act as the coordinator.

The prudential requirements and supervisory approach applied to foreign bank branches are broadly the same as those applied to authorized institutions incorporated in Hong Kong. They are also subject to the HKMA's off-site reviews, on-site examinations and are required to submit returns in respect of their Hong Kong operation. However, as the foreign bank branches are not required to hold capital in Hong Kong, they are not subject to local capital adequacy requirements and the statutory limitations which are measured in relation to capital base. The primary responsibility of supervising capital adequacy of these foreign banks rests with their home supervisor. However, the HKMA will generally require such banks to have a capital adequacy ratio of at least 8% measured in a way which is consistent with the Basel Capital Accord. The HKMA will also make sure that such banks are under adequate supervision in their home country (e.g. the home supervisor practices adequate consolidated supervision). These are some of the minimum authorization criteria that will be assessed at the time of authorization and on an on-going basis thereafter.

The HKMA also maintains regular contacts with other overseas supervisors to exchange information relating to the operations of these foreign banks. In addition, it welcomes the home supervisor to carry out on-site examination of their Hong Kong operations and meetings will usually be held before and after the examination to exchange views on the banks.

INDIA

In India, banking, insurance and capital markets are the three main segments of the financial sector. They are supervised and regulated respectively by the Reserve Bank of India (RBI), the Insurance Regulatory and Development Authority (IRDA) and the Securities Exchange Board of India (SEBI). Major developments during the period under review are given below.

Banking

The RBI's efforts to improve the functioning of India's banks included measures to improve transparency, efficiency, and competition and to assist the banks to follow the internationally accepted best practices. Some of the major announcements made during the period are enumerated below.

With a view to improve internal controls and audit procedures of banks, the RBI has decided to review the existing norms for empanelment of Statutory Auditors for Public Sector Banks (PSBs) and select financial institutions. The Central Bank has also decided to deal with the issue of the appointment of statutory central auditors (SCA) for public sector banks as well as other related matters. In order to bring out some uniformity and transparency in the country's banking system, a high-level committee was set up by the RBI to examine and remove discrepancies in accounting procedures between listed and non-listed commercial banks.

As far as non-performing assets (NPAs) of the banks are concerned, many measures were introduced with a view to reduce bad debts and also to classify the assets of the banks as per internationally accepted best practices.

Loan Loss Reserves and Past Due Loans

The RBI relaxed the non-performing asset classification norms for direct agricultural lending in February, 2002. It has extended the repayment period for interest and principal from 180 days to two harvesting seasons but not more than one year. This relaxation is largely due to the unpredictable nature of the agriculture sector.

The RBI has also indicated to banks that the asset should be classified as doubtful if it remained in the sub-standard category for 12 months effective from March 31, 2005. Further, banks are instructed to phase in the consequent additional provisioning over a four - year period, with a minimum of 20 percent each year.

One Time Settlement for Small/ Marginal Farmers

Pursuant to one of the proposals in the Union Budget 2002-03 of a special one time settlement (OTS) scheme for small and marginal farmers to cover loans up to Rs.50,000, the RBI has advised all Public Sector Banks to formulate a policy for recovery of these loans. Salient features of the Scheme are (a) it covers all loan accounts with an outstanding balance of up to Rs.50,000 principal amount (excluding any interest element) to small and marginal farmers, which have become non-performing assets (NPAs) as of March 31, 1998, (b) the guidelines also covered suit-filed and decreed debts, (c) the scheme did not cover cases of fraud, malfeasance and wilfull defaults, and , (d) the guidelines are operative up to December 31, 2002.

One Time Settlement of NPAs

The RBI instructed the Boards of the Public Sector Banks to formulate a policy for one time settlement (OTS) for recovery of dues pertaining to loans outstanding up to Rs.25,000. The OTS scheme covered all loan accounts with an outstanding balance of up to Rs.25,000 principal amount (excluding interest) which have become non-performing assets (NPA) as of March 31, 1998. The guidelines covered suit-filed and decreed debts. After the settlement was reached, the banks could take appropriate steps for closure of cases in respective courts. The scheme did not cover cases of fraud, malfeasance and willful defaults. The guidelines were operative up to June 30, 2002.

Corporate Debt Restructuring

The RBI in consultation with financial institutions and the Government of India has finalized a scheme on Corporate Debt Restructuring (CDR). The objective of the CDR framework is to ensure a timely and transparent mechanism for restructuring of the corporate debts of viable corporate entities affected by internal or external factors, outside the purview of the Board for Industrial and Financial Reconstruction (BIFR) Debt Recovery Tribunal (DRT) and other legal proceedings, for the benefit of all concerned. The CDR Scheme is to be applied only to multiple banking/consortium accounts, in the standard and substandard category, with outstanding exposure of Rs.200 million and above with banks and Financial Institutions. The Scheme has become operational since August, 2001. The scope of the scheme originally envisaged as a platform for public sector banks and Financial Institutions for restructuring debt, is widened to cover private and foreign banks also.

Ordinance for the Securitization of Assets of Banks and Financial Institutions

The Union Cabinet recently cleared a bill on the Ordinance for the Securitization of assets of banks and financial institutions. This bill gives more powers to banks and financial institutions to deal with the willful defaulters. The Ordinance aims at putting in place a framework for the enforcement of security or foreclosure norms and setting up asset reconstruction companies (ARCs) to take over non-performing assets (NPAs) of banks and financial institutions. The Ordinance, however, proposes to keep NPAs and loans up to a certain amount to the agricultural sector out of the ARCs. While ARCs will take over the NPAs of banks and FIs at a discount and help in cleaning their books, foreclosure laws will help in attachment of defaulters' properties. Securitization will aid in raising more funds**,** thereby enhancing the credit flow.

Capital Adequacy Requirements

As per the existing stipulation, Indian banks were required to achieve the Capital Adequacy Ratio of 9 percent by the end of March, 2000. As of the end of March, 2001 95 out of 100 banks operating in the country (public sector , private sector and foreign banks), had achieved the target of 9 percent. The new Basel Accord on Capital Adequacy is under active consideration of the Reserve Bank of India. In connection with this, it should be mentioned that banks are instructed by the RBI to examine their capital requirement to meet the new Basle Capital Adequacy norms once they are in place. Further, banks are also advised to prepare for risk-based supervision in the future. The RBI has also advised banks to constitute an expert internal team to study the methodology of the new proposals and their likely impact.

Depositor Protection Arrangements

India is a pioneer in introducing protection to the bank depositors and the Deposit Insurance Credit and Guarantee Corporation (DICGC) used to look into the matter. Recently, in the Union Budget 2002-03 a proposal has been made to convert the existing DICGC into the Bank Deposits Insurance Corporation (BDIC) to make it an effective instrument for dealing with depositors' risks and for dealing with distressed banks. Appropriate legislative changes for this purpose are expected shortly.

Reporting and Disclosure Requirements

Banks have to disclose a) movement of provisions held towards NPAs and b) movement of provisions held towards depreciation on investments with effect from March 31, 2002. Further, banks are advised to disclose large individual exposures and connected lending in their balance sheets from March 31, 2003. The RBI limits the banks' exposure to a single borrower group at 30 percent of capital funds. This limit could be further relaxed to 40 percent where additional exposure is for financing infrastructure projects.

Other Policy Announcements

Guidelines on Internet Banking

The RBI has issued guidelines to banks for conducting business through Internet banking. Three areas where the guidelines were focussed are (i) technology and security issues (ii) legal issues and (iii) regulatory and supervisory issues.

Bank Rate

The Bank Rate has been brought down from 7.0 percent to 6.5 percent effective from October 22, 2001. This level is the lowest bank rate since May 1973.

Cash Reserve Ratio (CRR)

The CRR has been gradually brought down in three phases from 7.5 percent to the present level of 5 percent effective from June 1, 2002.

Interest rate on CRR Balances

The interest rate on eligible CRR balances was increased further to the level of the Bank Rate, i.e. 6.5 percent (from 6.0 percent since April 21, 2001 and 4.0 percent earlier).

Two New Private Sector Banks

The RBI has given its " in-principle" approval to two private applicants to set up banks in the private sector under the new guidelines. The in-principle approvals will be valid for a period of one year during which period the applicants can mobilize the required capital and fulfill other conditions outlined in the RBI guidelines for licensing of new banks in the private sector. Some of the salient features of the revised guidelines for opening banks in the private sector are as follows:

- The requirement of minimum paid-up capital of Rs. 2 billion with a proviso that it should be increased to Rs.3 billion within 3 years.

- The Capital Adequacy Ratio of the bank should be 10 percent on a continuous basis from the commencement of operations as against 8 percent prescribed earlier.

- Companies, directly or indirectly connected with large industrial houses, could invest up to 10 percent of the bank's capital without having controlling interest in the new bank.

Anti-Money Laundering Measures

A Bill on prevention of money laundering along the lines of a Special UN Resolution in 1998 is pending before the Indian Parliament. With a view to exploring anti-money laundering measures which banks can take within the existing legal provisions, the IBA formed a working group to prepare a Code of Conduct for Indian banks keeping in view the legal framework and banking procedures. The recommendations of the working group were submitted to the RBI for consideration. Subsequently, in the Monetary & Credit Policy Statement for 2002-03, the RBI has indicated that detailed guidelines on anti-money laundering measures would be issued soon.

Insurance

The Indian Insurance regulator IRDA keeps life insurance and general insurance companies separate. No composite insurance business is encouraged in the Indian market. Though the Insurance Act of 1938 and the IRDA Act of 1999 prescribe that the regulator would encourage the setting up of health insurance business on a stand-alone basis, due to a large working capital requirement of about Rs.1 billion, the health insurance business has not yet picked up in India. After the opening of the Insurance Sector to private players, 16 new players entered the market during the period under review. With a view to protect the interest of the customers, the insurance industry has Ombudsmen in 12 cities. Each Ombudsmen is empowered to redress customer grievances in respect of insurance contracts on personal lines where the insured amount is less than Rs.2 million, in accordance with the Ombudsmen Scheme.

Some of the important announcements made by IRDA for the insurance sector are as follows:

- Insurance companies are advised to speed up the settlement of claims. A delay in settlement of claims may call for a higher interest payment of Bank Rate plus 2 percent. This is applicable for both life and non-life policyholders.

- All insurance companies are advised to close their financial accounts at the close of the fiscal year. This is needed for the comparative analysis of the performance of the companies.

Non-Banking Finance Companies (NBFCs)

At present, the Non-Banking Finance Companies are regulated by the Reserve Bank of India. Some of the major announcements with regard to the supervision and strengthening of the operations of the NBFCs are listed below:

- Asset -Liability Management (ALM) guidelines were announced for non-banking financial companies (NBFCs) including residuary non-banking companies (RNBCs) with assets of of Rs.1 billion and above or public deposits of Rs. 200 million and above as per the balance sheet as of March 31, 2001. The NBFCs were advised to constitute an asset-liability management committee under the charge of the chief executive officer along with other specialist members for formalizing the ALM system in the institution.

- The maximum rate of interest that NBFCs can pay on their public deposits was reduced, effective November 1, 2001, from 14 percent to 12.5 percent per annum.

- In the event of default in the submission of returns by an NBFC, the RBI would impose penalties and would consider court proceedings, besides considering rejection/cancellation of the Certificate of Registration of NBFCs having public deposits of Rs 500 million. Stipulation in respect of the size of NBFCs will be progressively reduced over time.

Capital Markets

In the capital market sector, the primary capital market activities were very subdued as compared to the previous year. The secondary market fluctuated in response to various internal and external developments and policy changes. As far as the regulation is concerned, SEBI announced many measures to provide more transparency in the working of the bourses.

Some of the major policy announcements are as follows:

- With a view to tighten the insider trading norms, the SEBI has advised all listed companies to declare a trading window specifying the time period during which their employees and directors can trade in the company's share.

- Segment reporting was made mandatory for listed companies.

- All Foreign Institutional Investors are permitted to participate in the trading of all derivative products. This step is expected to boost derivative volumes on Indian bourses.

- The SEBI has been empowered to impose a maximum penalty of Rs.250 million , or three times the profit earned, for any capital market violation.

- Amended the secrecy clause regarding client information to brokers. Stock brokers are allowed to share information about their client with market players like institutional investors with the prior consent of their client.

- The Government has given to SEBI the powers of search and seizure in cases relating to insider trading and market manipulation.

INDONESIA

Bank Regulatory Developments

Bank Indonesia has continued to review and improve banking regulation, including:

1. The implementation of know-your-customer principles. Before entering into a business relationship with its customer, a bank shall obtain information supported by legal documentation regarding:

   - the identity of a prospective customer;
   - the purpose and objectives of the business relationship the prospective customer intends to have with the bank;
   - other information related to the prospective customer's profile; and
   - beneficial owner identification in case the prospective customer acts for and on behalf of another party.

2. Good Corporate Governance Principles. The principles include practices in 4 key areas:

   - *Shareholder rights and responsibility*. The effectiveness of the company in protecting the rights of all of its shareholders, including its ability to prevent majority shareholdings.
   - *Corporate Governance Policy*. The policies in place to ensure that the management works in the best interests of its shareholders and other relevant stakeholders.
   - *Corporate Governance Practices.* The structures in place to ensure that the management works in the best interests of its shareholders and other relevant stakeholders.
   - *Disclosure.* The accuracy and timeliness with which a company discloses its financial position, condition and prospects, and other key non-financial information, and the ability of existing and prospective investors to access this information.

Disclosure also covers non-financial matters, such as the company's ownership structure, corporate governance and ethics, which should be a matter of public record.

Indonesian Bank Restructuring Agency (IBRA)

During the period under review, the Indonesian Bank Restructuring Agency undertook initiatives in the following areas:

- accelerating the debt restructuring and disposal of assets under the administration of the Asset Management Credit (AMC);

- enhancing efficiency;
- empowerment for the settlement of legal issues; and
- endorsing the principle of transparency.

Those initiatives are supported by policies which have been established since 2001, including:

- Asset Bond Swap program;
- program for the resolution of the "certificates of entitlement" for banks that have been recapitalized;
- program for the sales of corporate debtor loans held by IBRA that have not been restructured;
- direct sales program of restructured and unrestructured loans at a minimum 70% of book value;
- policy designed to accelerate asset sales through joint venture companies, holding companies, and collateralized debt obligations;
- policy designed to accelerate asset sales through an independent third party auditor;
- policy designed to enhance transparency in non-core-asset sales;
- policy designed to enhance the restructuring of the Sinar Mas Group of companies by obtaining the personal guarantee of Me.Eka Tjipta, the founder of Sinar Mas Group;
- policy designed to maintain the currency level of USD 1 equal to IDR 7,800 for cash settlement;
- policy designed to finalize Letter of Credit (L/C) and Bank Guarantee for small and medium size enterprise (SME) debtors;
- announcement of IBRA audit report conducted by an independent Public accounting firm; and
- establishing CMU (Consultant Management Unit) to assist in proper handing of consultant's procurement process.

Developments in the Banking Industry

In the bank restructuring program, Bank Indonesia focused on the achievement of the minimum 8% Capital Adequacy Ratio (CAR) requirement that banks were to have met by the end of 2001 as well as the achievement of the indicative maximum target of non-performing loans (NPLs) at 5%. Unfavorable economic conditions, however, delayed recovery in the Indonesian banking sector. The Rupiah remained volatile against the US Dollar and SBI rates continued to increase. During 2001, the average one-month SBI rate was 16.3% versus 12.4% in

2000. As a result, restructuring of outstanding NPLs faced delay and new loan disbursement was limited. This caused the level of NPLs to remain high during the year.

Nevertheless, the performance of the banking sector has shown progress. The bank capital structure has improved, as reflected in an increase in the number of banks that have met the 8% CAR requirement. As of mid-September 2001, 139 banks out of 149 had complied with the minimum 8% CAR requirement. NPLs have also made quite significant improvement by reaching 13.6% compared with 18.8% in 2000.

The banking net interest margin (NIM) increased from the average of Rp 1.9 trillion in 2000 to Rp 3.5 trillion in 2001. This increase is consistent with the positive spread due to an increase in the SBI interest rate and the large amount of income from government bonds, reaching approximately 45% of the total interest income.

Consolidation in the Indonesian banking sector, meanwhile, has also continued. The government announced the merger of five banks under the supervision of IBRA, namely Bank Bali, Bank Universal, Bank Media, Bank Patriot and Bank Prima Ekspress.

IRELAND

Supervision of Financial Institutions

Introduction

The statutory responsibilities of the Central Bank of Ireland (the Bank) cover a wide range of institutions including banks and building societies, investment firms, investment intermediaries, insurance intermediaries, securities exchanges and collective investment schemes. There are now five departments in the Bank involved in the supervision of financial institutions as follows:

- Banking Supervision;
- International Financial Services Centre (IFSC) and Funds Supervision;
- Securities and Exchanges Supervision;
- Retail Investments and Insurance Supervision, and
- Regulatory Enforcement and Development.

The latter two departments were established during 2001 with responsibility for retail intermediaries and consumer issues (Retail Investment and Insurance Supervision) and regulatory development and enforcement issues (Regulatory Enforcement and Development).

Policy Developments

The Bank addressed a wide range of supervision policy issues during the period including concerns relating to credit growth and credit quality, capital review proposals, Money Laundering Guidance Notes, auditing/accounting related issues, Client Money Rules, Codes of Conduct for the banking industry and retail intermediaries and the supervisory regime for insurance intermediaries.

Money Laundering

The revised Money Laundering Guidance Notes for Credit Institutions were issued by the Bank to all credit institutions in November 2001, and reflect amendments to the anti-money laundering legislation which have been made since 1995 (e.g. regulations which have designated additional institutions which are subject to the legislation, provisions in the Criminal Justice Miscellaneous Provisions Act, 1997 on education and training obligations) as well as expanding on the guidance provided in certain areas. Revised Guidance notes for Financial Institutions are expected to be issued in 2002.

Following the events of September 11, 2001 a number of initiatives occurred in the area of terrorist financing and money laundering including requesting institutions to examine their records for the existence of relationships with any individuals who were under investigation in connection with these events with the aim of reporting them to the Irish police authorities.

Auditing and Accounting Related Issues

There has been increased communication between the Bank and external auditors/ the accountancy profession. The Bank provided assistance to the auditing profession in the development of guidance on the audit of banks (issued in February 2002) and is providing similar assistance in the development of guidance on the audit of other entities regulated by the Bank. Trilateral meetings (Bank/external auditor/credit institution) are being organized to discuss matters of mutual interest. A Liaison Group has also been set up between the Bank and the wider accountancy profession which will provide a forum for discussing matters of mutual interest regarding financial institutions.

Client Money Rules

A second consultation paper, incorporating some of the comments received from industry representatives on the first consultation paper, was published by the Bank in April 2002. It is anticipated that new requirements will be finalized in the coming months.

Unauthorised Activities & Complaints

It is an offense for any person or firm to provide investment business services without an appropriate authorization. Prompt investigations are carried out by the Bank where there is reason to believe a person or firm is carrying out unauthorized activities. During the year ended December 31, 2001, thirteen warning notices concerning 22 firms carrying on unauthorized investment business were published bringing the total since the power to publish such notices was given to the Bank in August 1998 to 41 notices concerning 82 firms. Any complaints relating to firms under its supervision are dealt with by the Bank or referred to the appropriate ombudsman, where necessary. The Bank operates a Lo-call line (1890 200469) providing a facility to the public to enquire whether or not a firm is authorized by the Bank. The register of authorized entities maintained by the Bank is also available for inspection by the public on the Bank's premises.

Banking Supervision

The Bank 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

The following codes of conduct for the banking industry were prescribed in 2001 for all credit institutions (banks and building societies) operating in the State, after consultation with the Minister for Finance:

- 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 – outlining requirements applicable to the different types of product being advertised by credit institutions; and

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

Developments in the Banking Sector

Banking licenses were issued to Zurich Bank, Bank of Bermuda (Europe) plc and DePfa Bank plc; ACC Bank was acquired by Rabobank Nederland on February 28, 2002; the banking business of Citibank NA (branch) was transferred to Citibank International plc and its license revoked in October 2001; the transfer of the banking business of Guinness & Mahon (Ireland) Limited to Irish Life and Permanent plc was completed on December 31, 2001 and its license revoked on that date; the banking business of Bank of Scotland (Ireland) Limited and ICC Investment Bank Limited was transferred to ICC Bank plc on March 23, 2002 - the three existing banking licenses were cancelled on March 25, 2002 and a new license was issued to Bank of Scotland (Ireland) Limited on the same day.

The high level of credit growth remained the principle prudential concern in 2001. The slowdown in the global economy, the weakness of the technology, media and telecommunications industry, and the events of September 11 all raised concerns about potential for a deterioration in credit quality and banks' exposures to vulnerable industrial sectors. This was addressed through a detailed assessment of credit institutions' exposure to the telecommunications sector. The impact of September 11 was assessed through a detailed survey of banks' exposures to industries vulnerable to the aftermath of the terrorist attacks namely, airlines, aviation industry, insurance and tourism. 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.

The Asset Covered Securities Act, 2001, was passed in December 2001. The Act permits Irish banks, where designated by the Bank, to issue bonds (similar to the German Pfandbrief) backed by pools of mortgages or public credits. The Bank is currently in the process of drafting regulations in consultation with the banking industry to supplement the legislation**.**

Securities and Exchanges Supervision; IFSC and Funds Supervision; Retail Investments & Insurance Supervision

Apart from credit institutions, the Bank is also responsible for the supervision of a wide range of non-bank financial institutions which is carried out by three separate departments: Securities & Exchanges Supervision, IFSC & Funds Supervision and Retail Investments & Insurance Supervision.

The Bank's responsibility for the supervision of non-bank financial institutions is derived from various pieces of legislation including the Investment Intermediaries Act, 1995 (as amended by the Central Bank Act, 1997, the Investor Compensation Act 1998 and the Insurance Act, 2000) which provides for the authorization and supervision of investment business firms; the Stock Exchange Act, 1995, (as amended by the Investor Compensation Act, 1998) which provides for the approval of stock exchanges and the authorization of their member firms and the ongoing supervision of such exchanges and member firms. (The 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 Exchange itself.) 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.

Under the Insurance Act, 2000, the Bank assumed responsibility for the supervision and regulation of insurance intermediaries (both life and non-life). Insurance intermediaries are now regulated under the Investment Intermediaries Act, 1995. There are three categories of investment and insurance intermediary under the new supervisory regime: multi-agency intermediaries, which may only receive and transmit orders, and provide advice on investment instruments available from the institutions from whom the intermediary holds a written letter of appointment; an Authorized Advisor also provides advice on investment instruments without the necessity to hold a letter of appointment - the firm is obliged to recommend the most suitable investment product available in the market, regardless of whether or not the firm holds an appointment from the relevant product producer; an Authorized Cash Handler, which may provide a wider range of investment business services -they may be authorized to act on a discretionary basis on behalf of clients and can accept cash in wider circumstances.

The Bank issued a revised Guidance Note to the funds industry in December 2001 which introduced stricter requirements in relation to investment by Irish authorized schemes in overseas schemes established in jurisdictions which allow unregulated schemes. Amendments to EU Directive 85/611 regarding Undertakings for Collective Investment in Transferable Securities (UCITS) entered into force in February 2002 by way of two separate directives. Both must be adopted by Member States by August 13, 2003 and applied by February 13, 2004.

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. The Central Bank and Financial Services Authority of Ireland Bill was published in April 2002. The Bill allows for the restructuring of the Central Bank of Ireland to include a new regulatory authority with extended supervisory responsibilities including the insurance sector. The proposed new legislation will ensure that the system of prudential regulation and co-ordination of financial stability will further enhance the regulatory system. The considerable role given to consumer issues in these new proposals will also lead to increased protection to the customers of financial services and promoting greater consumer awareness and education. An interim board has been appointed to manage the transition to the new regulatory arrangements.

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.

- The finalization of a reform of the settlement of the retail clearing mechanisms is under way which will include legal agreements specifying obligations and responsibilities. In addition, a review of the availability and use of retail payment instruments has commenced.

- 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 transactions between the local market and Euroclear participants have to be notified between the Bank and Euroclear.

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

Consolidated Supervision

The Bank is required to supervise a credit institution and its associated enterprises on a consolidated basis in accordance with the requirements of the EU Directive on the Supervision of Credit Institutions on a Consolidated Basis (92/30/EEC).

In accordance with the principles of the Directive and subject to the detailed provisions of the Regulations, the Bank's policy on consolidated supervision is as follows:

- the various ratios and limits set out in the Central Bank's Licensing and Supervision Requirements and Standards for Credit Institutions are applied on a consolidated basis to each credit institution under the Bank's supervision. In addition, the ratios and limits are applied, in accordance with the Regulations, to each subsidiary credit institution authorized by the Bank, in order to ensure the satisfactory allocation of risks within the group;

- in the case of a credit institution, whose parent is a financial holding company, the ratios and limits are applied to the group on a consolidated basis as well as to the credit institution itself. Moreover, the Bank will require from all undertakings within the group such information as is necessary to enable it to carry out its supervisory functions effectively; and

- consolidation at group level is not required in the case of a credit institution which belongs to a group the majority of whose activities are of a non-financial nature. However, in such cases the Bank will require from all undertakings within the group such information as is necessary to enable it to carry out its supervisory functions effectively.

In the case of an Irish credit institution which is owned by a financial holding company (FHC) headquartered in Ireland, consolidated supervision is applied to the group encompassing all financial subsidiaries including insurance and investment firms. Where the FHC is part of a larger group which is subject to consolidated supervision elsewhere, then the Bank will supervise on a consolidated basis up to the Irish FHC. Where the FHC is headquartered and supervised outside Ireland, the Bank focuses on the Irish regulated entities and subsidiaries on a sub-consolidated basis. However, if the FHC is not subject to consolidated supervision elsewhere then the Bank will supervise on a consolidated basis.

ISRAEL

The profits of the major Israeli banks declined substantially in 2001, due to increased provisions for bad and doubtful debts. The unrest in the financial sector was heightened by a relatively rapid devaluation of the NIS, following a sharp cut in the Bank of Israel`s discount rate in late December 2001. The dollar\NIS rate of exchange that was NIS 4.23 to the dollar on November 30, 2001 climbed in early June to almost NIS 5 to the dollar, due mostly to uncertainty as to the resolve of the Government in controlling the budgetary deficit. The rate of exchange changed its course and retreated to around NIS 4.75 in the end of June, after interest rates were raised. It remains to be seen whether the drastic action by the Bank of Israel will restore the stability of the financial markets.

