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Institute of International Bankers

Global Survey 2003

Regulatory and Market Developments

Banking - Securities - Insurance
Covering 40 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 sixteenth 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, 2002 to June 30, 2003 in 40 countries and the European Union (EU) and is published with the cooperation of banking associations and financial services supervisory authorities from those countries and the EU.

A matter selected for special attention in this year's Survey relates to the approach countries are taking to implementation of the proposed New Basel Capital Accord, or Basel II. While some countries have not yet made definitive decisions regarding the scope of application, the overwhelming trend is in the direction of applying Basel II to all banking institutions in a given country, as opposed to only the most complex (see chart on page 1). In contrast, the four federal bank and thrift regulatory agencies in the United States have indicated that they intend to use only the most sophisticated approaches of Basel II, which will be required for only about the 10 largest U.S. banks, with another 10 U.S. banks expected to adopt them on a voluntary basis. All other U.S. banking institutions would remain subject to Basel I.

While the work of the Basel Supervisory Committee has contributed greatly to the harmonization of supervisory practices around the world, significant challenges and problems remain with respect to internationally active financial institutions and the appropriate roles of home and host country authorities in supervising the cross-border operations of such global entities. Within the confines of the European Union, this issue was addressed by the principle of "home state supervision" contained in the Second Banking Directive (since consolidated into the Consolidated Banking Directive), pursuant to which a bank incorporated and licensed in one Member State of the European Union (the "home state") does not need to obtain separate licenses to operate in the other Member States of the European Union. Prudential supervision is performed for that bank, including all its branches throughout the European Union, by the home state. Supervisors in host country Member States can generally only apply conduct of business rules to the branches or branchless cross-border activities of such a bank. In cases where an EU banking group operates through a number of banking institutions incorporated in different EU Member States, there are a set of rules by which one Member State will be selected to be solely responsible for the consolidated prudential supervision of the banking group's activities taken as a whole, notwithstanding that each subsidiary will still be subject to some supervision by its home Member State.

As in past years, however, this year's Survey documents that most countries apply to branches of non-domestic banks their own host country supervisory standards separate from the home country's global supervision. (The application within the EU of the "home state supervision" principle is unique to EU Member States.) The Survey has also documented a variety of approaches that countries take to consolidated supervision of the operations of domestic and non-domestic financial groups. It remains to be seen whether there will evolve a more universal version of the EU's "home state supervision" system, perhaps one in which the host country supervisor, while deferring to home country supervisors, would monitor non-domestic banking organizations' host country activities and reserve the right, where warranted by circumstances, to resume a more active supervisory role.

In its July 31, 2003 comment letter to the Basel Committee regarding the third Consultative Paper (CP-3) on Basel II, the Institute of International Bankers urged the Committee to articulate clear international standards for cross-border implementation of Basel II to ensure the primacy of the home country supervisor's role in supervising the capital adequacy of internationally active banking institutions under the new accord. The Institute argued that host country standards requiring capital in excess of Basel II minimum requirements – such as U.S. capital standards under the Gramm-Leach-Bliley Act – present an especially compelling case for cross-border consultation and appropriate deference to home country supervisors.

In addition to addressing plans for the implementation of Basel II, many of the country chapters in this year's Survey discuss ongoing efforts to combat money laundering and the financing of terrorism. In the U.S., the Treasury Department continued to implement the anti-money laundering provisions of the USA Patriot Act, which was enacted nearly two years ago in the immediate aftermath of the September 11th terrorist attacks. In Canada, new regulations came into force that require financial institutions and organizations (such as casinos) to report large cash transactions to the Financial Transactions and Reports Analysis Center (FinTRAC), while other requirements came into force concerning the reporting of electronic funds transactions made through the SWIFT system. In Germany, the focus was on implementing anti-money laundering provisions that had been introduced in 2002. In this regard, Germany has now implemented all of the FATF (Financial Action Task Force) recommendations. The Hong Kong Monetary Authority, meanwhile, issued a supplement to its anti-money laundering guidelines reflecting the regulatory standards recommended by the Basel Committee, while in other developments, the Swiss Federal Banking Commission remodeled its 1991/1998 anti-money laundering guidelines into an ordinance that obliges banks to take a risk-based approach to anti-money laundering measures.

Several country chapters highlight initiatives to overhaul accounting, auditing and corporate governance practices as well as measures to ensure the independence of securities research. In the United States, regulators have drawn a sharp line separating research from investment banking activities, most notably in the historic $1.4 billion "global settlement" with ten of the largest investment banking firms that was announced on April 28, 2003. Separation of research and investment banking activities was also addressed in the Sarbanes-Oxley Act of 2002, which prohibits investment banking firms from punishing research analysts who issue negative reports on firm clients. It is not clear whether the U.S. approach of imposing a strict separation between research and investment banking will be broadly followed in other countries. Officials in Europe are reportedly considering a more flexible approach. Meanwhile, accounting and corporate governance issues continued to be addressed. In Ireland, for example, new legislation is currently in progress to establish the Irish Auditing and Accountancy Supervisory Authority

(IAASA), which will supervise the regulation by the accountancy bodies of their members' professional standards. Elsewhere, the Singapore Monetary Authority issued a consultative paper on a proposed corporate governance framework.

During the period under review, deposit insurance schemes were also introduced or strengthened in several countries, including Hong Kong, Israel, Japan, Romania and Singapore. In the U.S., deposit insurance reform continued to be a hot topic of debate, particularly with regard to increasing the current amount of insurance coverage.

In other developments, Australia took steps to strengthen its regulatory approach with the development of new risk assessment and supervisory response tools. In Denmark, a new Act on Financial Undertakings will take effect on January 1, 2004 with the aim of ensuring uniform treatment of financial groups. The structural reform legislation is a response to the growing integration of financial markets, including the establishment of financial conglomerates. Bahrain, meanwhile, completed its plans to create a single financial sector regulator, becoming the first country to do so in the Gulf region.

Several country chapters highlighted efforts to deal with troubled loans. The China Banking Regulatory Commission (CBRC) officially started functioning on April 28, 2003, to reform the country's banks troubled with bad loans. In Japan, the Financial Services Agency (FSA) announced on October 30, 2002 the "Program for Financial Revival: Revival of the Japanese Economy through Resolving Non-Performing Loan Problems of Major Banks." The goal of the program is to cut the ratio of non-performing loans in half at major banks by fiscal 2004 and build a sound banking system that supports restructuring. In a major development, the FSA issued a business improvement order to Resona Bank in May 2003 due to its capital adequacy ratio falling below 4%. A month later, the FSA determined to recapitalize Resona in a huge bailout that put it under government control.

Meanwhile, in another notable development, China took its first steps to open up its securities market to foreign companies. On May 26, 2003, UBS Warburg and Normura Securities became the first two foreign financial services companies to be granted licenses as qualified foreign institutional investors (QFIIs).

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

Lawrence R. Uhlick
Executive Director and
General Counsel

For further information contact:

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

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

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

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

[2] U.S. supervisory authorities intend to use only the most sophisticated approaches of Basel II, which will be required for only about the 10 largest U.S. banks (another 10 U.S. banks are expected to adopt them on a voluntary basis).

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

[4]Subject to the final outcome of industry consultation on implementation proposals and further development of the new accord.

[5]The Bangko Sentral ng Pilipinas will adopt the approaches appropriate to Philippine banks, i.e., simplified standardized approach for smaller banks such as rural banks and thrift banks. Universal and commercial banks, on the other hand, are expected to adopt at least initially the standardized approach.

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

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

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

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

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

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

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

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

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

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

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

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

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

[10] The 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.

[11] 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[8]
Belgium	Canada[9]
Czech Republic	Cayman Islands
Denmark	Finland
France	Hong Kong
Germany[3]	Ireland
Indonesia[4]	Japan
Italy	Latvia[10]
Korea	Norway
Luxembourg	Sweden
The Netherlands	Switzerland
Panama	United Kingdom
Philippines	United States[11]
Portugal[5]	Turkey
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] The branch must maintain net head office funds of not less than S$10 million in Singapore, of which $5 million must be in the form of assets approved by the Monetary Authority of Singapore; viz "immovable" properties in Singapore, Singapore Treasury bills and Singapore government securities.

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

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

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

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

[11] 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". In December 2002, the New York State Banking Department lowered its asset pledge requirement to 1% of third-party liabilities from 5%.

AVAILABILITY OF CENTRAL BANK "DAYLIGHT OVERDRAFT" CREDIT

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

[1] Intra-day liquidity is provided through repurchase agreements with the central bank.
[2] In order to obtain short-term liquidity, banks may resort to overnight credit facilities granted by the National Bank of Romania. The Lombard credit is granted under the condition of being collateralized with eligible assets covering 100% of the credit and related interest.

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

PERMISSIBILITY OF MERCHANT BANKING ACTIVITIES[1]

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

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

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

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

4 The holding of shares by Hong Kong banks is subject to restrictions based on the capital of the bank.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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[4]
Czech Republic	Greece (securities firms)	European Union[5]
Denmark	Ireland (securities firms)	Finland
Estonia	Italy (securities firms)	France
European Union	Korea (securities firms)	Germany
Finland	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[6]
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[7]
Norway		Spain
Peru		Sweden
Philippines[2]		Switzerland
Poland		Turkey
Portugal		United Kingdom
Romania[3]		United States
Singapore		
South Africa		
Spain		
Sweden		
Switzerland		
Turkey		
United Kingdom		
United States		
Venezuela		

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

[1] In Latvia, the 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 and credit risk at present.

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

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

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

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

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

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Argentina	Permitted	Permitted, but only with regard to pension fund affiliates	Limited; based on bank capital and investment	Limited	Permitted but subject to prior approval of authorities
Australia	Permitted	Permitted through subsidiaries or sister companies, subject to controls under the insurance laws	Limited	A bank can make equity investments in non-financial businesses up to an aggregate amount equal to 5% of its consolidated Tier 1 capital without prior reference to the Australian Prudential Regulation Authority. Individual investments are generally subject to a limit equal to 0.25% of a bank's consolidated Tier 1 capital. A bank may undertake equity investments in non-financial businesses in excess of the 5% aggregate limit, provided the excess is to be deducted from Tier 1 capital of the bank and/or the group as appropriate.	Shareholdings of more than 15% in a bank need the approval of the Treasurer. The Treasurer has signaled a willingness to consider an association between a bank and a non-financial company where a sound case can be presented. This policy will be applied conservatively.
Austria	Permitted	Permitted through subsidiaries	Permitted	Permitted, subject to capital deduction rules relating to equity investments in non-financial entities.	Permitted, but subject to notification and prohibition under certain circumstances

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

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

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Canada	Permitted through subsidiaries	Permitted through subsidiaries	Permitted 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, through registration with the Securities and Futures Commission and 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

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Indonesia	Permitted through subsidiaries	Permitted through subsidiaries	Not permitted	Not permitted	Permitted
Ireland	Permitted; usually conducted through a subsidiary	Permitted to engage in agency and certain life assurance activities through a subsidiary, which must be separate and independent	Permitted	Acquisition of more than 10% of voting rights of a firm requires Central Bank approval	Permitted, but subject to prior notification to the Central Bank for acquisition of more than 5% of total bank shares
Israel	Permitted; brokerage and investment advice by banks directly, other activities through subsidiaries	Not permitted	Permitted on a limited basis	Permitted on a limited basis	Permitted, but subject to prior approval of the Bank of Israel

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Italy	Permitted	Limited to 10% of own funds for each insurance company and 20% aggregate investment in insurance companies	Generally limited to holding bank premises	Permitted, up to 15% of the bank's capital, subject to approval of the Bank of Italy	Permitted, up to 5% of shares of the bank, subject to the approval of the Bank of Italy
Japan	Some services (e.g., selling of government bonds and investment trusts) permitted to banks, others permitted through subsidiaries.	Some services (selling insurance policies in connection with housing loans) 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	Permitted, but limited to 15% of the total shares of non-financial companies	Permitted, up to 10% of the bank's capital, but subject to prior approval based on suitability of the shareholder
Latvia	Permitted	Permitted through subsidiaries	Permitted; together with the investments in industrial firms must not be more than full amount of the bank's capital	Permitted, but limited to 15% of bank's capital; in the aggregate limited to 60% of the bank's capital	Subject to regulatory approval for acquisitions of voting shares equal to or in excess of 10, 20, 33 and 50%

[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	Any person who intends to acquire a “qualified holding” (10% or more) in a financial institution must notify the authorities and get prior authorization

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Pakistan	Permitted, except for some specifically disallowed securities	Not permitted	Generally limited to holding bank premises	Permitted as a form of financing, subject to the Central Bank's prudential guidelines	Permitted
Panama	Permitted through subsidiaries	Not permitted	Not permitted	Permitted up to 25% of the bank's capital	Permitted
Peru	Permitted; dealing usually conducted through subsidiaries	Not permitted	Generally limited to holding bank premises	Generally not permitted	Permitted, subject to approval of Superintendent of Banks if investment exceeds 15% of bank's capital
Philippines	Permitted; universal banks may engage in securities activities directly or through a subsidiary with limitations; regular commercial banks may engage in securities activities only through 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	Permitted, beginning in 2004	Insurance brokerage permitted	Permitted only for carrying out banking activity in compliance with the Banking Law, for employees' use, and the enforced collection of claims	Interests may not exceed 20% of a company's share capital and 15% of the bank's own funds. Such investments in the aggregate may not exceed 60% of the bank's own funds.	Acquisitions of 10% or more requires prior notification of the National Bank of Romania
Russia	Permitted	Not permitted	Not permitted	Permitted, but not more than in one financial-industrial group	Permitted, but acquisition of more than 25% of a bank's shares requires the Central Bank of Russia's prior approval

Country	Securities[2]	Insurance[3]	Real Estate[4]	Bank Investments in Industrial Firms[5]	Industrial Firm Investments in Banks
Singapore	Banks may hold equity participation in stockbroking 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

Since the beginning of 2002, the Argentine economy has been facing the effects of public debt default, devaluation and rescheduling of deposits.

In this environment, the government issued Decree 905/02 in June 2002, which provided for a deposit exchange for public debt in the hands of the banks, determined the way financial institutions were going to be compensated for losses coming from the asymmetric pesification, and allowed the raising of new deposits in foreign currency to finance foreign trade transactions. Pursuant to the information disclosed by the Ministry of Economy, approximately 25% of the rescheduled deposits were exchanged for bonds denominated in dollars.

In mid-September of 2002, the government decided to apply a new set of measures aimed at solving the financial system problem. Therefore, it launched a new exchange partially collateralized by bonds. The so called "*Canje II*" sets forth that holders of rescheduled deposit certificates (CEDROS) had the option to exchange their deposits for public bonds issued in US Dollars with approximately 10-year maturities, together with an option to sell such bond coupons to the financial institution at $1.40 per US Dollar, adjusted to CER (the inflation adjustment index). Alternatively, such holders were given the opportunity to exchange the rescheduled balance for a Fixed Term Draft in Pesos issued by each financial institution, together with a Conversion Option to the currency of origin issued by the National State. Such Drafts were issued for a term of 10-and-a-half years and at a rate of $1.40 adjusted to CER, per US Dollar of the original deposit, while the option to convert to the currency of origin covered the difference between that value and the amount of the payment denominated in US Dollars. The "*Canje II"* was extended several times and expired in May 2003.

At the end of November 2002, the Ministry of Economy decided to eliminate the restrictions on cash deposit withdrawals from sight accounts *("corralito")*. This provision did not have an immediate impact and no significant deposit losses were registered due to the higher cash availability allowed by this measure.

At the beginning of April 2003, the government decided to launch the third exchange of deposits giving the option to convert the Certificates of Rescheduled Deposits (CEDROs) at the exchange rate of 1.4 pesos to the US dollar adjusted to CER and a new public bond for the difference to the exchange rate of the market. This exchange was accepted by depositors for half of the amount of CEDROs.

Adjustment to CER Exemptions

In April 2003, the government decided that a significant portion of bank loans duly pesified and subject to adjustment to CER –basically retail inflation- should be adjusted to a new index created by the INDEC, the Salary Variation Coefficient (CVS).

This measure created a new asymmetry in the financial system as banks have to index rescheduled deposits through the application of CER while they adjust an important number of loans to CVS. During 2002, CVS did not vary even though some salary increases had been recorded, while CER increased 40.5%.

Thus, the introduction of asymmetric indexation generated an additional loss of around 3.8 billion pesos on accrual basis, as it was estimated by the Government in the Technical Memorandum of Understanding enclosed with the Letter of Intent submitted to the IMF. (As of the end of June 2003, the exchange rate was 2.8 pesos to the US dollar.) This measure will continue bringing additional losses to the financial system as long as CER variation and the financial cost of deposits continue to exceed the salary variation reflected by the CVS.

In January 2003, the government reached a Stand-by Agreement with the IMF, for the credit tranches of the loan granted by that Agency, until August 2003, for approximately 3 billion US Dollars. These resources would be used to refinance the maturities of Argentine obligations to the IMF.

Judicial Injunctions

The increase in the number of judicial injunctions recorded as of March 2002 absorbed an important amount of the financial system's liquidity. Even though the Government instituted several measures to stop the execution of these injunctions, they continued affecting bank liquidity reserves. The loss resulting from judicial injunctions during 2002 amounted to 5.4 billion pesos.

New Regulations on Minimum Capital Requirements

At the end of May 2003, the Central Bank set forth new capital requirements for banking institutions, which lowered the general ratio from 11.5% to 8% on a Basel risk adjusted basis. This ratio will apply also to public exposures of financial institutions, which were previously excluded. This new regime will apply gradually.

AUSTRALIA

Approach to Prudential Supervision

During the period under review, the Australian Prudential Regulation Authority (APRA) took a deliberate decision to strengthen its regulatory culture. To facilitate this, from October 2002, APRA installed new risk assessment and supervisory response tools. The main risk assessment tool is PAIRS (Probability And Impact Rating System) which is a hybrid development of international best practice and a harmonization of approaches from APRA’s predecessor bodies. PAIRS is in the process of being applied to APRA’s roughly 3000 supervised entities (expected to take two years).

As the name implies, PAIRS assesses both the ‘Probability’ that each entity could fail over the medium term, and the potential ‘Impact’ on the Australian economy should such a failure occur. These two assessments are then combined in a single ‘Supervisory Attention Index’ measure of overall supervisory concern, which acts as a guide to the amount of supervisory attention to be given to each regulated entity. The SOARS (Supervisory Oversight and Response System) also uses the PAIRS ‘Probability’ and ‘Impact’ outputs to determine how supervisory concern should be addressed qualitatively through a progressively more intrusive and directive supervisory stance escalating from “Normal” through “Oversight”, “Mandated Improvement” and “Restructure”.