The slowdown of the economy in 2001 led the Supervisor of Banks to issue in September 2001 a Directive demanding that banks make a supplementary allocation to their doubtful debt reserves, amounting to 0.15 percent of their risk assets and of up to 2.50 percent of their problem loans. Some additional allocations were requested in February 2002 in cases of excessive concentration of credits in certain industries. The regulatory requirements and the deteriorating condition of many borrowers led to substantial increases in the provisioning for doubtful debts in the annual accounts of 2001 and in the first quarter of 2002.

Anti-Money Laundering Developments

The most important regulatory development of the past year relates to the full implementation of the Prohibition of Money Laundering Law enacted in August 2000. During the course of 2001 the operational machinery of the Law was set in place: both the pool of information and the authority in charge of handling it in the Ministry of Justice and the secondary legislation on reporting on monies moving into Israel or being taken out and on the duties of identification, reporting and record-keeping of banking institutions.

The Supervisor of Banks issued two important directives intended to define modes of activity to be followed by banks and their subsidiaries and to assure compliance with the new regulations. The directive on the Prevention of Money Laundering, the Identification of Customers and Record Keeping was issued in May 2002. It broadens the scope of a previous directive which related to identification requirements, with the aim of better implementing the principle of “know your customer”. The directive includes procedures of identification, of record-keeping and of monitoring compliance with the adapted procedures. Banks are expected to treat the anti-money laundering measures as part of their risk management apparatus and to appoint an officer to evaluate the implementation of the legal requirements , as stipulated in the Law. Special attention is called for in dealing with "high risk customers", e.g. non-resident public figures such as high ranking politicians and the like.

In January 2002 the Supervisor required the banks and their subsidiaries to nominate a senior officer to the position of Compliance Officer. The mandate of this officer is to assure compliance with the laws, regulations and directives that deal with consumer protection, including the Law prohibiting money laundering and the supporting provisions.

After reviewing the measures taken by the Israeli authorities to implement the anti-money laundering legislation, the Financial Action Task Force on Money Laundering decided to remove Israel from the list of Non-Cooperative Countries.

Other Bank Regulatory Developments

Some regulatory developments of lesser importance include the following directives issued by the Superintendent of Banks:

- Banks are prohibited from acquiring their own shares. A new Companies Law, enacted in 1999, enables corporations to repurchase their own shares, subject to certain conditions. A directive issued in January 2002 does not allow banks to utilize this provision and limits the amount of credit granted by the bank and secured by its own shares.

- The banks are barred from charging service fees for a list of activities in customer accounts, mostly for activities initiated by the bank and not by the customer.

- Banks are allowed to open deposit accounts for regular customers of other banks, without opening a corresponding demand deposit. The money deposited is automatically transferred back to the regular account at the expiration of the term of the deposit. This provision , issued in January 2002, is designed to facilitate competition for deposits among banks. The directive also stipulates the conditions of transmitting to the banks orders by cellular phones and the Internet.

- Procedures for the prepayment of small loans (up to $25,000) are designed to protect the interests of small borrowers. A cap was imposed on the level of prepayment commission.

In late April a small Israeli bank (Trade Bank) collapsed as a result of a large scale embezzlement (close to $50 million). Beside raising questions concerning the efficacy of the bank`s internal controls and of the oversight performance of the external auditors and the Department of Banking Supervision, the bank`s failure renewed the debate relating to the lack of a formal system of deposit insurance in Israel. The Banking Ordinance enables the Bank of Israel to guarantee the deposits of a failing bank but the extent and terms of the guarantee are within the discretion of the central bank, and subject to government approval. The need to change this indefinite arrangement is quite obvious.

Regulatory Developments in the Securities Markets

The securities markets were depressed during most of the year but several regulatory developments are worth mentioning:

- Quoted companies were required to report in their accounts the amounts of their charitable contributions and their policies in this matter.

- Investment advisors and portfolio managers failing to produce their reports to the Securities Authority in due time will be subject to an administrative fine and not to criminal proceedings as before. This change reflects the tendency not to treat technical violations of the securities laws as criminal offenses. (An amendment to the Law to this effect was proposed by the Securities Authority.)

- The Securities Authority submitted a proposal to change the existing arrangements relating to the underwriting of securities that was approved by the Government but not yet enacted. The amendment will permit companies to start marketing a new offering, relying on a draft of the prospectus (prior to its final approval by the Authority), and will allow underwriters discretion as to the allocation of the subscribed securities.

- Another amendment to the Securities Law proposed by the Securities Authority, following the recommendations of a public committee, will limit the responsibility of a company providing forecasts or projections that do not materialize, if they were given in good faith and were reasonable at the time of their release.

Consolidated Supervision

Domestic financial groups in Israel are subject to requirements of consolidated reporting but supervision is not consolidated. Banks are subject to the supervision of the Supervisor of Banks, who is an official of the Bank of Israel. Insurance companies, pension funds and other retirement funds are supervised by an official of the Ministry of Finance, while the securities markets are supervised by the Securities Authority, a statutory agency, subject to the ministerial authority of the Minister of Finance. The fragmentation of supervisory authority over the financial markets was criticized by both professional authorities and politicians and changes in the current structure may be seriously considered in the near future. Non-domestic financial groups have very limited presence in Israel and their activities in Israel are subject to the same rules regulating the activities of domestic groups.

Governance of the Bank of Israel

Changes in the organization of the governance of the Bank of Israel were recently subject to a fierce controversy between the central bank and the Ministry of Finance. The current law, enacted in 1954, gives to the Governor of the Bank sole authority to decide on monetary policy. A public committee that was nominated to review the old Bank of Israel Law recommended that monetary policy decisions should be entrusted to a small board headed by the Governor, whose membership will assure the independence of the Bank from political interventions. It was also recommended that maintenance of price stability should be the only policy target of the central bank.

Disregarding these recommendations, the Minister of Finance decided to submit a bill that aimed to create a board to be composed of political nominees and to add to the policy goals considerations of economic growth and employment. These proposals were strongly objected to by the Bank of Israel and by most professional observers. The unrest in the financial markets in the past few months persuaded the Minister of Finance to shelve his proposals, at least for the time being.

ITALY

The structure of the Italian financial market was enhanced and its regulation was revised in a number of ways during the period under review.

The Italian Stock Exchange introduced a new segment (named MTF) for exchange traded funds (ETFs) and listed closed-end mutual funds. All intermediaries that already trade on the electronic share market are automatically admitted to trade on the new segment. ETF trades are settled by means of Monte Titoli's post-trading infrastructure.

The Italian Stock Exchange also launched a stock futures contract. The underlying shares were selected to represent a range of sectors and for their liquidity. The liquidity of the new contracts will be supported by two market makers, who are required to display bids and offers on a continuous basis. The advantages of stock futures include:

- the possibility of taking short positions in a share without having borrowed the securities;

- the amount of capital needed to trade in these securities;

- posting a percentage of the contract value (initial margin) without having to fund the entire position; and

- cost savings in clearing. The margin integration system of the Italian Clearing House enables it to calculate integrated margins for stock futures and stock options on the same underlying instrument.

The Italian Stock Exchange also approved revisions to the Code of Conduct issued in 1999. With reference to national and international *best practice*, the main amendments refer to:

- independent directors: the Code lays down stricter criteria for each board's evaluation of the independence of its members. It also recommends that the boards of companies controlled by other listed companies should include a sufficient number of independent directors for the establishment of a committee for internal control exclusively composed of independent members;

- internal control: the Code adopts a new definition of "internal control", in line with international standards, and specifies the relevant duties and the responsibilities of the board. It also requires the committee for internal control, composed of non executive directors, the majority of whom must be independent, to conduct prior verification of the accounting principles adopted at group as well as company level; and

- transactions with related parties: companies are required to define general criteria for identifying transactions which require the approval of the board of directors.

Anti-Money Laundering Developments

During the period under review, the sector was heavily engaged in combating the financing of international terrorism. This action was conducted both by freezing bank accounts held by or traceable to persons identified in the lists contained in the related Community regulations and by utilizing the anti-laundering instruments currently available in Italy. In particular, the Bank of Italy and the Italian Foreign Exchange Office (UIC) transmitted to ABI, for subsequent dissemination to the banks, lists of names for the banks to check against their customer records. Banks finding such names among their customers must report them pursuant to the UIC pursuant to Article 3 of Law 197 of July 5, 1991 (the anti-money-laundering law).

A specific measure issued by the UIC allowed financial intermediaries to fulfill the customer identification requirement of Article 2 of Law 197/1991 by means of digital signatures, provided the identification procedures established by the so-called digital signature certifier comply with the salient points of Law 197/1991.

Finally, the UIC converted the transaction recording threshold amount under Article 2 of Law 197/1991 from 20,000,000 lire into 10,329.14 euros.

Market Developments

Further mergers and acquisitions were carried out in the Italian banking market during the period. The market share of the five largest groups expanded from 51.7 to 56.4 percent, while that of the ten largest groups increased from 65 to 71.2 percent.

The second half of 2001 and the first half of 2002 were characterized above all by consolidation of banks' activities, against the background of pronounced uncertainty due both to economic factors (the economic slowdown and weakness of the stock exchanges) and to non-economic factors (the terrorist attacks and armed conflicts).

Payment Systems and Services

The changeover to the euro was the dominant event last year in the field of payment systems. Although the activity for interbank procedures had been largely carried out in 1997 and 1998 in connection with the launch of the so-called bank euro, the approach of the deadline for abandoning the lira saw a sharp rise in testing preparatory to the dropping of procedures in lire and, above all, in the definition of the normative aspects at interbank level. The work accomplished yielded the expected results and the closure of the lira channels of the various procedures did not create any operating problems.

Activities to increase the effectiveness and efficiency of Italy's payment systems proceeded alongside those for the changeover to the euro. Meanwhile, work went forward within the European credit sector associations, especially in the second half of the year, to define the measures needed for a single European payment area. The outcome was a document (*Blueprint* *for a single euro payment area*) that represents the point of departure for drafting, in 2002, more detailed plans on the technical and legislative standards to prepared in the coming years.

Another important project, whose technical aspects were finalized in 2001 but which was brought into production by the banks in 2002, was the launch of a bank inpayment transfer form called Freccia. This relatively simple instrument is designed to recoup competitiveness among market segments (debtors and issuers) where the Post Office has been making increasing inroads. The relative slowness of its launch is attributable to the work for the introduction of the euro, which caused many banks to postpone the activities necessary for acceptance of Freccia inpayments at bank branches until March.

The other “classic” family of payments was also involved in a series of activities aimed at integrating the domestic sphere as far as possible with the cross-border sphere at the European level. Of particular importance was the project begun by the Bank of Italy for a new version of Birel, the real-time gross settlement system, which will not only be enriched with several important functions but will soon be utilizable by means of the Swift messaging system rather than with the National Interbank Network(RNI) proprietary standard.

With regard to domestic checks, substantial support was provided to the Bank of Italy, within the Interbank Convention on Automation (CIPA), with view to devising the procedures for the operation of the Interbank Alarm Centre, the database envisaged by the law decriminalizing certain minor offenses, as a safeguard replacing the penal sanctions in force in the past. The Centre, some of whose principal functions went live in June 2002, will provide support not only for the circulation of checks but also for the issue of payment cards, even though the safeguards already put in place for the latter by the operators concerned are already well developed and effective. Turning to the activities of the Bancomat Brand Management Convention, these focused on the inquiry conducted by the Bank of Italy in 2001 into the consistency of the default interbank fees indicated by the circuit and unified, at the request of the Bank of Italy, for all retail sectors.

The Bank of Italy, with Order 38 of 27 November 2001 issued at the conclusion of its investigation, closed the case on PagoBancomat after finding, *inter alia*, that the Convention had complied with the obligation of eliminating the differentiation of the interbank fee according to retail sector within the deadline set by Order 23 of 8 October 1998; and that the interbank fee set by the Convention was consistent with the costs incurred by the banks.

In view of the results achieved by the Convention in managing the PagoBancomat brand, in 2001 ABI decided to award the Convention the exclusive licence for managing the Bancomat brand and, more in general, to entrust it with managing rules, standards and communications regarding the cash withdrawal function distinguished by the Bancomat brand.

With reference to the adoption of microchip technology, the drafting the specifications of the cards and terminals in 2000 was followed in 2001 by the finalization of the specifications for the interbank protocols. Microchip card providers were given the opportunity to prepare the definitive prototypes (in hard mask), which were sent to the international circuits for the appropriate certifications. The pilot roll out, scheduled to begin on September 15, 2002 in some Italian cities, will conclude on December 31, 2002. National roll out, with the entire system engaged in migration to microchip technology, will commence in 2003 and is expected to last approximately three years. In line with the arrangements decided autonomously by each of the international circuits, there are plans for a system of incentives linked to the domestic PagoBancomat circuit: a special fund, managed by the Microchip Project, will reward those banks that lead the others in adapting their cards and terminals to microchip technology.

JAPAN

Regulatory Developments

No Action Letter System

On July 16, 2001, the Financial Services Agency (FSA) introduced the "No Action Letter System", which is a confirmation procedure for companies that precedes the application of laws and ordinances to their businesses. The system enables private companies, which are planning to engage in a business or transactions for the first time, to lodge an inquiry in advance with the FSA and learn whether their proposed business or transaction breaches relevant financial laws and ordinances.

Non-Performing Loans

The following measures have been established as part of the policy to reinforce the disposal of non-performing loans (NPLs), with the goal of having those loans moved off the balance sheet within two to three years:

- "Guidelines for multi-creditor out-of-court work-outs" were established by private institutions (in September 2001) to encourage equitable and smooth out-of-court settlements between concerned parties.

- The deadline for the purchase of NPLs from ordinary financial institutions by the Resolution and Collection Corporation (RCC) was extended by three years, to March 2004. In August 2001, the RCC obtained approval to establish a trust to purchase NPLs, in an effort to enhance the functions of the RCC. Furthermore, amended legislation was enacted in January 2002 which stipulated that the acquisition prices of NPLs by the RCC, which had been substantially below market values prior to that, would be based on the NPL's market value. Prior to the legislation, Company Reconstruction Division was set up within the RCC, designed to encourage the restructuring of companies.

The FSA conducted special inspections of Japan's 13 major banks, with a focus on borrowers whose market assessment had changed dramatically (a total of 149 borrowers with total credit of 12.9 trillion yen) and announced the results of its inspections on April 12, 2002. The total loss incurred in the second half of fiscal 2001 (ended March 2002) due to the disposal of NPLs concerning these 149 borrowers by the banks came to 1.9 trillion yen.

Restrictions on Bank Shareholdings

A law, due to come into force from September 2004, was passed on November 21, 2001 to restrict the shareholdings of banks. The total shareholdings of banks will be restricted to within the value of the bank's shareholders' equity, in an effort to prevent not only the financial soundness of banks but also the stability of the financial system as a whole from being impacted by the risk of share price fluctuations. In addition, the Banks' Shareholdings Purchase Corporation was established in January 2002 under the same legislation, in order to encourage the smooth sale of bank shareholdings to meet these requirements. The Corporation will enable the purchase of these shareholdings in transactions off the market.

Lifting of Ban on Trust Business by City Banks

A partial revision of the cabinet order relating to concurrent trust business came into effect on February 1, 2002, which enabled a wider range of financial institutions to conduct trust business at the parent entity level. The institutions permitted to conduct trust business have been expanded from regional banks to city banks, long-term credit banks and the Norinchukin Bank.

Regulations on Ownership of Banks

Revisions to the Banking Law brought into effect on April 1, 2002 established provisions on the ownership of banks, bringing the shareholders of banks under the supervision of the FSA by: i) requiring a shareholder with a stake of more than 5% in a bank to notify the FSA, and ii) identifying a shareholder with a stake of 20% or more as a "major shareholder", and requiring them to seek approval for share purchases and to comply with FSA's requests for reports and inspections.

Resumption of "Pay-Off" Scheme

The exceptional measure of blanket deposit insurance by the Deposit Insurance Corporation of Japan was abolished at the end of March 2002 and, as of April 1, 2002, a protection ceiling of up to 10 million yen of principal and interest per depositor was established in the case of failure of an insured financial institution. However, the blanket deposit insurance will remain in place until the end of March 2003 on liquid deposits such as checking accounts and ordinary deposit accounts.

Lifting of Ban on Over-the-Counter Sales of ETFs by Banks

From April 1, 2002, banks are able to engage in over-the-counter sales of Exchange Traded Funds (ETFs).

In June 2001, the government lifted the ban on in-kind subscription ETFs and on July 13, five funds (including funds linked to TOPIX and the Nikkei 225) were listed and their trading began on the Tokyo and Osaka Stock Exchanges. The number of funds had increased to 12 as of April 2002.

Short-Selling Regulations

The FSA implemented a series of specific measures to regulate short-selling of stocks from December 2001 to February 2002, as part of its effort to reform the structure of the securities market. One of the reasons behind these measures was the contravention of short-selling regulations by some securities firms. The specific details of the measures are as follows: securities firms in contravention of the regulations will be severely dealt with; demand and supply in margin transactions will be managed appropriately (including the disclosure of the balance of margin transactions by the stock exchanges); price regulations for short selling will be reviewed; and stock certificate procurement costs (including the establishment of stock lending commission for loan transactions) will be reviewed.

Anti-Money Laundering Developments

The government implemented measures in response to the terrorist attacks in the US on September 11, 2001, including the freezing of assets in Japan held by Taliban connections. The government now requires financial institutions to report to the authorities transactions that they suspect are connected with the Taliban or those associated with the Taliban, as suspicious transactions according to Anti-Money Laundering measures.

In order to establish the domestic legal structure required to conclude the International Convention for the Suppression of the Financing of Terrorism, the government established the Law on Customer Identification and Retention of Records on Transactions with Customers by Financial Institutions on April 22, 2002. On the same day, it revised the articles of Foreign Exchange Law, which also relate to this issue. The law requires that financial institutions confirm the customer's name and date of birth using public documents such as a driver's license when entering into transactions with the customer, such as the opening of a bank account or a large cash transaction (which is set to be defined as greater than 2 million yen). The legislation is due to come into effect in January 2003.

Market Developments

Restructuring of Banking Groups

The UFJ Bank was formed on January 15, 2002 as a result of a merger between Sanwa Bank and Tokai Bank, which were part of the UFJ group.

Mitsui Trust Holdings was established on February 1, 2002 as the holding company of The Chuo Mitsui Trust and Banking Company.

Daiwa Bank Holdings was established on December 12, 2001 as the holding company of Daiwa Bank. Asahi Bank was incorporated into the group on March 1, 2002. Group restructuring plans were announced and the group began operating under its new name, Resona Group, on April 12, 2002.

The Dai-Ichi Kangyo Bank, Fuji Bank, and Industrial Bank of Japan, which were part of the Mizuho Financial Group, were reorganized into the Mizuho Bank and the Mizuho Corporate Bank on April 1, 2002.

Demutualization of Life Insurance Companies and Securities Exchanges

Daido Life Insurance, located in Osaka, demutualized into a joint stock company on April 1, 2002. This was the first case of demutualization of life insurance companies. The Tokyo Stock Exchange and the Nagoya Stock Exchange were demutualized on November 1, 2001 and April 1, 2002 respectively.

Other Developments

The issue of paperless CP was made possible on April 1, 2002.

As part of its December 2002 plan to reorganize and streamline special public corporations, the government has indicated that it will abolish the Government Housing Loan Corporation within five years.

A bill was submitted to the Diet on April 26, 2002, proposing the transfer of the postal services, postal savings, and postal insurance to public corporations.

Consolidated Supervision

All financial institutions established in Japan are subject to the supervision of the single supervisory authority, the Financial Services Agency. Therefore, each financial institution, which is a member of a financial group, is supervised by the FSA separately. In the case of a banking group comprised of bank(s) and their subsidiaries, holding companies and affiliates, the scope of business permitted to each company constituting the group and the group as a whole is restricted. FSA may request subsidiaries and holding companies of banks, securities companies and insurance companies to submit reports or materials as well as conduct on-site inspection where necessary.

Each office of foreign financial groups located in Japan is treated separately. Such offices may be a branch of a foreign bank, branch of a foreign securities company, branch of foreign insurance company, or bank/securities subsidiaries established with foreign capital. These entities are supervised by FSA according to their type of business. A foreign company, which has a bank subsidiary located in Japan, is regarded as a Bank Holding Company established overseas and is not permitted to own subsidiaries beyond the limitation permitted to a Bank Holding Company in Japan.

The nature and extent of supervision depends on the type of presence maintained.

The nature of the restrictions differs according to the nature of the financial group's business, given that the group is under the supervision of a single supervisory authority (FSA).

In applying restrictions based on the capital adequacy ratio of a non-domestic bank's Japanese branch, the capital adequacy ratio of the non-domestic bank itself based on its home country's standard is the criterion used. The FSA does not make its own assessment of the bank's capital based on Japanese standards.

The FSA is able to request from a foreign bank's Japanese branch, where necessary, the submission of reports or materials on the business or financial condition of the foreign bank. The FSA is also able to request from a bank holding company located abroad the submission of reports or materials relevant to the business or financial condition of the subsidiary bank, in the same way that it is able to make this request of Japanese holding companies. However, in the case of a foreign insurance company with a branch office in Japan, the FSA is only able to request the submission of reports or materials relating to the business and financial conditions of its operations in Japan. There are no similar rules on the Japanese branches of foreign securities companies.

The objective of these restrictions is not necessarily limited to risk management or the detection of money laundering.

KOREA

Corporate Restructuring Promotion Law

Purpose of the Law

The Corporate Restructuring Promotion Law (CRPL) of August 2001reflects a general consensus on the issue of prompt corporate restructuring.

The CRPL specifies clear and transparent regulations for the imposition of market principles among creditor financial institutions. It is expected that these institutions, utilizing the provisions of the CRPL, will be more likely to initiate further action to impose corporate restructuring on financially-troubled debtor companies.

Furthermore, application of the law will substantially solidify the rehabilitation plans for corporate restructuring and aid the progress of companies toward sound management. The law takes effect at mid-September and its duration is five years

Comparison between the CRPL and the Prior Workout Program

The CRPL applies to all financial institutions, totaling 420, as well as the Korea Deposit Insurance Corporation (KDIC) and Korea Asset Management Corporation (KAMCO). Under the prior system, 130 financial institutions voluntarily participated in the workout program.

Before, the decision to join a creditor association rested with the individual financial institution. The CRPL, on the other hand, stipulates mandatory participation of all the creditor financial institutions in the creditor association, once 75 percent of the creditors agree to create one.

Should a creditor bank oppose a decision made by the association, the bank has the right to request the association to purchase its loan claims at market value and withdraw from the association. This measure of the CRPL ensures prompt and efficient management by the creditor association.

The major creditor bank oversees the financial condition of the restructuring companies on a quarterly basis while companies under court receivership and composition programs are to be reviewed at least once a year. After monitoring the results, if a company is judged to be non-viable, it shall be placed in court receivership or bankruptcy.

Additionally, by establishing a system for managing accounting information more accurately, the CRPL mandates a more transparent accounting system.

New Disclosure Requirements on Domestic Banks' Risk Management

In accordance with the expected implementation of the BIS capital adequacy rule which incorporates various market risks, the Financial Supervisory Committee(FSC) /Financial Supervisory Service(FSS) announced new disclosure requirements for domestic banks' market risk management to ensure harmony with international norms and enhanced discipline by the market participants. The new disclosure requirements, which went into effect on January 1, 2002, mandate stringent disclosures on the bank assets subject to the new market-risk capital adequacy regulation as well as the magnitude, measurement method, and management policy of market risks

Disclosures on bank assets subject to the new capital adequacy regulation

Domestic banks are now required to disclose the current market value of assets in their trading books as well as the components (and their relative share) of those assets subject to the new capital adequacy requirements. In addition, domestic banks are required to disclose the core strategies and guidelines they follow in buying and selling assets in their trading books or in taking positions in financial instruments.

Magnitude of market risks, measurement method, and market risk management policies

For banks that must comply with the new capital adequacy regulation, disclosure of the magnitude of the market risk, the measurement methods used, and the bank management policies toward market risk are mandatory.

With respect to the magnitude of market risk and the method used to calculate it, domestic banks may elect either the standard risk measurement model adopted by the Basel Committee or their own proprietary risk measurement models. Domestic banks that utilize the proprietary risk measurement model should receive approval from the FSS and are required to disclose the risk factors (e.g., interest rates, equity positions, and foreign exchange risks) used in the models.

Disclosure of market risk management policies are mandatory. Market risk management policies to be disclosed are policies dealing with capital allocation vis-a-vis the market risk profiles, policies establishing trading ceilings, valuation methods to be used for market-risk weighted assets, and other pertinent information regarding banks' market risk management policies.

Plans to Improve Corporations' Foreign Exchange Risk Management

In April 2001, the FSS established measures to strengthen corporations' foreign exchange risk management. Banks are now required to regularly evaluate corporate foreign exchange risk management and then utilize the results from these evaluations when making credit rating assessments and determining credit ceilings and loan rates. The FSS examines and evaluates how well banks carry out these evaluations, and uses these results in CAMELS assessments.

The FSS plans - effective January 2002 - aim at improving existing measures through a variety of ways. The most significant measure is the expansion of the coverage of corporate borrowers subject to foreign exchange risk management monitoring by banks. The criteria for foreign exchange risk management - set according to minimum amounts of total credits extended and differences between foreign currency denominated assets and liabilities - decreased from 3 billion won and 5 million dollars to 1 billion won and 1 million dollars, respectively. As a result, small- and medium-sized enterprises (SMEs) and large firms are now required to manage their foreign exchange risk.

The plans also allocate two different weights to both quantitative and qualitative indexes utilized in banks' evaluations for large firms and SMEs, recognizing the differences in corporation size. The quantitative index weight for large firms is set at 60% and 70% for SMEs. The qualitative index weight is set at 40% and 30%, for large firms and SMEs, respectively.

Lastly, in order to expedite changes in the foreign exchange risk management system, the FSS stresses banks' compliance with the complementary measures.

Introduction of the "Exclusive Right" System for New Financial Products

In order to encourage the development of new financial products, a system that grants developers exclusive rights to new financial products was introduced in December 2001. This system provides protection against duplication by other financial companies. As a part of financial software reform plans, the measure aims at eliminating practices that copy other companies' financial products and establishing fair rules for competition in the regulations of self-regulatory organizations, which include the Korea Federation of Banks (KFB) and the Korean Securities Dealers Association (KSDA).