PAIRS risk assessments are conducted by supervisors using standardized risk and risk mitigation analyses. While every PAIRS assessment must consider the same factors, there is considerable flexibility for the supervisor to adjust these factors for the individual entity.

Regulation and Supervision of Banks and Authorized Deposit-taking Institutions (ADIs)

The new standard on Outsourcing by ADIs (available on APRA's web site) became effective from July 1, 2002. The standard, which reflects the growing importance of outsourcing in the financial services industry, 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. The Standard provides for APRA access to service providers, including the ability to conduct 'on-site' visits. As outsourcing is a common activity across all industry sectors, APRA intends to introduce similar standards for all regulated institutions.

In August 2002, the APRA announced its proposed regulatory arrangements for a new class of Authorised Deposit-taking Institutions (ADIs) specializing in credit card services. Known as Specialist Credit Card Institutions (SCCIs), the new entities will issue credit cards and acquire credit card transactions from merchants. The new SCCI model will allow non-financial organizations to establish credit card subsidiaries regulated by APRA, thereby allowing increased competition within the Australian credit card industry. Under the Reserve Bank of Australia's credit card reforms, a four-party credit card scheme that has been designated by the Reserve Bank (namely Visa, MasterCard and Bankcard) will be required to consider applications for participation by SCCIs on the same terms as for banks and other ADIs. Copies of the authorization guidelines and prudential standard is available on APRA's website www.apra.gov.au, together with the proposed capital, reporting and levy requirements for SCCIs. The new SCCI regime came into effect in July 2003.

In November 2002, APRA released updated prudential standards for ADIs on capital adequacy, large exposures and associations with related entities. The revised standards (and related guidance notes) give effect to the policy framework for prudential supervision of conglomerate groups containing ADIs (as detailed in the April 2000 Policy Information Paper and the October 2001 Discussion Paper) and came into effect on July 1, 2003. The new standards replace those issued in September 2000 on Capital Adequacy (APS 110); Capital Adequacy: Measurement of Capital (APS 111); Large Exposures (APS 221); and Equity Associations (APS 222).

The revised standards have tightened the rules on ADI exposures to third parties and to related entities within a conglomerate group by stipulating a system of exposure limits that reflect different counterparty risks. The standards also give APRA the power to impose capital adequacy requirements at the widest level on conglomerate groups that undertake substantial insurance and/or non-financial activities.

APRA also has finalized the revised requirements for ADIs deducting investments in subsidiaries from capital to avoid double counting capital for regulatory purposes. The new deduction rules will be implemented to coincide with the introduction of the new Basel Capital Accord on January 1, 2007. The revised prudential standards and associated guidance notes and a final draft of the prudential standards for implementation in 2007 are available on the APRA website.

In September 2002 APRA surveyed ADIs on the accounting treatment for the recognition of capitalized expenses and intangible assets. The results highlighted that although the exposure to capitalized expenses at the industry level is modest, the exposure for several ADIs comprised a material proportion of regulatory capital. In addition, there was inconsistency in the financial reporting and capital adequacy treatment of capitalized expenses. As a result, in June 2003 APRA proposed that capitalized expenses recognized as assets by ADIs, including loan origination fees and commissions paid to originators and brokers, securitization establishment costs and costs associated with debt/capital raisings, be treated as intangible assets and deducted from Tier 1 capital. This proposal harmonizes the capital adequacy treatment irrespective of the accounting policy adopted by ADIs and is consistent with the prudential accounting treatment applicable for APRA regulated general insurers. ADIs are to adopt the proposed prudential treatment for quarterly prudential reporting periods ending after July 1, 2004. The proposal is open to a period of public consultation, closing September 30, 2003.

The Financial Sector Legislation Amendment Bill (No.2) 2002 is currently before Parliament and is expected to be debated in the second half of 2003. Among other things, the Bill (available on the Parliament of Australia website www.aph.gov.au) proposes the following amendments to the Banking Act 1959:

- allow APRA to apply fit and proper provisions to directors and senior managers of ADIs and authorized NOHCs;
- allow APRA to apply fit and proper provisions to 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 broaden information gathering powers to all Australian subsidiaries of foreign corporations with an ADI in Australia;
- allow APRA to revoke ADI and NOHC authorities where false or misleading information had been provided in applications; and
- Harmonize APRA's indemnity in relation to ADI supervision in line with the indemnity in the APRA Act.

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.

General Insurance

The new prudential regime for the general insurance industry commenced on July 1, 2002 comprising significant amendments to the Insurance Act 1973, via the General Insurance Reform Act 2001, and a complementary set of prudential standards. The reforms include significantly increased capital requirements, strong reinsurance management and risk management strategies and processes. At the same time the new regime addresses the industry's management issues via a stronger fit and proper regime, applying not only to management but to auditors and actuaries. Most general insurance companies successfully met the new requirements and were authorized under the new regime. APRA's reauthorization process involved a rigorous assessment of a general insurer's situation and business practices and plans. Further work is required before all currently identified weaknesses in the regulatory framework for general insurance have been addressed.

In April 2003, the Royal Commission investigating the failure of HIH Insurance delivered its findings and recommendations on the failure of HIH Insurance, one of the largest corporate collapses in Australia (Report available on http://www.hihroyalcom.gov.au/). The Government is considering the Report's 61 recommendations which have further implications for the regulation of general insurance and the funding and structure of APRA. The Government has accepted and implemented the Report's recommendation that a group of full-time executives replace the Board which comprised mainly non-executive members.

Life Insurance

During the past year, APRA has been undertaking an internal review of the Life Insurance Act in light of international developments and the desire to harmonize the structure and style of the regulatory regime with others administered by APRA. To this end, APRA is currently planning to address identified issues within the current framework over the next 18 months. Fundamental changes to the structure of the Life Insurance Act and subordinate instruments, as well as measures to align the framework with international developments, will be developed over the next three years.

Superannuation

Following the Government sponsored inquiry into options for improving the safety of superannuation, the Government announced in October 2002 major reforms to strengthen the regulation of the superannuation industry (assets totaling around $520 billion at December 2002). The reforms will require all trustees (around 2000) of APRA-regulated superannuation entities to be licensed by APRA, rather than only the 157 trustees operating public offer entities, as is the current situation.

In addition, trustees will be required to prepare a risk management strategy for themselves and a risk management plan for each fund or trust that they operate. Further, all APRA regulated superannuation funds and trusts, both existing and new, are to be registered with APRA. There are currently over 10,000 funds and trusts that are to be registered. Under the proposed reforms, trustees will be required to demonstrate that they have the resources and competency necessary to operate a superannuation business. All trustees of APRA regulated superannuation funds and trusts will be subject to licence conditions and will be expected to comply with these conditions on an ongoing basis.

The proposed requirements will be inserted into the Superannuation Industry (Supervision) Act 1993 (SIS Act), with further detail of the prudential requirements to be contained in regulations. The reforms are expected to commence from late 2003 with licensing to be undertaken over a 2 year period starting early in 2004.

Regulation of the Financial Services Industry

The *Financial Services Reform Act 2001* (FSR Act and Part 6 of the Government's Corporate Law Economic Reform Program), which substantially amended the Corporations Act 2001, commenced in March 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 ten policies and three guidance papers dealing mainly with the licensing and disclosure provisions and codes of conduct (available on ASIC's website www.asic.gov.au). Over the past year four of these policies have been redrafted and re-issued as part of the FSR implementation. An electronic licensing system also has been implemented. An additional Policy Statement, Licensing; Financial Product Advisers-Conduct and Disclosure, was released in June 2003. Under the Act a transitional period runs to March 2004 during which ASIC will assess applications from financial services providers, financial markets and clearing and settlement facilities and issue licenses under the new regime. The new licensing provisions will apply to existing and new entrants into the respective industries.

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

Corporate Law Economic Reform Program (CLERP)

The Government continues its program to update arrangements for the regulation of business. CLERP 7 (effective July 1, 2003) primarily involves replacement of the requirement for companies to lodge annual returns with the obligation only to advise changes to company details. The obligation on companies to submit annual financial statements is unaffected by the reforms. In addition CLERP 8 and 9 discussion papers covering respectively cross-border insolvency laws and corporate disclosure and governance have been issued by Government for public consultation.

As with many overseas jurisdictions, the latter is in keeping with an increased focus on corporate governance in response to a number of high profile corporate collapses.

In the interim, the principal stock market within Australia, the Australian Stock Exchange, has issued "Principles of Good Corporate Governance and Best Practice Recommendations". There are ten corporate governance principles including: lay solid foundations for management and oversight; promote ethical and responsible reporting; make timely and balanced disclosure; and respect the rights of shareholders. For each principle, there are best practice recommendations. The ASX listing rules require companies or entities listed on its market to provide a statement in their annual returns disclosing the extent to which the best practice recommendations have been followed. The best practice recommendations are not mandatory, but a company or entity will be required to provide an explanation in the event that a recommendation is not adopted.

In addition, ASIC continues its role in monitoring and enforcing compliance with a broad range of existing corporate government provision in the Corporations Act 2001.

Payment Systems, Electronic Commerce and Banking

The Reserve Bank of Australia (RBA) announced its reforms to credit card schemes in August 2002. From January 1, 2003, merchants were permitted to impose a surcharge on customers who pay with a credit card. From the end of 2003, interchange fees will be capped by a cost-based transparent benchmark. It will be based on the costs incurred by card issuers in processing and authorising transactions, fraud and fraud prevention, and funding the interest-free period. Access to the credit card schemes will be broadened to allow specialist credit card institutions authorised and supervised by the Australian Prudential Regulation Authority to apply to participate in designated credit card schemes (see also above).

In September 2002, MasterCard International and Visa International each filed an application in the Federal Court to have the reforms overturned. The six week hearing concluded at the end of June 2003 and a decision was deferred.

The RBA convened, in early 2002, a series of meetings of industry participants to explore options for debit card reform. In July of that year, a paper was released outlining possible reforms to interchange fees. In February 2003, a number of participants in the EFTPOS system lodged an application with the Australian Competition and Consumer Commission to reduce debit card interchange fees to zero. The application is still under consideration.

In March 2003, the industry released for public consultation a proposal that interchange fees paid to ATM owners/acquirers be replaced by a regime where each ATM owner can levy charges directly on customers.

The Continuous Linked Settlement Bank (CLS Bank) began operating in seven currencies, including the Australian dollar on September 9, 2002.

The RBA has formal responsibility for ensuring that licensed facilities for the clearing and settlement of securities and derivatives conduct their affairs in a way that is consistent with financial system stability. Following a period of public consultation, the Reserve Bank determined

Financial Stability Standards on May 30, 2003. The standards cover the operation of central counterparties and securities settlement systems. The objective of the standards is to ensure that clearing and settlement facilities identify and properly control risks associated with their operation, thereby promoting the stability of the Australian financial system.

Anti-Money Laundering

AUSTRAC is Australia's specialist financial intelligence unit and is an integral part of Australia's ongoing efforts to deter and combat serious crime including money laundering and terrorist financing. AUSTRAC has both regulatory and analytical responsibilities; principally the administration and enforcement of the Financial Transaction Reports Act 1988 (FTR Act) and the analysis and dissemination of FTR intelligence to relevant law enforcement and revenue collection partner agencies.

During 2002/03 the FTR Act was amended to ensure the legislation reflects the contemporary anti-money laundering environment. These amendments included:

- adding a specific reference to s16 (suspect transactions) to include terrorist financing as a reportable transaction;
- clarifying the definition of cash dealer (s3) to ensure that remittance dealers are captured by the FTR Act's reporting regime; and
- transferring the document retention provisions from the previous Proceeds of Crime Act to the FTR Act (Part VIA).

AUSTRAC received increased base funding for the financial year July 2003 - June 2004 to increase its capabilities in a range of areas including data mining, international development and terrorist financing. AUSTRAC also received dedicated funding for increased work in the area of high risk cash dealers / underground banking as part of the Government's National Illicit Drugs Strategy (NIDS).

AUSTRAC has recently hosted the annual meetings of the EGMONT group of Financial Intelligence Units (FIU) to compare operational issues and progress in best practices for FIUs. At these meetings the number of member jurisdictions rose from 69 to 84. A significant number of observer jurisdictions and international organizations such as the United Nations and the World Bank also attended the meetings. AUSTRAC signed a further 6 memoranda of understanding with international FIU partner agencies bringing the current number of such agreements to 20. These agreements allow AUSTRAC and its MOU counterparts to share financial intelligence, both on request and spontaneously.

An ongoing priority for AUSTRAC will be amendment of the FTR Act to reflect the Financial Action Task Force's revised forty recommendations and 8 special recommendations on Terrorist Financing to combat money laundering.

For further information on AUSTRAC, the FTR Act or Australia's efforts to combat money laundering et al, interested parties should email the following address: help_desk@austrac.gov.au

Basel II Implementation

While APRA has yet to make a final decision, it is likely that Basel II capital requirements will be applied to all banks licensed in Australia, except foreign bank branches to which capital adequacy requirements do not apply on a stand-alone basis.

AUSTRIA

Payment Systems Oversight

An amendment to the Federal Act on the Oesterreichische Nationalbank (Austrian Central Bank) conferred payment systems oversight in Austria on the Austrian Central Bank. In connection with the mandate to oversee the systemic stability of payment systems as well as the secure participation in payment systems, this amendment specifies, in particular, the reporting obligations of payment systems operators and participants with regard to the measures in place to ensure legal, financial, organizational and technical systemic security. Also, the Austrian Central Bank is empowered to declare recommendations issued by the European Central Bank and the Basel Committee on Payment and Settlement Systems – which contain international principles to maintain systematic stability – binding by way of ordinances.

Money Laundering

The EU amended directive on the prevention of money laundering has been transposed into Austrian Law. The directive obliges the EU Member State to combat money laundering of the proceeds of all serious crimes. The amendment also extends the coverage to a series of non-financial activities and professions that are vulnerable to misuse by money launderers. In fulfilling the requirements of FATF's Special Recommendation VI, money transmitters shall require a licence from and will be supervised by the Austrian Financial Market Authority.

Basel II

In Austria the proposal by the Basel Committee at the international level is closely monitored and as a EU Member State Austria is actively taking part in the preparation of the European Commission's draft directive. At the national level, the Austrian Central Bank in cooperation with the Financial Market Authority regularly organized events to prepare credit institutions for QIS 3. The share of Austrian Banks participating in the quantitative impact study was above average compared to other countries. For Austria it will be vital that the final framework of risk weightings under Basel II take into account Austrian banks' specific portfolios. The current proposals are much better adapted to the needs of SMEs as well as small and medium sized banks than older proposals, which guarantees an adequate treatment of the Austrian corporate sector.

KINGDOM OF BAHRAIN

The period under review saw significant changes in the Kingdom's regulatory landscape, with the implementation of the Government's earlier announcement of plans to create a single financial sector regulator. Bahrain thus became the first country in the Gulf region to adopt a single regulator model, in a move aimed at further enhancing the effectiveness and efficiency of its regulatory system.

Regulatory staff from the Ministry of Commerce and Bahrain Stock Exchange transferred to the Kingdom's central bank – the Bahrain Monetary Agency – over the summer of 2002. The legal transfer of responsibilities took place in August, at which point the Agency became the sole regulator of the Kingdom's financial sector (it already had regulatory responsibilities for the banking sector).

Following the transfer, the Agency continued to apply existing BMA Law (which lays down the regulatory framework for the banking sector as well as the operating framework of the Agency) and the current Insurance Law.

Work on drafting a new, integrated financial services law to replace existing sector-based legislation was undertaken by the Agency during the second half of 2002. This included a round of public consultation with the financial services industry. A draft text was finalized by the end of the year and forwarded to the Government for it to review and submit to the Kingdom's legislative process.

In November 2002, a new Agency organizational structure was created to reflect the expansion of its scope of responsibilities. Two new supervisory divisions were created, each headed by an Executive Director. The first comprises directorates covering banking supervision, on-site examinations, and licensing and policy development. The second comprises directorates for the supervision of Islamic financial institutions, insurance firms, and other non-bank financial firms (such as money changers), as well as mutual funds. Other additions also include newly formed units that assist H.E. The Governor and H.E. the Deputy Governor, which are the Strategic Planning Unit and Promotion and Media Unit.

A Strategic Review

The Agency, in co-ordination with McKinsey & Company, has conducted a strategic review of the financial sector of Bahrain. The project started in May 2002 and is now in the implementation stage. Seven asset class task forces have been established to study means of developing areas of strategic importance, in addition to two support task forces.

Some results were already achieved. Examples are:

- Launching a package to enhance human resources and bridge any skill gaps. This includes a Human Resource Development Fund and BMA scholarship and Internship Programs.

- Establishing a platform for the development of remote service activities to serve the Kingdom of Bahrain, and the region.

- Establishing a platform for the development of the Kingdom's equity capital markets.
- The issuance of a Debt Capital Market calendar for all issuance in Bahrain.
- Establishing a platform for the development of the Kingdom's Debt Capital Market.
- The establishment of International Islamic Rating Agency.
- Work in progress to establish a world-class Islamic educational, research and training center.

Regulatory and Supervisory Developments

In order to capitalize on the advantages of a single regulator, a number of major projects were identified and initiated to enhance supervisory processes, the internal coordination and utilization of resources, and the BMA's regulations. Work on these is expected to bear fruit over the course of 2003-04.

Projects initiated during the period include creating a "rulebook" of all regulatory requirements, systematically organized by subject matter, to replace the existing system of ad-hoc circulars; a simplified, integrated license structure and improved licensing processes; and a completely new regulatory framework for the insurance sector.

The Agency also completed the development phase of a new risk-focused inspection methodology, a core component of which will involve the systematic risk profiling of all BMA licensees, in co-ordination with off-site supervision directorates. As part of the project, new software was acquired and tailored to help examiners undertake their examination procedures and record their findings while working on-site.

In terms of new policy requirements, the Agency required banks' prudential returns to be reviewed by external auditors, with effect from end-June 2002 onwards. The Agency also introduced new regulations regarding the outsourcing of critical functions or processes by bank licensees.

In addition, a number of banking regulations were identified for review or further development. These include revisions to liquidity requirements, and to the Agency's anti-money laundering regulations, to take into account the Financial Action Task Force's review of its own recommendations. Also, preparatory work on the implementation of Basel II capital standards for banks was initiated.

An important objective of the reorganization was the creation of a dedicated policy development team, to allow other directorates to focus solely on supervisory matters. Resource needs and a team structure were agreed upon in 2002 and actions were initiated to resource the policy team over the course of 2003.

In overall terms the financial sector as a whole performed positively during 2002 and into 2003, although extremely challenging conditions in world financial markets precipitated financial difficulties in two small, locally based, investment banks. The BMA was heavily involved in encouraging a market-based resolution of their problems. At the time of writing, these efforts appeared to be nearing a successful conclusion.

Meanwhile, Bahrain's financial sector continued to grow and attract new entrants during the period. Thirty-three new licenses were issued in 2002; as at end-2002, a total of 339 banks, insurance companies, securities brokers and other financial institutions were licensed by the Agency. Of these, 178 were banks and other financial institutions; 149 were insurers and related licensees (e.g. insurance brokers, consultants and actuaries); and 12 were securities brokers approved under the Bahrain Stock Exchange's 1988 By-law.

Basel II

The Agency is at an early stage of developing its policy towards implementation of Basel II. (As a non-G10 country, Bahrain is not necessarily constrained by the Basel Committee's end-2006 target implementation date.)

In May 2003, subsequent to the release of the Basel Committee's CP3, the Agency embarked on a series of discussions with the leading local banks based in the Kingdom, to assess their analysis of the Basel II proposals and their state of readiness. These meetings will be followed up with the creation of an industry-working group, which will be used by the Agency as a sounding prior to the formulation of implementation policies. This working group will start work in September 2003, and the process of formulating a detailed implementation policy is expected to take three to six months.

At this stage, the Agency does not anticipate allowing less complex institutions to remain with Basel I in its current form. Rather, the Agency will be exploring the possibility of allowing banks that would not be classified as "internationally active" to apply simplified elements of Basel II. No decisions on this matter have yet been taken.

The Agency currently supervises credit processes and risk management in Bahraini branches of non-domestic banks, and would expect to continue doing so in the future.

BELGIUM

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

The new organization of the supervision on the financial markets and institutions which has been prepared these last years has been laid down in two laws dating from August 2, 2002. The cooperation between the central bank (National Bank of Belgium, at the top of the new framework), the supervisory authority for banking and for the financial markets (Banking and Finance Commission) and that for insurance companies (Office de Contrôle des Assurances (OCA), i.e. insurance control office) is currently being examined and carried out with the official target of a full implementation on January 1, 2004. At this date, the related reorganization of the different services concerned in these institutions will be complete and the OCA will merge into the

CBF as a specific department; the enlarged institution will be called CBFA ("Commission Bancaire et Financière et des Assurances").

Especially with respect to the control of banks, a new distinction is being introduced in the organization of the control bodies between, on the one hand, the application of the individual control on institutions (the so-called "micro-prudential" supervision) and, on the other hand, the prudential policy, including the systemic control and the preparation of new rules both national and international (the so-called "macro-prudential" supervision).

The Regulation and Supervision of Securities Firms, Insurance Firms, Commodities Firms and Other Nonbank Financial Institutions

Asset management: Last year, the Banking and Finance Commission (the national supervisory authority) made an evaluation of the current regulations in the field of asset management. The aim was to ensure the application of uniform supervision to all of the financial institutions concerned (banks, investment companies), to see if the regulations are still adequate and to put forward recommendations for adapting them, if necessary.

Recommendations have been made for increased transparency and for a different treatment of professional and non-professional customers

Other Developments

Law of July 17, 2002 on electronic funds transfers

The 1997 European Recommendation (97/489/EC) concerning electronic funds transfers has been transposed into Belgian law. That particular law came into effect on February 1, 2003, except for the provisions dealing with the individual limits for the use of payment cards, which will come into effect on August 1, 2003.

This law chiefly aims at offering better protection to consumers drawing upon different means such as payment cards, PC or phone banking or electronic purses for their electronic funds transfers. The law does not only contain provisions with respect to the information to be provided before and after the transaction, but it also introduces a significant change as for the levels of liability in case of loss or theft of the instrument.

Law of February 25, 2003 transposing European Directives 2000/28/EC and 2000/46/EC concerning the issuers of electronic money

This law creates a new category of credit institutions, i.e. issuers of electronic money. As for banks, the conditions for reimbursing electronic money which has not yet been spent are specified in a special provision.

Single European Payments Area (SEPA) : Creation of the European Payments Council (EPC)

The EPC was established in June 2002 as the platform mandated by the European banking industry, represented by the European Credit Sector Associations (ECSAs), to create the architecture, instruments and processes for the Single European Payments Area (SEPA). This development was the result of the SEPA Workshop, which was organized in Brussels in March

2002 by the ECSAs and some 40 European banks. The EPC, split up into five Working Groups, addresses the whole gamut of payment instruments, from checks and credit transfers to cards and cash, including emerging instruments such as e- and m- payments, in a cross-sector and holistic approach and from a banking business perspective. The progress which has already been made towards the EPC, is as follows :

Banks have established rigorous standards in order to comply with the Cross-Border Payments Regulation:

The EPC approved two market conventions to meet the July 1, 2003 deadline in the Regulation 2560/2001:

- The CREDEURO Convention establishes a standard for the execution of a "basic" bank-to-bank pan-European credit transfer, which will allow participating banks to give guarantees to their customers as regards information requirements, execution time (3 days from acceptance to beneficiary credit), and remittance information transmitted.

- The *Interbank Charging Principles (ICP) Convention* establishes a standard procedure for achieving end-to-end certainty in charging methods, and allows for the instructed amount to be credited to the beneficiary customer in full.

Banks have decided on a pan-European architecture for clearing retail and commercial payments Instructions:

EPC Members have unanimously approved the Pan-European Automated Clearing House (PE-ACH) as the preferred model of the industry for credit and debit transfers.
The PE-ACH (provided neither by a single company, nor by a single technical system) should be "country neutral", owned and used by banks, with Central Banks as potential users or facilitators for technical access. The STEP2 project of the Euro Banking Association (EBA) is the most likely to satisfy the business needs of the industry, by July 2003, with respect to credit transfers falling under EC Regulation 2560/2001. At this stage, industry efforts should be focused on its implementation and rapid connectivity and usage.

The fully integrated European payments infrastructure will be achieved in steps. First, for credit transfers, in combination with existing clearing and settlement systems, then a pan-European infrastructure bridging current domestic and cross-border payments will be developed.

Banks are paving the way for a Single Payments Area for Cards:

EPC Members have unanimously endorsed a resolution by which they commit to lead the realization of a Single European Card Market - through the deployment of profitable customer value propositions and taking advantage of the global acceptance provided by present international schemes. Concerted actions are being carried out at the card industry level involving both global and domestic card schemes, as well as all stakeholders (including the ECB/Eurosystem, the European Commission, national governments, and merchants). They will make possible and strengthen the implementation of the banking industry vision. EPC members will actively work within the existing governance structures of card schemes to achieve this goal. Preventing and combating fraud, promoting an open and competitive market for cards that enables widespread usage, advocating a coherent legislation and regulation (with a preference for self regulation), and developing deeper standardization and stronger cooperation (especially on chip migration) are among the main issues at stake.

Finally, banks are developing a true Single Area for Cash:

EPC Members have unanimously approved a resolution which recommends moving forward to develop joint cash and card strategies in order to reduce the cost of handling cash, promote electronic products in liaison with key stakeholders, as well as Europe-wide standardization of requirements for hardware and software equipment, the development of "best practices" to enhance cash service operations, and to study the migration to a "utility-type" wholesale system.

Basic banking service

According to the Law of March 24, 2003 on the basic banking service, all credit institutions offering demand deposit accounts in Belgium will have the obligation, as of September 1, 2003 to grant the basic banking service to natural persons who are customers. A maximum of 12 EUR may be charged for this basic banking service and the applicant/holder must not (yet) have another demand deposit account at a credit institution.

The basic banking service is a demand deposit account allowing deposits and withdrawals, standing payment orders and direct debiting of invoices as well as funds transfers. Depending on the credit institution, the holder may obtain a payment card. Checks and credit cards are incompatible with this basic banking service.

If the credit institution refuses to grant the basic banking service without any kind of justification, an administrative fine may be imposed and a civil sanction will be applied (i.e. a basic banking service free of charges for a period of two years).

Draft law on the financial markets

Large parts of the draft law on the financial markets have already come into effect by means of a Royal Decree, except for the aspects concerning the rules of conduct for financial intermediaries. These rules will probably come into effect by the end of 2003.

In other developments, NasdaqEurope has announced it will end its activities in Brussels.

Basel II

National regulations based on the EU Capital Adequacy Directive implementing Basel II will apply to all banks and investment firms (as is now the case for the Accord of 1988).

There can be no doubt that the function of the Belgian supervisory authority as a host country supervisor will be fulfilled completely. But, during the beginning of the implementation period, the precise content of this function will remain subject to discussion as for the concrete application of the parts of "Pillar 2" referring to the convergence between prudential practices. The risk management and credit risk models logically should be supervised for the bank as a whole and even, as much as possible, for the whole group because the Basel Accord will be applicable on a consolidated level. Therefore, this control should be the responsibility of the home supervisor. But it does not exclude in principle that the cooperation of host country supervisors can be useful depending on the best prudential practices and on their application to various individual cases. All this will become clearer after the discussions between supervisors as mentioned above as well as after the experience gained in a first part of the implementation period, when guidelines and criteria in this matter will be disclosed by the authorities.

BERMUDA

The Bermuda Monetary Authority was closely involved during the period in discussions pertaining to policy for new or amended legislation as well as in the ensuing process of consultation with industry on new draft provisions.

Insurance

The Insurance Amendment Act 2002 came into effect on October 14, 2002. The Act provides the Authority with new powers to obtain information and reports and to require the production of documents from licensed insurers, insurance managers and intermediaries. As such, the Act provides the legal underpinning for the Authority to introduce on-site supervisory review visits to the Class 3 and 4 and Long-Term companies, as previously proposed. The Act also provides for the Authority to publish a Statement of Principles regarding its exercise of the new powers to obtain information and report and to require documents. This Statement has been published and copies are available from the Authority. The Authority has now established a standard program for the review visits, which is currently being carried forward. The first visits took place during January 2003.

Banking and Trust

The Trusts (Regulation of Trust Business) Act 2001 came into force on January 25, 2002. The Trusts (Regulation of Trust Business) Amendment No. 2 Act 2002 came into effect in August 2002. Under this amendment, individuals and partnerships not previously subject to a licensing requirement were allowed to continue to operate provided they applied for a licence by January 24, 2003.

At the same time, the Trusts (Regulation of Trust Business) Exemption Order 2002 specified certain strictly limited exemptions from the standard licensing requirement. This includes a provision for private trust companies, established solely to provide trust services to a stipulated trust or group of 'related' trusts and not providing services more widely.

The Authority took steps during the year to alert the public and those service providers potentially affected by the new legislation, including through advertising in the local press. It also undertook extensive preparatory work for the full implementation of the new regime. This included the draft and publication, after extensive consultation with the market, of the Statement of Principles required under section 6 of the Act, and of a Code of Practice issued pursuant to section 7. Both documents were published in September 2002.

The Statement of Principles provides guidance on the Authority's approach in interpreting and applying the minimum licensing criteria and its formal intervention powers in the Act. The Code of Practice provides guidance on the standards expected of licensed undertakings, including on the systems and controls they need to have in place.

Section 13 of the Act also provides for the Authority to compile and maintain a register giving particulars of each trust license.

During the year, the Authority also finalized details of the supervisory approach to be applied under the Act, including both on-site and off-site elements. The Act requires licensed undertakings to provide the Authority with copies of their financial statements as well as with annual certificates of compliance with the licensing criteria, Code of Practice and any limitations placed on their business. Following receipt and review of this material, the Authority holds a prudential discussion with the senior management of the licensed undertaking to review the development of the business, the key risks and controls and any issues or concerns there may be.

Extensive preparations were also made for the full implementation of the Authority's on-site compliance program for licensed undertakings. As part of this, the Authority recruited new resources and provided additional training for existing staff with a view to enhancing its practical experience in the detailed internal control and compliance issues pertaining to the industry. Going forward, a standard, three-year rolling program is planned. However, within that, certain undertakings will be visited more frequently, reflecting an assessment of the risks inherent in the business and the effectiveness of management, systems and controls in dealing with the risks. Fuller details of the Authority's supervisory approach are included in Guidance Notes for Intending Applicants published by the Authority during the year 2002. Copies of this, and of other published material, are available from the Authority's website, www.bma.bm.

Investment

The Authority has been working hard to enhance the protection available to the public in their dealings with investment service providers. It remains concerned about reports of local investors being defrauded by non-licensed investment businesses or purchasing poor quality or inappropriate products. An important element of the enhanced protection that is intended will be through a new regulatory framework. The **Investment Business Bill 2003** is expected to complete the Parliamentary processes towards the end of 2003.

Work has also been underway on drafting the related secondary legislation that will be necessary. A committee of Authority representatives and Ministry of Finance officials is carrying forward detailed planning of the transitional and other arrangements that will be required for the introduction of the new legislation.

The principal changes proposed under the new legislation include the following:

- clarification of the scope of the present Act, particularly with regard to the meaning of 'investment' and 'investment business' in order to remove a number of areas of legal uncertainty;
- an amendment to the scope of regulated activities to include custody of securities;
- new provisions to deal with controllers of licensed investment providers;
- new provisions to deal with confidentiality of information and the Authority's ability to disclose information to other regulators for regulatory purposes;
- new provisions for the recognition of securities exchanges and clearing houses as self-regulatory organizations under the Act; and
- new powers to investigate and deal with investment business conducted by non-licensed persons in contravention of the Act.

Separately, draft Client Money Regulations will also be introduced following consultation with the industry.

Following consultation with the market, the Government has agreed to introduce new provisions in the Criminal Code to prohibit insider dealing and price manipulation. It is expected that the necessary legislation will be introduced in Parliament in the second half of 2003.

Equally important, however, will be related public information and education measures to ensure that consumers of investment services have an adequate understanding of financial markets and products, as well as of their rights as consumers and of the protections provided through the relevant regulatory legislation. The Authority will be working closely with other interested partners, including the Consumer Affairs Bureau, to coordinate plans for public information in this area.

Proceeds of Crime Legislation

The BMA is closely involved in the review and development of Bermuda's anti-money laundering legislation and policy framework. It participates in the work of the National Anti-Money Laundering Committee (NAMLC), a statutory body that brings together representatives of all the agencies involved.

Bermuda has had very effective anti-money laundering provisions in place for a number of years. These include the Proceeds of Crime Act 1997 which creates general law offences relating to the concealment or transfer of the proceeds of criminal conduct or assisting another person to do so. There are then specific regulations (and associated guidance notes) making detailed provisions for regulated financial institutions. Bermuda's National Anti-Money Laundering Committee ("NAMLC") has been conducting public consultation on a number of proposed changes in Bermuda's anti-money laundering provisions, in parallel with the Financial Action Task Force (FATF) review of the Forty Recommendations.

With the completion of the FATF exercise, the NAMLC will now be finalizing its own review of Bermuda's provisions, and making recommendations for the changes necessary to ensure that Bermuda continues to meet fully the relevant international standards. The Authority is closely involved in this work, both as a member of NAMLC and as the financial regulator for many of the businesses subject to the regulations. The Authority's supervision of licensed financial businesses subject to the regulations includes specific checks on their compliance with anti-money laundering requirements.

Meanwhile, work is under way on new primary legislation dealing with terrorism offences. This will enable Bermuda to complete its legal implementation of the FATF provisions designed to combat terrorist financing. The Authority has already encouraged institutions regulated under the Proceeds of Crime legislation to treat suspicions of terrorist financing as being covered fully by that legislation. Licensed institutions have, at the Authority's request, reviewed their customer records in order to identify any links with known or suspected terrorists or terrorist organizations. During these reviews, no suspicions of such links were identified.

Bermuda Monetary Authority Amendment Act 2002

The Act, which came into effect at the end of 2002, introduced some minor technical amendments to the Bermuda Monetary Authority Act. In particular, the effect was to provide for existing regulatory fees payable to the Authority to be set within the framework of the Bermuda Monetary Authority Act, instead of under the Government Fees Act, as has previously been the case.

The Act also made an addition to the list of principal objects set for the Authority, to include assisting with the detection and prevention of financial crime. This change reflects what is now international best practice for similar regulatory bodies. However, it does not of itself involve any extension to the Authority's present role, which is governed by the powers and duties given to the Authority under the Act together with the various regulatory statutes.

CANADA

Summary

Since the passage of the last major revision of the federal financial services legislation in 2001, the federal government has been gradually implementing the necessary related regulations. Over the last twelve months the government has almost completed this process. Several years ago, a number of domestic banks were planning to merge, but were unable to overcome government opposition. This matter has remained a high profile issue in Canada with respect to which the federal government has recently explained its future plans. Both the federal and provincial governments have also begun initiatives aimed at reforming the system of securities regulation in Canada. More anti-money laundering measures have also been introduced.

Mergers

In 1998**,** four of the six major domestic banks in Canada sought government approval to merge, but were denied. Since then, the federal government has introduced new financial sector legislation and indicated that mergers were a legitimate business strategy. In this regard, the government set out a merger review policy for large banks. Last year, the government asked two

Parliamentary Committees to clarify the public interest criteria by which mergers would be evaluated. Those Committees released their findings and the government responded on June 23, 2003 with a document outlining further issues to be studied and laying out a schedule that would not permit a merger proposal to be placed before the government earlier than September 30, 2004.

Financial Services Regulations

127 regulations have been passed, bringing the regulation-making process to substantial completion, with only one substantive matter – the *Holding Company Conversion Regulations* – still uncompleted.

The two other substantive regulations that had remained outstanding at the start of the year have now been completed (the *Information Technology Activities Regulations* and the *Access to Basic Banking Services Regulations).* The former will be supplemented by a regularly updated advisory document prepared by the Office of the Superintendent of Financial Institutions, which will serve as an instruction guide to assist financial institutions in making their applications for approval under the regulations and will contain examples of activities and permitted investments that OSFI would recommend for Ministerial approval. The focus of the regulation and instruction guide is to set out where banks may engage in commercial information technology activity.

After two years of consultations, the government has finalized the *Access to Basic Banking Services Regulations;* the final version was published in June 2003 and will come into force September 30, 2003. The ABBS Regulations require banks to provide "basic retail banking services" to anyone, subject to certain identification conditions and a few specific exceptions.

Foreign Banks

Now that, pursuant to Bank Act changes in 1999, authorized foreign banks are permitted to establish branches in addition to, or in lieu of subsidiaries, over 20 of the approximate 35 foreign banks active in Canada have established branches, mainly through converting their foreign bank subsidiaries. With one or two exceptions, the remaining foreign bank subsidiaries offer "retail deposit-taking services" because authorized foreign bank branches, while permitted to provide retail products such as house mortgages and credit cards, are still not permitted to accept "retail" deposits.

Securities Regulatory Reform
Wise Persons Committee

On March 4, 2003, the federal Minister of Finance appointed seven individuals to a "Wise Persons Committee" (WPC) to recommend a plan for determining what should be the preferred securities regulatory system for Canada.