Under the new system, a consulting committee consisting of 7-10 members awards protection to newly developed financial products and the length of the protection period, which is up to six months depending on the level of originality. The committee's decisions will be sent to the financial company or published on the Internet homepages of self-regulatory organizations. If another financial company violates the decisions made by the committee, the company at fault will have to stop the sales of their copied financial products or be prohibited for a certain period of time from applying for a exclusive right, should they develop a new financial product. The committee members are financial specialists from financial research institutions, academia and financial institutions.

As a result, financial companies are expected to have more incentives to develop custom-made financial products that are sensitive to customer demand as well as other advanced financial products. The new system will also expand financial companies' profit bases, enhance the competitiveness of the financial industry and improve customer services.

Plans to Better Protect Investors from Back-Door Listing

On June 4, 2001, the FSC/FSS announced a set of new measures aimed at better protecting investors from losses arising from back-door listing (BDL). BDL is generally understood as a way for unlisted venture companies to become listed on stock exchanges through M&A or acquisition & development (A&D) with listed companies. However, investors are exposed to potential losses when companies engage in BDL for short-term capital gains. As such, the new measures will require a stricter disclosure of the purchase of controlling shares of unlisted companies and impose a mandatory share-holding period for the controlling shareholders of the unlisted companies targeted for a merger.

Listed companies that acquire controlling shares of unlisted companies are required to disclose the purchase prices of the shares in their Registration Statements for Securities Issuance and Public Disclosure Statements. One important goal of the disclosure requirement is to prevent purchases at unreasonably high prices through collusion with the company being acquired, which leads to the significant deterioration in the financial condition of the acquiring company and thus causes financial losses to its shareholders. When a listed company and an unlisted company merge, the controlling shareholders of the unlisted company are barred from selling their shares for a certain period of time as in the case of the controlling shareholders of the listed company after its initial public offering.

The new measures went into effect at the end of June 2001, after revisions to the regulations on Korea Stock Exchange and the Korea Securities Dealers Automated Quotation were completed.

Strengthening the Supervision of Firewalls at Branches of Foreign Securities Companies in Korea

In May 2002, the FSS began to examine branches of foreign securities companies (BFSCs) for compliance with firewall-related requirements.

The FSS began to monitor and apply punitive measures against BFSCs in Korea which have back offices and computer system operations integrated with other financial sector companies such as banks, and staff serving in regular positions at more than one financial company. These efforts will reinforce existing legal restrictions on these activities, aimed at preventing incidences such as insider trading and conflicts of interest.

The FSS gave BFSCs the opportunity to voluntarily report and comply with firewall-related requirements by the end of April 2002. Comprehensive examinations by the FSS of

BFSCs' internal control systems and business tie-ups were conducted in May 2002, and those found to be in violation of these requirements will be fined and penalized.

Enhancing the Disclosure of Punitive Measures and Inspections to Strengthen Market Discipline

The FSS, drawing from the disclosure systems of major advanced supervisory authorities, announced its plan to provide sanction contents and inspection results of financial companies through its new database system on the FSS homepage. As a means to improve the effectiveness of sanctions through market discipline, the database search system will systematically disclose information regarding disciplinary actions imposed on financial companies for a period of five years.

The database system, scheduled to be complete in the third quarter of 2002, will facilitate the general public's ability to access information on financial companies and their staff. It will allow users to search by financial company, year or type of sanction. This system is designed to strengthen the self-discipline against moral hazard by market participants, contributing to the enhanced soundness of financial companies.

The New Penalty Scheme for a Negligent Audits

The FSC announced a revision to the regulatory provisions pertaining to external auditing that institutes a new penalty scheme for negligent audits by external auditors.

Under the new scheme, penalty points corresponding to the severity of negligence are to be accumulated against auditors for failure to provide proper and due auditing, and sanctions corresponding to the number of penalty points accumulated during a period are to be imposed against them upon the review of their audits. As such, the new penalty scheme replaces the existing system of imposing sanctions on external auditors per each individual instance of negligent audit with a more systematic and stringent supervision of accounting negligence.

In order to enable lending institutions to take into account the results of the audit reviews of corporate borrowers in their loan decisions, the Securities and Futures Commission (SFC) plans to make the audit results available to all domestic financial business entities, including banks, insurance companies, and investment trust companies.

Consolidated Supervision in Korea

Financial holding companies and their subsidiaries are subject to consolidated supervision with respect to prudential regulations such as capital adequacy, management performance analysis and evaluation.

Supervisory authorities examine whether the financial group as a whole meets total capital requirements, which may vary according to the types of financial institutions included in the financial group.

Consolidated supervision is not applied to non-domestic financial groups.

LATVIA

The Financial and Capital Market Commission (FCMC) commenced its activities on July 1, 2001, becoming the legal successor to the rights, obligations and liabilities of the Insurance Supervision Inspectorate, the Securities Market Commission, administration of the Deposits Guarantee Fund and of the Bank of Latvia in the field of credit institution supervision. The FCMC is an autonomous public institution and the purpose of its activities is to promote the protection of interests of investors, depositors and the insured, and the development and stability of the financial and capital markets. To this end, the FCMC regulates and supervises the financial and capital markets and activities of its participants. The Council of the FCMC takes decisions independently. No one is entitled to intervene in activities of the FCMC. In fact, the degree of its independence is comparable to that of the central bank. The organizational and management structure of the FCMC was fully set up along functional lines in order to ensure mutual co-operation and equal supervision quality in all financial and capital market sectors. The FCMC comprises the following three departments: the Supervision Department; the Legal and Licensing Department; and the Regulations and Statistics Department.

The main objective of the Bank of Latvia is to implement monetary policy by controlling the amount of money in circulation with the aim to maintain price stability in the State. The Bank of Latvia advises the Parliament and the Cabinet of Ministers on monetary policy and other matters pertaining to the execution of its tasks. The Bank of Latvia is entitled to receive information necessary for the execution of its tasks from the Financial and Capital Market Commission, credit institutions and other state and government institutions. The Bank of Latvia promotes the smooth operation of the payment systems in the Republic of Latvia. The Bank of Latvia is entitled to approve regulatory requirements to ensure efficient and sound functioning of the clearing and payment systems.

During the second half of 2001 and in the beginning of 2002, the FCMC proceeded with the harmonization of regulatory requirements governing the activities of financial and capital market participants, which, in the opinion of the International Monetary Fund, conforms to the requirements of EC directives and recommendations of international organizations of financial supervisory authorities.

The Regulation for Drawing up Annual Accounts of Banks approved by the Council of the FCMC on December 21, 2001 has been prepared, taking into account amendments made to IAS since 1996 as well as amendments 2001/65/EC to EC Directive 86/635/EEC on the Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions. The Regulation provides for the procedures for classification of financial assets and financial liabilities according to their types and their initial recognition, as well as subsequent valuation in compliance with the IAS 39. Qualitative and quantitative information on risks inherent to banking activities, including market risk, shall be disclosed in the notes.

The amendments to the Law on Natural Person Deposit Guarantees make deposits of legal entities eligible for compensation from the Deposit Guarantee Fund. Deposits of legal entities are eligible for compensation from January 2003, in the same amount as the deposits of natural persons and the guaranteed compensation will be gradually increased to reach the minimum prescribed by the EC Directive 94/19/EC on Deposit-Guarantee Schemes in January 2008.

The amendments to the Law on Credit Institutions were adopted by the Parliament on April 11, 2002. These amendments grant the FCMC powers to prevent close links between a credit institution and a third party in cases where such relations might jeopardize the financial stability of the credit institution or hinder the performance of supervisory functions of the FCMC. The provision for the establishment of creditors' meetings is intended to streamline banking insolvency procedures. The amendments to the Law on Credit Institutions also provide the provisions on the out-of-court settlement of disputes. Credit institutions shall ensure effective procedures for the examination of complaints of customers and disputes with the credit institution regarding credit transfers of payment instruments other than cash and transactions in electronic means of payment.

The said amendments to the Law on Credit Institutions also include requirements that will implement the "single license" principle with respect to setting up branches of banks licensed in EU and European Economic Area countries and providing financial services in Latvia. As a result of the introduction of the "single license" principle, a bank registered in a relevant country will not have to receive an operating licence in the country where it intends to open a branch or provide financial services. This provision will come into effect by a separate law.

The FCMC is drafting amendments to the Law on Insurance Companies and Their Supervision. The amendments will allow a foreign insurance company to establish a branch in the Republic of Latvia as well as implement the EU requirements concerning the single license principle and home country control principle.

In regard to investments in foreign assets by private pension funds and insurance companies, amendments to the Law on Private Pension Funds, as well as the Law on Insurance Companies and Their Supervision have been prepared. The amendments will liberalize the provisions on private pension funds' and insurance companies' investments abroad. Both amendments are scheduled for adoption in the Parliament by the end of 2002. Amendments to the Law on Investment Companies similarly cancel the restrictive provisions on investments abroad. The amendments are expected to be approved by the Parliament by the end of 2002.

On November 23, 2001, the Council of the FCMC approved the Guidelines for Developing Procedures for Identifying Clients and Unusual and Suspicious Financial Transactions. The new Guidelines pertain not only to credit institutions but also to credit unions, brokerage firms, investment companies, insurers, depositories, stock exchanges and private pension funds.

Consolidated Supervision

A credit institution that is the parent of other credit or financial institutions, that owns directly or indirectly 20 percent or more of the share capital or of the voting rights in other credit or financial institutions, or whose parent undertaking is registered in Latvia as a financial holding company shall comply with the requirements governing the activity of credit institutions set forth in the Law on Credit Institutions on the basis of consolidated financial statements.

The procedure for preparation of the consolidated financial statements and information necessary for the supervision of credit institutions, as well as the set of undertakings (business ventures) to be included in the consolidated financial statements, shall be prescribed by the Financial and Capital Market Commission. The Financial and Capital Market Commission requires a credit institution whose supervision is performed by the Financial and Capital Market Commission on the basis of consolidated financial statements to comply with the requirements governing the activity of credit institutions also on solo basis.

A credit institution whose supervision is performed by the Financial and Capital Market Commission on the basis of consolidated financial statements shall ensure the presence of an effective internal control system in all undertakings (business ventures) whose financial statements are consolidated, thus ensuring that accurate information is prepared for the purposes of supervision.

To assess the accuracy of information submitted for the purposes of supervision, the Financial and Capital Market Commission shall be entitled to carry out internal inspections (on-site) of the undertakings (business ventures) whose financial statements are consolidated.

The Financial and Capital Market Commission has the right to request information required for the supervision of a credit institution from undertakings (companies) whose financial statements are not consolidated in accordance with the requirements of the provision of the Law on Credit Institutions, but who have close links with the credit institution by way of control, and to perform internal audits of them in order to evaluate the veracity of the information provided.

LUXEMBOURG

Electronic Commerce

The Government has continued to put in place the regulatory framework for electronic commerce. Important Government initiatives in this area included the Grand Ducal regulation of June 1, 2001 on electronic signatures and the draft law on electronic money establishments.

The Grand Ducal regulation of June 1, 2001 seeks to supplement the law of August 14, 2000 on electronic commerce, notably in respect to the provisions relating to the electronic signature and certification service providers. In the first place, a number of definitions, which are not contained in the law, are provided by the Grand Ducal regulation. Secondly, the text stipulates the compulsory content of any qualified certificate, the requirements relating to the providers of certification services who deliver qualified certificates and the technical requirements for the securitized systems for the creation of the electronic signature pursuant to Attachments I, II and III to Directive 1999/93/EC of December 13, 1999.

Measures to Control Money Laundering and to Fight Terrorism

After the events of September 11, 2001 many international organizations advocated a rapid and coordinated effort to detect and prevent use of the financial system by terrorists. At the national level, following European and international initiatives and to respond to the request made by the US authorities, the CSSF and the Public Prosecutor's Office asked the financial community to ascertain whether they maintained business relations of any nature whatsoever with persons or institutions suspected of being involved in the New York and Washington attacks.

In the context of fighting terrorism and money laundering, the Luxembourg banking supervisory authority issued several circulars:

- *Circular CSSF 2001/31. Supplement to Circulars CSSF 2000/16 and LMI 94/112 on the control of money laundering and the prevention of the use of the financial sector for laundering purposes.*

- *Circular CSSF 2001/37. Supplement to Circulars CSSF 2000/16, 2000/31 and LMI 94/112 concerning measures to combat money laundering and prevent the use of the financial sector for laundering purposes.*

- *Circular CSSF 2001/38. Identification and declaration of business relations with terrorist groupings.*

- *Circular CSSF 2001/39. Identification and declaration of business relations with terrorist groupings.*

- *Circular CSSF 2001/40. Details of the scope of the professional obligations stipulated in Part II of the amended law of April 5, 1993 on the financial sector and LMI Circular 94/112 concerning the fight against money laundering and the prevention of the use of the financial sector for laundering purposes.*

- *Circular CSSF 2001/41. Identification and declaration of business relations with terrorist groupings.*

- *Circular CSSF 2001/48. Supplements to Circulars CSSF 2000/16, 2001/31, 2001/37 and LMI 94/112 concerning measures to prevent money laundering and the use of the financial sector for money laundering purposes.*

Company Administration

Under the law of May 31, 1999 on company administration ("domiciliation") services, the provision of company administration services is restricted to specific categories of professionals - including credit institutions and other financial sector professional - established in Luxembourg and subject to CSSF supervision. The law makes mandatory the existence of a written company administration agreement between the service provider and client company and imposes a series of professional obligations upon company administrators.

The purpose of circular 2001/29 is to specify those matters which are the subject of mandatory stipulation in the company administration agreement. In addition, circular 2001/47 stipulating the professional obligations of domiciliary agents for companies and issuing general recommendations was published by the CSSF.

Law of August 1, 2001 Concerning the Circulation of Securities and Other Fungible Instruments

This law replaces the Grand-Ducal decree of February 17, 1971 on the circulation of transferable securities. The developments occurring in the financial markets during the last decades have made its review indispensable. The law aims to reinforce the legal framework in the area of conservation of transferable securities and the trading of stocks – an area of activity that is one of the underlying strengths of Luxembourg's financial markets. The principal legal amendments are the following:

- the scope of the Grand-Ducal decree is extended by a new definition of the securities and depositories;
- the legal position of depositors has been strengthened by better definition of their rights; and
- the rules on the constitution and implementation of securities have been made less rigid, particularly to better respond to the demands of foreign clients.

Law of August 1, 2001 on the Transfer of Ownership by Way of Guarantee

The transfer of property on a guarantee basis constitutes an interesting technique for capital mobilization at reduced rates, which makes it today the most commonly used guarantee technique in the international financial markets. The present law aims to adapt the legal framework to international practice to eliminate all legal uncertainty and to maintain competition on the financial center.

Laws of August 1, 2001 on the Exchange of Information

A first law extends the list of authorities, bodies and persons of third-party countries with whom the Commission for Supervision of the Finance Sector, acting in its capacity as supervisor of credit institutions and other finance-sector professionals, may exchange information in order to fulfil their respective duties. It establishes the conditions under which such exchanges of information may take place.

In addition, this law establishes a system, in conformity with Community rights, for the exchange of information in which the commission, in its capacity as supervisor of the financial markets, may participate. The law specifies the conditions under which the commission may exchange information and collaborate with the authorities of other countries, whether they be Member States of the European Community or third-party countries, whose public duty it is to supervise the financial markets.

A second law modifies the system by which the Commission for Supervision of the Finance Sector, acting in its capacity as supervisor of collective investment institutions, may exchange information with other authorities, bodies and persons of third-party countries in order for them to fulfil their respective duties.

It also amends the clauses relating to the professional secrecy that binds the Commission for Supervision of the Finance Sector in the fulfilment of its duties as supervisor of collective investment institutions. As a result, the commission may now exchange information and collaborate, acting in its capacity as supervisor, not only with those other authorities, bodies and persons dealing with collective investment in transferable securities but with any collective investment institution.

Law of January 13, 2002 on the Suppression of Counterfeiting Currency

The law adopts the Geneva International Convention for the suppression of counterfeiting currency of April 20, 1929 as well as the respective protocol. The law modifies the Criminal code as well as the banking law of April 5, 1993. Counterfeiting of money is generally forbidden and banks are obliged to withdraw counterfeited currency in euro and to deliver it to the competent authority.

Law of May 14, 2002 on Electronic Currency Establishments

Faced with the progress of technology which has permitted the development of a new type of payment instrument namely electronic currency, a Community directive was adopted on September 18, 2000 with a view to organizing the prudential supervision of the establishments which issue electronic currency. The electronic currency may take the form of a monetary value stored electronically on a support such as a smart card or simply a computer memory. This enables payments to be made directly from an individual computer and is likely to become the privileged payment instrument for electronic commerce.

In Luxembourg only credit establishments have issued electronic currency so far, but the present law will enable electronic commerce and electronic means of payment to develop in accordance with Community legislation. As credit establishments, electronic currency establishments are covered by the principal requirements of the law of April 5, 1993 concerning approval, prudential rules and rules of conduct of the financial sector. On the other hand certain provisions of the law of April 5, 1993 are not applicable to these establishments, in particular those concerning the protection of investors and the guarantee of deposits to the extent that the funds received in exchange for electronic currency do not constitute reimbursable deposits within the meaning of the law.

The proposed text also introduces a new rule applicable to conventional credit institutions and to electronic currency establishments and seeks to assure the eligibility of funds for reimbursement and thereby protect the bearers of electronic currency.

THE NETHERLANDS

Developments in Supervision

During the period under review, the supervisory scene in the Netherlands changed dramatically. Although cross-sector institutions existed for over a decade, supervisors were organized along the traditional lines of business: banking and investment services, insurance, and securities firms and the exchange. From 1999 the three supervisors were working together in a council (RFT) to prevent overlap in their activities and to fill in the gaps in supervision, for example in consumer protection. It was believed that this cooperation would eventually result in a merger of the three supervisors.

In mid-2001, the Ministry of Finance launched talks with the financial sector on how supervision should be shaped to be effective, market-oriented and efficient. In November 2001 the new plans were revealed. Instead of sector-wide supervision, a functional oriented organization of supervision was introduced. The new supervision is structured along two lines: prudential supervision of banks, investment firms, securities firms and insurers; and behavioral supervision of these institutions

Prudential supervision will be exercised in close cooperation between the Nederlandsche Bank (Dutch central bank and banking sector supervisor) and the Pensioen- en Verzekeringskamer (insurance supervisor). These two supervisors are expected to merge in the future.

In the past, the Autoriteit Financiële Markten (Financial Markets Authority) supervised all securities activities of all institutions. From now on, it will supervise the behavior of all institutions in the markets, i.e. the behavior of professionals among themselves and their behavior towards the consumer. In this regard, the new structure reflects the growing attention to consumers in general.

The financial sector was quite surprised that so shortly after the introduction of the RFT, which only functioned for two years, a whole new system was introduced. One of the main complaints from the sector dealt with the overlap in information sought by supervisors. The RFT was thought to do a good job in reducing this overlap. Furthermore the RFT took initiatives in the field of consumer information and protection. The sector, therefore, did not see a need for an overhaul of the system.

Furthermore, the new system came at a time when changes in other European countries had just taken place (the UK and Germany have one supervisor) and discussions on supervision on a European level were starting up. The durability of the new system was therefore called into question by the sector.

On a European level, discussions have started on the most desirable layout of supervision of the financial sector. The British and the German system will probably guide the way, though these systems have not been tested yet.

Payment Services

The development of new technologies in payment services over the last ten to fifteen years (ATM's, banking by phone, the Internet, etc) has changed the cost-effectiveness of doing business through the branches. This has led to a critical assessment of the number of branches of banks and the level of service they offer. This development was fueled by the downturn of the economy and led to the closing of many branches in remote areas as well as large towns.

This policy caused many protests, not only from consumers but also from politicians who threatened a legislative response. As a result, the banks were forced to come up with plans to provide services to customers even when these services would not be cost effective.

Discussions are also taking place on the transfer of account numbers when a consumer changes banks. Transfer of account numbers was possible in the 1980's but was not widely used. Today it is felt that the transferability of account numbers could play an important role in encouraging competition among banks. Because the account number is deeply rooted in the administration of banks, however, such transfers are extremely expensive for the banks. A law which enforces transfer of account numbers is awaited.

As from July 1, 2002, based on a EU-regulation, ATM-withdrawels in another EU-member state than the home country of the consumer must be priced as if the withdrawel took place in his home country. In the Netherlands, where domestic payment services are largely free of charge, this affects the profitability of the banks.

Behind these and other measures is the view held by the authorities that payment services are a utility service that should be provided by banks at low or no cost.

Regulation on Organization and Control

In 2001 the Regulation on Organization and Control (ROC) became effective. The purpose of this regulation is to provide directives and recommendations for the organization and control of business processes within institutions. The principle is that institutions are responsible for organizing and controlling their business processes in such a way that their business is conducted in a controlled and sound manner.

The regulation deals with controlling risks to which institutions are exposed, including the risks arising from non-compliance, or inadequate compliance, with regulations and from breaches of sound business conduct. The risks concerned are material risks, in other words, risks that may have a significant adverse effect on the financial performance, financial position, continuity or reputation of an institution. The principle is that the institution itself is responsible for drawing up procedures, rules and standards, for embedding these in the business processes and for monitoring their effectiveness and compliance therewith. The management board of the institution must ensure this is achieved in practice.

The regulation focuses on the following elements: risk control, organizational measures, information, communication and examination, evaluation and rectification. The correct emphasis on these elements should result in effective steering and control of business processes.

The regulation, together with the policy rules of the Nederlandsche Bank (the supervisor), aims at creating a framework which is to be elaborated on by institutions themselves. This approach allows room for an interpretation that reflects appropriately the individual circumstances of an institution and new developments.

Consolidated Supervision

In the Netherlands, supervision of financial conglomerates is under review at the moment. In the course of 2002, a bill will be put forward on prudential supervision of financial conglomerates.

Meanwhile, more research is needed on the use and qualities of capital allocation models for financial conglomerates and the implications for their supervision. It remains to be seen how reliable these models will be in periods of stress and recession. A study on this is being conducted jointly by representatives of the supervisors of the banks and insurance sector and the industry.

NIGERIA

Bank Regulatory Developments

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 such enterprises, continued to be a main policy objective during the period under review.

As previously reported, the Central Bank of Nigeria (CBN), in its commitment towards further strengthening of the capital base of banks, directed that in the 2001 fiscal year, the minimum paid-up capital for new banks be raised from ₦1 billion to ₦2 billion. In a new development, existing banks are required to raise their capital base to ₦1 billion by the end of 2002 from ₦500 million.

In an attempt to improve the quality of management in banks, the CBN previously set a minimum requirement to be attained by individuals appointed to top management positions. For example, the Managing Director, apart from having a postgraduate degree or other professional qualification, should have at least 20 years of experience, including at least 15 years in the banking industry. The General Manager should have 15 years of experience, 10 of which must be in the banking industry.

Developments in Foreign Exchange and Trade

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 accepts to pay in foreign exchange, the funds shall be from either its domicilliary account or offshore sources.

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. Non-compliance shall render the bills invalid.

In 2001, the initial validity for an approved Form 'M' in respect of payments for the importation of machinery, plant and equipment made to specification was 360 days, subject to extension for another 180 days by the processing bank without recourse to the CBN. However, where there is need for further extension, application shall be made to, and approval be granted by the CBN. Thus, the maximum life span of an approved Form 'M' for importation of machinery, plant and equipment is 540 days. The same applies in the 2002 fiscal year.

Other Developments in the Financial Sector

In its bid to promote transparency and ethical standards in the banking sector, the CBN has been intensifying the process of monitoring operators to ensure compliance with regulations while also encouraging self-regulation in the industry. Banks under the aegis of the Bankers Committee set up a Sub-Committee on Ethics to address ethics issues in the banking system.

NORWAY

Developments in the Financial Sector

Regulatory Framework for Asset Management

After significant pressure from the industry, important amendments were made to the Act on Securities Funds in 2001, allowing the fund management sector greater scope to improve the efficiency of the business. It will now be possible for fund management companies to delegate discretionary mandates to investment firms within the same group of companies or to external portfolio managers.

New Instruments for Banks

A set of rules will be implemented soon for secured bonds and in due course probably also for bonds originating from securitization of bank loans. These instruments are expected to contribute to the vitalization of the Norwegian bond market, which is limited in size when compared to the bond market in other countries.

Following an amendment to the tax legislation in 2001, Norwegian banks may issue hybrid capital securities that qualify as Tier 1 capital in the banks' own funds.

Changes in Norwegian Rules on Ownership in Financial Institutions

An Expert Group has proposed to replace the existing Norwegian ownership rules with a system based on the provisions on ownership control as contained in the relevant EEA-directives. In Norway there is a maximum ownership limit of 10 percent for any single owner of a financial institution. The Group proposes that a person who intends to acquire a "qualified holding" (a holding representing 10 percent or more of the capital or the votes) in a financial institution must notify this to the competent authorities, and get a prior authorization (or a no-objection) before the acquisition can be implemented.

In addition, the Group proposes a specific rule in relation to takeovers of financial institutions. It is considered to be of prudential interest to establish a clear and transparent ownership structure in the institution. The current regime requires a 100 percent holding in order to acquire a financial institution as a subsidiary. The Group proposes to lower this limit to 67 percent in relation to takeovers. Further, the Group proposes that a takeover bid must be put forward if the owner intends to acquire a total holding in excess of 25 percent of the shares in the company. This also implies a substantial change in the ownership structure, and such a rule can therefore protect the minority shareholders as well.

New Regulations on Savings Banks

The Ministry of Finance has proposed amendments to the present legislation on savings banks, allowing such banks to convert into private or public limited companies. The proposal requires the shares in a converted savings bank to be transferred to a foundation, with the exception of shares being transferred to the current owners of primary capital certificates. The general 10 percent ownership rule regarding ownership in financial institutions will not apply to such foundations when it comes to holding shares in the converted savings bank.

The main purpose of the foundation shall be to provide a stable and long-term governing of the ownership in the converted savings bank. It is also required that the foundation is independent from the converted bank. The foundation shall have a general assembly, whose members shall reflect the converted savings bank's clients and other interest groups. Furthermore, the foundation's disposal of shares in the converted savings bank is made dependent on the acceptance from two-thirds of the members of the general assembly in the foundation.