The process to establish the WPC took considerably longer than expected, and it was not until May 2003 that the Committee issued its consultation paper. Cross-country hearings have now been concluded and the Committee is finalizing its research undertakings in preparation for its report, which is officially due at the end of November 2003. Submission to the WPC has been made public, with the majority of witnesses calling for the creation of a single national securities regulator.

The WPC's consultation paper and research program are aimed at enabling the Committee to make a detailed examination of the costs and inefficiencies of the current system, the extent to which there are local/regional markets, and the experiences of other jurisdictions, as well as to put forward a full assessment of the options for reform. While the WPC's consultation paper discusses different approaches for reform, it is clear that its focus will be on structural reform with a view to addressing the regulatory overlap and duplication in the current system.

Provincial Ministers Initiative

In parallel to the WPC, the Ministers responsible for securities regulation in British Columbia, Alberta, Ontario and Quebec (later joined by Saskatchewan and Manitoba) established a committee earlier this year to consider reforms to the current system. In contrast to the WPC process, the Provincial Ministers Committee (PMC) is focusing its discussions on how to achieve a "passport" model across Canada (i.e., a system in which issuers and registrants who satisfy the regulatory requirements of one province would be able to carry on business in all other participating provinces). Representatives of the PMC have made clear that it will not be considering a single regulator approach (although it is understood that the Ontario Finance Minister is supportive of examining such a model in addition to the passport model).

A noteworthy feature of the PMC is that Ministers are leading the discussions. A concern with previous attempts at securities reform was that securities regulators, without the buy-in of their respective governments, led the discussions.

The PMC issued a discussion paper on the passport model in June 2003 and has concluded its public consultations. The PMC has indicated that its report, providing more detail about the workings of its proposed passport model, will be issued in September 2003.

Uniform Securities Law

A third significant initiative in the area of securities reform now under way is the Canadian Securities Administrators' Uniform Securities Law (USL) project, launched in 2001 and aiming to develop a model securities statute that would be adopted in all provinces and territories in Canada. The project is at least a year away from completing the model statute, following which individual provincial legislatures will be requested to adopt it.

Anti-Money Laundering Measures

Over the last few years, the federal government has implemented a number of anti-money laundering measures, including the establishment of a new agency called FINTRAC to receive and analyze data. New measures have been introduced in the last twelve months. In November 2002 regulations came into force that required financial institutions and a number of other organizations, such as casinos, to report "large cash transactions" (essentially, cash deposits of C$10,000 or more) to FINTRAC. In March 2003, requirements came into force concerning the reporting of electronic funds transactions made through the SWIFT system, while reporting of non-SWIFT electronic funds transactions will be required as of November 2003.

CAYMAN ISLANDS

A primary focus of the Monetary Authority during the period under review has been the preparation for operational independence. Following extensive consultation with the Cayman Islands Government and private sector associations, *The Monetary Authority (Amendment) Law, 2002* was officially published and consequently effective March 12, 2003. Operational independence enables the Monetary Authority to execute directly the key functions of licensing, on-going supervision, enforcement and regulatory cooperation. In practice operational decision-making is placed into the hands of the Board of Directors of the Monetary Authority. Other functions such as currency operations, and the Monetary Authority's advisory role to Government will remain unaffected by independence.

The Monetary Authority has also been working diligently towards the implementation of a licensing regime for securities business. The regulation and supervision of which will fall to the Investments Services Division. Typical activities covered by *The Securities Investment Business Law 2001* include: dealing in securities, arranging deals, investments management and investment advice. Under this legislation, market manipulation and insider dealing will be classified as criminal behavior. As of June 30, 2003 two Orders, namely *The Securities Investment Business Law, 2002 (Commencement) Order 2002*, and *The Securities Investment Business (Amendment) Order 2002*, were issued under the Law.

The licensing regime will be effective once the Regulations under the Law come into force. This is planned for July 2003. The Law will be accompanied by three sets of Regulations: namely the conduct of business regulations; the financial standards regulations; and the application and fees regulations. Eight statements of guidance will also be issued by the Monetary Authority to facilitate understanding of the Law.

Anti-Money Laundering Developments

In respect of anti-money laundering legislation, *The Money Laundering (Amendment) Regulations, 2003*, gazetted on June 24, 2003, extended the deadline for the retrofitting of client identification. The deadline was extended from December 31, 2002 to September 30, 2003. In practice this means that for client relationships in existence prior to the enactment of the Money Laundering Regulations, licensees have an additional twelve months within which to carry out identification procedures in accordance with the Regulations.

The Cayman Islands Registered Stock Law, 2002 enacted in the December session of the Legislative Assembly added a significant new responsibility to the Monetary Authority, namely for the registration and transfer of Government stock. The Law also gives the Managing Director and one other director of the Monetary Authority responsibility for acting as Trustees to any sinking fund established under the Law.

As part of the Financial Action Task Force review of the Forty Recommendations commenced in 2001, a consultation paper for review was issued in May 2002. Industry associations were specifically consulted on the FATF proposed Interpretative Note for its special recommendation VII regarding wire transfers in the Monetary Authority's review of the Forty plus Eight Recommendations. A coordinated response was then forwarded to Government in January 2003 for submission to the FATF.

The Monetary Authority, along with members of the fiduciary services industry in Cayman, has recognized the Working Group on Trust and Company Services Providers' statement of best practice, issued by the Offshore Group of Banking Supervisors (OGBS) in September 2002. Compliance with the best practice statement, should not pose significant difficulty to high quality licensees regulated by the Monetary Authority as the standards document practices that should have already been adopted by experienced and professional Fiduciary Services practitioners.

Financial Performance
Banking Sector

The Cayman Islands continues to maintain its position as a leading financial center being host to over 40 of the world's top 50 banks, and representing major international banks from over 56 different countries around the world. During the fourth quarter of 2002, the sector hit a significant milestone with total international assets reportedly exceeding US$1 trillion.

The number of banking and trust companies licensed at the end of June 2003 stood at 477 compared to 526 in June 2002. This reduction is symptomatic of the global trend of mergers and acquisitions leading to greater synergies and rationalization of international networks. Locally the major change in the retail-banking sector was the joint venture between Canadian Imperial Bank of Commerce and Barclays Bank Plc., which saw the amalgamation of the Caribbean retail business of both banks throughout 15 jurisdictions in the Caribbean, under the name of FirstCaribbean International Bank. The Cayman Islands entity is one of the largest subsidiaries of the new joint venture

Basel II

The challenge facing the banking sector for both industry and the Monetary Authority is the preparation for the introduction of the New Basel Capital Accord, or Basel II. The new accord does pose a number of issues and concerns for emerging markets such as the Cayman Islands and representatives from the Monetary Authority have commenced a discourse with industry to flag these concerns. In the future, the Banker's Association will be working closely with the Monetary Authority in addressing the challenges that the new accord poses.

Insurance

During the period June 2002 - June 2003, the Cayman Islands maintained its position as the second largest captive insurance domicile in the world with an increase from 557 to 617 companies writing over US$4.9 billion in premiums and reporting total assets in excess of US$18.5 billion. These companies emanate mostly from the USA (86%), followed by the Caribbean and Latin America (4%) and Europe (3%).

The main category of captives continued to be Pure Captives, accounting for 60% of all captive insurance licences. Traditionally, the Islands are known as a world center for healthcare captives. Thirty-two percent of Cayman captives are healthcare related, but the trends of recent years would suggest that all types of captive insurers now consider Cayman the domicile of choice.

On the domestic front there are 28 Insurance Companies licensed to carry on business generally in or from within the Islands, 24 Insurance Brokers and 65 Insurance Agents. The most popular line of business written, in terms of gross written premium, is health followed by property. 2002 was both an interesting and challenging year for the local insurance industry as it continued to be influenced by a number of external factors. Consistent with global trends, premiums for property and motor coverage increased in 2002, dictated by the need for both insurers and re-insurers internationally to return to profitability post September 11th.

The prognosis for 2003 for the captive industry as a whole is relatively flat due to limited fronting capacity. According to A M Best, the total number of active captives is expected to remain relatively stable at around 4,500. In Cayman current indicators regarding licence applications confirm that the jurisdiction remains attractive. The trend of last year appears to be continuing, albeit at a slower pace, with current licences being at 621, accounting for 37 issued and 20 cancelled. We have seen a particular surge in the level of new captives for health care providers emerging with over 70% of new applications originating from this sector in 2003. (*This market normally accounts for 33% of new applications*). No fall out is anticipated from this sector unless the US introduces some tort reform.

Investment Services

The number of Mutual Funds has experienced continuous growth over the last 12 months. Statistics published at the end of June 2003 reveal that the growth rate is increasing with an additional 510 licences being issued since June 2002. As of June 30, 2003 there were 4,522 Mutual Funds registered and 206 Mutual Fund Administrators. The Cayman Islands have clearly emerged as one of the leading domiciles for offshore hedge funds. Based upon figures from the 2002 edition of *The U.S. Offshore Funds Directory*, Cayman holds 51% of the overall world market for offshore hedge funds.

CHILE

Signing of the FTA between Chile and the U.S.

Chile signed a Free Trade Agreement with the United States on June 6th. The subject of Financial Services was considered as a distinct matter within Services. The Chilean negotiation strategy on this subject was based on General Agreement on Trade of Services (GATS), as it pertains to Financial Services.

These issues were agreed to in line with current Chilean law, and hence the position of the Chilean government was to avoid modifying the General Banking Act ("Ley General de Bancos").

Mergers

The merger of banks Santiago and Santander took place, thus creating the new Banco Santander Santiago.

New Regulations Regarding Banks' Auditing Committees

The Banking Superintendence (Superintendencia de Bancos) instructed the organizations under its supervision to give their respective Auditing Committees a structure and ensure their functioning is regular, systematic and independent from the company's management.

The afore-mentioned measure seeks that the stated Committees hold an essential and mandatory role within the systems of Internal Control of all institutions within the banking system. This should ensure the commitment of this organization in the increasingly regulated environment of the financial system.

The Auditing Committee of each institution should oversee the efficiency of the company's Internal Control system and the compliance with laws and regulations. By the same token, it must possess a clear understanding of risks inherent to the organization's activities.

New Regulation Regarding Client Classification and Provisions

This regulation, based on the current recommendations used worldwide, seeks the attainment of two equally important goals regarding client classification: know-your-customer and accurately determining expected losses. It allows banks to apply their own methodologies and demands a higher level of involvement by management, the Board and external auditors.

New Banks

The creation of the following banks was authorized: HNS, Ripley, Monex (which has yet to operate), Conosur (which changed its former status of Financial Company) and HSBC.

New Products and Services

- Voluntary provisional savings
- Interest-bearing checking accounts
- Mortgage loan in pesos

New Interbank Letter that Facilitates Changes of Clients Among Banks

This instrument will guarantee credits that one individual holds in more than one financial institution, hence facilitating movements from one institution to others.

Basel II

Chile is prepared to implement the new agreement.

CHINA

Significant Developments in Banking

Starting from July 1, 2002, a new capital settlement scheme for foreign invested accounts was implemented throughout the country, according to the China State Administration of Foreign Exchange (SAFE).

According to a SAFE statement released on August 21, 2002, enterprises within China's bonded areas needed to observe a new set of foreign exchange management regulations. The new regulations will cover 38 forex items in the areas of registration, annual checks, accounts, income and expenditure and the management of sales.

SAFE announced on Sep. 27, 2002 that it has reformed the administrative policies governing the current accounts in foreign exchange and the new policies will be put into effect as of October 15, 2002.

The reformed policies simplified the requirements for opening of forex accounts and made these the same for both Chinese and overseas-funded enterprises.

At the same time, a nationwide information system for the administration of forex accounts is being adopted to improve the electronic level of forex administration.

The Chinese authorities on November 28, 2002 released a detailed regulation on foreign exchange issues related to the Qualified Foreign Institutional Investors (QFII) scheme.

The rule, designed by SAFE, clarified foreign exchange management systems for the account and quota used for QFII investment, as well as remittance of capital, liabilities of the custodians and the supervisory role of the government.

China's foreign-exchange authorities on December 19, 2002 announced an adjustment to the administration of the forex loan regime.

Commercial banks will take over some of the registration and monitoring functions in an attempt to improve regulatory efficiency. Starting on January 1, 2003, the lending bank will report forex loans to the SAFE.

Since February 1, 2002 when the regulatory rules governing foreign financial institutions came into effect, the People's Bank of China (PBOC) has approved 23 foreign banks in China to conduct RMB businesses, bringing the total number to 53.

By the end of October 2002, the number of foreign banking institutions in China had reached 181, with aggregate assets worth $37.965 billion and debts of $33.797.

PBOC announced a procedure on January 14, 2003 for reporting large-sum and suspicious payment trading in the Chinese currency RMB.

The move is aimed to enhance the supervision of payment trading in RMB, standardize reports on RMB payment trading, and ward off money laundering and other criminal activities by means of payments and clearing through banks.

A new rule on foreign-backed mergers and acquisitions in China came into effect on April 12, 2003.

The temporary rule was issued by the Ministry of Foreign Trade and Economic Co-operation, the State Administration of Taxation, the State Administration for Industry and Commerce and the State Administration of Foreign Exchange.

The new rule mapped out principles, procedures, examination and approval of international mergers and acquisitions and will provide practical legal guidelines for various forms of foreign investment.

China's central bank PBOC has decided to revoke 26 rules on administrative ratification and will gradually sort out related regulations and regulatory files.

The revoked rules mainly involve the trading of out-of-circulation RMB, the ratification of a licensed fake-money discriminator, trading of gold and silver, banking bills, Chinese branches of foreign banks and many other sectors.

The China Banking Regulatory Commission (CBRC) officially started functioning on April 28, 2003, setting out on a mission to reform the country's banks ridden with bad loans and to stave off banking risks.

CBRC plans to set up a non-profit international advisory committee for advice from its overseas members. Members of the advisory committee would be hired by the CBRC chairman, mainly from the ranks of people with supervisory roles in internationally-renowned banks.

Significant Developments in Securities

On July 11, 2002, the China Securities Regulatory Commission (CSRC) issued detailed regulations on fund management joint ventures (JVs).

It said that foreign institutions could be the biggest shareholders in fund management companies, through negotiating with its domestic partners. China allows foreign companies to take up to 33 percent of the stake in fund management JVs and 49 per cent will be allowed in three years.

China unveiled new rules on acquisition of controlling stakes in domestically listed companies on October 8, 2002, laying the legal groundwork for the acceleration of mergers and acquisitions. Investors will be able to buy controlling stakes in listed firms through the markets or by agreements with the firms and their shareholders.

Holdings of 30 percent or more are considered controlling stakes under the rules, which take effect on December 1, 2002.

On December 1, 2002, China officially issued and enforced regulations on the administration of securities investments by QFIIs in early November. According to the new regulations, foreign investors should use securities companies inside China in securities trading.

China-European International Securities Co. Ltd. was formally approved by CSRC on December 19, 2002. It is the first joint venture securities corporation after China's WTO membership.

With the approval of the CSRC, a Sino-Dutch mutual fund joint venture has been established in Shenzhen City, Guangdong Province. It is the first Sino-foreign mutual fund joint venture set up since China's WTO accession in 2001. The joint venture is operated by China Merchants Securities, ING of the Netherlands, China Electric Financial Affairs Co., Ltd., China Huaneng Financial Affairs Co., Ltd. and COSCO Financial Affairs, Ltd.

China may allow qualified foreign institutional investors (QFII) to buy into domestic initial public offerings (IPOs) in addition to trading yuan-denominated A shares.

Three foreign banks and five domestic banks have been granted licenses as custodial banks for QFII. Citibank, HSBC and Standard Chartered Bank PLC can now offer custodial services to investors admitted into domestic markets. The five Chinese banks are the Industrial and Commercial Bank of China, the Bank of China, the Agricultural Bank of China, the China Construction Bank and the Bank of Communications.

China has taken its historic first step to practically open up its securities market to foreign companies.

On May 26, 2003 in Beijing, UBS Warburg and Nomura Securities became the first two financial service companies to get a QFII license.

Significant Developments in Insurance

A Chinese and a British insurance company have been given the go-ahead to set up China's largest life insurance joint venture in the northern port city of Tianjin.

Heng An Life Insurance Company of China and Standard Life Assurance Company of Britain received the approval on November 1, 2002.

Significant Developments in Other Financial Sectors

The Shanghai Futures Exchange (SFE) has applied to the China Securities Regulatory Commission to open a stock index futures market. Besides stock index futures, the exchange is considering other derivatives, such as interest futures and foreign exchange rates futures.

On December 5, 2002, China International Trust and Investment Corporation (CITIC) Holdings, China's first state-owned financial holding company, was established in Beijing.

CITIC Holdings is solely funded by the CITIC Group and is responsible for managing the group's financial business at home and abroad.

Other Developments

The People's Bank of China (PBC) on June 28, 2003 issued regulations on seizure and verification of counterfeit currency, effective July 1, 2003.

The rules stipulate the currency holders' rights and obligations and require the staff of the financial institutions to avoid wrongful seizure or verification which might bring losses to the currency holders. The rules cover RMB and foreign currencies.

CZECH REPUBLIC

Following harmonization acts adjusting central and commercial banking legislation to the EC Directives, which were adopted and set in force in the first half of 2002, the activities in the latter half of 2002 and during 2003 have focused on the regulation of the capital market.

The implementation of the harmonization amendment to the Law on Banks (in force from May 1, 2002) established a higher standard and wider scope of compensation to clients of insolvent banks from the deposit protection fund. Financial intermediaries, primarily banks, adjusted the credit transfer regime to the requirements of the Credit Transfers, Electronic Payment Instruments and Payment Systems Act and a so-called Financial Arbiter, authorized to resolve the complaints and disputes of clients, related to credit transfers up to an equivalent of 50,000 euros, began to operate (all starting from January 1, 2003).

The banking terrain itself underwent no significant change. Thirty-five banks (including subsidiaries and branches of foreign banks) are domiciled, licensed and operating in the Czech Republic as of mid-year 2003. Four banks disappeared from the market in the course of 2002-2003, two of them by amalgamations or mergers, another two entered a winding-up process following their insolvency. The privatization of the banking sector has been fully accomplished. A major position in the bank sector belongs to foreign banks and foreign owners have majority in the ownership structures of most banks.

Legislative developments during the period under review involved primarily the following:

- modernization of the capital market laws, including also further adjustment to the respective EC Directives;
- preparatory steps to the Basel II implementation; and
- strengthening and expanding anti-money laundering laws.

Several draft bills or amendments to existing laws are at various stages of their way to adoption. This refers in the first place to a package of laws on capital markets and investment. Draft Bill on Capital Market Undertakings is of dominant importance. The government bill has been practically finished, but for several controversies, relating primarily to the mandate and regulatory powers of the Securities Commission, has not yet been submitted to the Parliament. The

Capital Market Undertakings Act should replace the current Stock Exchange Act and the Securities Act (particularly in its public-law provisions; other provisions, relating to private law, are to be included into a re-codified Civil Code). The Draft Bill on Capital Market Undertakings contains enumeration and definitions of the investment services (in accordance with the respective EC Directive), determines the requirements of the investment services providers, regulates public bidding of investment instruments and acceptance of investment instruments to public markets, specifies the responsibilities of issuers, and includes investor protection provisions. It also defines terms and conditions for providing investment services by foreign subjects on the territory of the Czech Republic. Some problems, however, the draft failed to resolve, namely the issue of double supervision (by the central bank and by the securities commission) over banks that provide investment services, the regulation of investment consultancy and the problem of investment accounts in the name of a person different from the owner in the securities registry.

A part of the package of new and amended laws on capital markets and investment is formed also by a new Collective Investment Act, replacing the current Investment Companies and Investment Funds Act.

Private law aspects relating to securities should, after a temporary period, be transferred to a new civil law codification. The whole package of laws, which should also establish full compatibility with the respective EC Directives (regulating public listing of securities, securities prospectuses, insider trading, capital adequacy of investment companies and credit institutions, investment services in securities, investors protection and compensation programs, irrevocability of settlement in credit transfer and securities settlement systems, and the approach to activity of investment institutions) is expected to enter into force from January 1, 2004.

An amendment to the Law on Some Measures Against Proceeds from Criminal Activities etc. - to be in force shortly - considerably expands the scope of sanctioned activities in the direction of handling the financial means, used for or suspect to be involved in support of terrorism and also extends the scope of persons, who have specific responsibilities in this respect (i.e. by notaries, barristers etc.).

The draft Bill on Limitation of Cash Payments was repeatedly submitted by the Government, but the adoption by the Parliament was postponed primarily for the disputed limit for these payments. The adoption of the bill with a limit of 500,000 CZK (equivalent to approximately 16,000 euros) for a cash payment now seems likely.

Basel II

Preparations for the implementation of Basel II are well underway. The approach is to incorporate fully CAD 3 requirements into the legal framework of the Czech Republic (which would be a full member of the European Union at the time of the expected entry of Basel II regime into force). Consequently, no banking institutions will be exempt from Basel II and permitted to remain subject to Basel I. The Czech Republic is going to assume some major responsibilities under Pillar II of the new capital accord with regard to its host country supervision of branches of non-domestic banks, namely in regard to the liquidity of branches of non-domestic banks, money-laundering prevention in branches of non-domestic banks, and surveillance of statistical data reporting (particularly in the foreign currency sphere).

An active debate is underway among commercial banks, the central bank and ministry of finance concerning the introduction of some sort of "umbrella law on financial sphere", including - inter alia - an integrated supervision over banks, capital market and possibly other significant segments of the financial market. A formal reference, supporting this concept, is in the Activities Program of the Government, with a deadline for a preliminary draft set at the end of 2003.

DENMARK

Joint Act on Financial Undertakings

In June 2003 the Parliament (Folketinget) adopted a new Act on Financial Undertakings, tabled in the Folketinget by the Minister of Economic and Business Affairs in March 2003. The Act will take effect on January 1, 2004.

The Act is a unified Act compiling the specific provisions from various ad hoc financial legislation and includes commercial banks, savings banks, cooperative banks, mortgage credit banks, insurance undertakings, investments services companies and UCITS-managements companies (financial services companies). In terms of these undertakings the Act contains both common provisions applying to all the undertakings and specific sector provisions in separate parts of the Act. The Act also contains in separate parts of the Act the legislation concerning issuers of electronic money and some specific Danish savings institutions. Altogether, the Act consists of more than 440 articles.

The aim of the joint Act is to ensure uniform treatment – level playing field – of financial groups and to make various simplifications possible. The Act is also a complement to the Danish single Supervisory Authority of Financial Affairs.

The Danish Bankers' Association views the structural reform very positively and finds that the joint Act will facilitate knowledge of the law and ease the administrative burdens for the financial institutions. The Act can also be regarded as a legal consequence of the growing integration of the financial markets, including the establishment of financial conglomerates and the ongoing diversification.

The Act does not imply major changes in the traditional characteristics of banks etc. In order to emphasize the specific characteristic of the Danish mortgage lending based on the principle of balance the joint Act is supplemented by a specific Act on mortgage credit lending and mortgage bonds.

The structural reform dates back to 2001 and the recommendations from the Committee on the Financial Sector after the Year 2000. The above Act is the second and for the time being last step in the reform, but it will shortly be followed up by further initiatives. One of the first initiatives will be a review of the structures between UCITS-management companies and the depositary company/bank.

Payment Cards - The Danish Act on Certain Payment Instruments

In June 2003 the Parliament adopted a Bill amending the Danish Act on Certain Payment Instruments concerning collection of fees from retailers receiving card payments. The Act will take effect on January 1, 2005.

Up till then, Article 14 prevents settling agents from charging a service fee from the payees when settling a payment by national payment cards. An exemption from the rule allows settling agents to charge a service fee of 0.75 % of the amount on international payment cards issued in Denmark, while there is no price regulation on the service fee charged for settling payments with international payments cards issued abroad.

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 Danish Bankers' Association has argued to the Danish authorities that Article 14 is preventing a well functioning market as the banks have no incitement to develop the national payment cards and because new settlement agents and foreign banks have no inducement to enter the market.

After a long debate a compromise concerning the issue has been established amongst the politicians.

However, Article 14 has not been repealed according to the wishes of the Danish Bankers' Association.

Consequently a new Article 14 has been adopted. The new Article 14 states:

- The maximum fee of a payment transaction with a payment card issued with a chip is 0.50 DKK pr.

- No fee can be charged for payment cards issued with magnetic stripe and without a chip

- All shops are entitled to 5.000 payment-transactions pr. year free of charge.

The above-mentioned article will cover the situation until January 1, 2010, where the maximum fee of 0.50 DKK no longer will apply. However, the 5.000 payment-transactions free of charge will still apply.

The exemption from the rules allowing settling agents to charge a service fee of 0.75% of the amount will be maintained for international credit cards. When it comes to international debit cards the fee is limited to 0.4% of the amount, though not exceeding 4.00 DKK.

Capital Markets

In the area of capital markets, there have only been a few changes in regulation during the period under review. The most significant came in January 2003 when the Ministry of Economic and Business Affairs adopted changes in the Regulation of Good Practices for Securities Trading (Best Execution). The changes provides for more information to be given customers in relation to the execution of orders and that there shall be an agreement about the execution method. The new rules took effect on July 1, 2003. The rules apply for trades in stocks up to the amount of DKK 1 million and for trades in fixed income instruments up to DKK 3 million.

During the last year there has been ongoing work to establish an electronic trading platform for Danish government bonds. Trading and market making in the Danish wholesale market for government bonds are still taking place in a telephone market where most other mature markets use electronic systems. Implementation of the new system is expected in by the end of this year.

Implementation of Basel II

As a Member State of the European Union, Denmark will implement the new Basel capital adequacy requirements through the coming EU Directive on this issue. The EU Directive will apply to all credit institutions and investment firms.

Within the EU framework it is expected that the advanced IRB approach will be available for the more sophisticated banks (2-3 banks) and the mid-sized and small banks (approximately 160 banks and savings banks) will use the standardized approach, which is more or less equivalent to the existing credit risk framework in Basel I.

The Danish Financial Supervisory Authority is not expected to assume any responsibilities under Pillar II with regard to its host country supervision of branches of non-EU banks. Branches of EU-banks are subject to home country supervision.

The Danish Financial Supervisory Authorities, who also have the power of issuing new regulations regarding accounting, has published plans about new accounting regulations based on the principles of IFRS/IAS.

The future regulations on accounting are expected to be based on and not in contradiction with the recommendations in IAS, but certain options will be prohibited.

Not all of the accounting principles in the Act on Financial Undertakings (i.e. fair value of loans) are in force at present, but they are supposed to be enacted by the authorities according to the development in international accounting practices.

EGYPT

Still recovering from the impact of September 11th, the Egyptian economy was further affected by instability and tension in the region the aftermath of the war in Iraq. The most hard-hit sectors were tourism, transportation and foreign trade. Egypt's foreign exchange receipts have been significantly affected, leading to instability in the foreign exchange market.

Following are the salient economic developments and decisions that characterized the period under review.

The Egyptian pound's exchange rate was liberalized as of January 29, 2003 to halt FX speculations. The central rate for the US Dollar was been abolished and banks were permitted to determine sale and purchase rates daily in accordance with market conditions.

Pursuant to a decision by the Prime Minister, public and private companies are obliged to sell 75% of their foreign currency revenues to banks within a week from the date of receiving such revenues. The decision also requires depositing the remaining 25% in national banks' accounts in order to help such companies meet their commitments to banks and fulfill their foreign currency requirements. Moreover, the state adopted a strict plan to control expenditures in foreign currencies.

The Central Bank of Egypt (CBE) adopted a package of procedures to encourage banks to lower their debit and credit interest rates during the period under review. However, this policy was temporarily shelved following the FX liberalization, which called for keeping high interest rates to enhance L.E. savings and confront the dollarization process.

As for the banking sector, the government submitted a new draft law on the central bank and banking system to the people's Assembly. The law bolsters the Central bank's independence and supervision as well as its role in serving the national economy in an effective manner. New income tax and anti-monopoly legislation is also expected to be introduced.

In addition, a program to modernize and develop public sector banks was launched with the aim of raising capital, expanding retail banking services, speeding up the processing of credit applications, and implementing a program to settle bad debts.

The CBE's Money Laundering Unit, formed by virtue of the Presidential Decree No. 164/2002 started its operations.

The completion of the banks' IT setup its underway with emphasis on the security of electronic systems.

Operating banks were committed to raise their capital adequacy ratios from 8% to 10% by the end of March 2003, in line with the international Basel standards

The CBE and the Ministry of Finance agreed to increase the capital of the six commercial and specialized public banks by 4 billion L.E.

A CBE center was created to provide information on credit card holders and retail customers to help banks make credit decisions.

The CBE has excluded treasury bill balances due within fifteen days from the cash reserve ratio deposited by banks at the CBE and amended the calculation method of this ratio. Seeking discipline in the banking sector, the CBE has set new measures to limit credit to borrowers with joint accounts, such as family businesses. In addition, it has reduced the lending and discount rate with the aim of encouraging investment and enabling banks to reduce the costs of lending in order to boost the national economy.

The period under review also witnessed a 9.4% increase in the total financial position of the Egyptian banking system to L.E 518.60 billion. Owners' equity increased by about 7.7% to L.E 25.25 billion. Banking system investments in securities increased by 34.7% to L.E 102.80 billion. Loans rose by 3.8% to L.E. 267.5 billion. Deposits increased 12.5% to L.E.357.16 billion.

There has also been an increased interest in electronic banking, including Internet banking, with new regulations applied to ensure the safety of these operations for the public. A draft "electronic signature" law was prepared for issuance soon.

Egyptian banks have made structural reforms and enhanced the standard of their performance by applying modern banking industry concepts.

In other developments during the period under review, a new real estate finance law went into effect. The law aims to develop the real estate market and treat real estate portfolio distortions. A draft law also has been prepared to facilitate the mortgage and assets registration process.

The Prime Minister adopted an initiative to solve the bad debts crisis in the banking system, including the rescheduling of such debts.

The most important change in the stock exchange during the period under review was the addition of a new chapter to the executive regulation of the Capital Market Law that introduces for the first time in Egypt the buying of securities on margin. In addition, a new dispute resolution system was approved. As a result of these developments, the Association of International Stock Exchanges approved the membership of Egypt as an acting member, making Egypt the first Arab country to join the Association.

EUROPEAN UNION

Review of the Basel Capital Accord

The European Banking Federation (FBE) has supported the general framework and evolutionary structure of the proposed New Basel Capital 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 Basel Committee issued its third consultative paper on April 29, 2003 and released the results of the third quantitative impact study (QIS 3) on May 5, 2003. The European Commission has issued a consultation document setting out proposals for the implementation of the New Accord in the European Union, following a dialogue with the industry on the basis of a working document issued in November 2002.

The FBE has called for the EU capital adequacy framework to: apply to all credit institutions and investment firms; be based on the principle that activities which carry the same risks must be treated in the same way; be proportionate and practical in terms of application to the financial sector; and generate pressure to safeguard the Single Market by limiting the scope and reducing the number of national discretions. The FBE also attaches a high priority to developing a framework that is able to evolve to reflect market developments.

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 in September 2002. The procedure has now been finalized, the official legal text has been published. Transposition in the Member States is currently awaited

The Lamfalussy Process

In October 2002, the "Inter-Institutional Monitoring Group" for securities markets met for the first time. Composed of six independent experts, two nominated by each of the EU institutions, the Group is tasked with reviewing the progress of the implementation of the Lamfalussy process and reporting on results, including possible suggestions for improvements, twice a year. The FBE participated in an informal consultation organized by the Group in February 2003: the first report of the Group, published in May 2003, covered to a great extent the issues raised by the FBE in its feedback, such as the need to provide sufficient time for Commission and Committee of European Securities Regulators (CESR) consultations, and the need to ensure that work by CESR does not prejudice the outcome of a co-decision framework directive still in process. As the FBE argued, the report also highlighted that the priority should be the quality of legislation, rather than its timing, if a truly functioning single market is to be established.

Investment Services Directive

The FBE finalized its position paper in response to the Commission's consultation on the Investment Services Directive in June 2002. The paper, supported in full by 16 members of the FBE, argued in favor of a regime for in-house matching that would constitute the best of execution and post-trade reporting obligations.

The Commission finalized its draft proposal for a revised Investment Services Directive in September 2002 and sent it to Member States. The final proposal was adopted on November 19, 2002.

The formal proposal imposes mandatory limit order and quote disclosure obligations on broker-dealers. Throughout 2002 and spring 2003, the FBE continued to argue that a better way of protecting the investors would be through a vigorous enforcement of best execution rule and post-trade reporting.

The Parliament held a hearing of experts in February 2002, to which the Chairman of the Financial Markets Committee of the FBE, Wim Mijs, was invited as a speaker. The First Reading at the Parliament is expected to be concluded in July 2003.

Finally, in 2002, CESR adopted two papers that are linked to the ISD regime. In July, CESR adopted the "Standards for Alternative Trading Systems" which will govern alternative trading systems on a non-binding basis (as a CESR recommendation) until the ISD comes into effect. In April, CESR adopted a retail regime of investor protection rules, to be adopted by all CESR members on the same non-binding basis, which will govern how investment firms and banks providing cross-border investment services should act towards their clients. This paper was complemented in July by a CESR paper on investor protection rules for professional investors and the regime for entities classified as counterparties. In the spring of 2003, CESR started planning its future work for the Level 2 measures on these subjects under the ISD, although formal work will not start until the end of the First Reading at the Parliament.

Directive on Market Abuse

At the end of September 2002, CESR concluded its first consultation on the provisional mandate for advice on the implementation measures to be adopted by the Commission as part of the Market Abuse Directive. The FBE Financial Markets Committee submitted a detailed response. An FBE delegation also participated in the September 6th hearing in London; the FBE emphasized the importance of a proper consultation being conducted by CESR and by the Commission as the Directive is adopted and during the period in which the provisional mandate for implementing measures becomes a formal mandate. CESR adopted its final advice in December, after holding a consultation hearing in late November. After consulting the European Securities Committee (ESC), the Commission transformed the provisional mandate into a formal mandate in December 2002.

The Second Reading at the Parliament, which started formally in September, was concluded in November, with the October 21-24 plenary vote on the amendments on of the Directive. Among the amendments proposed, one aimed at banning front-running; the FBE and several other associations opposed it, but it was upheld. The Member States adopted the Parliament's amendments on December 3rd, thus formally adopting the first Lamfalussy Directive.

Responding favorably to a unanimous demand for consultation from the FBE and other associations, the Commission organized a consultation on the draft legal text of the implementing measures, based on CESR advice, in March 2003. The FBE and several of its members submitted comments on these drafts. The revised draft measures will be submitted to the ESC by June 2003.

At the end of April 2003, CESR started a new consultation on the remaining subjects to be covered in the second group of implementing measures, including accepted market practices that will form the legal defense against market manipulation charges, insiders' lists, and the duty to notify suspicious activity. The FBE will submit comments for the consultation that will close in mid-June.

Proposal for a Directive on Prospectuses

The FBE, together with nine other associations under the umbrella of the "Inter-Associations Meeting" (IAM), met in July 2002, in Brussels, to discuss the contemplated modified Prospectus Directive; the members of the IAM sent a joint letter to Commissioner Bolkestein to demand a formal consultation with all interested parties before adopting the modified draft. The Commission submitted its modified Prospectus Directive proposal in early August 2002. The new draft, while much improved in several aspects, offered an inadequate solution on the choice of competent authority by proposing to choose only those non-equity issuers above a minimum threshold of 50,000 euros (thus cutting out all warrants which have denomination, all convertible bonds which are counted as equity, and 2/3 of the bond market which have lower denominations).

In the European Parliament, the Economic and Monetary Affairs Committee (EMAC) held an "experts panel hearing" on the Directive on October 2nd, during which several members of the FBE Prospectus Working Group were present.

A political agreement among the Member States was reached in the November ECOFIN Council. Prior to the ECOFIN meeting, the FBE, together with 13 other associations, wrote a letter to all Ministers of Finance to urge the Member States to support a workable compromise on this key remaining issue, yet to be resolved, and the choice of competent authority, by giving choice to at least all non-equity issuers, without any minimum denomination restriction. Partly in response to this call, the political agreement reduced the minimum threshold to 5,000 euro. The Second Reading at the Parliament started in March 2003 and will last until July 2003. The FBE and its partners will continue urging a better proposal on the choice of competent authority that will give at least all non-equity issuers choice.

On the implementing measures for the Directive, CESR published a consultation document in October 2002 and an addendum in December. The FBE was present in both public hearings organized by the CESR Working Party, and has urged the Commission to consider changing the deadline for the technical advice, which was March 2003, so that the results of the Second Reading at the Parliament could also be taken into account. The Commission agreed to this change and the deadline was postponed to July 2003.

Euribor and Eonia

Euribor and Eonia have become firmly established as the benchmarks for the euro-denominated interbank market. The panel of contributing banks consists of 49 banks. Historic Euribor data has been posted on the Euribor website to help users and academics.