Converted savings banks will have the right to call themselves savings banks as long as the foundation holds more than 10 percent of the shares in the bank. Converted savings banks will on the same conditions be allowed as members of the Norwegian Guarantee Scheme for Savings Banks.

Significant Market Developments

In January 2002, Den norske Bank (the country's largest bank) signed an agreement on the acquisition of Skandia's global asset management operations.

Consolidated Supervision

Financial Groups Headquartered in Norway

Financial groups (including cross-sector groups) headquartered in Norway ("domestic financial groups") are subject to consolidated supervision, including with respect to examination and reporting requirements, prudential capital requirements, regulation of transactions among affiliates etc.

The nature and extent of consolidated supervision does not depend on the types of financial institutions that are included in the financial group.

Financial Groups Headquartered Outside Norway

Financial groups headquartered outside Norway ("non-domestic financial groups") are not subject to consolidated supervision by Norwegian authorities as host country supervisors.

PAKISTAN

During the period under review, there were a number of policy changes in the areas of banking, monetary and credit policy, and export financing.

Banking Policy Measures

- On October 10, 2001, banks were advised to submit to the Credit Information Bureau data on their non-performing loans of Rs. 10 million and above on a monthly basis, starting from the month of October 2001, within 15 days of the end of each month.

- On January 1, 2002, the State Bank of Pakistan issued guidelines for subordinated debt of commercial banks.

- On January 1, 2002, banks were disallowed from nominating any person associated with the stock market or money changers to their boards of directors.

Monetary and Credit Policy Measures

- Effective from September 15, 2001, the minimum margin requirement for financing facilities against shares of listed companies was reduced from 30 percent to 25 percent.

- On October 17, 2001, the SBP advised banks about the arrangement made for the confirmation of their eligible L/Cs in order to reduce the cost of imports. In this regard the Government of Pakistan negotiated a facility with Asian Development Bank (ADB) to guarantee payment to international banks, thus transferring Pakistan country risk into ADB risk

- On January 1, 2002 the SBP instructed banks that their foreign currency deposits mobilized under FE-25 schemes after netting-off the deposits utilized to finance trade related activities such as financing against import and export documents, should not at any point exceed 20 percent of the local currency deposits of the banks/NBFIs at the close of business on the last working day of the preceding quarter. All banks violating this condition as of January 1, 2002 were given until July 1, 2002 for strict compliance, and were also asked to report the rupee equivalent amount of FE-25 deposits as a footnote in their weekly statements of position.

- On January 31, 2002, the investment banks and Development Finance Institutions (DFIs) were allowed access to SBP 3-day repo facilities on the same terms and conditions as commercial banks.

- Effective from March 2, 2002, banks were allowed to invest up to 20 percent of their specified time and demand liabilities abroad.

- On March 20, 2002, SBP withdrew the then existing maximum limit of 15 percent for development loans against the total mandatory credit targets until June 30, 2003.

Export Finance Policy Measures

- Effective from October 1, 2001, SBP modified Part-1 of the Export Finance Scheme (EFS) to eliminate excessive documentation, cut in the rate of markup, extend coverage and set up a Pre-Shipment Export Finance Guarantee (PEFG) agency.

- On October 24, 2001, the credit utilization period was extended to 270 days (both pre-shipment and post shipment) for EFS.

- On October 30, 2001, it was decided that foreign earnings on all consulting services would be treated as export proceeds and would qualify for export finance facility under part-1 of EFS for a period not exceeding 180 days at the prescribed rates.

- On December 27, 2001, SBP redefined the term Overdue Export Proceeds and asked banks to ensure that the exporters who had overdue export bills against any finance availed under EFS should not be eligible to use the facility unless and until giving a solid reason in writing.

- On March 16, 2002, banks were asked to re-price their outstanding loans under EFS on monthly basis effective from December 1, 2001, in order to pass on the benefit of reduction in EFS rates to the exporters under both parts of the scheme.

- On April 12, 2002, banks/NBFIs were asked to ensure that loans under EFS were classified as current liabilities for the purposes of calculating the current ratio.

PANAMA

Bank Regulatory Developments

The Superintendency of Banks issued the following regulations under the 1998 banking law, in compliance with the Basel criteria and standards for banking supervision as well as with the International Monetary Fund:

- Criteria for the authorization of banking license for banks of Panamanian and foreign ownership and capital. It establishes specific criteria with respect to moral and economic solvency, experience, proof of adequate corporate governance, exclusion of bearer shares for both Panamanian and foreign banks, required documentation for banks formed both by Panamanian and foreign corporations, pre-operative inspection, requirement for foreign banks to have authorization from their home supervisor, and operating limitations for Representative Offices, as established in the banking law.

- Defining "Corporate Governance" for banks operating in Panama, fixing the responsibilities of the Board of Directors, establishing minimum requirements for corporate governance, definition of *Internal Control* and fixing corresponding responsibilities for it upon the Board of Directors, Management and other officers, establishing the participants in the matter of internal control and fixing minimum requirements for it and for its continued oversight, the responsibility for detecting deficiencies, conformation of the board of directors and the audit committee and their responsibilities, the requirement of a *Risk Unit* within the bank in charge of identifying and managing risks, its characteristics, policy for human resources and fixing responsibilities of top management; it also includes sanctions for non compliance.

- Establishing regulations for the management of *market risk*, defined as the risk of losses derived from adverse movements in the prices of products in financial markets in which the bank maintains positions in operations both on and off the balance sheet. Requires banks to establish policies, procedures and guidelines for the identification and management of market risks; fixes responsibilities for identifying and properly managing market risks on the board of directors and top management, and establishes minimum requirements for properly identifying and managing such risks. Requires that banks establish organizational structures for managing risks, and have proper policy and procedural manuals.

- Organization and establishing procedures for the Department of Bank Client Protection. The new (1998) banking law granted the Superintendency of Banks the responsibility for handling "Banking Customer Protection" matters, and for receiving and handling claims filed by baning customers. The new regulation establishes the procedure for handling this matter.

- Fixing on the banks´ Board of Directors the responsibility for the financial statements prepared by their external auditors. The BOD is also responsible for making sure that the general plan for the external audit is adequate to comply with the aspects of financial information about the most significant areas of risks in the banks´ businesses. It amplifies the responsibilities of the Board´s Audit Committee and establishes the basic characteristics of an external audit. Establishes provisions regarding the appointment of external auditors and their minimum responsibilities as regards their banks´ audits and preparation of financial statements. Defines parameters for determining the independence of the external auditors with respect to the banks, and establishes how external auditors should be rotated periodically.

- New regulations were issued for “off balance sheet” operations, that set the notion of what constitutes such an operation, that are subject to ratings as Normal, Special Mention, Subnormal, Doubtful and Lost, as well as setting the requirements for specific provisioning, and the obligation of banks to establish adequate limits to exposure and concentration of “off balance sheet” operations. The regulation also incorporates the criteria about concentration limits for loans to a single borrower and to related parties.

A new regulation was issued defining cumulative limits for investment by banks in other companies, in compliance with the basic provision in the banking law that limits such investment in companies not related to or involved in banking business to no more that 25 percent of a bank´s capital funds. According to the new regulation, the 25 percent limit refers to the accumulated total of all investments. The new regulation further defines the notion of companies not related to banking business.

The banking law provides that interests are set freely by banks. However, banks must inform all clients of the “effective rate” both on loans and deposits. The new regulation defines “effective rate” and establishes the formula for calculating the “effective rate”.

Another regulation was issued regarding the establishment of branches and subsidiries in other countries by Panamanian banks, that are defined by the banking law as those banks that have their Main Office in Panama. The new regulation establishes the capital adequacy index applicable to these foreign branches and subsidiaries, norms for loss provisions regarding the loan portfolio and also regulates the acquisition of foreign banking entities by Panamanian banks. The regulation indicates that no branch or subsidiary will be authorized unless there is some type of arrangement with the foreign authority for international cooperation.

Short of just a few minor details, the Superintendency of Banks has fully completed a comprehensive program to upgrade the information system. The program will serve as an off-site monitoring information system, which will provide better detail regarding the financial and legal structure information for regulated institutions. The program includes a “Credit Center” (a database similar to a credit bureau), which will include the details of each individual loan in the banking systems. The program will greatly enhance the supervisory capacity of the Superintendency by allowing it to establish worst-case scenario for each bank utilizing as a basis the bank with the most conservative reserving judgement or the individual loan a given borrower has lagged in his/her payment. The worst-case scenario is a usefull tool for early detection of problematic situations and analysis thereof. The program should be fully tested, validated and operational before the end of the year.

Consolidated Supervision

The banking law, in accordance with the Basel criteria, adopted the consolidated supervision of offices in Panama of foreign banks, for which the law authorizes the Superintedency of Banks to sign agreements or memorada of understanding with foreign counterparts for such purpose. The Superintendency has so far signed such agreements or MOUs with: Brazil, El Salvador, Dominican Republic, British West Indies, Guatemala, Bolivia, Colombia, Peru, Costa Rica, Ecuador and Turks and Caicos.

Banking Regulation and Supervision Assesment

The July 2002 Report by the Board of Directors of the International Monetary Fund, corresponding to their Article IV consultation with Panama, expresses that Panama has achieved substantial progress in strengthening the supervisory and regulatory framework of the banking system, which has displayed resilience to the difficult domestic and regional environment. The average risk-weighted capital to asset ratio stood at 15.5 percent in March 2002, well above the regultory minimum of eight percent. In August 2001, and IMF Offshore Financial Center Module II assesment found Panama to be compliant with 23 out of 25 Basel Core Principles, and partly compliant with two.

Money Laundering and Harmful Tax Practices

In June 2001, the Financial Action Task Force – FATF removed Panama from its list of noncooperating countries. In April 2002, Panama was removed from the OECD list of noncooperating countries related to Harmful Tax Practices.

PHILIPPINES

Policy Changes

During the period under review, the Bangko Sentral ng Pilipinas (BSP) continued to promote policy reforms aimed at strengthening the banking system's ability to respond to the challenges brought about by globalization and addressing economic crises. Specifically, the BSP issued various circulars to strengthen the banking system, align the current banking practices with international best practices, enhance management capability, and cooperate with the international effort to fight money laundering.

- ***Raised bank' equity investment limits.*** The BSP raised the limit on the equity investment of universal and commercial banks in any single enterprise from 15 percent to 25 percent of the net worth of the investing bank. At the same time, the aggregate limits of the equity investments of commercial banks in all enterprises was increased from 25 percent to 35 percent of the net worth of the investing bank. (Circular 331 dated May 2, 2002).

- ***Expanded scope of compliance to the required loans-to-deposit ratio.*** The BSP included Real and Other Properties Owned or Acquired (ROPOA) as part of compliance with the required loans-to-deposit ratio (75 percent of total deposits, net of required reserves against deposit liabilities and the total amount of cash in vault) subject to the following conditions: (a) that only real and other properties acquired by banks in settlement of loans shall be eligible; and (b) the amount to be considered shall be limited to the next book value of the ROPOA, excluding capital gains tax, documentary stamp tax and such other capitalized expenses. (Circular No. 330 dated April 29, 2002).

- ***Earlier, the BSP set guidelines on recording of ROPOA.*** The BSP required, among other things, that the property acquired in settlement of loans through foreclosure shall be recorded at the balance of the loan or bid/purchase price, whichever is lower. In cases, where the amount of the ROPOA exceeds the appraised value of the acquired property, an allowance for probable losses equivalent to the excess of the amount booked over the appraised value shall be set up. (Circular No. 306 dated November 6, 2001).

- ***Refined definition of Loans Especially Mentioned***. The BSP amended certain provisions of Circular No. 247 dated June 2, 2000 on Classified loans categorized as Loans Especially Mentioned. In particular, Loans Especially Mentioned which were characterized by the absence of latest income tax return and/or latest audited financial statements, was more specifically defined to exclude consumer and small and medium enterprises (SME) loans which are current, have not been restructured and are supported by latest income tax returns and/or latest audited financial statements at the time they were granted. (Circular No. 329 dated April 11, 2002).

- ***Issued regulations governing the establishment and management of a sinking fund for banks' redeemable shares of stock.*** The BSP prescribed procedures for the establishment and administration/ management of the sinking fund for the redemption of redeemable private preferred shares of stocks issued by banks. In addition, the BSP set eligible securities and investments for the fund, required sinking fund administrators/managers to report to the bank's Board, with such reports being available for the examination of the BSP, and established sanctions for non-compliance. Before this, existing regulations were silent on the subject. (Circular No. 327 dated April 4, 2002).

- ***Improved quality of bank management.*** In September 2001, the BSP issued regulations strengthening the qualification requirements and grounds for disqualification of bank directors and officers. In particular, the BSP required bank directors, whether incumbent or newly elected, to attend a special seminar on corporate governance conducted or accredited by the BSP within a period of 6 months from the date of the circular (for incumbent directors) or from the date of election (for newly elected directors) (Circular No. 296 dated September 17, 2001). In March 2002, the BSP extended the deadline for compliance with the required attendance in a corporate governance seminar to December 31, 2002. (Circular No. 325 dated March 12, 2002).

- ***Increased limits on banks' investments in the equities of financial allied undertakings.*** Pursuant to provisions under the Republic Act No. 8791, otherwise known as the General Banking Law of 2000 (GBL 2000), the BSP issued a circular allowing publicly-listed universal or commercial banks to own up to 100 percent of the voting stock of only one other universal or commercial bank. Unlisted universal or commercial banks remain limited to a minority holding, i.e., not more than 49 percent (Circular No. 323 dated March 13, 2002). Earlier, the BSP also removed the 51-percent limit on a universal bank's investments in the equities of insurance companies (Circular No. 316 dated January 29, 2002).

- ***Allowed thrift banks to operate Foreign Currency Deposit Units (FCDUs).*** The BSP issued regulations allowing thrift banks, with a net worth or combined capital accounts of at least ₱650 million if located in Metro Manila or ₱150 million if located outside Metro Manila, to operate an FCDU subject to prior Monetary Board approval. Among the prerequisites set for the grant of authority to operate an FCDU include: profitable bank operations during the preceding calendar year and for the period immediately preceding the date of application; a risk-based capital adequacy ratio not lower than 12 percent; no net weekly reserve deficiencies within 8 weeks immediately preceding the date of application; general compliance with banking laws, rules and regulations in the last two preceding examinations prior to the date of application; established risk management system appropriate to its operations; and a CAMELS Composite Rating of at least 3 in the last regular examination with management rating of not lower than 3. (Circular No. 322 dated March 7, 2002).

- ***Phased-out BSP powers over Building and Loan Associations (BLA).*** Pursuant to provisions under the GBL 2000, the BSP announced the phase-out and transfer of its supervising and regulatory powers over building and loan associations (BLAs) to the Home Insurance and Guaranty Corporation (HIGC), now Home Guaranty Corporation (HGC). The phase-out and transfer shall be effected within a period of three (3) years from the effective date of the GBL 2000, which is to expire by June 23, 2003. All BLAs were advised to submit all their required reports and requests/applications to the HGC effective February 22, 2002. (Circular Letter dated February 22, 2002).

- ***Amended guidelines on banks' profit-sharing programs.*** The BSP revised regulations on the profit sharing program for bank directors, officers and employees such that the amount required to be transferred to Surplus Reserves is no longer excluded from the bank's net income for the year in determining the base in any profit sharing program. Furthermore, to protect the funds of depositors and creditors, new provisions were added allowing for the imposition by the BSP of restrictions on the payment of compensation and other benefits to bank directors and officers under certain circumstances such as when a bank/NBQB under controllership/conservatorship is found to be conducting business in an unsafe manner or is found to be in an unsatisfactory financial condition. (Circular No. 321 dated February 19, 2002).

- ***Refined regulations governing real assets acquired by banks in the settlement of claims.*** Pursuant to provisions under the GBL 2000, the BSP issued a circular allowing banks to continue to hold real property acquired by way of the satisfaction of claims after the five-year period provided by law. However, under such circumstances, the 50 percent ceiling (i.e., 50 percent of combined capital accounts) on a bank's investment in real estate and improvements (for the bank's own use) should be applied. (Circular No. 320 dated February 18, 2002).

- ***Amended the accreditation requirements for external auditors.*** Circular No. 245 dated May 25, 2000 was amended to allow the BSP to dispense with the requirement that the external auditor (and the members of the audit team) to be accredited has a certification from the Professional Regulation Commission. In particular, if the certification cannot be obtained because a case is pending against the auditor, the BSP may dispense with the requirement if it was determined that the said case involves a purely legal question, or does not, in any way, negate the auditor's adherence to the highest standards of professional conduct and degrade his integrity and objectivity. (Circular No. 318 dated January 30, 2002).

- ***Raised limit on bank's investments in non-financial allied undertakings.*** Pursuant to provisions under the GBL 2000, the BSP issued a circular allowing a bank to acquire up to 100 percent of the equity of a non-financial allied undertaking. Moreover, the circular allowed the following: universal, commercial and thrift banks to invest in the equities of Service Bureaus organized to perform services allowed to be outsourced (under Circular No. 268), provided that data processing companies may be allowed to invest up to 40 percent in the equity of Service Bureaus; and, universal banks to invest in health maintenance organizations (HMOs). (Circular No. 317 dated January 29, 2002).

- ***Required prior BSP approval for the issuance of subordinated debt.*** The BSP advised banks, non-bank financial institutions (NBFIs) with quasi-banking functions (NBQBs), investment houses with trust functions, and all other NBFIs which are subsidiaries or affiliates of banks or NBQBs that the following required prior BSP approval: the issuance of subordinated debt instrument for it to qualify as Tier 2 capital under Circular No. 280 dated March 29, 2001; and any asset transfer plan to a special purpose vehicle/asset management company. (Circular Letter dated January 16, 2002).

- ***Redefined loanable funds covered by agri-agra requirements.*** The BSP excluded from the loanable funds covered by agri-agra requirements the deposits of the Bureau of the Treasury representing revenue collections of the Bureau of Internal Revenue and the Bureau of Customs. (Circular No. 315 dated January 9, 2002).

- ***Endorsed a model Anti-Money Laundering Operating Manual.*** The BSP endorsed the said model to guide banks/NBFIs in developing their own anti-money laundering programs and in complying with R. A. No. 9160, otherwise known as the "Anti-Money Laundering Law of 2001" as well as with the various BSP rules and regulations against money laundering. (Circular Letter dated January 7, 2002).

- ***Adjusted general loan loss provisions.*** To make it more consistent with international practices, the BSP adjusted the minimum required general loan loss provisions of banks. In particular, the Circular: (a) lowered the provisioning ratio from 2 percent to one percent of the latest outstanding balance of unclassified loans other than restructured loans (less loans which are considered non-risk under existing laws/rules/regulations) to spur new lending; and (b) imposed a 5 percent reserve on the outstanding balance of unclassified restructured loans (less the outstanding balance of restructured loans which are considered non-risk under existing laws/rules/regulations) to reflect the higher risks attached to such loans even if they are presently performing. These adjustments represent a fine-tuning of policy to reduce disincentives to the lending activities of banks with otherwise sound loan portfolios. (Circular No. 313 dated December 27, 2001).

- ***Disallowed banks from acting as trustee for government funds.*** The BSP prohibited banks from receiving or holding as trustee/agent/administrator any fund or money from the government and government entities. However, the circular allows government-owned banks to hold (as trustee/agent/administrator) funds of local government units, provided that these are invested only in government securities; and funds of government and government entities authorized by law to be placed in trust. (Circular No. 311 dated December 10, 2001).

- ***Amended guidelines on the adoption of the risk-based capital adequacy framework.*** The BSP amended Circular No. 280 dated March 29, 2001, which provided guidelines on the adoption of the risk-based capital adequacy framework. In particular, the Circular provided for the inclusion of local government unit (LGU) bonds, which are covered by Deed of Assignment of Internal Revenue Allotment of the LGU and guaranteed by the LGU Guarantee Corporation, among the on-balance sheet assets which are assigned a 50 percent risk weight. (Circular No. 310 dated December 10, 2001).

- ***Amended rules on the transfer of the voting shares of stocks in banks***. The BSP amended regulations governing the transfer of the voting shares of stocks in banks, which require Monetary Board approval. The amendments include: 1) requiring prior BSP approval for any sale or transfer which will result in ownership or control of more than 20 percent of the voting stock of the bank by any person which will enable such a person to elect or be elected as a director of such bank; and 2) providing sanctions for any violation of the provisions of said subsection. (Circular No. 309 dated November 16, 2001).

- ***Enhanced anti-money laundering regulations.*** In August 2001, the BSP authorized the issuance of cashier's, manager's or certified checks or other similar instruments in blank or payable to cash, bearer or numbered account as an exception from the provisions under Circular No. 259, subject to conditions (Circular No. 291 dated August 16, 2001). In addition, following the enactment of Republic Act No. 9160 (also known as the Anti-Money Laundering Act of 2001), the BSP provided the rules and regulations implementing Section 9 of R.A. No 9160 on banks' customer identification, record-keeping and reporting requirements for covered transactions. Among others, the circular provided for the following: required banks to record the true identity of their clients; prohibited anonymous accounts, accounts under fictitious names and other similar accounts; allowed peso and foreign currency non-checking numbered accounts; required the preservation/storage of all transactions for 5 years from the dates of transactions and the records of closed accounts for at least 5 years from the dates the accounts were closed; required banks to report to the Anti-Money Laundering Committee all covered transactions within 5 working days from its occurrence; and prescribes sanctions and penalties for violations of these rules. (Circular No. 302 dated October 11, 2001). Moreover, the BSP required all banks and off-shore banking units concerned to make the necessary reports on transactions with terrorists and other organizations named in Resolutions Nos. 7 and 9 of the Anti-Money Laundering Council (AMLC) within five working days from the date of occurrence. (Memorandum to All Banks and Off-Shore Banking Units, November 13, 2001).

- ***Provided alternative compliance to the agri-agra law.*** The BSP allowed the use of the proposed ₱50 billion worth of 5- and 10-year Special Purpose Treasury Bonds (SPTBs) as alternative compliance with the agrarian reform credit requirement under Sec. 4(a) of P.D. No. 717, and as eligible reserve for trust duties with certain provisions. (Circular No. 301 dated October 2, 2001).

- ***Improved Transparency.*** The BSP required all rural banks to fully disclose the amount of restructured loans in their Consolidated Statements of Condition. (Memorandum to All Rural/Cooperative Banks, September 19, 2001).

- ***Tightened rules on derivatives transactions.*** To further enhance the regulatory functions of the BSP and address financial risks, the BSP amended rules and regulations governing financial derivatives activities of banks, non-banks with quasi-banking functions and their subsidiaries/affiliates. The amendments include: a) redefining the scope and pre-qualification requirements; b) adding provisions on renewal of license and reporting requirements; and c) prescribing monetary penalties on any institution that engages in derivatives activities without prior approval of the BSP. (Circular No. 297 dated September 17, 2001).

- ***Set the guidelines for reviewing major acquisitions or investments by a bank and its corporate affiliations or structures.*** The BSP issued regulations which defined major acquisitions as those investments in allied or non-allied undertakings including corporate affiliations or structures that give the bank significant interest and/or control, such as stockholdings, sufficient to elect one member to the acquired entity's board of directors. In addition, the circular required a bank's board of directors, which has the authority to approve any major investment by the aforementioned institutions, to ensure the following: that the investment is in accordance with the bank's business plan and management objectives; that the investment will complement/support the main business of the banks; and, that bank management shall provide for an efficient and effective "exit mechanism" or contingency plan in case the investee's operations fail or do not prosper. (Circular No. 295 dated September 7, 2001).

- ***Amended rules on ceiling of total investments.*** Pursuant to provisions under the GBL 2000, the BSP mandated that a bank's total investment in real estate and improvements, including bank equipment, shall not exceed 50 percent of a bank's net worth. Investments covered include: 1) bank premises- land and buildings, buildings under construction, leasehold rights and improvements, and furniture, fixtures and equipment; and 2) real properties, equipment or other chattels purchased by the bank in its name for the benefit of its officers and employees, net of depreciation, and for non-depreciable property, net of payments made to the bank by bank officers and employees. (Circular No. 294 dated September 6, 2001).

- ***Adopted a Checkless Payment System.*** The BSP introduced the checkless payment system, replacing the physical checks in its disbursements. The payments will be credited directly to the bank accounts of payees through the demand deposit account of banks maintained with the BSP. This system allows for the immediate availability of funds to the payees on the same date that the credit is effected to the demand deposit of the payees' bank. (Circular Letter dated August 24, 2001).

Anti-Money Laundering Developments

On 29 September 2001, Republic Act No. 9160 or the Anti-Money Laundering Act of 2001 (AMLA) was enacted, complementing already existing regulations that constitute the country's anti-money laundering regime. Among other things, the AMLA contains the following salient features:

- Definition of money laundering as a crime where proceeds from illegal activities are made to appear to have originated from legitimate sources;
- Creation of the Anti-Money Laundering Council (AMLC), which is given the power to require the reporting of all suspicious transactions irrespective of amounts involved;
- Definition of money laundering as a crime where proceeds from illegal activities are made to appear to have originated from legitimate sources;
- Definition of 14 unlawful activities;
- Definition of covered transactions subject to mandatory reporting to the AMLC as a single, series, combination or pattern of transactions in excess of ₱4 million; and
- Provision of penalties for money laundering. including, among others, imprisonment ranging from 7 to 14 years and a fine of not less than ₱3 million but not more than twice the value of the monetary instrument or property involved in the offense for a person convicted of money laundering.

With the enactment of the AMLA, the FATF, in its February 20, 2002 letter, commended the government for the positive steps taken and its commitment in joining efforts to combat money laundering. However, it still had 4 remaining concerns.

These concerns were addressed by the Implementing Rules and Regulations (IRR) of the AMLA which were approved on March 8, 2002. Specifically:

- *On the high threshold level for "covered transactions" (₱4 million/US$ 80,000.)* - The IRR mandates that suspicious transactions, regardless of amount, be reported to the AMLC (circulars on these have been issued by the BSP, SEC and IC).
- *Non-retroactive effect of the law to deposits/investments prior to October 17, 2001, the effective date of AMLA* – The IRR clarifies that even if the subject account was created prior to the effective date, any suspicious movement of funds (or transaction) relating to said account shall still be covered by the AMLA and its IRR.
- *Powers of council being curtailed by the bank secrecy law* - The IRR allows effective inquiry into accounts and the subsequent freezing of said accounts related to the proceeds of an unlawful activity.
- *Limited authority of the BSP to determine owners of non-checking numbered accounts* - Before the AMLA, the BSP had no power to check numbered accounts. The AMLA provisions now give power to the BSP, significantly bringing down absolute confidentiality particularly on access to documentation and identification requirements on numbered and foreign accounts.

Other Developments

Banking sector performance

The Philippine banking system has proven to be resilient to the stresses experienced in the recent past and remains fundamentally sound. Indicators of the soundness of the system show that it has benefited from the reforms that have been undertaken since the 1980s. The generally healthy liquidity position and a strong capital buffer are key strengths that have helped the banking system meet the challenges posed by the slowdown in economic activity, repercussions from the September 11 terrorist attacks, and the crisis in Argentina.

The system's average capital adequacy ratio (CAR), using the old method of computation, rose from 16.05 percent in end-December 2001 to reach 16.79 percent in March 2002. This is more than double the BIS standard of 8 percent, and is well above the statutory level of 10 percent.

Using the new risk-based capital adequacy framework adopted in July 2001, commercial banks' CAR reached 13.2 percent in September 2001, lower than the 16.1 percent ratio recorded for the same period under the old framework.

Asset quality—while showing signs of weakening—has been manageable, with the NPL ratio of commercial banks standing at 18.4 percent as of May 2002. While this ratio is higher than the 17.35 percent posted in December 2001, it is still lower than the peak rate of 18.8 percent registered in October 2001. The level of NPLs is expected to improve as efforts aimed at corporate restructuring take hold and as economic growth gains momentum. At the same time, the BSP is encouraging the speedy off-loading of ROPOAs through private sector-led initiatives to enable banks to concentrate on new loans, thus allowing them to focus on areas within their core competence. This should also provide a much-needed boost for investments.

Reflecting the stronger economic activity and the sustained downtrend in domestic interest rates, commercial bank lending rose slightly in March 2002 to reach ₱1.4 trillion, a 0.11 percent increase from its year-ago level. About 67.7 percent of the total loans during the period were channeled to financial institutions, real estate and business services; manufacturing; and the wholesale and retail trade sector.

Number of institutions

As of March 31, 2002, there were 44 commercial banks, 100 thrift banks and 782 rural banks. Of the total commercial banks, 41 were privately owned, including 13 branches of foreign commercial banks and 4 subsidiaries of foreign commercial banks.

In addition to the foregoing banking institutions, as of March 31, 2002, there were 33 investment houses, 45 finance companies, 26 security dealers/brokers, 5,018 pawnshops, 9 investment companies, 9 lending investors, 139 private insurance companies, 85 non-stock savings and loan associations, 9 venture corporations, 6 mutual building and loan associations and 4 Government non-bank financial institutions regulated or supervised by the Bangko Sentral.

Mergers and consolidation

From the period July 2001-March 2002, six mergers/consolidations took place involving seven commercial banks, two thrift banks, two rural banks and 1 NBFI. In addition, a number of mergers and consolidations are currently under discussion.

Foreign bank entry

Until year-end 1994, there were only four foreign banks operating in the Philippines. The liberalization of the entry of foreign banks in 1994 resulted in the establishment of new foreign bank branches and foreign bank subsidiaries. As of December 31, 2001, there were 13 foreign bank branches and 4 foreign commercial bank subsidiaries, for a total of 17 foreign commercial banks operating in the Philippines. The number of foreign banks is expected to increase as a result of the provisions in the General Banking Law of 2000 which allow 100 percent ownership of domestic banks by foreign banks, within seven years of the effective date of the law.

This year, Bank of China, whose application to establish a branch in the Philippines was approved in principle by the Monetary Board on April 18, 2001, started operations on January 28, 2002.

The major thrust of banking sector policy includes support for legislative initiatives to help enhance the BSP's supervisory and regulatory framework and strengthen banks' balance sheets; modernization of the payment infrastructure; and completion of the shift to consolidated and risk-based supervision.

- ***Secure passage of proposed amendments to the New Central Bank Act of 1993.*** The reforms introduced in the General Banking Law (GBL) of 2000 or R.A. No. 8791, which now forms the basic legal fabric governing the banking system, will be complemented by the proposed amendments to the Charter of the BSP. Broadly speaking, this legislative measure aims to enhance the supervisory and enforcement powers of the BSP, further improve prudential standards for the banking system, intensify competition in the banking sector, and enhance the BSP's independence. Major reforms being proposed in this regard involve: (1) granting authority to the BSP to conduct more frequent banking examinations; (2) implementing prompt corrective action in the case of problem/distressed banks; (3) restoring tax exemption privileges; and (4) imposing stronger criminal and administrative penalties for violation of banking laws and regulations.

- ***Support passage of the Special Purpose Asset Vehicles (SPAV) and securitization bills***. To help banks address the problem of non-performing assets (NPAs), the BSP will support the passage of the SPAV and securitization bills, filed in Congress to hasten the disposal of and attract investments in banks' non-performing assets.

  SPAV Bill. The SPAV bill seeks to encourage/facilitate private investments in NPAs of banks through the creation of SPAVs which will be empowered to, among other things: acquire/invest in NPAs of financial institutions; engage third parties to manage, operate, collect and dispose of permitted investments; restructure debt, reorganize the debtor's businesses and affairs, dispose of assets of the debtor, and borrow money and/or issue bonds, bills or other instruments of indebtedness for the purpose of acquiring, managing, improving and disposing of investment unit instruments (IUIs) and paying for all operational, administrative and third party costs.

  Securitization Bill. The securitization bill aims to provide a legal and regulatory framework for the sale of assets on a non-recourse basis by the originator or seller to a Special Purpose Vehicle (SPV) and the issuance of asset-backed securities (ABS) which depend, for their payment, on the cash flow from the assets so sold and in accordance with the securitization plan registered with the SEC. This is intended to create a favorable market environment for a wide range of asset-backed securities (ABS) and develop the secondary market for these securities, thus generating liquidity for both the private and government sectors that can be used for productive endeavors.

- ***Modernize the payment infrastructure***. To enhance operational efficiency, reliability, speed and timeliness as well as limit the settlement and systemic risks of payments and settlement transactions, the BSP initiated the upgrading of the existing payment system into a real time gross settlement system (RTGS). The RTGS is intended to cover transactions in the equities, fixed income, money and foreign exchange markets.

  In mid-July 2001, the RTGS system (dubbed MIPS2) began to be partially implemented to cover interbank loan transactions and the purchase of government securities under repurchase agreements between and among banks and the BSP. Effective November 15, 2001, MIPS2 was expanded (designated as MIPS2 Plus) to cover all other types of interbank fund transfers such as settlement of foreign currency (FX) transactions, government securities transactions and other interbank payments. Full implementation is scheduled in end-2002.

- ***Shift to consolidated and risk-based supervision.*** The complete shift to consolidated supervision of financial conglomerates as well as from a compliance-focused supervisory approach to one that focuses on risk and risk management will be vigorously implemented to enable a more comprehensive assessment of the risks involved in the banks' activities. This will involve the reorganization of the BSP supervision sector and the enhancement of coordination with other local regulatory agencies (e.g., SEC and IC and international supervisory authorities).

Consolidated Supervision

Domestic Groups

Banking groups in the Philippines are supervised on a consolidated basis. As early as 1998, the Bangko Sentral ng Pilipinas (BSP) had already adopted the consolidated supervision approach. The present conduct of consolidated supervision is, however, still rather rudimentary especially since existing laws impose constraints that hamper full implementation.

Existing banking laws, for example, limit the BSP supervisory authority to banks and quasi-banks and their subsidiaries and affiliates engaged in allied activities, non-bank financial institutions (NBFIs) with authority to engage in trust and investment management operations, and NBFIs required by law to be under the BSP's supervision (i.e., pawnshops, trust companies, and non-stock savings and loan associations). Moreover, some of the subsidiaries and affiliates of banks (such as investment houses, securities dealers/brokers, finance companies and insurance companies) are primarily regulated by other government agencies (such as the Securities and Exchange Commission (SEC), and the Office of the Insurance Commission (IC) under relevant laws.

To address these concerns, however, the BSP supports the present move to amend the existing laws so as to include in the scope of BSP authority the parent and non-allied affiliates of a bank for purposes of assessing the banking group's overall risk profile. It has also established formal arrangements with the SEC and the IC to receive information on the financial condition and the adequacy of the risk management system and control of their regulated entities.

As an initial step towards consolidated supervision, the BSP has implemented the practice of using a common cut-off date for examination of banks and their subsidiaries and affiliates under BSP direct supervision, i.e., if the subsidiaries and affiliates are banks or quasi-banks.

Presently, reportorial requirements on the banking groups are limited only to: (i) the required publication of the quarterly consolidated statement of condition (parent bank and its subsidiaries engaged in financial allied activities) side-by-side with the combined statement of conditions (head office and branches) as of the call date; and (ii) the required submission of annual audited financial statements of the bank, which under the Philippine accounting standards, should be prepared both for the banking group and the parent bank. There is, however, an ongoing study to enhance the reporting requirements so as to include submission of more detailed: (i) quarterly consolidated statement of condition and statement of income and expenses; and (ii) annual updated family tree showing full legal names and inter-company ownership and control relationships, together with detailed information on principal shareholders, directors and officers.

With respect to the imposition of prudential regulations, all prudential regulations (such as the single borrower's limit and ceilings on DOSRI loans, etc.) are presently applied only on a solo basis, except for the required compliance with the risk-based capital ratio (which is applied both on solo and consolidated basis), and the limit on the net open foreign exchange position (which is applied only on a consolidated basis). However, there is also an ongoing study to determine the need to prescribe the aforementioned other prudential limits on consolidated basis.

Non-Domestic Groups

Branches and subsidiaries of foreign banks operating in the Philippines are subject to the same consolidated supervision as are domestic banks.

Subsidiaries and affiliates engaged in financial allied undertakings (such as investment houses, securities dealers/brokers, finance companies and insurance companies) of branches and subsidiaries of foreign banks are primarily regulated by other government agencies (such as the SEC and the IC) under relevant laws; hence, the BSP's initiative to establish formal arrangements with these supervisory agencies to receive information on their regulated entities.

The BSP imposes as one of the qualification requirements for the establishment of foreign bank branches or new banking subsidiary the submission by the foreign bank's home country supervisory authority of a certification of the foreign bank's compliance with the capital requirement as prescribed by the laws and regulations of its country of origin.

The BSP also imposes as one of the qualification requirements for the establishment of foreign bank branches or new banking subsidiary the submission by the foreign bank's home country supervisory authority of a certification that adequate information on the foreign bank and its subsidiaries will be provided to the BSP to the extent allowed under existing laws.

On an ongoing basis, foreign bank branches and subsidiaries operating in the Philippines are required to submit the annual reports of their head office/parent bank.

Developments in the Insurance Industry

With enactment of the Anti-Money Laundering Act of 2001, the Insurance Commission (IC) issued an operating manual against money laundering for IC covered institutions.

POLAND

The Polish banking system although modern and efficient is relatively small in comparison to other European countries. In 2001, the number of commercial banks declined to 69 as a result of the following mergers:

- BIG Bank SA with BIG Bank Gdanski SA;
- Citibank (Poland) SA with Bank Handlowy w Warszawie SA;
- Bank Zachodni SA with Wielkopolski Bank Kredytowy SA;
- Bałtycki Bank Regionalny SA with Gospodarczy Bank Wielkopolski SA; and
- BWP UNIBANK SA with Nordea Bank Polska SA.

The merger of three banks quoted on the Warsaw Stock Exchange with unlisted banks had the effect of expanding the share of the banking sector in the overall market capitalization of the Exchange (taking it to 35.8 percent), and also of increasing concentration within the banking industry, as indicated by the proportion of total assets held by the five, ten and fifteen largest banks.

Due to the mergers, the number of private-sector banks decreased to 62 (from 66 at year end 2000), with the number controlled by foreign investors coming down to 44 (from 46).

Foreign investors directly controlled 15 banks incorporated as public limited companies that were under 100 percent foreign ownership (including 3 acquired from their original Polish founders), 2 branches of foreign banks, and 20 banks with a majority foreign interest.

The number of banks indirectly controlled by foreign investors remained constant, although there were significant changes within this group of banks. The place of BIG Bank SA (now merged with BIG Bank Gdanski SA) was taken by Lukas Bank Swietokrzyski SA, with control over the latter now being exercised, via the company of Lukas SA, by the French bank Caisse Nationale de Credit Agricole. Bank Wspolpracy Regionalnej SA changed its name to Deutsche Bank 24 S.A. as a result of acquisition of a controlling stake by Deutsche Bank Polska S.A.

At the end of 2001, the 46 banks controlled by foreign investors accounted for 80.2 percent of the capital funds and 69.2 percent of total assets of the whole banking sector. These banks had taken 63.9 percent of non-financial sector deposits and originated 71.3 percent of loans outstanding less provisions (as against 70.2 percent).

The 3 banks directly controlled by the Treasury accounted for 22.2 percent of total assets in the banking sector, 18.1 percent of loans less provisions, 27.9 percent of deposits, and just 11.2 percent of capital funds.

The largest investments in the Polish banking sector had been made by American, German and Dutch institutions. The equity held by these investors amounted to 1,061.3m, 990.0m and 648.7m zloty, respectively, representing 12.6 percent, 11.8 percent and 7.7 percent of the authorized capital of the commercial banks. Irish investors moved into fourth place, holding 514m zloty of equity in Polish banks, equivalent to over 6 percent of the authorized capital of the commercial banks.

The more subdued growth of total assets at the commercial banks (up 5.1 percent, as against 16.3 percent a year earlier), was principally due to slowing growth in non-financial sector borrowings. This was caused by the high cost of borrowing, in an environment where the corporate income is weakening. Some businesses chose to draw on cheaper, alternative financing vehicles, such as loans from foreign banks or from parent companies abroad, or the issuance of securities, either at home or abroad. In addition, the rising proportion of irregular assets in total portfolios led banks to apply stricter underwriting criteria to would-be borrowers. There was also a major reduction in the growth of personal borrowings caused by noticeable slowdown of the economy.

The retail funding base of banks has large growth potential because almost 40 percent of the households do not have a bank account. Despite the high number of banks, the country is under-banked in terms of branches, with only 6 branches per 100,000 inhabitants (the average for EU is 48 per 100,000 inhabitants).

The banks have been seeking to strengthen their market position not only by expanding their customer networks, especially small customer service offices and ATMs, but also by developing electronic banking services, including those offered through such modern distribution channels as the Internet and mobile phones (WAP banking). Three banks, namely, BRE Bank SA, Bankgesellschaft Berlin (Polska) SA and Volkswagen Bank Polska SA, have launched their own “virtual” retail banks (trading as, respectively, “mBank”, “Inteligo”, and “Volkswagen Bank direct”).

PORTUGAL

Among the most significant developments during the period under review was the enforcement by the supervisory authority of a simulation exercise by banks, which will most likely lead to the imposition of a new category of provisions for credit risks that are not readily evident.

A new prudential framework has been established for the securitization of assets and reporting requirements in relation to liquidity in which particular emphasis is placed on the concentration of deposits.

Anti-Money Laundering Developments

During this period, banks have been subject to several recommendations by the supervisory authority to give increased attention to business with people having residence or established in countries or territories considered as non-cooperative in the anti-money laundering efforts.

Consolidation Supervision

Domestic financial groups are subject to supervision on a consolidated basis when the holding company is a bank or a financial company or owns subsidiaries that are banks or financial societies, or owns more than 50 percent of the shares or voting rights of the same entities or controls them. The scope of consolidation does not cover insurance companies.

Supervision on a consolidated basis includes examination, reporting and compliance with prudential requirements, namely on:

- capital requirements;
- relations between shareholdings and own funds;
- relations between shareholdings and the voting rights or the capital of the banks' investments in corporations;
- concentration of risks (by clients and country); and
- transactions among affiliates.

ROMANIA

Regulatory Framework

In order to meet the conditions arising from the Agreement with the International Monetary Fund, in 2001 the legal framework was improved as follows:

- Law no. 58/1998 – The Banking Law – imposing tougher requirements to hold managerial positions in banks and the compulsory approval by the National Bank of Romania of the members of the board of directors, and the introduction of quality requirements for significant shareholders.

- Law no. 101/1998 - the National Bank of Romania's Statute – achievement of a legal framework allowing the cooperation between the National Bank of Romania and the competent authorities in other countries.

- Law no. 83/1998 - the banks' bankruptcy procedure – allowing for an accelerated initiation of bankruptcy procedures for an insolvent bank and shortening the time for removing such a bank from the system. The result is a better protection of the depositors and a mitigation of contamination risk.

During the period under review, so as to be in line with the international standards, new regulations came into force dealing with 1) the supervision of the banks' foreign exchange positions, imposing limits for every foreign currency and computing the total foreign exchange position by "short-hand" method; 2) banks' licensing; 3) improved rules on bank liquidity; and 4) know-your-customer standards, which aim at ensuring a proper framework as regards anti-money laundering. These rules apply the Basel Committee recommendations, permitting banks to draw up their own policies and procedures of knowing their customers.

As regards the accounting system for banks, this is largely in line with the related European standards. An extremely important event in this field was the issuance in 2001 of the Accounting Regulations harmonized with Directive No. 86/635/EEC and the International Accounting Standards applicable to credit institutions.

In the payments field, an important achievement was the issuance of the NBR Regulation no. 1/2002 regarding the large value funds transfer system. The regulation sets the principles and the way of performing the processing and the gross settlement of large value payments during the same banking day by TransFonD S.A., in its capacity as the National Bank of Romania's agent.

With regard to the movement of capital, by the recent amendment to the NBR Regulation no. 3/1997 on the performance of foreign exchange transactions (Circular no. 26/2001), the capital operations scheduled for 2001-2002 were liberalized (e.g. the residents' direct investments abroad; the residents' real investments abroad; the admittance of the securities and units of national collective investment bodies in the foreign markets). At the same time, the regulatory framework required for the achievement of the gradual liberalization of other capital operations, at present under authorization, has been created.

As result of the ongoing harmonization process with the EU and international standards, the following regulations are in the process of being issued:

- rules on consolidated financial statements of credit institutions;

- rules on financial derivative instruments; and

- new rules concerning classification of loans and placements and their provisioning. Beginning January 1, 2003, an additional classification criterion will be introduced besides the former ones (debt service and initiation of legal proceedings), namely the debtor's financial standing, used only for the assessment of an economic non-banking entity.

Developments with Regard to Credit Cooperative Organizations

Further to the provisions of the Government Emergency Ordinance no. 97/2000, as subsequently approved by the Law no. 200/2002, the last stage of the licensing process is developing. The credit cooperative organizations being rejected in any stage of the licensing process are legally dissolved and thereafter liquidated.

In light of the new legislative framework regarding credit cooperative organizations, the National Bank of Romania is set to push ahead with the regulation of their activity mindful of their status as credit institutions. In this respect, credit cooperative organizations will have the same prudential requirements as banks, set by National Bank of Romania regulations and harmonized with the European directives.

Depositor Protection Arrangements

At present, the Banking Deposits Guarantee Fund may cover up to Lei 100,453,000 per depositor, subject to semi-annual adjustments based on the consumer price index.

Treatment of Non-Domestic Financial Institutions

In accordance with the legal provisions in force, banks established as subsidiaries of foreign banks or of other foreign legal persons are treated the same as Romanian legal persons, while foreign banks' branches operating in Romania comply, to a large extent, with the regime applied to Romanian legal persons (for instance, activities allowed to be provided, terms for granting or withdrawing the licence, management and capital requirements).

Market Developments

During the period under review, the main goal of the supervisory process was its quality, achieved by:

- Improvement of the Uniform Banking Rating System – CAAMPL, by including a new indicator - banks' liquidity, beginning in July 2001.

- Increased cooperation with other supervisory authorities by agreements on information sharing, as provided by Directive 2000/12/EC.

- Strengthening cooperation with the domestic supervisory authorities in charge of the supervision of other components of the financial sector. In this respect, in April 2002 the NBR concluded a Cooperation Agreement with the National Securities Commission and the Insurance Supervisory Commission. Likewise, the NBR co-operates with foreign supervisory authorities - the Memorandum of Understanding with the National Bank of Moldova and with the Central Bank of Cyprus were concluded, while the negotiation process with six other foreign supervisory bodies is in progress.

- Development, within the PHARE program, of two projects: (1) the improvement of the early warning system aimed at achieving an IT program with a high level of accuracy and forecasting capacity, and (2) the development of a system for assessing the exposure against the market risk.

Beginning in October 2001, the Supervision Department assesses on a monthly basis the quality of the supervision activity, considering the banking system performance and the harmonization with the Basic Principles for Effective Banking Supervision adopted by the Basel Committee.

The actions for strengthening the supervisory ability resulted in significant progress in the trend of some indicators, especially those defining the loans portfolio quality. The measures for improving the banking system's capitalization led to an important increase in the solvency ratios.

As for the structure of the Romanian banking system, in 2001 two significant changes occured:

- the completion of the privatization process of Banca Agricola S.A.; and
- the purchase, by foreign investors, of the main share of West Bank S.A. and Banca Comerciala (Unirea) S.A.

The market share of the foreign-owned banks increased from 50.9 percent to 54.2 percent, and at the same time the public sector's position decreased from 46.1 percent to 42.9 percent, while there was a slight decrease of the domestic private owned banks sector (from 3.0 to 2.9 percent).

The Romanian payment and settlement systems are subject to an ongoing reorganization and development process for implementing an interbank electronic payment system, in line with the European Union.

SINGAPORE

Introduction

Singapore's financial sector continued to restructure during the period under review, marked by mergers among the local banks and further liberalization by the Monetary Authority of Singapore (MAS). Not only has the banking sector become more competitive during the year, additional measures were also introduced to create a stronger and more dynamic financial industry.

Banking Developments

A key development in the banking sector during 2001 was the consolidation among the domestic banks. Oversea-Chinese Banking Corporation acquired Keppel TatLee Bank in August 2001, while United Overseas Bank acquired Overseas Union Bank in October 2001. Following these mergers, the number of local banking groups is reduced from five to three.

On June 29, 2001, MAS announced the second phase of its five-year liberalization program (first announced in May 1999), under which it will broaden the access to domestic wholesale banking and further enhance competition in domestic retail banking. Each Qualifying Full Bank (QFB) is allowed to establish up to 15 locations (previously 10), of which up to 10 (previously 5) can be branches, and the rest off-site ATMs. Furthermore, from July 1, 2002, QFBs may provide debit services on an electronic funds transfer at point of sale (EFTPOS) network, through an existing EFTPOS network such as NETS, Visa and Mastercard; offer Supplementary Retirement Scheme (SRS) accounts; accept Central Provident Fund (CPF) fixed deposits; and offer agent bank accounts under the CPF Investment and Minimum Sum Schemes. On December 4, 2001, MAS granted QFB status to two additional banks (bringing to six the number of QFBs) and Wholesale Bank (WB) status to sixteen banks (of which eight were upgraded from Qualifying Offshore Banks).

MAS will progressively award WB privileges to all the remaining offshore banks, as well as to reputable new foreign banks in the Singapore market. Over the period from 2001 through 2002, twenty WB licenses are expected to be granted. MAS will also consider further steps to liberalize the retail banking sector, including extending QFB privileges to more foreign banks, in a phased manner. Its aim remains to promote keener competition, provide Singaporeans with higher quality of banking services, and add depth and competitiveness of the financial sector.

The Singapore Consumer Credit Bureau will be launched in September 2002 as a joint-venture initiative between the Association of Banks in Singapore and a consortium comprising Dun & Bradstreet International, among others. The establishment of the Bureau serves to enhance the reliability of banks' internal credit rating systems. Participating banks will disclose and in turn receive credit information from the Bureau to assess the credit worthiness of their retail customers. In this respect, both the Bureau operators and participating members would have to observe high standards of data confidentiality. Initially, nine consumer banks — DBS, OCBC, UOB, HSBC, Standard Chartered Bank, Citibank, Maybank, ABN Amro, and American Express — will contribute data on their customers to the bureau and are the only members allowed to access the database. Later, other financial institutions like finance houses and credit card companies may join with MAS permission and have similar access.

Several key regulatory changes took effect on 18 July 2001 under Singapore's Banking (Amendment) Act 2001 (Amendments) and the Banking Regulations 2001 (Regulations), as follows:

- *Separation of Financial and Non-Financial Activities*
  Banks are prohibited from carrying out any business which is not banking business, other financial business regulated or authorized by MAS, or business which is incidental to financial business. They are allowed to purchase or own non-controlling stakes of 10 percent or less in the share capital of any company. For such shareholdings of above 10 percent, banks will have to obtain MAS' prior approval. To limit concentration risks, a bank is generally also required to limit its equity investments in any single company to 2 percent of its capital funds, and immovable property holdings to 20 percent of its capital funds.

- *Revision of Ownership Rules for Local Banks*
  A new shareholding approval threshold of 12 percent was added to the existing thresholds at 5 percent and percent. The new 12 percent threshold gives MAS greater flexibility to allow strategic partners and large institutional investors to reach and cross the 5 percent shareholding level in a local bank, without having to allow their stakes to grow unrestrained up to 20 percent.

- *Reduction of Paid-Up Capital Requirements for Local Bank Subsidiaries*
  The Amendments provide for a reduced minimum paid-up capital requirement of S$100 million for banking subsidiaries of Singapore-incorporated banks, which have met the S$1.5 billion capital requirement. The reduced paid-up capital requirement facilitates the setting up by local banks of banking subsidiaries which adopt new business models, such as Internet-only banking.

- *Flexibility for MAS to Prescribe Capital Adequacy Requirements*
  Applying a risk-focused supervisory approach, the Amendments allow MAS to impose above the minimum capital adequacy ratio of 12 percent, capital requirements appropriate to an individual bank's risk profile and management capabilities.

- *Revision of Methodology for Regulating Property-Related Exposure*
  All loans and debt instruments for the purpose of property development or investment, excluding owner-occupied housing loans, should not exceed 35 percent of the bank's total non-bank loans and debt instruments. This is to encourage healthy diversification in the bank's loan portfolio.

In July 2001, MAS also announced a new Liquidity Supervision Framework for banks in Singapore. Under the Framework, to be implemented in two phases, banks can choose either to remain subject to the existing 18 percent Minimum Liquid Assets (MLA) requirement or move to a risk-determined MLA requirement specific to the bank. In the first phase, from May 2002, banks can opt for the bank-specific MLA requirement to maintain MLA between 12 percent and 18 percent. In the second phase, expected to begin in May 2004, a bank will be allowed to use its own internal liquidity risk model to determine its MLA requirement.