Eurepo

Since its launch in March 2002, Eurepo has established itself as the representative benchmark for secured money market transactions in the Euro zone.

Market participants are increasingly using Eurepo as the volatility of the spread between secured and unsecured funding increases.

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 contributes 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 further benefits from a large integrated market with a single currency, a solid Code of Conduct setting out strict rules for the panel banks and an independent Steering Committee of market experts that oversees the application of the Code of Conduct and monitors market developments.

Further details can be found on www.eurepo.org

Retail Cross-Border Payment in Euro

Regulation 2560/2001 of 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 entered into force for card based payments on July 1, 2002. It will enter into force for credit transfers on July 1, 2003.

- The maximum amount of the payments falling under the Regulation is 12,500 euros. Starting January 1, 2006, the maximum amount will be raised to 50,000 euros.

- Paper checks are excluded from the scope of the Regulation, at least concerning 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 straight-through processing (STP) information (IBAN+BIC), additional charges may be levied on him by the institution.

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

In reaction to the above-mentioned Resolution, the European Banking Industry stepped up its cooperation and decided to take a proactive role in the creation of SEPA.

The EPC was set up in June 2002 as the banking industry's main body for payment issues in the EU. It is the result of the whole banking industry (small and large banks) joining forces with the 3 European Credit Sector Associations (ECSAs). The mission of the EPC is to build a true, market driven, single euro payments area ("SEPA"). A roadmap with deliverables extended over several years has been established and agreed.

First Results and Successes

In its initial nine months of existence, the EPC has met three times in plenary session and has set up five Working Groups covering five broad areas: cards, cash, clearing infrastructure, STP and business & customer requirements.

After a somewhat difficult set up, it can now be considered that the EPC has established its credentials and proven its usefulness through a series of initial achievements and successes. The increased cooperation between the three ECSAs has certainly been an essential factor in this successful start.

The first concrete outcome has been:

-Agreement on the **"Credeuro" convention** by which banks undertake to process cross-border credit transfers in euro below 12,500 euros within three days. This convention is voluntary. The EPC will heavily promote its wide acceptance.

-Agreement on the Interbank Charging Practices-ICP" convention.
This convention is based on two main principles to be adopted as from July 1, 2003 for payments in euro falling under Regulation 2560: "Shared" will be the standard charging option and the benededuct principle will be outlawed (intermediary banks deducting their charges from the principal amount).

-Work started on a pan-European direct debit scheme allowing customers to pay their bills all over Europe by allowing the debiting of their account in favor of the creditors, located in their country or in other member states.

-Agreement to set-up a pan-European automated clearing house ("PE-ACH) to handle first cross-border and second "domestic" payments in euro. This PE-ACH will be open to all banks in the EU (small & large). The STEP 2 retail payment clearing system launched by the Euro Banking Association(EBA) in April of this year has become the first service provider for the PE-ACH.

Integration of the European Payments Clearing Infrastructure

The decision of the EPC to establish a pan-European ACH progressively integrating the existing "domestic" infrastructures is to be viewed with a parallel move from the Governing Council of the European System of Central Banks to launch the TARGET2 project. TARGET2 will be the second generation of the TARGET system and according to unofficial information received, will be a much more centralized system, with almost all national central banks sharing the use of a single platform.

New Legal Framework for payments in the internal market.

The European Commission has announced that it will issue during the second part of this year a proposal to create a coherent legal framework for payments in the internal market. The FBE has stated that the new legal framework being considered by the Commission for payments in the EU should limit itself to removing, where appropriate, any legal or regulatory barrier to the establishment of the Single European Payment Area.

- 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 "polluter pays" principle is at the basis 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.

Upon 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 concerns for banks relate to lender liability-legal certainty and mandatory financial security. 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.

By the same token, the imposition of compulsory financial security must be avoided as it can result in limiting the range of available security schemes only to nominal ones, solely for the sake of complying with the legal requirements and totally ignoring the actual quality of the coverage provided. This is why banks would favor the encouragement of meaningful and appropriate forms of financial security while taking into consideration objective criteria such as the "polluter pays" principle, covered activities, availability of insurance and reasonableness of cost.

The Commission's definition of the key concept of "operator" as "any person who directs the operation of an activity covered by the Directive including the holder of a permit or authorization for such an activity and/or the person registering or notifying such an activity" is welcome, as a positive step to ensure legal certainty. The same can be said about the Commission's negative approach towards mandatory financial security.

However, despite the balanced proposal of the Commission and the report of the competent Parliamentary Committee, the situation was totally reversed in the May plenary vote, where amendments proposed by Socialist and Green MEPS passed, albeit in a close vote. The definition of the operator now includes: **"**any *natural, legal, private or public person,* who directs *or controls* the operation of an activity covered by this Directive, *or to whom decisive economic power over the technical operation of such an activity has been transferred under national law …" as well as persons "effectively in control of the operator".* A strict regime of mandatory financial security is also envisaged in the European Parliament's amendments to the proposal.

Subsequently it is up to the European Commission and Council to accept, substantially amend or replace the European Parliament text. The Greek Presidency insists on ending with the adoption of this directive. The Environment Council is supposed to reach a compromise before the end of the Presidency.

The FBE, together with other credit sector associations will contact once more the Commission and Council, urging it to reinsert its definition of operator and of the non-mandatory insurance regime.

Revision of the FATF 40 Recommendations

The FBE contributed actively in the revision process of the Financial Action Task Force (FATF) 40 Recommendations.

Pursuant to the FBE, the following four principles should be taken into consideration in the revision of the 40 Recommendations (and any other anti-money laundering initiative):

- any anti-money laundering measure must be efficient and proportionate.
- anti-money laundering must tend towards greater harmonization in order to ensure a global level playing in the fight against money laundering.
- anti-money laundering arrangements must not duplicate with existing rules issued by another institutions.

The FBE made the following three step proposal concerning the risk-based approach:

- basic requirements for low-risk banking
- more elaborate requirements for complex business relationships with high amounts of money involved
- more specific requirements for specific and higher risks such as PEPS and correspondent banks.

The new Recommendations were approved at the Plenary Meeting of the FATF in Berlin on June 16-18, 2003.

Competition

The Council of Ministers– as instructed by the Barcelona European Council of March 2002, formally adopted on December 16, 2002 the much expected Council Regulation on the implementation of the rules on competition laid down in Articles 81 (prohibited agreements, decisions and concerted practices) and 82 (abuse of dominant position) of the Treaty.

This new instrument, which will apply from May 1, 2004, is meant to replace Regulation 17 and its *centralized* procedure and demands no previous decision in order for a practice, decision or concerted practice of art. 81 (EC) and for an abuse of dominant position of art. 82 (EC) to be prohibited (art. 1). The FBE had expressed reservations on this switchover from a notification system to a directly applicable exception system, stating that the transition to a directly applicable exception system will entail considerable legal uncertainty, particularly in cases where investments are to be made on the basis of an agreement possibly at stake.

The new Regulation dictates, for cases falling into the field of application of both the national and the community legal order, the cumulative application of national and community competition legislation, taking into account the primacy of EC law (art. 3); while allocating the power to apply arts. 81 and 82 (EC) to national competition authorities and member states (arts.

5-6), in close cooperation (art. 11); The FBE supported close cooperation with national competition authorities, but stated that a scheme of exchange of information and evidence must also be workable, since difficulties will certainly occur in making the co-operation possible and preserving the confidentiality of business secrets.

The Commission now has the obligation to consult the Advisory Committee on Restrictive Practices and Dominant Positions prior to taking decisions regarding finding and termination of infringements, interim measures and commitments, findings of inapplicability and withdrawals in individual cases (art 14). The Commission shall also cooperate with national Courts for the coherent application of arts. 81 and 82 (EC) (art. 15). The FBE asked for an affirmation of the principle of independence of Courts and opposed the excessive intrusion of the Commission in national judicial proceedings.

Most importantly, the Regulation confers upon the Commission powers of investigation (art. 17), of request for information (art. 18), of taking statements (art. 19), of inspection of premises (arts. 20, 21), of imposing fines up to 10% of the total turnover in the preceding business year of the undertaking and association of undertakings (art. 23) and of imposing periodic penalty payments up to 5% of the average daily turnover in the preceding business year per day (art. 24). The FBE opposed the provision allowing the Commission to ask any representative or member of staff of the undertaking for information relating to the inquiry and to record the answers. The provision as it now stands (art. 21) makes premises, land and means of transport, including the homes of directors, managers and other members of staff of the undertakings and associations of undertakings concerned subject to inspection only if a reasonable suspicion exists that books or other records related to the business and to the subject-matter of the inspection, which may be relevant to prove a serious violation of Article 81 or Article 82 of the Treaty, are being kept there.

Directive on Financial Collateral Arrangements

The Proposal was formally adopted on June 6, 2002. After carrying out very active lobbying in order to have the Collateral Directive adopted, the FBE monitors the implementation procedure in EU Member States. One particular issue of concern still relates to the scope of the Directive and the non-exercise by Member States of the opt out given by art. 1 (3): 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.

In the near future, the Commission might revise article 9 of the Directive (private international law), if, upon consultation with the Member States, it is found that it needs to be brought in line with the Hague Convention "*on the Law Applicable to Certain Rights In Respect of Securities Held with an Intermediary*". The FBE has already addressed a preliminary letter to the competent Commission officials, stating the need for uniform, precise and predictable rules designating the applicable law in cases of cross-border collateral arrangements, as well as the need, in this conjuncture of events, for the transposition of the directive to continue unhindered.

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 offenses 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.

The second Directive was due to be implemented by the deadline of June 15, 2003 in the Member States. However, implementation is still being processed in several Member States.

A proposal of the Commission for a third Money Laundering Directive is expected by the end of the year.

Fight Against Financing of Terrorism

In the aftermath of September 11, 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 October 19, 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 organizations which are in circulation: the information concerning targeted persons and embargoed organizations should be as complete as possible.

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

The FBE, in co-operation with other European Credit Federations, has, under exceptional circumstances, proposed to the Commission to set up at their own expenses an EU consolidated electronic database of persons and organizations subject to financial sanctions under the condition that the Commission accepts to ensure the maintenance (i.e. regular update) of this database under its sole responsibility. Although the banks consider that it is the responsibility of the public authorities (the Commission in the present case) - and not of the private sector - this proposal is made as a positive additional contribution of banks to the fight against terrorism.

Such a database will enable banks to process data and block the assets of suspected terrorists and terrorist organizations much more swiftly and efficiently.

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, would 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.

In January 2003, the ECOFIN Council reached a political agreement that apparently paved the way towards the adoption of a Directive on the taxation of savings. In particular, the Council recognized as equivalent the measures proposed for agreement with Switzerland, i.e. a retention tax combined with information exchange in case of fraud and the like. In the meantime, Italy has impeded the Council from agreeing on the proposed Directive, due to disagreement on an Italian request on milk quotas. The Member States are now working on the Italian request, so that they can take a final decision on the Directive in June.

The FBE has no position on the milk quota issue. However, the FBE insists that most Member States will need at least 12 months to transpose the Directive into national law when a text is eventually adopted by the Council. In view of the deadlock related to the milk quotas, it is therefore very unlikely that all Member States will introduce the necessary legislation and guidance by January 1, 2004.

Notwithstanding this, we understand that, as suggested by the FBE, the Council is now working on a proposal which provides for a period of 12 months between the date by which the transposition of the Directive into domestic law must be completed and the actual implementation date. From the FBE viewpoint, the implementation date of the Directive should correspond to the beginning of a calendar year, which, in the light of the above, can only be 2005 at the very earliest, if not 2006.

The FBE is also very concerned that the provisions of the Directive including documentary requirements, i.e. specific information and procedures to establish the identity and the residence of customers, would be implemented for new customer relationships entered into as from January 1, 2004. The FBE strongly argues that all the provisions proceeding from the Directive, including the documentary provisions, should come into force on the same date.

Furthermore, the FBE is still very concerned about key practical issues and has urged the Member states and the Commission to take the necessary action. First, it will be vital for paying agents to receive detailed information about which documents are used in the different Member states to establish the identity of the customers (identity card, passport, etc) and whether or not a tax identification number is clearly shown on these documents. The FBE has also recently reiterated its request for a formal, recognized list of those collective investment vehicles qualifying as "residual entities", referred to in Article 4(2) of the proposed Directive, and has encouraged the Commission and the Member states to establish such a list. Finally, the FBE has urged the Commission and Member States to issue guidelines on the computation of interest.

Consumer Protection: from Green Paper to Directive

After two rounds of consultations, one ex ante impact assessment and a recent workshop, the Commission now plans to reform EU consumer protection "as quickly as possible" through a framework Directive containing a general clause defining a B2C commercial practice as unfair, a possibility set forth in the Green paper on EU Consumer Protection last year.

When the framework Directive is adopted, Member States will not be able to use the minimum clauses in other directives to impose additional requirements to the pre-empted field. However, according to the Commission this should only apply for B2C provisions. The proposed directive will apply only where there are no specific provisions regulating unfair commercial practices in sectoral legislation. Mutual recognition of laws relating to unfair commercial practices for any residual un-harmonized provisions is envisaged by the proposal.

The proposal's mechanisms shall determine whether a commercial practice is unfair, not whether it is fair. Traders must not generally meet with specific criteria to prove fairness. The proposal does not distinguish between pre- and after- sales practices. Products covered are also broadly defined and include financial services. An internal market clause permits traders from any EU member state to only comply with the national provisions, falling within the field approximated by this Directive, of the Member State in which they are established.

Commission Consultation of Social Partners on the Protection of Workers' Personal Data

Towards the end of 2002 the Commission launched the second stage of the consultation. The Community action envisaged was a sectoral Directive.

The Commission's main arguments are the specificity of the employment relationship, the fragmentation of the legal provisions in Member States and the ambiguous role of consent in the context of the employment contract. The specific sectors to which the legislative framework should extend, were, according to the Commission, medical data (including drug and alcohol testing), genetic testing data, trade union membership data and monitoring - surveillance of workers' e-mail, internet and telecommunications. The Commission favored an extensive involvement of workers' representatives when surveillance mechanisms were being set in place.

The Banking Committee for European Social Affairs strongly opposed a potential proposed directive on account of it being premature and on the legal grounds of subsidiarity. Although the Commission acknowledges that Directive 95/46/EC applies to workers, it has so far failed to produce any evidence indicating the inadequacy of the legislative framework in the context of data protection within the work place.

The compromise of non-binding legal instruments has been proposed to the Commission. Regulation of this sensitive issue may also be pursued by means of national collective agreements.

The reaction of the European Commission is expected within 2003: the approach would be apparently to wait for the Commission Report on the Review of the Data Protection Directive 95/46.

Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary

The text of the Convention has been adopted by the Nineteenth Diplomatic Session of the Hague Conference on December 13, 2002.

The FBE contributed positions on the issues presented in the Permanent Bureau Preliminary Documents.

The FBE advocated for the contractual approach to PRIMA (Place of Relevant Intermediary Approach). Other FBE interventions concerned simplifying the provisions relating to Multi-unit State and including practical examples and clarifications of specific terms in the explanatory notes.

An issue of major concern for the banking sector was article 20 of the draft on renegotiation of existing custody agreements. Taking the business approach, the FBE noted that massive renegotiation of agreements was practically impossible and that article 20 should be redrafted as to avoid it. Finally, the FBE opposed the insertion of a specific provision in order that the Convention ensure that the relevant intermediary be the same for all dispositions of securities.

The deposit of three instruments of ratification, acceptance, approval or accession is required for the Convention to enter into force.

Proposal for a Directive of the European Parliament and of the Council on takeover bids

The proposal was communicated to the Parliament and the Council on October 2, 2002, more than a year after the lapse of the previous one and shortly after the release of the High Level Group of Experts' report. Its provisions are largely similar to those of the lapsed proposal.

Innovations include definition of equitable price, greater transparency of defensive measures, greater degree of employee involvement and introduction of a breakthrough right, a squeeze-out right and a sell-out right.

Notably, in the Commission's proposal the breakthrough right (i.e. the right enabling a successful bidder who has acquired a substantial part of the risk bearing capital in a general bid for all the shares of the company to breakthrough any mechanisms which frustrate the exercise of proportionate control) does not extend to securities carrying double or multiple voting rights. The alleged reason is potential constitutional problems in Member States. The question of multiple voting rights is of extreme importance for Scandinavian countries, where granting of such rights is the norm. Complex negotiations in Council and Parliament are the main reason for the delay in the legislative procedure; it has been rumored that certain Member States use the delay of this proposal as a bargaining chip for other EU legislative initiatives, thought to be harmful for their interests.

The *Rapporteur* has equally deplored retention of double and multiple voting rights; the Greek presidency of the Council proposed compromise amendments early in 2003.

Parliament vote in plenary is still expected in 2003, but the exact date will largely depend on the results of the Council debate on May 2003.

At the FBE level, a Joint Working Group on Takeover Bids has been established by the Financial Markets and Legal Committees. Early on, it decided upon a general strategy and drafted an FBE Position Paper, which was circulated to the EU stakeholders. The FBE amendments argue for, among other things, the establishment of uniform exemptions from the requirement to launch a mandatory bid, of minimum and maximum percentages of voting rights triggering a mandatory bid, and for exclusion from the breakthrough rule of agreements between shareholders.

FINLAND

Developments in Finnish Financial Markets

The relatively positive performance of the Finnish economy during the period under review was largely based on consumer confidence and the resulting increase in private spending. Consequently, the unemployment rate continued to fall, although that is not expected to continue. Historically low interest rates have led to a steady growth in mortgage loans.

The new government has voiced intentions to alter tax deductibility of interest expenses of housing loans to favor more first-time buyers and families with children.

Due to the uncertainty in the stock market, money market funds were the most popular among institutional investors, but also among households. In the longer term, changes in household savings opportunities and investment behavior provide a foundation for growth in long term savings. Interest rates in the Finnish bond and money markets have been following the general euro rate development.

Market Structure Developments

At the end of 2002, a total of 344 deposit banks were operating in Finland. These included 11 commercial banks, 243 co-operative banks part of the OKOBANK Group, 42 local co-operatives, 40 savings banks and eight branch offices of foreign credit institution entitled to receive deposits.

Three new deposit banks were licensed in 2002 and work to establish a commercial bank, a savings bank with limited liability as well as a branch of a foreign bank (Den norske Bank) was in progress. The newly established banks are all small commercial banks, whose founding members have been active in the finance and insurance sector for some time.

The Finnish (HEX) and Swedish (OM) stock exchanges announced on May 20, 2003 that it plans to merge the companies in order to create an integrated Nordic and Baltic market for listing, trading, clearing, settlement and depository of securities (OM HEX). The operations of OM HEX will be divided into two divisions; HEX Integrated Markets, northern Europe's largest securities market, offering access to 80 percent of the Nordic equity market, and OM Technology, a provider of transaction technology to the world's financial and energy markets. HEX today owns and operates the exchanges and central securities depositories in Finland, Estonia and Latvia. OM is today a leading provider of transaction technology and owns and operates Stockholm stock exchange.