The non-internationalization of the Singapore dollar (S$) policy was further liberalized with effect from March 20, 2002, in a significant step in facilitating participation by international investors and financial institutions in Singapore’s capital markets. What used to be a policy comprising detailed and complex guidelines has now been substantially stripped down to two basic requirements: (a) where non-resident entities wish to obtain a S$ loan, or tap Singapore’s equity or bond markets to fund overseas activities, they would need to swap or convert the S$ proceeds into foreign currency as and when the proceeds are used offshore; and (b) MAS will continue to prohibit financial institutions to extend S$ credit facilities exceeding S$5 million to non-resident financial entities where there is a reason to believe that the proceeds may be used for speculation against the S$ exchange rate.

MAS has taken further steps to tighten existing external audit procedures. In March 2002, it mandated that banks incorporated in Singapore shall not, except with the prior written approval of MAS, appoint the same audit firm for more than five consecutive financial years. Banks which currently use the same audit firm for five consecutive years have to appoint another audit firm not later than the end of their financial year of 2006.

MAS is also looking into two measures to safeguard depositor interests. It is considering requiring systematically-important foreign banks with a large retail presence to subsidiarize their operations in Singapore (i.e. incorporating the business and meeting the minimum paid-up capital of S$1.5 billion as well as MAS’ CAR requirements of minimum of 8% Tier I capital and

12% Tier I plus Tier II capital). MAS is also studying the need for deposit insurance scheme in Singapore.

Developments in the Bond Market

The Singapore bond market saw exceptional growth in both depth and breadth, despite the worsening external environment in 2001. In the Singapore Government Securities (SGS) market, for instance, the outstanding SGS volume has grown by 24% from S$43 billion by end-2000 to S$54 billion by end-2001. Gross issuance was also higher at S$14.2 billion in 2001, up from S$12.1 billion in 2000, with larger and more liquid benchmark issue sizes as part of the MAS' efforts to develop the local capital market. The average daily turnover has also broken the S$1 billion mark to register a record S$1.9 billion per day in 2001. To extend the benchmark yield curve from the then-existing 10-year tenor, the inaugural 15-year SGS bond was launched on September 3, 2001.

Reflective of an increasingly active SGS market, repo market volume also more than tripled to S$1.8 billion in 2001. This is equivalent to the previous five years' average daily repo volume combined. Trading in the Singapore Bond Futures contract, which was launched in June 2001, also took off, with open interest peaking at 4,145 contracts on August 25, 2001. The MAS also introduced the SGS eApps facility, an internet-based platform that facilitates more effective communication between the primary dealers and the MAS. The first application was the online bidding facility to enhance the efficiency of the auction process by shortening the auction window.

On the corporate bond front, growth indicators were also very encouraging and pointed to a more mature capital market. New corporate bond issuance jumped 43% from 2000 to a record S$72 billion last year, with the number of issues rising from 909 to 1,450 during this period. Fuelled by merger and acquisition activities in the banking and telecommunications sectors, there was an unprecedented number of successful issuance of around S$1 billion. As a result, total outstanding corporate debt volume increased 63% to S$81 billion in 2001. Structured debt products also accounted for 47% of the total S$ debt issued in 2001, reflecting a move towards more sophisticated debt instruments.

Paving the way for even greater liquidity and range of activities in the local debt capital markets, the MAS further liberalized the S$ non-internationalization policy in March 2002. Banks could lend S$ to non-residents for investment purposes in Singapore, and freely transact S$ currency options among financial institutions in Singapore. All individuals and non-financial entities, which include corporate treasury centers, are exempted from the S$ lending restrictions of the non-internationalization policy. For non-resident financial entities that continue to be governed by the S$ policy, restrictions on transactions such as asset swaps, cross-currency swaps, cross-currency repos, S$ securities borrowing and lending, S$ FX options, and S$ credit facilities for investment in financial assets and real estate will also be lifted.

Developments in the Equities and Derivatives Markets

The Securities and Futures Act (SFA) was passed by Parliament in October 2001 and serves as an omnibus Act that sets out the regulatory framework for the capital market. The reforms introduced in the Act include:

- The introduction of a modular, single licensing regime for securities and futures intermediaries.
- The introduction of a Recognized Trading System Providers regime to facilitate the regulation of Alternative Trading Systems and Overseas Stock and Futures Exchanges.
- The transfer of corporate fund-raising provisions from the Companies Act to the SFA and fine-tuning of these provisions.
- The continuous disclosure of material information by listed companies and notification by holders of substantial shareholdings.
- The transfer of unit trust provisions from the Companies Act to the SFA, and fine-tuning of these provisions.
- The introduction of an information-connected test for insider trading.
- The extension of civil fines and civil remedy provisions (presently applicable only to insider trading) to other forms of market misconduct (e.g. market rigging or employment of fraud).

The Financial Advisers Act (FAA) will come into operation on October 1, 2002. The FAA will provide a more flexible and streamlined licensing framework for market intermediaries, as only one license will be required to give advice on a spectrum of investment products. This reduces the administrative burden on and the compliance costs incurred by market intermediaries, who previously had to comply with different regulatory provisions and obtain multiple licenses under the securities, futures and insurance laws. The FAA will also facilitate the maintenance of consistent professional standards across the financial advisory industry.

In April 2002, MAS announced a new risk-based capital (RBC) framework for Singapore Exchange (SGX) members. The new RBC framework will form part of the Securities and Futures Regulations 2002, which will be released later this year. The new capital requirements will enhance the capital efficiency of SGX members, with capital requirements more directly related to the risks arising from the business activities of each firm. It will also lower the entry hurdle for legitimate and qualified players to be admitted into the Singapore market.

Under the framework, a member will need to comply with two capital requirements: a fixed-dollar, Minimum Capital Requirement and a risk-based Financial Resource Requirement. The minimum capital requirement will be much lower than the existing paid-up capital requirement. Risks that will attract capital are counterparty risk, position (or market) risk, large exposure risk, underwriting risk and operational risk. To facilitate a smooth migration to the new framework, existing members will be given a 12-month grace period from the date of implementation to comply with to the new capital regime.

In efforts to grow the securities market, the SGX has announced plans to broaden its membership base by attracting new international members by marketing membership to securities houses on a regional as well as global basis. It will be looking at increasing the number of classes of membership in the market divisions and is currently reviewing the possibility of introducing a trading-only membership.

SGX also took several initiatives to introduce new products and services over the past year:

- In October 2001, SGX and Tokyo Stock Exchange announced plans to pursue a strategic alliance with the aim of broadening distribution and enhancing the liquidity of products traded on both markets.

- Single Stock Futures (SSFs) based on 15 selected stocks listed on SGX-ST were launched in October 2001. SSFs based on major stocks listed in the key regional, European and US stock markets will be listed at a later stage.

- The ASX-SGX co-trading linkage, the first such facility in the world, was officially launched in December 2001. This electronic linkage allows brokers at each exchange to transmit orders through their existing trading terminals directly into the electronic trading system of the other exchange for execution.

- A joint venture company between the SGX and DBS Vickers Securities (Singapore) Pte Ltd and OCBC Securities Pte Ltd (Asia Converge Pte Ltd) to provide securities processing and settlement outsourcing services was officially launched in December 2001. Services provided will ultimately enable straight through processing for the entire chain of securities processes by integrating the front-end with the back-end of a securities transaction. The company now processes more than 20% of the securities markets transactions in Singapore.

- The SGX Securities Lending program was officially launched in January 2002. This facility improves investment and hedging opportunities for market participants and will help pave the way for the development of an active equity options market. SGX-ST is developing the next phase of the lending program, which offers strategic lending, whereby borrowers can request for specific loan periods and negotiate the borrowing and lending rates.

- In January 2002, SGX announced that its Derivatives Members can access overseas derivatives markets directly from the exchange's derivatives trading floor and electronic trading room via GL NET, a dedicated network by GL Trade, a leading provider of electronic trading solutions.

- Singapore's first local Exchange Traded Fund, the streetTRACKS℠ Straits Times Index Fund was listed and traded on SGX from April 17, 2002.

- In April 2002, SGX announced plans for a series of Japan-related initiatives on its derivatives market. These include the launch of MSCI Japan Index futures on 15 May 2002, and the introduction of Euroyen options on SGX's Mutual Offset System (MOS) with the Chicago Mercantile Exchange later in the year. SGX and the Tokyo Commodity Exchange also signed an agreement to cooperate on the launch of the Middle Eastern Crude Oil futures on SGX. The full-sized SGX 10-year Japanese Government Bond (JGB) Futures and Options Contracts were also launched.

Developments in Fund Management

In September 2001, the Securities and Futures Act (SFA) was enacted. One of the key liberalizations under the SFA is the removal of the previous restrictions preventing the direct offer of foreign funds in Singapore. A foreign offeror would be able to sell its funds directly in Singapore by establishing a legal presence by registering as a branch of a foreign company in Singapore and registering a prospectus with the MAS. The foreign prospectus may be used so long as the contents include those required under Singapore law.

According to the latest statistics available from the 2000 MAS asset management survey, total assets under management in Singapore stood at S$276.2 billion at end-2000. This represents an increase of S$2.5 billion, or 1 percent, over the S$273.7 billion managed at end-1999 (revised figure). Out of the total S$276.2 billion, 60 percent were discretionary assets which fund managers could invest at their discretion. Of the discretionary assets managed in Singapore, 27 percent of the funds came from Europe, 25 percent from Singapore and 16 percent from North America. Compared to end-1999, there has been an increase in funds sourced from Asia while funds sourced from Europe and the US experienced a slight decline.

The bulk of the discretionary funds were invested in Asia with S$49.4 billion (30 percent) in Singapore, S$18.7 billion (11 percent) in Japan and S$66.6 billion (40 percent) in the rest of Asia. The asset management survey indicated that the discretionary assets continue to be invested predominantly in equities (59 percent). However, there has been an evident shift towards bond investments, with 19 percent of the investments allocated to bond investments, compared to 12 percent in 1999.

The unit trust industry saw healthy growth in 2000 with 31 unit trust managers managing a total of 265 unit trusts compared to 25 managers managing 187 unit trusts at end-1999. The total assets for these unit trusts increased by 15 percent, from S$6.8 billion at end-1999 to S$7.8 billion at end-2000. Net subscriptions of unit trusts for 2000 grew by about two-fold to S$2.9billion compared to S$1.5 billion in 1999. According to Standard & Poor’s data, the total assets in unit trusts grew further to S$11.9 billion at end-2001, while the number of unit trusts increased to 341.

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. The Committee on Efficient Distribution of Life Insurance (CEDLI), comprising senior insurance practitioners and appointed by MAS submitted 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 also accepted many of the recommendations in CEDLI’s supplementary report issued in late 2000, which covered 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. Implementation of the recommendations of both reports began in 2001.

In the area of cost disclosure, commissions and pricing, the industry implemented two CEDLI recommendations. In July 2001, the industry implemented full disclosure of all marketing and distribution costs and administrative charges and expenses, offering consumers greater policy cost transparency. On January 1, 2002, the industry lifted existing regulated limits on commissions and agency costs allowing market forces to determine these levels.

MAS is believed to be considering a number of CEDLI recommendations on the development of alternative distribution channels for life insurance, which 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.

One related piece of legislation that will likely impact the industry in the longer term is the FAA, which will come into operation on October 1, 2002. The FAA will create a "level playing field" among all institutions and individuals providing personal financial advice and the related products and services. The initial implementation will have the largest impact on traditional life insurance agency and brokerage sales forces and bank sales channels distributing life insurance, unit trusts and managed fund products.

As part of the measures to strengthen protection of policyholders' interests by insurers, the actuarial certification of general insurance reserves was implemented in February 2002. To ensure good discipline and sound insurance management, MAS requires insurance policy liabilities of general insurers and reinsurers to be assessed and certified by qualified professionals with effect from accounting year 2001.

The Singapore Interbank Payment System

In support of the initiative to include the Singapore Dollar as a CLS currency, MAS and ABS are currently working on the enhancement of MAS Electronic Payment System (MEPS) to cater to the CLS specific requirements. This is targeted to be completed in March 2003.

Clearing and Payment Services Pte Ltd (CAPS), a shared utility jointly owned by the three Singapore banks, DBS Bank, United Overseas Bank and OCBC Bank, has been formed to provide access to CLS and other clearing and payment services. A working group has also been formed to conduct a review aimed at identifying specific user requirements for MEPS+, a second generation MEPS.

Singapore's Approach to Consolidated Supervision

When MAS was formed in 1971, it was responsible for both monetary policy and the supervision of banks. It took over supervision of the insurance industry in 1977, and the securities industry in 1984. From the beginning, MAS' approach to supervising the financial sector was centered on a strict admission policy, high prudential requirements, and rigorous enforcement that sought not only to maintain systemic stability, but also to protect individual institutions from failing, and the public and investors from losses. Since 1998, MAS has been reviewing and updating its approach to regulating and supervising the financial sector. First, it has instituted a fundamental shift in emphasis away from "one-size-fits-all" regulation of institutions to risk-focused supervision, and from merit-based regulation of products to a disclosure-based regime. Second, it has embarked on a program to liberalize access to all parts of the financial industry to stimulate greater competition and dynamism.

The MAS' new supervisory framework seeks to encourage dynamism and innovation without compromising the safety and soundness of institutions or undermining systemic stability.

Risk-focused, consolidated supervision will place more emphasis on understanding and evaluating an institution's risk profile, risk management capabilities, and internal systems and controls. Stronger institutions will be given more flexibility. This approach will be applied group-wide across all constituent institutions, local or overseas. At the micro-level, MAS is improving the processes and techniques it uses to systematically evaluate a bank's operations and risk profile to determine the key areas that require attention. At the macro-level, MAS is enhancing its financial surveillance capabilities, to help identify emerging vulnerabilities, and assess how they will affect individual institutions or business activities, so that adequate supervisory resources could be devoted to these areas.

A more harmonized and integrated approach to regulation will be developed as consistency in regulation across similar financial activities and products will help level the playing field, lower compliance costs, and reduce the scope for regulatory arbitrage. In this regard, MAS has begun to streamline the licensing regime and put in place a risk-based capital framework across the financial sector. The new Securities and Futures Act will introduce a single, modular licensing regime for securities and futures intermediaries. The Financial Advisors Act will provide a single licensing regime and a more flexible integrated regulatory framework, with consistent standards of business conduct for entities engaging in financial advisory activities for all investment products. Progress is also being made in applying the concept of risk-based capital. In banking, where risk-based capital standards already exist, MAS is working with the local banks to implement the proposed New Basel Capital Accord. In insurance, securities and futures trading, existing disparate capital frameworks will be revised and replaced by a consistent risk-based approach based on common principles and objectives.

Over time, the MAS will rely more on corporate governance and market discipline to complement prudential regulation and supervision. Good corporate governance is crucial to fostering a strong risk management culture and effective internal controls, and ensuring that the interests of all stakeholders are appropriately safeguarded. The MAS has instituted a policy requiring the separation of financial and non-financial activities, and the unwinding of cross-shareholdings within the local banking groups. MAS is also working with the industry to introduce appropriate measures to enhance the independence and effectiveness of boards of directors overseeing financial institutions.

MAS has also sought to promote market discipline by fostering greater information disclosure and encouraging the adoption of international standards of financial accounting. Banks and other financial institutions will progressively raise their levels of disclosure in such areas as directors' remuneration, non-performing loans and risk management practices to meet international best practices. To ensure that accounts are prepared in accordance with clear and reliable standards and policies, Singapore companies will be required by law to comply with the International Accounting Standards (IAS) from 2003.

SPAIN

Legislative and Regulatory Developments

During the period under review, the most significant changes concerned investment services, bank transparency and consumers protection.

The Royal Decree 867/2001 on Investment Service Companies and Royal Decree 948/2001 on Compensation Systems of Investors were approved in August 2001. The first decree regulates the requirements and procedures to create Investment Services Companies (Sociedades de Valores, Agenciaes de Valores y Sociedades Gestoras de Carteras) and, in general, the investment services provided in Spain by foreign companies as well as by Spanish ones. Its contents agree with those of the European Investment Services Directive (Directive 93/22/CE).

The second Royal Decree regulates the so-called Fondo de Garantía de Inversiones. This fund is an equivalent scheme to the guarantee fund of bank deposits, complying with the European Directive 97/9/CE. The objective of the guarantee fund is to ensure to investors the refund of the securities and cash entrusted to the investment services companies, with a ceiling of 20,000 euros.

Concerning protections for customers of credit institutions, an important Circular was published in September 2001 by the Bank of Spain. The Circular requires that customers be provided with detailed information when they order cross-border wire transfers, and also adapts the consumer protection rules to those services performed through the Internet.

Apart from these regulatory developments, a very interesting development concerns the process of integrating the several regulated markets and the Spanish settlement systems into one single structure, with the purpose of reinforcing their competitiveness in the European context. Presently, this process is advancing quickly and the projected holding company has already been set up.

In addition, two important laws are under negotiation in the Spanish Parliament. One concerns the reform of the financial system, and it includes partial changes in certain aspects of the legislation on credit institutions, investment and insurance services. The second law concerns the financing of terrorism, and establishes a governmental blocking system for accounts and transactions suspected of being related to such financing. It is expected that this law will be approved within 2002 and the law concerning the reform of the financial system should be approved before the end of the year.

Consolidated Supervision

In Spain, there exists a system of consolidated supervision of financial institutions. Since this matter has been harmonized, its characteristics are identical to those of the other countries of the European Union. Consolidated supervision also applies to affiliated banks and branches of foreign banks from outside the European Union, although only with respect to their Spanish group. Nevertheless, the Bank of Spain takes into consideration the global situation of the group when authorizing the establishment of the affiliated bank or branch, and cooperates with the home-country supervisory authorities.

SWEDEN

Legislative and Regulatory Developments

In the spring of 2002 there was a government proposal for a new law called the Financing Business Act. A first proposal came a few years ago from the Banking Law Committee, and the Ministry of Finance has now published a somewhat revised version.

The proposal includes a new definition of banking business, which would open up the possibility for credit market undertakings other than banks (for example, mortgage credit institutions and finance companies) to take deposits from the public and for companies that are not credit market undertakings, and therefore not regulated by the new act, to take deposits up to 50,000 Swedish kronor (about 5,500 euro). It is also proposed that banks will have more freedom to engage in non-financial operations.

However, the proposal has been criticized by the banks and the Swedish Financial Supervisory Authority.

In another development, the Swedish Parliament has decided that the EU regulation on cross-border payments in euro from July 1, 2002 shall apply also to cross-border payments in Swedish kronor. This means that charges for cross-border payments in Swedish kronor must be that same as the charges for payments within the country.

Market Developments

In September 2001, the EU Commission interrupted the proposed merger of Skandinaviska Enskilda Banken (SEB) and Swedbank (FöreningsSparbanken) into the new bank SEB Swedbank. The EU decision started a debate in Sweden concerning the application of the merger rules and the difficulties for banks in small member states to merge into a larger bank.

Nordea acquired the state-owned Postgirot Bank in the autumn of 2001. Postgirot Bank is a leading bank on the Swedish payment market. Most Swedish companies and organizations have a business relationship with Postgirot Bank.

The two largest food store chains in Sweden - ICA and COOP - have started banking operations. The new banks - ICA Banken and COOP Bank - will base their operations on Internet services and on their nationwide network of food stores.

In recent years, the major Swedish banks have developed their banking operations in the Baltic states and in Poland. Swedish banks now own several large banks in this area.

In the autumn of 2001 Svenska Handelsbanken acquired the Danish bank Midtbank.

Swedish banks have a leading position in electronic and Internet banking. The number of customers using the banks' Internet services has increased quickly since the introduction of these services in 1996. More than 30 percent of all Swedes use their banks' Internet services on a regular basis.

Consolidated Supervision

As a member of the European Union Sweden has implemented the EU legislation and also participates actively in EU co-operation.

In its role as home country supervisor, the Swedish Financial Supervisory Authority (Finansinspektionen) receives consolidated financial and prudential information regarding financial groups' global operations. Finansinspektionen also conducts on-site examinations of financial groups. In this respect Finansinspektionen has the possibility to conduct on-site examinations in other jurisdictions, if a Memorandum of Understanding (MOU) exists. The ambition of Finansinspektionen is to establish MOU's with countries where Swedish banks have larger establishments.

In its role as host country supervisor, Finansinspektionen conducts both on- and off-site supervision of bank subsidiaries and affiliates of non-domestic financial groups.

SWITZERLAND

Reform of the National Bank Law

In March 2001, the Federal Department of Finance initiated a consultation procedure on the total revision of the National Bank Law (NBL). The current National Bank Law dates back to 1953 and has been revised only partially since then. Numerous provisions are therefore outdated. Moreover, after the revision of the article on monetary policy in the Federal Constitution (art. 99 FC), adjustments on the legislative level became indispensable. Comments on the draft were not unanimous but it was in its broad lines generally welcomed by a large majority of commentators. The draft will be discussed in Parliament later this year and the reformed NBL will presumably enter into force around 2004.

Main tasks: Whether price stability should be the overriding goal of monetary policy has been the main political issue at hand. The importance of price stability is generally recognized. The exact wording, however, is still hotly debated. As it is now in the draft, the central bank's mandate consists of “conducting a monetary policy in the interests of the country as a whole. The SNB ensures price stability. By doing so it respects the current economic situation of the country.” The provision to take account of economic development is sensible and conforms to established practice. Further, it is intended to explicitly vest with the SNB the responsibility of overseeing payment systems as well as securities clearing and settlement systems. The SNB will fulfill this expanded mandate by cooperating with the Swiss Federal Banking Commission (SFBC). The SNB will focus on systemic issues, while the SFBC - as bank and securities supervisor - will deal with institutional aspects.

Currency reserves: The NBL assigns the duty of determining the appropriate amount to be set aside from the SNB's earnings as reserves to the Governing Board (as it is today). The decision of the Governing Board must then be approved by the Bank Council.

Independence: The independence of the SNB is already guaranteed in the constitution (art. 99) and will be reaffirmed in the law in such manner that neither parliament nor government may give directives concerning the conduct of monetary policy. The SNB retains its legal form of a joint-stock company. As counterpart to its independence, the SNB will be submitted to strict accounting and information obligations vis à vis the government, the Parliament and the public.

Overall assessment: All in all, the reform is of a technical rather than substantive nature. Still, the modernization of the Act on the SNB is desirable.

Federal Consumer Credit Legislation

A federal law on consumer credit was adopted in the spring of 2001 and is expected to enter into force on January 1, 2003. The most significant changes are that the law enhances consumer protection and that cantonal (state) laws on consumer credit will become obsolete. The maximum duration of a contract is 36 months and in general the interest rate must not exceed 15 percent. The new law is also applicable to leasing, credit cards and to bank account overdrafts (salary accounts). Credits of less than CHF 500.00 or more than CHF 80,000.00 are not subject to the new law.

The implementing ordinance to the law is currently being drafted.

SWX Swiss Exchange

The Federal Stock Exchange Act of 1995 has transformed Stock Exchanges from state institutions into private corporations, thereby promoting entrepreneurial flexibility and cross-border mobility. As a result of these changes, SWX Swiss Exchange was able, jointly with the London-based Tradepoint Financial Networks plc, to establish virt-x, a fully automated stock exchange in London operating with SWX technology, designed for trading European blue chips and competing on an international scale. As of June 25, 2001, Swiss blue chips listed in Zurich are traded no longer in Zurich but in London. On May 6, 2002, virt-x issued its Rules. Market supervision is operated by the Financial Services Authority (FSA) in London while the primary market and listing procedures remain under Swiss law. Coordination between FSA and the Swiss Federal Banking Commission (SFBC) follows the principles of administrative assistance as embodied in the Federal Stock Exchange Act.

Consolidated Supervision and Financial Privacy

Consolidated supervision has been a focus of capital-market law during the past years. Since the mid-1990s, the Federal Banking and Stock Exchange Acts have been amended to enable the Swiss Federal Banking Commission (SFBC) to cooperate with foreign supervisory authorities such as the US Securities and Exchange Commission (SEC). Thereby, Swiss law requires the SFBC to follow the rules of specialty and privacy. "Specialty" means that information provided to a foreign authority must not be used for other than market supervision purposes or, under certain conditions, the investigation of capital-market crimes (insider trading and market abuses). Privacy, on the other hand, means that the foreign authority asking the SFBC for information has to keep such information confidential. During the past year, the Swiss Federal Supreme Court repeatedly held that disclosure and publicity rules of the SEC contradict such requirements and prevent the SFBC from passing information to the SEC. Cooperation among the two authorities has therefore been blocked for some time, and Swiss authorities, jointly with the Swiss Bankers Association (SBA), are currently studying possibilities to overcome these problems. It remains an important concern of the Swiss Government not only to preserve bank customers' privacy rights but also to cooperate in the fight against international crime. Consolidated supervision, however, is to be focused on topics such as a bank's organization, capital ratios, and handling of systemic risks. Customer files should only be involved in exceptional cases (i.e., big risks and capital-market crimes). Reconciling privacy rights with the requirements of consolidated supervision is one of the first commitments on the agenda of the Swiss financial industry for the coming years.

Anti-Money Laundering Developments - Combating Terrorism

When after September 11, 2001 the first lists of terrorists were available and transferred to all Swiss banks, these banks immediately checked this information against all their account holders, beneficial owners and holders of powers of attorney. In case of matches, they blocked the accounts and reported such actions to the Swiss Money Laundering Reporting Office (MROS).

This was possible because of the reporting obligation in cases where the financial intermediary has a substantial suspicion that a criminal organization exercises the power of disposition over valuables deposited with it (article 9 Money Laundering Act). Article 10 of the same act stipulates that in the case of a reporting obligation, the bank has to block the valuables immediately for a period of five days; this together with the reporting gives the judicial authorities the opportunity to intervene with their own blocking order. As a result, there was no need for quick legislative or regulatory fixes.

TURKEY

Banking Sector Restructuring Program

In Turkey, restructuring of the banking sector continued during the period under review. The Banking Sector Restructuring Program, announced on May 15, 2001, aims to eliminate distortions in the financial sector and adopt regulations to promote an efficient, globally competitive and sound Turkish banking sector.

The restructuring program is based on the following main pillars: i) restructuring of the state banks; ii) resolution of banks under the Savings Deposits Insurance Fund (SDIF); iii) strengthening of the private banks' capital structure; and iv) strengthening of the regulatory framework.