The Amendment of the Credit Institute Act

The Credit Institute Act was amended at the beginning of 2003. One important regulatory change was that companies were given the right to take funds from customers. The maximum limit is 3000 euros per customer. These so called customer accounts cannot, however, be used for payment transfers and they do not have deposit protection.

The new law also incorporates a provision regarding a customer's right to basic banking services, i.e. the right to open a current account and to acquire bank cards (domestic debit cards) and codes for internet banking. Following intervention by the Finnish Bankers' Association, the right to basic banking services was somewhat modified and made compatible with anti-money laundering objectives.

Basel II

The Finnish banks will be following Basel II. The scope of application of the new capital requirements will be defined in the EU banking directives (CAD 3). Consequently, Finland will have no national discretion in this area.

FRANCE

2002 marked the first year of the widespread implementation of the euro currency. It is important that this success does not mask the fact that difficulties persisted with regard to a number of European and specifically French issues that fall within the legal and regulatory frameworks of the banking sector.

2002 was a year of transition for the banking sector, both in France and across Europe, and one in which the French Banking Federation took a major step forward and set up a representative office in Brussels.

Antenna in Brussels

Opened in October 2002, the French Banking Federation now has a permanent office in Brussels which oversees the drafting of most of the banking and financial regulations applicable in France. A team of three collaborate closely with the FBF's experts in Paris in monitoring the development of European texts that are in the process of being drafted and in maintaining the necessary contacts with all players and participants therein.

European Projects

Among the many and varied issues covered by the FBF in 2002, particular attention was given to four key areas.

Draft Directive on Investment Services:

The FBF is in favor of free competition amongst the different trading systems in place across Europe (regulated markets, Multi-Trading Facilities (or MTF), internal processing of orders by investment companies (or internationalization)) where this competition is structured and transparent and acts as a genuine form of protection for investors and company finances alike.

As such, the FBF globally approves the provisions put forward by the Commission as regards equity trading and governing:

- pre-trade transparency rules;
- the client limit-order display rule where orders cannot be executed immediately by internationalization;
- the quote disclosure rule (by the investment company which guarantees the orders of its clients);
- the express approval of clients as to the way in which an investment company proposes to execute orders.

IAS/IFRS Standards

As of 2005, all listed companies in the European Union will be required to publish their consolidated accounts in line with the accounting standards laid down by the International Accounting Standards Board (IASB). This principle, approved by the European Parliament, features in the regulation adopted by the EU's Council of Finance Ministers in June 2002, the aim of which is to allow for the comparison of the consolidated accounts of companies listed in different countries and to facilitate the convergence of EU and US accounting standards.

While the FBF supports the notion of international accounting standards that afford greater transparency, it has nonetheless always disputed the proposed standard for the reporting of financial instruments (IAS 39) for two core reasons:

- the "fair value" principle, namely the notion of evaluating items at their market value in IAS 39 is not adapted to the scope of activities of commercial banks. Its application would inevitably result in a high degree of volatility as regards their equity and results without bearing any real relation to their economic reality,
- the process according to which the standards have been drawn up and validated is not transparent: firstly, because the IASB, as a private institution, is not subject to any outside controls and, secondly, because the bodies mandated by the European Commission to oversee the application of the standards (ARC and EFRAG) play too minor a role therein.

Talks are scheduled with the IASB where detailed proposals will be put forward to improve on draft standard IAS 39.

Basel II : Solvency Ratio

In November 2003, the Basel Committee is to publish its recommendations along with the so-called "McDonough" ratio scheduled to replace the Cooke ratio at the end of 2006. Implemented over ten years ago, the Cooke ratio is ill-adapted to the increasingly complex nature of banking activities and the progress made in terms of risk assessment. These new recommendations are for the most part to be integrated within a European directive which shall apply as of the same date to all credit institutions across Europe, the aim being to define a common regulatory framework for all banks, thereby affording them greater risk management and control.

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Throughout 2002, French banks have worked very hard to respect the calendar therein, devoting considerable investment, both human and equipment, to defining statistical series to enable them to accurately assess the implications of the three methods proposed by the Basel Committee for calculating capital adequacy ratios.

Draft Consumer Credit Directive

On September 11, 2002, the European Commission, without any prior consultation with the professionals concerned, adopted a draft consumer credit directive which, were it to be applied in its present form, would seriously hamper the development of this sector without for as much improving on the protection afforded to consumers. The draft directive is intended to update the 1987 directive whose regulatory framework bears little resemblance to today's credit industry.

The FBF, in collaboration with the sector's professional bodies both in France and across Europe, manifested its opposition to the new draft directive which, in its opinion, contains several provisions that either do not apply to or exceed the scope of credit establishments (joint and several liability of the creditor and supplier where the goods supplied are faulty, the principle of responsible lending which implies the liability of the lender, conditions for the use of personal data, etc.).

The discussions held over the course of 2002 (and which are likely to continue in 2003) did not result in an acceptable draft directive.

Problems Specific to France

Two major issues monopolized the banking sector headlines in France in 2002, namely the new provisions governing retail banking customer relations and safety in the cash transport sector.

Cash Transport Sector

Following a series of particularly violent attacks in 2000, the French government urgently pushed through a law imposing a number of extremely cumbersome requirements on banks in terms of security. Certain provisions governing the layout of branches proved impossible to implement given the short deadlines afforded (December 31, 2002), the cost of the works and the government's requirements therein. The closure of the cash services of those branches which did not comply with the provisions of the law on December 31, 2002 was seriously considered.

Following the FBF's intervention in this matter, the directive's deadline was pushed back a year (to the end of 2003) and talks were initiated with the French authorities on the issue of safety. The profession underlined the fact that a global approach to the problem was needed rather than focusing on the cash transport sector in the strict sense of the term. It emphasized the need to develop other solutions in order to limit the number, frequency and cost of cash transport operations and, in particular, to promote alternative means of transporting cash (electronic suitcases in unmarked cars) rather than further developing more traditional and dangerous forms of transportation (armoured vehicles and guards).

Retail Customer Relations

France is one of the last European countries to impose ombudsmen services within its banking sector. As such, each bank must now inform its clients that they may have recourse to an ombudsman in the event of a dispute. Ombudsmen can either be persons appointed by a bank (as is generally the case in most major retail banks) or recommended by a bank where customers do not wish or are unable to procure the services of a given ombudsman.

At the request of the French Ministry of Economy, Finances and Industry, the FBF has defined a charter governing deposit account agreements which reflects the results of a survey carried out amongst French banks and consumer associations. This charter binds both the banks and their clients in relations governed by contract, confidence and responsibility.

As a result, banks must formalize their contractual relations with customers by proposing "account agreements" that specify the day-to-day management of a deposit account (how an account may be opened, transferred or closed; the products and services on offer; the permitted methods of payment and overdraft limit; the ways in which incidents are processed and how they may be charged).

Furthermore, the banks undertake to specify the prices of the products and services listed in the agreement and to enable customers to close their accounts upon simple request and at no cost should they contest a substantial discrepancy in relation to the terms of the agreement. Finally, the banks also undertake to inform their customers of any changes in price three months prior to their application. Customers shall then have two months to contest the new prices in writing.

In the event of a dispute arising out of the application of the agreement, customers may freely call upon the services of the ombudsman that each bank places at their disposal. The contact details of each ombudsman shall be furnished on the new account agreement forms.

GERMANY

New legal provisions dealing with securities analyses, corporate governance, accounting, risk management and the fight against money laundering are strengthening the German financial marketplace. Further legislation is pending, particularly in the area of taxes. This is accompanied by other measures such as a "true sale" initiative for asset-backed securities, the introduction of a Central Counterparty on the stock exchange and an "Alliance for Electronic Signatures" to promote e-business and e-government. EU Commission decisions and court rulings and their translation into German law are gradually eroding the competitive privileges that Germany's public-sector banks enjoy.

New Developments in the Regulation of Securities Trading

Following the entry into force of the Fourth Financial Market Promotion Act on July 1, 2002, the Federal Financial Supervisory Authority (BaFin) has now further specified the provisions on securities analyses contained in this law. Investment services enterprises or enterprises associated with them are accordingly required to conduct securities analyses with the requisite degree of expertise, care and conscientiousness and to disclose potential conflicts of interest. Although this requirement does not apply to analysts themselves, this does not imply a regulatory loophole, as any conflicts of interest are already covered by various compliance rules.

The new provisions cover analyses of all kinds of securities; they are not restricted, as in various other countries, to stock analyses, nor are they confined to written or electronic analyses. The Financial Supervisory Authority's announcement of March 2003 stipulated that the term "securities analysis" also covers analyses presented by any other means (in the context of publications, for example). The analyzing enterprise is required to disclose, among other things, any participations it holds in the analyzed company (amounting to 1 % or more of share capital) or in a syndicate that has underwritten securities issued by the analyzed company during the preceding five years or manages the analyzed securities on the stock exchange or in the market on the basis of a contract concluded with the issuer. It is also required to disclose any net sales positions amounting to 1 % or more of the share capital of the analyzed company and whether its trading portfolio contains shares of the analysed company. Further conflicts of interest only have to be disclosed if organizational measures do not already ensure the required confidentiality vis-à-vis the securities analysis department (e.g. by setting up "Chinese walls").

The German government is planning a catalogue of legislative measures for the near future as part of a so-called "Financial Market Promotion Plan 2006". This plan comprises, among other things:

- an improved tax-law framework for ABS transactions (see next section);
- expanded rules on securities analyses;
- supervision of rating agencies; and
- implementation of the numerous directives currently under discussion at the European level.

Another part of the "Financial Market Promotion Plan 2006" consists of amendments to investment law. On July 8, 2003, the Federal Ministry of Finance presented a bill to translate the two European directives of February 2003 on undertakings for collective investment in transferable securities (UCITS) into German law. The bill would also integrate the rules for German investment companies and sale of foreign investment fund certificates; which up to now have been provided separately in the Investment Companies Act and the Foreign Investment Act, respectively. Apart from adapting to the new European rules mentioned, it is planned, among other things, to allow investment in hedge funds in Germany. According to the current draft, however, this would be made possible for private investors via investment in funds of funds only. In addition, the bill contains an Investment Tax Bill that would ensure equal tax treatment of domestic and foreign investment fund certificates. The bill is scheduled to enter into force by January 1, 2004.

"True Sale" Initiative for Asset-Backed Securities

The joint initiative launched in spring 2003 by big German private-sector and cooperative-sector banks and KfW (a German public-sector development bank) to set up a special-purpose vehicle (SPV) to securitize loans is designed to establish this market segment more firmly in the German financial marketplace. In Germany, loan securitization via true-sale operations (asset-backed securities, or ABS, transactions) is still underdeveloped compared with other countries.

It should also be stressed in this connection that how the rating agencies rate the ABS is determined by the composition of the loan portfolio backing each security. The rating of the owners of the new SPV does not play any role, on the other hand. Thus, the KfW's participation in the SPV would not distort competition.

The planned new SPV is also not a closed shop. The large German public-sector banks and a major foreign bank have in the meantime joined the initiative, while non-participating banks are also to be allowed to carry out true sale securitization transactions through it. For institutional investors, the ABS issued by the new SPV will compete with a variety of investment alternatives.

This project is of major importance for the German financial marketplace. The trade tax barriers that have so far prevented the establishment of such SPVs in Germany have been abolished in the meantime by a trade tax amendment approved by the German Parliament.

New Developments in Company Law and Accounting

A government commission adopted the German Corporate Governance Code on February 26, 2002. The code sets out the statutory German corporate governance rules already in place in a clear and transparent manner. It recommends additional standards for responsible corporate management. While companies are free to decide whether and, if so, to what extent they implement the code, they are required by the clause legitimizing the "recommendations" part of the code in the Corporate Transparency and Disclosure Act to report this ("comply or explain"). As first surveys have shown, the code's recommendations were already implemented in its first year to a large extent by the German blue chip (DAX-listed) companies. Their implementation of the "suggestions" part of the code, to which the legal requirement to comply or explain does not apply, is more difficult to overview at the moment. The Corporate Governance Code was revised slightly in November 2002. This was mainly to accommodate changes in the legal situation due, for example, to the entry into force of the Fourth Financial Market Promotion Act.

The government commission met in plenary session on May 21, 2003. The Commission's deliberations centered on the issue of appropriate and transparent executive compensation, which has also been the subject of lively public debate. Practice has shown that all the issues in the debate surrounding executive compensation are already dealt with generally in the Code. The Commission's primary aim was therefore to further clarify and firm up certain aspects with a view to eliminating the weaknesses revealed in implementation to date. Several points have been added to the relevant section of the Code:

- Recommendation "Individualized disclosure of management and supervisory board compensation": details of management and supervisory board compensation shall be published on an individualized basis with a breakdown into components.
- Recommendation "Cap for stock options": in the future, stock options and comparable schemes shall be related to relevant comparison parameters. The supervisory board shall agree a cap for extraordinary, unforeseen developments.
- Recommendation "Disclosure of value of stock options"
- Recommendation "Publication of compensation system on the internet": the salient points of the compensation system shall be published on the company's website in generally understandable form and detailed in the annual report. This shall include information on the value of stock options.
- Recommendation "Informing the annual general meeting about the compensation system": the chairman of the supervisory board shall outline the salient points of the compensation system and any changes thereto to the annual general meeting.

On February 25, 2003, the German government presented a "Catalog of measures to strengthen corporate integrity and investor protection", designed to give investors more rights and improve stock market transparency. This catalog of measures, which is based on the so-called "10-point Program" presented during the last legislative period, takes up, among other things, some of the proposals for changes in the law made by the German Government Commission on Corporate Governance as well as in the Sarbanes-Oxley Act of 2002 to reform the US corporate governance system. It is closely linked to the Financial Market Promotion Plan 2006 presented by the Finance Ministry on March 5, 2003, which aims to set out the regulatory framework for the

German financial marketplace and contains those parts of the catalogue of measures under the control of the Finance Ministry.

The main elements of the catalogue of measures are:

- Regarding personal liability of management board and supervisory board members vis-á-vis a company, shareholders' right of action are improved.
- Introducing personal liability of management board and supervisory board members for false capital market information circulated wilfully or through gross negligence; improving collective enforcement of investor claims.
- Improving the German Corporate Governance Code, particularly as regards the transparency of stock-based or incentive-based remuneration (stock options) of management board members.
- Improving accounting rules and aligning these with international accounting principles.
- Strengthening the role of auditors.
- Setting up an independent body to supervise the legality of specific company accounts (enforcement).
- Continuing the stock market reform and improving supervisory law.
- Improving investor protection in the so-called "grey" capital market.
- Ensuring the reliability of company valuations by financial analysts and rating agencies.
- Introducing tougher penalties for capital market offenses.

A key step in strengthening investor confidence is ensuring that company accounts are meaningful and reliable. German accounting law is therefore to be modernized, mainly by abolishing outdated accounting options and achieving further alignment with international accounting principles. In this context, there are plans to make the options given to EU member states under the European IAS regulation company options in Germany. This means that non-capital-market-oriented companies will also be given the chance to prepare their group accounts in accordance with the IAS. Where individual company accounts are concerned, IAS-based accounts may, for information purposes, be drawn up alongside the accounts required under the German Commercial Code.

The enforcement process is being discussed intensively at present in Germany. The preferred model appears to be a two-step approach, where, in a first step, a private and independent panel would examine the accuracy of annual accounts and, secondly, BaFin could sanction offenses or institute legal proceedings.

Another important element of the government's 10-Point Program concerns measures to strengthen the independence of auditors, mainly by introducing restrictions on certain audit-like advisory services they provide, toughening rules on their personal ties and financial dependence, broadening their liability and strengthening professional supervision. These measures are also being discussed at present.

New Bank Regulatory Developments

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 Authority (BaFin), which is overseen legally and professionally by the Federal Ministry of Finance. To maintain the joint banking supervision operated so successfully in the past in Germany, an agreement was signed between BaFin and Deutsche Bundesbank in November 2002 spelling out their co-operation in this field, based on an amendment to the German Banking Act.

At the end of 2002, the BaFin issued Minimum Requirements for the Lending Business of Credit Institutions ("*MaK*"). These further specify the organizational requirements for banks under Section 25a (1) of the German Banking Act and implement the Principles for the Management of Credit Risk published by the Basel Committee on Banking Supervision in September 2000. They spell out further minimum standards for the organizational structure of and processes used in the lending business, and the identification, management and monitoring of lending risks. Among other things, a clear functional and organizational separation of business operations and credit risk management is required.

New Stock Market Developments

In March 2003, Deutsche Börse AG introduced a Central Counterparty, which is designed to eliminate counterparty risk and settlement risk as far as possible. As the regional stock exchanges in Germany did not link up to the Central Counterparty, securities transactions are settled there in the traditional way.

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

Until recently, public-law institutions (Landesbanken and savings banks), by virtue of their legal status, could rely on unlimited state guarantees in the form of a business continuation obligation (Anstaltslast) and a statutory ultimate guarantee obligation (Gewährträgerhaftung) by the public body or bodies that created them (mainly the German Länder and municipalities).

Following a complaint lodged by the European Banking Federation with the European Commission concerning these state guarantees for German public-sector banks, an understanding was reached on July 17, 2001 between Brussels and Berlin to abolish *Gewährträgerhaftung* and replace *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. 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. At the end of 2002, the amendments to these laws required to implement the understanding had been made in all federal states.

Following the understanding on savings banks and Landesbanken, a similar agreement was reached between the European Commission and the German government 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. A law implementing this agreement in regard to federal public-sector development banks (“*Förderbankenneustrukturierungsgesetz*”) is currently being debated in parliament.

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. The German government, the state of North Rhine-Westphalia and WestLB appealed the Commission’s decision in the WestLB case. The European Court of First Instance announced its ruling on this case on March 6, 2003. In this ruling, it overturns the Commission’s decision because it finds that this decision is not sufficiently substantiated in two respects, while at the same time upholding the Commission’s fundamental position that the integration of the assets of the state housing agency WFA is unlawful state aid. The Commission has announced that it plans to review its decision quickly. At the same time, it has opened formal investigation proceedings in six similar cases concerning other public-sector banks.

Online Banking and Electronic Commerce

Thanks to the German direct banks, which are mainly subsidiaries of the big private banks, the private banks are the market leaders in this field, operating 40% of the 30 million online accounts.