Along with the financial and operational restructuring of the banking sector, legislative amendments and institutional changes have been adopted since 1999. These efforts aim to strengthen the regulatory and supervisory framework, facilitate sound banking practices and thus establish confidence in the sector. Prudential regulations are concentrated in the following areas:

- capital adequacy;
- foreign exchange exposure limits;
- loan loss provisioning and connected lending;
- repurchase agreements;
- risk management;
- accounting and auditing;
- supervisory activities of the Banking Regulation and Supervision Agency (BRSA);
- resolution of banks under the SDIF; and
- strengthening the institutional capacity of BRSA and SDIF.

Restructuring of State Banks

Financial restructuring of the state banks was completed in 2001, while important progress has been achieved in the area of operational restructuring.

Operational restructuring of the state banks aims at restructuring these banks in terms of organization, technology, human resources, financial control, planning, risk management and service quality. Developments regarding these issues include the following:

- The banking and deposit taking licenses of Emlak Bank was revoked and the bank was transferred to Ziraat Bank.
- Significant improvements have been realized towards the rationalization of the number of branches and staff.
- A detailed strategic and organizational implementation plan regarding the operational restructuring of Ziraat Bank and Halk Bank has been adopted and approved by General Assemblies of these banks.
- An agreement was signed with an independent audit company to assess the conditions of the state banks.

Resolution of Banks Under the SDIF

Major steps were taken regarding the financial and operational restructuring of the SDIF banks and management of their assets during 2001:

- Government securities were issued to the SDIF by Treasury in order to strengthen the capital structure of SDIF banks.
- Capital support was provided to SDIF banks through the SDIF's own resources as well.
- SDIF banks eliminated their short-term liabilities to clients and the private sector by the funds generated through the sale of special issue bonds to the Central Bank.
- Open FX positions of SDIF banks decreased substantially.
- SDIF banks' deposit interest rates were determined uniformly and below the interest rates on government securities, and brought down to the market level.
- The number of personnel and branches of SDIF banks was reduced substantially.
- An important portion of the SDIF banks' deposits were sold to other banks through a series of auctions, backed by matching government securities portfolios.
- The resolution process of the SDIF banks through mergers, transfer, sale or liquidation accelerated in the second half of 2001.

Strengthening the Capital Structure of Private Banks

The process of strengthening the capital structure consist of the following:

Audit and Assessment

- Auditing of the bank's contracted independent auditor.
- Auditing of the first independent auditing company's report by a second independent auditor for compliance with the announced principles and procedures of independent auditing.
- BRSA's assessments of all these inputs using on-site and off-site supervision results.

Bank Recapitalization

In case of a loss that cannot be covered by provisions, some banks will need to write down capital, authorize new capital, submit business plans, and raise additional capital within the strict limit of regulation.

State Support

Providing state support to the banks whose Capital Adequacy Ratio (CAR) is under 8 percent and meeting the necessary conditions.

The Methods of Recapitalization

Capital support shall be provided in two ways: a) investing direct capital not more than the amount paid by the shareholders to increase CAR to 5 percent (participation to common equity); and b) providing subordinated debt (convertible bonds with 7-year maturities) to increase CAR to 9 percent.

Conditions for State Support

- All banks that have positive CAR and an asset share of at least 1 percent in the banking sector as of September 30, 2001 or increased their share to this level by mergers and acquisitions may qualify for both methods of support.

- The banks that have an asset share under 1 percent in the sector can only benefit from the subordinated debt support if they increase their CAR to 5 percent.

Objectives of Recapitalization Scheme

- Ensuring transparency and enhancing confidence in banking sector.
- Maximizing capital contributions by banks' owners.
- Minimizing the fiscal cost by preventing transfer of viable banks to SDIF.
- Encouraging mergers and acquisitions.
- Enabling banks to start extending credits to real sector.
- Contributing to efficient functioning of corporate debt restructuring schemes.
- Creating an appropriate environment for removing blanket guarantees, thus restoring market discipline.

Measures to Ensure Efficient and Appropriate Use of Public Funds

- Direct capital injection by SDIF will be limited to the amount paid by the shareholders.
- SDIF will be shareholder on behalf of government in the direct capital injection.
- Subordinated debt will be given with a yield that is consistent with market conditions.
- Subordinated debt will be convertible to equity.
- The stocks of the major shareholders shall be taken as pledge.
- For any bank in which SDIF holds equity, SDIF would have board representation with veto rights.
- Banks will submit comprehensive business plans, projections and commitments to performance measures as a condition for state support.
- Banks will extend 60 percent of Tier 1 capital support as credits to non-group firms by the end of June-2003.

Changes in Banks Act

January 2002

With the purpose of strengthening the current economic program by developing strategies for the NPL problem, corporate debt restructuring and recapitalization of the private banks, the "Law on Restructuring of the Debts to the Financial Sector and Amendments to be made in some Laws, No. 4743" was put into effect on January 31, 2002.

With this law, the following important amendments were made to the Banks Act No. 4389:

- Privately owned deposit banks will go through a three-step auditing and supervision. Those that satisfy certain conditions can receive a one time support in the form of SDIF's participation in Tier 1 capital or subordinated debt (Tier 2 capital) as necessary.
- Important amendments were made in the Banks Act to prepare the legal infrastructure to accelerate the collection process of SDIF banks' receivables, and to strengthen SDIF's authority.
- Within the framework of the Law No. 4743, there were also changes in regulations regarding state banks:

  - State banks are not allowed to employ personnel who are not subject to provisions of private law after December 31, 2002.
  - Early retirement is encouraged by a 20 percent addition to retirement bonuses within two months of enactment of Law No. 4743.
  - Members of the Board of Directors and Board of Auditors of Ziraat Bank and Halk Bank, and Board of Liquidation of Emlak Bank will not be deemed as civil servants from the standpoint of the criminal law and administrative law, and their legal liabilities will be subject to the legislation and provisions applied to the private banks operating in the banking sector.
  - State Banks are authorized to restructure credits extended before February 21, 2001.
  - Ziraat Bank and Halk Bank are required to extend an additional loan from their own resources to the agricultural sector, tradesmen and artisans, small and medium sized enterprises and exporters. Additional loans will be extended in accordance with prudent banking procedures.

- The Law No. 4743 also provides tax incentives to encourage the establishment of asset management companies and arranges the framework for voluntary corporate debt restructuring.

New and Renewed Banking Regulations by BRSA

Regulation on Measurement and Assessment of Banks' Capital Adequacy

This regulation defines the principles and procedures to calculate banks' CAR both on a consolidated and solo basis, which was published in the Official Gazette, dated January 31, 2002. It states the principles and procedures concerning the incorporation of market risks -namely interest rate, exchange rate and equity risks- in the calculation of CAR and replaces the existing regulation, which was issued in February 2001. The new regulation includes the following amendments:

- Principles and procedures regarding the measurement of risks and capital adequacy issues related to the banks' options operations are defined.
- Risk weights are re-arranged to comply with the inclusion of repo transactions in the balance sheet.

- "Structural Position" is defined to prevent erosion of banks' own funds from steep price and foreign exchange rate movements. The work on the principles and procedures for inclusion of the structural positions in the calculation of the capital adequacy ratio is continuing.

Regulation on Establishment and Operations of Banks

Amendments were made to the regulation concerning the rules and procedures on establishment and operations of banks, which was published in Official Gazette dated June 27, 2001. With the amendments to the regulation on January 31, 2002, definition of own funds has been changed to provide uniformity both in the calculation of credit limitations and in the application of financial ratios.

Regulation on Principles and Procedures for the Implementation of the Foreign Exchange Net Position/Own Funds Standard Ratio

Regulation on principles and procedures for the implementation of "the Foreign Exchange Net Position/Own Funds Standard Ratio" for banks on a consolidated and unconsolidated basis was published on January 31, 2002. With this regulation, compliance with the changes in the definition of the own funds and consolidated own funds is provided.

Provisioning Regulation

The regulation on loan loss provisioning was amended on January 31, 2002 and an explanatory circular was published to clarify implementation related issues. Under the amendments, existing procedures on the restructuring of NPLs and other claims are revised in order to improve the efficiency of the voluntary corporate debt restructuring programs.

Regulation on the Principles and Procedures of the Banking Sector Recapitalization Scheme

The purpose of this regulation, which was published on February 1, 2002 is to lay down the principles and procedures for the recapitalization scheme designed for the privately owned deposit-taking banks incorporated in Turkey with the ultimate aim to establish a sound and transparent banking system. Among other things, the regulation stipulates the procedures regarding an increase or decrease of the banks' capital; the measures that need to be taken based on assessments of the Banking Regulation and Supervision Agency (BRSA); the transfer period for shares which are subject to the capital increase; the issuance of convertible bonds and triggers for the conversion of these bonds into shares; the sale of banks' shares taken over by the SDIF and conversion of subordinated debt to capital.

Implementation of Accounting Standards and Independent Auditing Regulations

- "Uniform Accounting Plan and Standards to be Applied by Banks" was changed in order to allow the inclusion of repo transactions on balance sheets beginning from February 1, 2002.

- Draft Regulation of Accounting Practices, which is compatible with the International Accounting Standards (IAS) has been posted at BRSA's Internet site for discussion. This regulation will be on a trial implementation period starting from February 1, 2002 and will be fully implemented from July 1, 2002 onward in order to ensure that banks' end-2002 balance sheets comply with IAS.

- On February 1, 2002 two separate regulations were published setting out the principles and procedures of independent auditing and authorization of independent auditing companies. With the regulation on principles and procedures of independent auditing, the procedures and principles to be applied in independent auditing are brought to international auditing standards and regulated in a more detailed fashion.

- The BRSA issued the regulation on principles and procedures of independent auditing to be carried out in banks within the context of the bank recapitalization scheme on February 1, 2002. According to this regulation, consolidated and unconsolidated financial statements will be prepared to reflect the banks' true financial position, by incorporating losses arising from required provisions from loans and other claims, from adverse exchange rate changes or from other activities. The audits of the privately-owned deposit banks will be based on the banks' financial statements set up as of December 31, 2001. The audit reports prepared by the independent audit institutions will be assessed by a second independent auditing institution for conformity with the announced audit instructions and procedures. The "Independent Auditing" is to be carried out in line with the International Accounting Standards.

Reserve Requirements and Liquidity Requirements

With regard to an amendment in the Communiqué on the application of reserve requirements, made in August 2001, interest would be paid on the reserve requirements, which are to be held as TL deposits with the Central Bank. The rate of interest will be determined and paid quarterly by the Central Bank.

Pursuant to another amendment on the application of liquidity and reserve requirements, made in April 2002, the reserve requirement ratio and liquidity ratio for TL deposits is reduced from 12 percent to 10 percent while that of FX deposits from 14 percent to 12 percent, effective from May 10, 2002. Interest is also paid quarterly on the reserve requirements to be held as FX deposits with the Central Bank.

Withholding Tax Rates

In order to encourage the savings in TL and to lengthen the maturity of time deposits, the withholding tax rates on time deposits was changed in July 2001.

The withholding tax rate was brought down from 16 percent to 14 percent on 3-6 month TL deposits, to 10 percent on 6 month-1 year TL deposits, and to 6 percent on TL deposits with a maturity of more than 10 years. On the other hand, the withholding tax rate was increased from 16 percent to 20 percent on repos and to 18 percent on foreign exchange (FX) deposits with less than a one-year maturity.

Tax Identification Number

According to the Decree published in Official Gazette dated on June 19, 2001 all banks (including their off-shore branches), intermediary institutions, special finance houses, leasing and factoring companies, insurance and reinsurance companies are required to determine customer tax ID numbers relating to the financial transactions which are specified in the Decree. The obligatory implementation of tax identification numbers in banking transactions will start by October 2002.

Istanbul Stock Exchange (ISE) Launched Currency Futures Market

The lack of an organized and liquid market for derivative instruments in Turkey has been an important issue for Turkish financial and industrial corporations having currency exposures. Thus, in order to help overcome the adverse effects arising from currency risk and to provide a market that will offer indicative currency prices for the future, a Currency Futures Market was launched within the ISE on August 15, 2001. Due to the nature of the contract to be traded in the Market, initially, only commercial banks are accepted as members.

Market Developments

Excluding the Central Bank, the number of banks operating in Turkey decreased from 74 to 57 during the period between July 1, 2001- June 30, 2002, 43 of which are commercial banks, and 14 are development and investment banks. The number of bank branches declined from 7,509 to 6,290 in the same period.

Closed Banks

The banking licenses of three banks, two from private development and investment banks (Atlas Yatırım Bankası and Okan Yatırım Bankası) and one from foreign banks having branches in Turkey (Rabobank) were revoked.

Mergers and Acquisitions

With the Regulation on Banks' Mergers and Acquisition providing tax incentives to encourage mergers and acquisitions of banks and their subsidiaries, such activities accelerated in the second half of 2001.

Developments related to mergers and acquisitions include the following:

- One of the state banks (Türkiye Emlak Bankası) was transferred to another state bank,(TC Ziraat Bankası) on July 6, 2001.
- Three domestic commercial banks belonging to the same private group (Birleşik Türk Körfez Bank, Osmanlı Bank, T. Garanti Bank) were merged under the largest of them, namely T. Garanti Bankası. The merger was completed at the end of 2001.
- Four commercial banks under the SDIF management were sold to the different private groups:
  - Demirbank was taken over by HSBC Bank Plc. on December 12, 2001.

  - Bank Ekspres was transferred to Tekfenbank A.Ş. on October 26, 2001.
  - The sale of Sümerbank to Oyakbank A.Ş. was completed on January 11, 2002.
  - Sitebank was sold to Nova Bank on January 11, 2002, and classified as a foreign bank established in Turkey.
- Two of the development and investment banks were merged, namely Sınai Yatırım Bankası and Türkiye Sinai Kalkınma Bankası, on March 27, 2002

Anti-Money Laundering Developments

Financial Crimes Investigation Board (FCIB) is the responsible authority on anti-money laundering activities and carries out preliminary investigations in order to determine whether money laundering offenses have been committed. FCIB is authorized to set the types of suspicious transactions as guidance to the financial institutions.

Regarding the fight against terrorism after September 11, an amendment was made to the national anti-money laundering regulation by FCIB. Financial institutions are obliged to report to the FCIB funds that are suspected as having a relation with terrorism or terrorist actions.

Payment Systems, Electronic Business

Currently, the TIC-RTGS includes all the high value interbank funds transfers, market and monetary policy payments as well as the retail payments. With the figures of 2001, the number of payment transactions in TIC-RTGS has reached 26.7 million with a value of 2.8 trillion euro. Securities settlements are also included in the system with an average of 1,000 securities transfers on a daily basis. The system is running with 61 direct members as of May 2002.

Commercial banks are offering TIC-RTGS to their customers by means of Internet and telephone banking facilities.

Turkey has been involved in e-Europe^{+} project. E-Turkey project started in October 2001 parallel with e-Europe^{+} project.

Consolidated Supervision

Any parent bank (headquartered in Turkey) and each of its consolidated financial partnerships which is a member of a financial conglomerate (group) is subject to consolidated supervision, including with respect to reporting and prudential capital requirements.

Banks Act No. 4389 and the regulations, which are put into effect in accordance with Article 13(4) of the Banks Act, regulates the consolidated supervision principles and procedures for banks.

- Article 13(4) of the Banks Act states that "Banks shall consolidate the financial statements of their direct and indirect affiliates and of the partnerships, where they have full control and/or partners and of the financial and non-financial partnerships owned or controlled and managed directly or indirectly by these partners. The standard ratios regulated under this Act have to be calculated and implemented by banks also on a consolidated basis within the principles and procedures determined by the BRSA. The real and legal persons who are included within the coverage of these consolidated statements by the BRSA, are obliged to hand over all documents to the relevant banks and the BRSA wherever requested to do so by them."

- Banks that are included in the financial group are required to prepare consolidated financial statements in accordance with the *Decree On The Principles And Procedures Related To The Preparation Of Financial Statements By Banks*.

- *Regulation on Measurement and Assessment of Capital Adequacy of Banks* defines "capital adequacy standard ratio" as the standard ratio of "capital base / risk-weighted assets, non-cash credits and obligations" which shall be prepared on both consolidated and unconsolidated basis. According to this regulation, any parent bank, which is required to prepare consolidated financial statements pursuant to regulations issued by the BRSA in accordance with the Banks Act, shall calculate and apply the capital adequacy standard ratio in accordance with the principles laid down by this regulation.

- *Regulation On Principles And Procedures About The Implementation Of "The Foreign Exchange Net Position/Own Funds Standard Ratio"* requires banks to calculate their foreign exchange net position/own funds standard ratio both on consolidated and unconsolidated basis.

Calculation of capital adequacy standard ratio on a consolidated basis will be effective from July 1, 2002.

UNITED KINGDOM

Despite a demanding market environment, the UK banking industry produced a robust financial performance in 2001. For the large UK banks, pre tax profits declined somewhat but profitability remained impressive by historical and international standards. For the markets, the past twelve months have, of course, seen a series of major shocks, most notably the tragic events of September 11. The collapse of Enron and Argentina's default were also defining events for the international financial community. In addition, there have been important developments in the regulatory framework for banks and other financial services firms in the United Kingdom.

Regulatory Developments

The Financial Services Authority (FSA) assumed its powers under the Financial Services and Markets Act 2000 at the end of November 2001. This date, known as N2, marked a watershed in the evolution of financial services regulation in the United Kingdom. It followed an extended period of intensive preparations by the FSA and the financial services industry alike.

In order to preserve legal continuity for firms, individuals and products that were authorized, registered or regulated under the legacy regimes, the FSA worked closely with the UK Treasury to produce transitional legislation which 'grandfathered' them into the new regime.

In consequence, firms and individuals were legally entitled to undertake the same business following N2 as they were before. For the FSA, this involved translating the status of around 11,000 firms and 180,000 individuals into the new permissions and approvals under the new regime.

Since N2, banks and other financial services firms have been subject to the new FSA Handbook of rules and guidance and both the industry and the regulator have been gaining experience with the new regulatory framework. This does not mean that the regulatory environment has reached a ‘steady state’. Over recent months, there have been a variety of policy initiatives, including key FSA consultations on further changes to the framework.

In December 2001, the Tiner report on the future regulation of insurance companies was published. Against the background of widely reported difficulties in pockets of the sector, the report proposed wide-ranging regulatory reform. The FSA is introducing a more proactive approach to insurance regulation and, inter alia, has established a specialized risk review team to provide advice to supervisors along the same lines as the team operating in banking supervision. With the implementation of the Integrated Prudential Sourcebook in 2004, the same broad principles of capital adequacy will apply to banks and insurance companies alike (and to other financial firms).

Also at the end of last year, the Government announced that the FSA regulatory framework would be extended to cover mortgage advisers. From 2004 advisers will require authorization by the FSA and a conduct of business regime will be put in place. To the same time scale, the Government announced that general insurance brokers would also be brought into the regulatory net – a development required to meet the pending EU Insurance Mediation Directive. These decisions will leave retail banking as the only key business area subject to self regulation rather than statutory conduct of business rules. This follows the Government’s acceptance of the recommendations of the Julius Committee on banking industry codes last December.

Prudential Regulation Developments

In May 2002, the FSA published proposals on individual capital adequacy standards for banks and other related firms. For banks and investment firms, these set out the regulator’s early thinking on how Pillar 2 of the revised Basel Capital Accord might be implemented. Key elements include self assessment by institutions themselves of the additional capital required to address business and systems and controls risks not adequately captured by Pillar 1 and a supplementary capital assessment by the FSA. As of July 2002, these proposals are under industry scrutiny.

Another capital adequacy issue on which there have been preliminary discussions between the FSA and the industry concerns the definition of capital. The regulator has undertaken a review of ‘innovative’ Tier 1 capital structures – such as stock settled preference shares – and possible limitations on the extent to which such instruments may receive regulatory recognition as Tier 1. It is expected that a formal consultation exercise will begin shortly.

The FSA has also issued a discussion paper on the future of regulatory reporting. One theme of the paper was that, as an integrated financial services regulator, the FSA should use a common underlying reporting framework across sectors – in respect of both supervisory data and the provision of information that would help consumers make more informed decisions. It is not expected that there will be a formal consultation on these issues before 2003.

Also in the prudential area, the FSA is undertaking a comprehensive review of policy for liquidity risk for banks and other regulated firms. In March 2002, a consultation paper on systems and controls elements was issued and a second paper on quantitative requirements is planned for the first half of 2003. The provisional intention is that systems and controls elements would be implemented in 2004 in advance of the introduction of quantitative requirements, though this sequential approach is currently the subject of discussions with the industry. On systems and controls, proposed policy would be in the form of guidance for the most part, with particular attention focussed on internal limits, scenario and stress testing and contingency funding arrangements. On quantitative requirements, it is expected that the FSA will explore the scope for introducing a unified approach for banks – at present two distinct regimes are applied depending on the character of the individual institution. It is expected also that the FSA will consider the possibility of structuring the requirements so as to give institutions an incentive to migrate to more sophisticated liquidity management arrangements.

Polarization

In early 2002, the FSA came forward with proposals to reform the 'polarization' regime for the selling of packaged products (life assurance, collective investment schemes etc). Polarization, which involves a clear distinction between independent financial advisers and those selling products on behalf of an single company or group, has been a feature of the UK savings market for many years. The FSA has proposed that polarization should be abolished, on the basis that it is not delivering sufficient consumer benefit to justify continuing intervention in the market – this would allow, for example, provider firms to increase the range of products they offer by adopting products from other provider firms. These proposals have generated a fair degree of controversy within the financial services industry and among consumer groups. At the time of writing, no final decisions have been taken.

Small Business Banking: Report of the Competition Commission

In addition to FSA developments, the UK retail banking markets remain subject to close Government scrutiny. Most recently, attention has been focussed on the small business market. Following a Government referral in 2000, the Competition Commission completed a review on the supply of banking services by the clearing banks to small and medium sizes enterprises. The conclusion of the Commission was that a 'complex monopoly' existed in this market, which in certain instances operated against the public interest. In March 2002, the Government accepted the recommendations of the Competition Commission, including the remedies that had been proposed. The latter included controls on the banks' tariffs. It now falls to the Office of Fair Trading to see that the proposed remedies are implemented, and to report on progress to the Government.

Events following Enron

In the United Kingdom, as elsewhere, public policy makers responded swiftly to the shock waves of the Enron affair. In particular, the collapse of Enron triggered a variety of precautionary initiatives by Government and regulators, focussing on issues of corporate governance, auditor relationships and financial reporting. Among the initiatives currently being pursued are: an independent review of the role and effectiveness of non-executive directors that will report jointly to the Secretary of State for the Department of Trade and Industry (DTI) and the Chancellor of the Exchequer; a review of financial reporting and audit issues by a group comprising the Treasury, the DTI, the FSA, the Accountancy Foundation and the Accounting Standards Board; an inquiry by the Treasury Select Committee into the financial regulation of public limited companies. In addition, the pending FSA review of the UK listing rules is expected to address issues relating to the auditing of listed companies.

Business Continuity

In the aftermath of the terrorist attacks in New York last September, both the financial services industry and the regulatory authorities have been focussing considerable attention on disaster recovery/business continuity issues. For example, the Bank of England, the Treasury and the FSA have launched a joint website on the UK financial sector's continuity planning. This presents an overview of the principal organizations involved in planning within the financial sector, their main responsibilities and a summary of the issues being considered.

Money Laundering

The Anti-terrorism Crime and Security Act 2001 which became law in December 2001 includes:

- Powers to allow terrorist funds to be forfeited.
- An offense for regulated institutions who do not report transactions they know or suspect, or have reasonable grounds for knowing or suspecting, that another person has committed an offense under sections 15-18 Terrorism Act 2000.
- Powers to monitor accounts of suspected terrorist organizations.
- Powers enabling the Treasury to freeze assets with immediate effect.
- Extension of anti-corruption legislation to acts carried on outside the UK.

The Proceeds of Crime Bill which will become an Act in July 2002 is primarily concerned with confiscation of the assets of criminals but has important sections extending existing money laundering legislation. It includes the following measures:

- A requirement to report suspicious transactions will be extended to all crimes, not just drug and terrorism related offences. In practice banks have reported on this basis since the introduction of the 1993 ML Regulations, as a defense against a charge that they have assisted a criminal to launder funds (an offense carrying a 14 year prison sentence).

- The offense of not reporting a suspicious transaction will be extended to cases where there were reasonable grounds for suspicion – this will catch cases of wilful blindness or negligence.

- The Bill also gives law enforcement agencies new powers to monitor activities on a suspected criminal's accounts and to freeze funds.

The Money Laundering Regulations 2001 gave regulatory powers to HM Customs & Excise and the Financial Services Authority over "Money Service Businesses". The regulations became effective on June 1, 2002. Money Service Businesses are principally retail foreign exchange bureaus and money transmission agents. Such businesses have always been subject to the 1993 Money Laundering Regulations but have not previously been supervised by a government regulator.

Taxation

The Finance Bill 2002, due to become Finance Act 2002 in July 2002, contains a number of new reliefs including:

- An exemption for disposal by companies of substantial shareholdings in other companies. Substantial is defined as not less than 10 percent of a company's ordinary share capital, beneficially entitled to not less than 10 percent of distributable profits, entitled to not less than 10 percent of assets in a winding up. Shareholding must have been held for at least 12 months.

- Extended relief for research development expenditures.

The Finance Bill includes a major consolidation of tax legislation on foreign exchange gains, losses, derivative transactions and corporate debt.

The Government has announced that taxable profits of UK branches will be calculated as if the branches were separate subsidiary entities with the same credit rating as the parent company. This will result in an allocation of free capital and a disallowance of a proportionate amount of the branches' interest expense. The proposals affect accounting periods commencing on or after January 1, 2003 but legislation will be in the 2003 Finance Bill. "Final draft" legislation is scheduled for publication in the autumn of 2002. The Government announcement came as a surprise because no changes were anticipated until a clearer lead had been given by the OECD consultation on taxation of permanent establishments.

Euro Blueprint

On possible UK membership of the European single currency, the Government has indicated that the Treasury will complete an assessment of the five key economic tests within two years of the start of this Parliament. Despite the continuing uncertainty, the banking industry, in view of its pivotal position in the economy, remains obliged to review the practical implications of a decision to join the euro. Most recently, June 2002, the British Bankers' Association and the Association for Payment Clearing Services, on behalf of the banking industry, published their outline blueprint for UK entry. The blueprint sets out the banking industry's current position on the practicalities and lead times that would be involved in a changeover to the euro in the UK – it does not express a view of the desirability or otherwise of the UK joining the single currency. The document concluded that following a Government decision to proceed with UK entry a period of two years would be needed before the banks' retail systems could be made ready. A further period of between 10 and 14 months would be required before euro notes and coins could be introduced.

Consolidated Supervision

Domestic Financial Groups

The European Union's Banking Consolidation Directive establishes the way in which consolidated supervision of groups including banks within the European Economic Area (EEA) is carried out. This requires consolidation only up to the highest relevant parent incorporated in the EEA, except where another EEA supervisor performs consolidated supervision. However the FSA recognises that other parts of the group may have an impact on the risk characteristics of the relevant EEA parent and *may* rarely extend consolidated supervision beyond the Directive.

Consolidation techniques are applied to the parent company, subsidiaries and any companies in which these companies have a participation, and which undertake relevant financial activities. Insurance businesses are not currently subject to consolidated banking supervision but the FSA is developing the integrated prudential sourcebook (PSB). This will apply a common risk-based methodology to the assessment of all financial businesses including insurance. The PSB, which is expected to be implemented in phases, starting in 2004, will include a separate chapter on 'groups' describing how cross sector groups will be regulated. This work is being carried out in advance of the implementation of the EU conglomerates directive in 2005.

Method of Consolidation

Full consolidation, on a line-by-line basis in accordance with established accounting principles is the norm although, exceptionally, pro-rata consolidation may be approved. This permits inclusion in consolidated returns of only the pro-rata share of the assets and liabilities of the relevant affiliates. It is permitted, where, for instance there are other significant shareholders that would provide similar levels at parental support to the affiliate.

Capital Adequacy

The FSA requires that a bank group meets a consolidated capital ratio in addition to that set on a solo basis. This is normally the same as that set on a solo basis for the principal bank in the group, but may be modified depending on:

- the location of capital, taking into account regulatory, exchange control or tax factors that may 'lock up' capital in specific countries or companies;
- the degree of risk diversification in the group as a whole compared to that of the principal bank; and

- risks that arise on a group basis but are not reflected in the factors influencing the principal bank's ratio.

In order to avoid double counting of capital, exposures to other group companies may be zero weighted in calculating a bank's solo capital ratio, subject to FSA approval. This will generally be given if:

- the group is managed centrally on an integrated group basis;
- those group companies are included in the group's consolidated capital ratio; and
- capital resources are freely transferable.

Large Exposures

The techniques used for the calculation of consolidated large exposures are the same as those used for individual banks but are subject to some variations including relief for short-term trading book exposures in subsidiaries.

Adequate controls

The principal bank must have adequate internal systems and controls to enable it to produce relevant data and information for the FSA, for the purpose of consolidated supervision.

Non-Domestic Financial Groups

UK branches of non-domestic financial groups (except EEA banks) that wish to accept deposits in the UK must maintain own funds of at least 5 million euro.

A bank owned by a non-domestic financial group but incorporated in the UK must comply with all the Rules contained in the FSA Handbook including *inter alia* those relating to conduct of business and prudential capital.

Where a bank is subject to consolidated supervision elsewhere, either within or outside the EEA, consolidation of the whole group for FSA purposes is not normally necessary. Thus the FSA will not make an assessment of the consolidated global capital of non-domestic financial groups or require disclosure of, for instance, its overall risk management and anti-money laundering processes.

However the FSA takes into account whether or not the parent company is subject to consolidated supervision by another supervisor and whether that supervisor adheres to the Basel minimum standards for the supervision of international banking groups and their cross border establishments. If it believes that the home country's supervisory standards do not meet the Basel minimum standards it may require the UK entity to provide more detailed information in accordance with GAAP to enable it to form a better view of the group's overall capital.

Only in the area of liquidity risk does the FSA require branches of non-domestic financial groups to disclose their liquidity management practices but just in respect of that branch, not the overseas bank as a whole.

UK branches of non-domestic financial groups must also have policy rules, which are shared with the FSA and regularly updated, on large exposures and provisioning.

Concluding Remarks

The scale of regulatory change has been a key feature in the environment for the UK financial services industry over the past 12-18 months. This looks set to remain the case with the further evolution of the FSA framework and continued Government scrutiny in the retail financial services area. In addition to the domestic agenda, the need to implement the revised Basel Capital Accord and a raft of important EU financial services legislation points to a very busy period ahead.

UNITED STATES

The terrorist attacks on New York and Washington on September 11, 2001 and the series of corporate and accounting scandals that began with the collapse of Enron Corporation in November gave rise to new federal legislation and implementing regulations that dominated the attention of policy makers, financial institutions and the markets during the period under review. The significance of these developments to internationally headquartered financial institutions operating in the United States is discussed below. Other important developments during the period under review included successful efforts on asset pledge reform, which will substantially reduce the over $40 billion of collateral currently pledged by federal and state licensed branches and agencies of international banks. Only one country other than the United States applies asset pledge requirements to branches of non-domestic banking organizations.

The USA Patriot Act of 2001

The USA Patriot Act, signed into law by President Bush on October 26, 2001 in the aftermath of the September 11th terrorist attacks, significantly expanded the authority of the United States Government to combat money laundering, with a particular focus on money laundering effected by non-U.S. persons through U.S. correspondent banks and private banking operations. The following are among the Act's principal provisions in this area:

- Effective upon enactment, Section 311 empowers the Treasury Department to apply "special measures" with respect to any jurisdiction, financial institution or type of international transaction that it finds to be of "primary money laundering concern". These measures include prohibiting, or imposing conditions on, the establishment or maintenance of a correspondent account in the United States for or on behalf of a foreign banking institution if the account involves a designated jurisdiction, institution or if a designated type of transaction can be effected through the account.

- Effective July 23, 2002, Section 312 requires the exercise of "enhanced" due diligence regarding a correspondent account maintained by or on behalf of a "foreign bank operating under an offshore banking license" or a bank licensed by a country designated as a "noncooperative" jurisdiction by the Financial Action Task Force (FATF).

- Effective December 25, 2001, Section 313 prohibits maintenance of a correspondent account for, or on behalf of, a foreign shell bank (generally, a bank that does not have any physical presence in the world and is not subject to oversight by any jurisdiction). In addition, U.S. correspondent banks must take "reasonable measures" to ensure that correspondent accounts they maintain for or on behalf of foreign banks that are not shell banks are not used by such foreign banks to indirectly provide banking services to foreign shell banks.

- Also effective December 25, 2001, Section 319(b) requires U.S. correspondent banks to maintain records identifying the owners of foreign banks for which they maintain correspondent accounts, as well as the name and address of a person resident in the United States who is authorized by such foreign bank to accept service of process for records regarding the correspondent account. This latter provision facilitates implementation of another provision of Section 319(b) authorizing the Treasury and Justice Departments to issue a subpoena to any foreign bank that maintains a correspondent account in the United States for "records related to such correspondent account, including records maintained outside the United States relating to the deposit of funds into the foreign bank." Foreign banks that fail to designate an agent for service of process in a timely manner run the risk of their correspondent account being closed.

The Institute concentrated its attention initially on compliance issues arising under Sections 313 and 319(b). In response to concerns expressed in Europe and elsewhere, the Institute on March 15, 2002 wrote to senior Treasury and Justice Department officials regarding the need for careful implementation of Section 319, which gives Treasury and Justice powerful new tools to seize assets in U.S. interbank accounts of international banks and to subpoena records relating to U.S. correspondent accounts, including records maintained by international banks outside the United States. (The letter is available on the Institute's web site at www.IIB.org.) These tools potentially could be used to circumvent established international procedures for cooperation among law enforcement authorities.

Senior Justice and Treasury officials have recognized that these tools raise important issues of international relations and have indicated that they intend to use them judiciously and as a last resort when traditional multilateral means of legal assistance fail.

The Institute also raised with U.S. authorities two additional issues of importance to international banks under the Patriot Act. The first issue relates to the "reasonable steps" that a U.S. correspondent bank is required to take under Section 313 of the Patriot Act to ensure that a correspondent account for a non-U.S. bank is not used indirectly to provide banking services to a foreign shell bank. The Institute addressed this issue in its February 11, 2002 comment letter to Treasury (also available on the Institute's web site), which sought clarification that the certification the non-U.S. respondent bank is required to make reaches only to a non-U.S. respondent bank's dealings with its direct customers -- i.e., that it does not require what could be an impossible investigation into the potentially long and complex chain of correspondent relationships that underlie such dealings. Final rules implementing Sections 313 and 319(b), issued by the Treasury Department's Financial Crimes Enforcement Network ("FinCEN") on September 18th, included the clarification sought by the Institute limiting the reach of the shell bank prohibition under Section 313.

The second issue relates to the enhanced due diligence required under Section 312 for U.S. correspondent accounts maintained by certain non-U.S. institutions.

The Treasury Department and FinCEN published on July 19th interim guidance regarding compliance with Section 312 (the Interim Guidance is available on the Treasury's web site at www.ustreas.gov/press/releases/docs/interim.pdf).

As indicated above, Section 312, which became effective on July 23rd, requires many U.S. financial institutions (including U.S. banks and broker-dealers and U.S. branches and agencies of international banks) to establish due diligence and enhanced due diligence procedures for correspondent and private banking accounts provided to certain non-U.S. customers.

Treasury and FinCEN published the Interim Guidance because FinCEN will not publish final regulations implementing Section 312 until well after the July 23rd statutory effective date of Section 312. In addition, industry comment letters regarding the proposed regulations published by FinCEN in May raised numerous significant issues. On July 1, 2002, the Institute joined ten other trade organizations in a cross-industry comment letter regarding the Section 312 regulations and submitted its own comment letter addressing issues of particular importance to international banks. (The comment letters are available on the Institute's web site.)

The principal focus of the Institute's comment letter relates to the appropriate scope of an exception from the enhanced due diligence requirements of Section 312 for correspondent accounts maintained by non-U.S. banking organizations that are subject to comprehensive consolidated supervision (CCS). The Institute's comment letter also addresses the proposed definition of "beneficial ownership interest" for purposes of private banking due diligence.

Representatives of the Institute subsequently held meetings on July 10th with the Treasury Department, Federal Reserve Board and Office of the Comptroller of the Currency, during which we discussed the issues raised in the Institute's comment letter.

The Institute's comment letter suggested several ways in which the proposed CCS exception should be expanded, consistent with the policies underlying the proposed exception. For example, the Institute argued that the CCS exception should apply to bank subsidiaries (and international banks themselves) that may operate under an offshore license. The Institute also argued that the CCS exception should apply not only to offshore operations but to operations in countries designated by the Financial Action Task Force ("FATF") as non-cooperative with anti-money laundering efforts (as for example, a European bank's branch in Moscow), provided the international bank meets the relevant criteria for the CCS exception.

Another important point that the Institute raised in its July 1st comment letter, and discussed in its meetings on July 10th, is the fact that the list of countries that the Federal Reserve Board has determined to be subject to CCS (and thus the list of countries that would qualify for the enhanced due diligence exception in FinCEN's proposed regulations) is arbitrarily defined by the list of countries in which international banks happen to have applied for Federal Reserve Board approval under the International Banking Act since 1991. As FinCEN noted in its proposal, these countries are Argentina, Australia, Austria, Belgium, Brazil, Canada, Chile, France, Germany, Greece, Hong Kong Special Administrative Region, Israel, Italy, Ireland, Japan, Korea, Mexico, the Netherlands, Portugal, Spain, Switzerland, Taiwan, Turkey, and the United Kingdom.

This list of countries would not include all FATF-member countries; it would exclude Denmark, Finland, Iceland, Luxembourg, New Zealand, Norway, Singapore and Sweden. Thus, for example, the Cayman Islands booking location of a Swedish bank would be subject to enhanced due diligence by U.S. banks, while the Cayman Islands booking location of an Australian, Belgian, etc. bank would not. In this regard, the Institute's comment letter had suggested that FinCEN's regulations under Section 312 create a mechanism whereby Treasury could make a determination to add to the list of countries that would qualify for the exception.

In a July 12th follow-up letter to Treasury, the Institute proposed that all members of FATF should automatically qualify for the enhanced due diligence exception (i.e., regardless of whether the Federal Reserve Board may have approved an application under the International Banking Act for a bank headquartered in a particular FATF-member country).

Meanwhile, the basic approach of the Treasury's Interim Guidance appears designed to defer, to the extent possible, to existing industry best practices relating to due diligence for correspondent accounts and private banking accounts pending release of a final rule under Section 312.

The Interim Guidance does not address whether FinCEN intends to adopt the Institute's suggested changes to its proposed regulations under Section 312. However, the Interim Guidance does contemplate that the application of enhanced due diligence may take into account the U.S. correspondent's overall risk assessment regarding an institution that falls within the categories of institutions identified as high-risk in Section 312. This appears to suggest that U.S. correspondents should have the flexibility to make risk assessments that would be consistent with the exceptions proposed by the Institute in its submissions to Treasury and FinCEN.

In this regard, FinCEN's proposed regulations specifically exempted offshore branches of banks from jurisdictions that the Federal Reserve has determined provide comprehensive consolidated supervision. Although the Interim Guidance does not address the scope of this exception, it also does not indicate that Treasury or FinCEN views the exception as inappropriate from a risk-assessment standpoint. In addition, the New York Clearing House Association's guidelines (which are cited in the Interim

Guidance as a source of best practices), contain a "regulated affiliate" exception from the scope of the recommended enhanced due diligence procedures for offshore banks.

The Interim Guidance provides important advice regarding how U.S. correspondents may implement the statutory requirements of Section 312 pending release of final regulations by FinCEN. However, the Interim Guidance is only temporary and does not necessarily indicate how Treasury will interpret Section 312 for purposes of FinCEN's final regulations. The issues relating to the scope of Section 312's enhanced due diligence requirements raised by the Institute in its submissions to Treasury will still need to be addressed in those final regulations.

The Sarbanes-Oxley Act of 2002

In an attempt to reform corporate accounting and governance following the collapse of Enron and other corporate and accounting scandals, Congress passed the Sarbanes-Oxley Act of 2002, which was signed by President Bush on July 30, 2002. Effective immediately, Section 402 of the Act prohibits public companies from making personal loans to their directors and executive officers. The Insider Loan Prohibition applies to all issuers, including non-U.S. issuers, that have securities registered under the Securities Exchange Act of 1934 or that are required to file reports with the SEC under the Exchange Act. Thus, international banks or their parent companies that have ADRs listed on a U.S. exchange are subject to Section 402.

The Insider Loan Prohibition is subject to certain limited exceptions, some of which apply to both U.S. and non-U.S. issuers. However, an important exception for banking institutions applies only to U.S. banks and does <u>not</u> apply to internationally headquartered banks. Specifically, loans made by FDIC-insured U.S. depository institutions are not subject to the Insider Loan Prohibition if they are subject to U.S. insider lending restrictions (such as the Federal Reserve Board's Regulation O) which generally do not apply to non-U.S. banks.

The Act generally, as well as the Insider Loan Prohibition, have drawn significant criticism from the European Commission and other non-U.S. governmental authorities, including bank supervisors in countries that subject their banks to comprehensive consolidated supervision. The regulation of insider loans by banks falls squarely within the domain of bank safety and soundness supervision—an area for which home country supervisors are responsible under international standards of bank supervision. In addition, the Insider Loan Prohibition as worded in the Act is inconsistent with current SEC policies that generally accommodate home country practices and regulation. Questions are also being raised as to whether the extraterritorial scope of the Insider Loan Prohibition and certain other requirements of the Act run counter to well established principles of international comity and could trigger retaliatory actions by other countries to subject U.S. issuers in foreign markets to non-U.S. principles of corporate practice and governance.

The Institute had meetings on August 12, 2002 with representatives of the SEC, the Treasury Department and the Federal Reserve regarding the application of Section 402 to international banks covered by that section. The Institute urged the SEC to consider an appropriate exemption from the Insider Loan Prohibition for international banks. The Institute also initiated discussions with the SEC staff concerning other problematic provisions of the Sarbanes-Oxley Act that have delayed effective dates, such as the requirement in Section 301 that issuers have an independent audit committee. The Institute noted that such provisions are likely to conflict with non-U.S. issuers' home country laws and corporate governance practices, and indicated that the Institute expects to be in contact with the SEC staff as the SEC undertakes rulemakings to implement those provisions.

In its subsequent submission to the SEC on August 16, 2002, the Institute urged the SEC to adopt a two-part exemption to Section 402 for international banks, in deference to international bank supervisory standards and to ensure national treatment for international banks. Under the Institute's proposed exemption, international banks from jurisdictions that the Federal Reserve Board has determined provide comprehensive consolidated supervision would be exempt from Section 402. International banks from other jurisdictions would be permitted to make loans without regard to the prohibitions in Section 402 if the loans comply with the core principles of U.S. bank insider lending regulations.

The Institute also sent letters to Federal Reserve Chairman Greenspan and Treasury Secretary O'Neill urging their support for the Institute's proposed exemption (the letters as well as the SEC submission are available on the Institute's web site).

Reforming Federal and State Asset Pledge Requirements

Throughout the period under review, the Institute continued its extensive efforts to achieve significant reform of the asset pledge requirements applicable to U.S. branches and agencies of international banks under federal and state law. These requirements obligate branches and agencies to keep on deposit liquid assets such as U.S. government securities that would be readily available to the appropriate authority in the event of their liquidation.

Underscoring the importance of this issue to international banks operating in the United States, during the past year expressions of support for asset pledge reform continued to be voiced to U.S. authorities by home country banking regulators and banking associations. On October 1, 2001, the European Commission wrote the New York State Superintendent of Banks urging reform of the asset pledge requirement to reduce its "discriminatory competitive effects."

On June 3, 2002, the New York Banking Department publicly released in draft form proposed revisions to its asset pledge requirement, which would greatly reduce the approximately $35 billion of collateral currently pledged by New York-licensed branches and agencies of international banks. The proposed revisions were consistent with the policy recommendations made by the Institute during the last two years and in its August 2nd comment letter the Institute expressed its strong support for the draft proposal, while also making a number of substantive suggestions (the August 2nd comment letter is available on the Institute's web site). The Banking Department subsequently published for public comment a formal regulatory proposal on September 18th which incorporates the general approach taken in the preliminary proposal released in June, while also reflecting a number of changes suggested by the Institute.

The proposal would amend New York's asset pledge requirement by, among other things, (i) reducing the amount of the asset pledge from 5 percent to 1 percent of third-party liabilities; (ii) capping at $400 million the amount required by "well rated" banks that meet certain "well capitalized" and "well managed" standards; (iii) providing for the pledge of additional types of assets not currently enumerated in Part 322 of the Superintendent's Regulations in an amount not to exceed 50 percent of a bank's total asset pledge requirement; and (iv) simplifying administration of the asset pledge by basing the calculation of the pledge on a backward-looking average of liabilities for the previous month.

In other developments at the state level during the past year, the Connecticut Banking Department capped its asset pledge requirement at $100 million for qualified institutions and reduced the standard requirement to 2 percent of third-party liabilities from 3 percent.

At the same time, the Institute continued its efforts in support of the Comptroller of the Currency's amendment that would eliminate the mandatory 5% capital equivalency deposit (CED) requirement applicable to federal branches and agencies of international banks in favor of a risk-focused approach under which the Comptroller would have the discretionary authority to impose such a requirement in appropriate circumstances. The amendment was included in the Financial Services Regulatory Relief Act of 2002 (H.R. 3951), which passed the House Subcommittee on Financial Institutions and Consumer Credit on May 8th and cleared the full Financial Services Committee on June 6th. As of mid-September, the regulatory relief bill had not been voted upon by the full House of Representatives and companion legislation had not been introduced in the Senate.

Meanwhile, the OCC implemented a more flexible regulatory approach for qualifying institutions, even as the existing statutory requirement of a 5% minimum deposit has remained in place. Among other changes, liabilities booked at an OCC-licensed branch's International Banking Facility (IBF) have been excluded from the liability base over which the CED is calculated. The OCC estimated that these regulatory changes would reduce the amount of assets currently set aside by federal branches by approximately $1.6 billion.

Tax Matters

On July 11th, the Chairman of the House Ways & Means Committee introduced The American Competitiveness and Corporate Accountability Act of 2002 which may, if enacted into law, restrict the interest expense deductions of U.S. subsidiaries and branches of international banks and other non-U.S. multinational companies. The proposal would significantly tighten the "earnings stripping" rules of Internal Revenue Code section 163(j). This proposal is generally supported by the Bush Administration as part of a broad approach to address the problems of "corporate inversions" (*i.e.*, U.S. corporations moving their tax domicile to Bermuda and other offshore tax havens) as well as a more general perception that U.S.-based multinationals are at a competitive disadvantage to foreign-based multinationals operating in the United States.

The proposal is most likely to affect international banks and other non-U.S. multinationals that have funded their U.S. subsidiaries with affiliated company loans (in addition to equity) or that guarantee third-party borrowings by their U.S. subsidiaries and branches. However, the proposal may also affect the funding decisions of U.S. branches.

The Institute met with the Treasury Department on July 25th and expressed its general opposition to the earnings stripping changes proposed in the bill. Further meetings were held with Congressional representatives in September.

Consolidated Supervision

Domestic Banking Organizations. U.S. commercial banks are subject to consolidated supervision by their principal federal regulator – i.e., the OCC in the case of national banks; the Federal Reserve in the case of state-chartered banks that are members of the Federal Reserve System ("state member banks"); and the FDIC in the case of state-chartered banks whose deposits are FDIC-insured but that are not state member banks. These institutions are subject to the risk-based capital guidelines prescribed by their principal federal regulator, which in each case require them to maintain minimum tier 1 and total risked-based capital ratios as well as a minimum "leverage" ratio (measured as the ratio of tier 1 capital to total assets unadjusted for risk). These ratios apply to the bank as a consolidated entity.

U.S. commercial banks may affiliate with nonbank financial companies (e.g., leasing companies, commercial and consumer finance companies, investment management firms and, subject to certain revenue limitations, securities broker-dealers) through the common control exercised by a parent "bank holding company". With the enactment of the Gramm-Leach-Bliley ("GLB") Act in 1999, banks satisfying certain standards based on their capital, management and other factors have also been permitted to affiliate through "financial holding companies" ("FHCs") with insurance companies and companies engaged in merchant banking activities, and the revenue limitations otherwise imposed on affiliation with securities broker-dealers do not apply. The Federal Reserve is responsible for the consolidated oversight of bank holding companies and FHCs. This responsibility is frequently referred to as "umbrella" oversight because it encompasses the bank holding company/FHC in all of its dimensions, but in particular with respect to the risks posed by nonbank members of the group to the safety and soundness of their bank affiliates.

As umbrella supervisor, the Federal Reserves prescribes minimum risk-based and leverage capital ratios for both types of entities, which are applied on a consolidated basis. Whereas bank subsidiaries of FHCs are subject to higher minimum capital ratios than bank subsidiaries of bank holding companies that are not FHCs, no such distinction applies at the holding company level. The Federal Reserve also has authority to examine bank holding companies/FHCs and their nonbank operations, although the GLB Act directs the Federal Reserve generally to defer to the supervisory authority directly responsible for so-called "functionally-regulated subsidiaries", which include the SEC in the case of securities broker-dealers, the CFTC in the case of futures commission merchants and the appropriate state insurance authority in the case of insurance companies. In the exercise of its umbrella supervisory authority, the Federal Reserve focuses on a bank holding company/FHC as a global entity.

In the United States, these umbrella supervisory arrangements apply only in the context of a bank holding company structure. For example, many investment banks that do not own U.S. commercial banks are not considered to be bank holding companies and thus fall outside the purview of the Federal Reserve's umbrella oversight. While their individual operations may be subject to functional regulation and oversight, there is no other U.S. supervisory authority that exercises the type of umbrella oversight function entrusted to the Federal Reserve in the bank holding company context

International Banks. In accordance with the U.S. policy of national treatment, U.S. bank subsidiaries of international banks are treated the same as bank subsidiaries of domestic bank holding companies/FHCs. Regarding Federal Reserve oversight of international banks as bank holding companies/FHCs, certain adjustments are made to take into account differences in the structure of international banks' U.S. operations – many international banks conduct their U.S. banking operations through U.S. branches and agencies rather than through U.S. bank subsidiaries – and the oversight of their global activities by their home country supervisory authorities.

In part to address issues regarding exercise of the Federal Reserve's umbrella oversight, an international bank may establish an intermediate U.S. holding company to own directly shares of a U.S. bank subsidiary. Under these arrangements, umbrella supervision applies to the intermediate U.S. holding company, including application of the capital standards generally applicable to domestic bank holding companies (risk-based and leverage ratios). However, because the parent international bank is itself also a bank holding company, the Federal Reserve monitors the condition of the international bank itself as a source of strength for its U.S. operations. This monitoring includes consideration of the adequacy of the bank's global capital (measured in accordance with applicable home country standards where such standards are consistent with the Basel Accord). The results of this monitoring are reflected in the periodic "Strength of Support Assessment" (SOSA) rating assigned by the Federal Reserve to each international bank that conducts banking operations in the United States.

International banks that operate through U.S. branches or agencies are deemed to be bank holding companies for purposes of Federal Reserve regulation and supervision regardless of whether they also own a U.S. bank subsidiary. In these instances, the Federal Reserve oversees the international bank's U.S. operations as a whole, giving due deference to any functional regulator such as the SEC, and coordinates with the licensing authority of the U.S. branch or agency (the OCC or appropriate state banking agency). In addition, the Federal Reserve monitors the overall condition of the bank and conducts a periodic SOSA review.

Where an international bank seeks to become an FHC, the "well capitalized" and "well managed" standards called for under the GLB Act are applied to any U.S. bank subsidiary of the international bank, as is the case with respect to domestic FHCs. In addition, the Federal Reserve assesses the global capital of the international bank itself to determine whether it is "comparable" to the "well capitalized" standard applicable to U.S. bank subsidiaries of domestic FHCs. However, this assessment generally is made in accordance with applicable home country standards, and the international bank is not required to meet the leverage ratio standard applicable to U.S. banks. Further, the Federal Reserve generally takes the position that where an international bank qualifies as an FHC, any intermediate U.S. bank holding company controlled by the international bank will not be required to comply with the Federal Reserve's capital adequacy guidelines.