At the end of 2002, the Association of German Banks, in collaboration with the research group Wahlen Telefonfeld GmbH, conducted a third representative survey of online banking and e-commerce in Germany to follow up on the mid-2001 survey. It revealed that every second German already has Internet access. At the beginning of 1999 – just four years ago – the figure was just over one in ten. 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 fallen slightly because of the difficult market environment. The number of German Internet shoppers has risen from 16 percent to 25 percent. The percentage of people using home banking facilities has remained stable, increasing slightly to 23 percent. Six percent of the population currently take advantage of online brokerage services. Here too, interest has waned somewhat on account of the difficult situation on the financial markets. An obstacle to an even wider use of online banking may be the perceived security risk, although 86 percent of Germans (mid-2001) 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. The customer always has to be 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 cooperation agreement aimed at making available to their customers bank signature cards and certificates which satisfy the requirements of the German Digital Signature Act. 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.

In April 2003, two big German private banks, Deutsche Bank and HypoVereinsbank, and the savings banks organization launched a so-called "Alliance for Electronic Signatures" together with representatives of the business sector and the Economics and Labor Ministry, the Ministry of the Interior and the Finance Ministry. The aim of this alliance is to allow e-business and e-government applications via a common infrastructure.

For users, this means they will have a clearer picture of the large number of individual signature applications and be able to use different applications with a single card. Together, the partners in the alliance aim to create the basis for cross-sectoral use of signature cards for a wide range of different applications in private and public life and thus provide a major boost to the electronic signatures market. They also plan to introduce technical standards for the applications and products used, plus multifunctional chip cards and uniform security requirements, by the end of 2005.

The Fight against Money Laundering and the Financing of Terrorism

Following the introduction in 2002 of some largely new provisions to combat money laundering and the financing of terrorism in four laws, the focus of attention in 2003 is on implementing the new provisions. Of great importance is the setting up of a Financial Intelligence Unit at the Federal Office of Criminal Investigation and implementing Special Recommendation VII (wire transfers) of the Financial Action Task Force on Money Laundering of October 31, 2001, Germany is among the countries that have implemented all of the FATF 40 Recommendations that called for action by legislators. Besides the launch of the FIU and implementation of SR VII, the introduction of automated access to account information stipulated in Section 24 c of the German Banking Act should be mentioned. This gives the Federal Financial Supervisory Authority direct electronic access to new bank files containing certain information on bank accounts and securities accounts and the persons holding these or authorised to draw on these, plus any different beneficial owners. A revised Financial Supervisory Authority announcement on measures by banks to combat and prevent money laundering is also due shortly.

At the European and global level, German banks are participating in the discussion on an update of the FATF recommendations and in the renewed amendment of the European Anti-Money Laundering Directive scheduled for autumn 2003.

Tax Developments

As of January 1, 2004, citizens who failed to meet their tax obligations in the past will be given the chance, for a limited period of time, to return to the path of tax honesty. Tax delinquents can obtain immunity from criminal prosecution or fines by furnishing a declaration and paying a lump sum. This declaration must specify the assets that were wrongly withheld from taxation (e.g. untaxed investment income and, as the case may be, untaxed investment capital). Under current plans, there will be a two-phase declaration period: where a declaration is furnished by the end of 2004, a tax rate of 25 % will be imposed on the assets declared, while anyone who furnishes a declaration between then and March 31, 2005 will have to pay 35 % tax.

The new legislation envisaged to regulate the taxation of interest income (the so-called "*Zinsabgeltungssteuergesetz*") has been postponed. It would tax interest income at a flat rate of 25 %, plus a "solidarity surcharge". Where interest is paid in Germany, this arrangement would effectively discharge the taxpayer's final tax liability. Citizens subject to a lower personal income tax rate are to be allowed to opt for applying this lower tax rate to interest income as well. Currently, consideration is being given to implementing a uniform overall concept for taxing private investment on the basis of such a final withholding tax that would cover not only interest but particularly also dividends and capital gains. The German banking industry strongly supports this new development.

Implementation of Basel II

As with Basel I, the EU intends to subject all credit institutions to the EU Capital Adequacy Directive that will implement Basel II, regardless of whether they are internationally active or not. The EU Directive will essentially implement all parts of Basel II. However, it might be that it will deviate from the Basel capital requirements in certain areas (e.g., partial use of advanced risk management techniques).

Host-Country Supervision of Foreign Bank Branches under Pillar II of Basel II

German branches of banks domiciled outside the European Economic Area are treated under German supervision like domestic banks. This principle will also be applied as regards Pillar II supervision.

HONG KONG

Deposit Protection Scheme

Hong Kong is in the process of introducing a scheme for the protection of deposits held at Hong Kong licensed banks to protect depositors from the effects of insolvency of banks. The salient features of the scheme are as follows:

(a) the scheme will be administered by a statutory body called the Hong Kong Deposit Protection Board which will carry out most of its functions through the Hong Kong Monetary Authority (HKMA), the regulator in respect of banks and deposit-taking institutions;

(b) all banks licensed in Hong Kong will be required to participate in the scheme but power will be granted to allow banks incorporated outside Hong Kong to be exempted from participation in the scheme if they can satisfy certain conditions, principally that their deposits in Hong Kong are protected by a scheme outside Hong Kong that offers at least the same level of protection;

(c) deposits are protected up to an aggregate figure of HK$100,000 for each depositor and for this purpose all deposits held directly or indirectly by depositors are aggregated;

(d) the scheme will be financed by a levy made on all scheme members based on the amount of their protected deposits so as to establish and maintain a fund at a particular target level. Compensation is payable to depositors of insolvent banks out of this fund;

(e) Contribution by each scheme member is based on a certain percentage of its protected deposits, which varies according to the regulatory rating of each scheme member;

(f) after payment by the fund, the fund is subrogated to the rights of the depositor against the insolvent bank to recover the amount which the fund has paid out to the depositor.

Money Laundering and Anti-Terrorism

The HKMA issued a Supplement to its Guideline on Prevention of Money Laundering on March 31, 2003. This Supplement primarily reflects the regulatory standards recommended by the Basel Committee and some of the changes proposed by the Financial Action Task Force's review of the Forty Recommendations. The Supplement also incorporates additional guidance on terrorist financing and the anti-terrorism legislation in Hong Kong.

Following the issuance of the Supplement, an industry forum (consisting of representatives of the two industry associations and the HKMA) was established to develop practical guidance for implementing the requirements of the Supplement. It was decided that a set of interpretative notes to accompany the Supplement would be developed to cover the wide range of implementation issues being addressed by the forum. The deadline for implementing the Supplement would thus be extended beyond 30 September 2003, the deadline originally notified to the industry, to allow time for the interpretative notes to be developed. Meanwhile, the requirements under the existing Guideline would apply.

The United Nations (Anti-Terrorism Measures) Ordinance, which criminalizes terrorist financing and requires the reporting of terrorist financing to the relevant authorities, was enacted on July 12, 2002. The provisions insofar as they are likely to affect banks can be summarised as follows:

The Ordinance allows freezing of funds, which the Secretary of Security has reasonable grounds to suspect to be terrorist property. Such funds are not to be made available to any person except under a licence granted by the Secretary for Security.

Funds may not be provided or collected if the funds are to be used, or there are reasonable grounds to believe that they are to be used, directly or indirectly by a terrorist or terrorist associate or a person who there are reasonable grounds to believe is a terrorist or terrorist associate.

No person may, except with permission from the Secretary for Security, make any funds or financial or related services available to a terrorist or terrorist associate or a person who there are reasonable grounds to believe is a terrorist or terrorist associate.

Where a person knows or suspects that any property is terrorist property, he must disclose that knowledge or suspicion to an authorised officer together with the information on which the knowledge or suspicion is based.

Where a disclosure has been made of such knowledge or suspicion, a person may not disclose any other information likely to prejudice any investigation following the disclosure.

Electronic Check Clearing

Following amendments made to the Bills of Exchange Ordinance, a system came into effect on June 21, 2003 whereby the clearing of checks takes place electronically by virtue of digital copies and truncated details of checks being presented to drawee banks rather than physical presentation. While the system caters to electronic presentation of all checks, during the initial phase of its implementation, checks that are either of high value or otherwise give rise to suspicion will continue to be physically exchanged. .

Sharing of Increased Scope of Consumer Credit Data

As one of the initiatives to combat the rising trend of personal bankruptcies, amendments have been made to the Code of Practice on Consumer Credit Data ("Code"). Before the amendments were made, this Code only allowed banks and financial institutions to share mainly negative data. The changes made enable banks and financial institutions to share via a Credit Reference Agency positive credit data. This will allow a participating bank or financial institution to know not only default information in respect to persons seeking credit but also information where the person concerned is not in default (e.g. number and amount of facilities extended to the person concerned). The new Code, which came into force on June 2, 2003, contains limitations on the extent of sharing of positive credit data during a two-year transitional period and also provides protections to individuals from abuse.

Basel II

The HKMA is consulting the Hong Kong banking industry on its current thoughts and proposals for implementing the New Accord in Hong Kong by the end of 2006. It is expected that most of the locally incorporated authorized institutions will, at least initially, adopt the simpler approaches for capital purposes, given their focus on traditional banking activities. While the HKMA will not mandate that particular approaches be adopted by particular types of institutions, it would expect to see levels of risk management that are commensurate with the types and levels of risk being run. To streamline the implementation process, the HKMA will also consider the extent to which certain proposals under the New Accord can be simplified. The HKMA will take into account subsequent developments of the New Accord and views gathered from the banking industry before finalizing the implementation plan.

In respect of branch operations of foreign banks, the HKMA will generally rely on their home regulators to decide on the applicable approaches and to ensure their compliance with the relevant standards and requirements under Basel II. Nevertheless, the HKMA will review the risk management systems of these branch operations as part of its on-going supervision on them. In line with its practice of supervisory co-operation with the home regulators, the HKMA will share the relevant results of such reviews with them where appropriate to facilitate their supervisory review process under Pillar 2.

INDONESIA

Regulation and Supervision of Banks

Continuing the policy course charted in previous years, Bank Indonesia's policies for the banking system during the period under review again focused on the continuation of the twin programs for restructuring of banking institutions and building resilience into the banking system. Under the bank restructuring program, Bank Indonesia has retained the government blanket guarantee scheme although phased reductions will be made in the scope of the blanket guarantee, while continuing to monitor progress in the recapitalization of commercial banks and restructuring of bank credit.

To build the resilience of the banking system, Bank Indonesia made further improvements to banking infrastructure, strengthened good corporate government, and made more changes to banking regulations based on the 25 Basel Core Principles for Effective Banking Supervision. By the end of 2002, Indonesia had achieved progress in compliance with the implementation of two of 25 Core Principles (CPs), namely CP-1 concerning Preconditions for Effective Banking Supervision encompassing Objectives, Independence, and Resources, and Legal Protection, and CP-2 concerning Permissible Activities of Banks. In Regard to a further 10 Core Principles, Indonesia has also come close to achieving full compliance.

During 2002, Bank Indonesia issued various prudential regulations, including amendments to assessment of earning asset quality and prudential regulation for purchase of credit by banks from IBRA. The two regulations are intended to provide further impetus to recovery in the bank intermediary function and encourage lending to the SME sector. Bank Indonesia has also pursued other measures in this area, such as micro credit project, provision of information through the integrated Small Enterprise Development Information System, signing of an agreement between Bank Indonesia and the Government on empowerment of SME's for poverty alleviation, and meetings between banks and business leaders.

Significant Market Developments in The Banking Industry

The various policies adopted in banking, supported by improvements in macro indicators such as the Rupiah exchange rate and easing of SBI rates, have helped bring about improved performance in the banking sector. This is demonstrated in growth in mobilized third party funds, increased capital and CAR, improvement in the NPLs ratio, and continued recovery in the bank intermediary function as evident from increased new loan disbursement, rising LDR, increased loan interest income, and change in composition of bank earning assets.

Third party funds in the banking system increased by 2.3% or Rp.18 trillion in 2002, reaching Rp 815.4 trillion. Improvement in the bank intermediary function was reflected in increased lending by the banking system, up 15.2% from Rp 316 trillion in 2001 to Rp 363.9 trillion in 2002. New loan disbursement in 2002 (until November) reached Rp 72.17 trillion, up from new loan disbursement for the entire year of 2001 that reached only Rp 56.8 trillion. A significant 41% of new loan disbursements in 2002 was made up of small loans to borrowers with a maximum ceiling of Rp 5 billion, comprising micro credit, small business loans, and medium business loans.

Analyzed by the net NPLs ratio, problem loans eased from 3.6% at the end of 2001 to 2.9% at the end of November 2002. While problem loans declined, bank capital rose by 52.8% overall to Rp 95.1 trillion. Improvements in asset quality in banks matched by increased capital helped strengthen the CAR from a nationwide average of 20.5% to 22.17%.

Payment System Policy

Bank Indonesia's general policy for the cash payment system include measures to improve cashier services to the banking system, improve distribution of cash in small denominations to the public and refine calculations used in the Cash Distribution Plan. In the non-cash payment system, policy emphasizes the minimizing of risks in inter-bank payments and improving services quality and capacity of the payment system. During 2002, the payment system saw generally increased activity in line with rising public demand for payment instruments, with growth taking place in both cash and non-cash payment.

In the non-cash payment system, policy in 2002 emphasized measures to minimize risks and improve efficiency. This policy was pursued through expanded coverage of the Real Time Gross Settlement (BI-RTGS) system, reduction in the capping of credit notes processed in clearing, establishment of a payment system supervisory division at Bank Indonesia, and establishment of the National Payment System Communication Forum (FKSPN).

Securities Companies and Exchange Institution

As of the end of 2002 there were 199 securities companies that had obtained operating licenses as broker dealers and underwriter from Bapepam. During the year, 18 securities companies opened 28 new branch offices in various locations, while 10 securities companies closed 20 of their branches. As of the end of 2002, there were 74 securities companies with a total of 159 branch offices nationwide.

Investment Managers

The number of investment managers that have been granted new operating licenses rose to 92 in 2002 from 79 in 2001. There were 48 investment managers that also had operating licenses as broker dealers and underwriters.

The total amount of public funds managed by investment managers in 2002 showed significant growth, from a mere IDR15.88 trillion in 2001 to IDR 53.95 trillion. Domestic institutional investors played a dominant role in creating such an unprecedented increase. From the total amount pooled by investment managers, IDR 53.36 trillion was generated from domestic investors.

Significant growth can also be noticed from the total number of investors whose funds were managed by investment managers. From a total of 449 in 2001, the number grew to 539 in 2002. Institutional investors still constituted a big chunk, i.e. 383 investors, compared to 156 individual investors. All in all, domestic investors recorded a 15.37% increase in total numbers whereas foreign counterparts grew by 22.77% on the same category.

Also in the year 2002, as one of the measures to protect investors, Bapepam revoked licenses of four Investment Managers and imposed administrative sanctions on another three. Those who were imposed with administrative sanctions by Bapepam fulfilled all of their obligations in 2002.

Indonesian Bank Restructuring Agency (IBRA)

In 2002, the Indonesian Bank Restructuring Agency (IBRA) committed to expedite the settlement process in all sectors, with a focus on small and medium enterprises (SME) or UKM and low cost home loans. The government has re-launched the Cash Settlement Program by providing discounts to the SME debtors, conducted in 11 cities of Indonesia.

The bank restructuring and rehabilitation program is still going on, with the full integration of five banks under IBRA's supervision forming Bank Permata. By becoming one of the 10 largest bank in Indonesia, the bank will be one of the key players in the process of the national banking sector recovery.

The activities performed by the IBRA legal directorate during 2002 in handling various cases were not less important. Legal supremacy and consistency is an important factor for economic recovery and similarly for the success of IBRA's programs. Meanwhile, up to November 2002, its Litigation Division has successfully collected the sum of Rp 1.4 trillion, from its legal workouts.

IRELAND

Supervision of Financial Institutions

Regulatory Developments

In February 2001, the Irish Government announced a new structure for the regulation of financial services in Ireland, which came into effect on May 1, 2003. Until that date, the supervisory responsibilities of the Central Bank of Ireland (the Bank) remained unchanged and it continued to cover a wide range of institutions. These responsibilities encompassed banks and building societies, investment business firms, investment intermediaries, securities exchanges and collective investment schemes.

On May 1, 2003, the Bank was restructured and renamed the Central Bank and Financial Services Regulatory Authority of Ireland (CBFSAI). A new Irish Financial Services Regulatory Authority (the Financial Services Regulator), a constituent part of the new CBFSAI, was launched as the single regulator for all Irish financial institutions (about 4,000 entities). In addition to prudential supervision, it also has a strong new role in consumer protection. The Financial Services Regulator's main role is to help consumers make informed and responsible decisions in a safe and solvent financial market. Its purview now covers the whole financial services industry in Ireland including credit institutions, the securities industry and insurance.

There is further legislation planned for enactment in 2003 which is expected to include the establishment of a statutory financial services ombudsman scheme for consumers, as well as a streamlined appeals system for the industry. The Minister for Finance has also indicated his intention that there will be consumer and industry consultative panels, where general matters of policy can be discussed with interested parties. In addition, it is proposed that this legislation will include new enforcement powers for the Financial Services Regulator, such as imposing fines and public censure.

Policy Developments

A wide range of supervision policy issues were addressed during the period including credit growth and credit quality, capital review proposals, prevention of money laundering, auditing/accounting related issues and client money rules.

Money Laundering

The revised Money Laundering Guidance Notes for Financial Institutions (excluding credit institutions) were issued by the Financial Services Regulator to all financial institutions in June 2003 and reflect amendments to the anti-money laundering legislation which have been made since 1995, and expand on the guidance provided in certain areas. Minor revisions to the Guidance Notes for Credit Institutions (issued in November 2001) were also issued within the last 12 months to reflect changes in money laundering legislation.

Implementation of the initiatives, introduced following the events of September 11, 2001, continued during the period. These included the examination by institutions of their records for the existence of relationships with any individuals who were under investigation in connection with these events with the aim of reporting them to the Irish police authorities.

Auditing and Accounting Related Issues

Communication continued between the Financial Services Regulator and external auditors/the accountancy profession in relation to certain issues including requirements of auditors to prepare reports on unincorporated entities and premium handling requirements. The Financial Services Regulator also continued to provide assistance to the auditing profession in the development of guidance on the audit of investment businesses subject to its supervision.

The Financial Services Regulator has nominated a representative to the interim Board of the Irish Auditing and Accountancy Supervisory Authority (IAASA). This Oversight Board will supervise the regulation by the accountancy bodies of their members' professional standards. New legislation is currently in progress to establish IAASA on a statutory footing and to implement certain recommendations of the Review Group on Auditing, established in 2000 to undertake a fundamental examination of the practices and structures of the auditing profession.

The Financial Services Regulator's nominated representative to the Accountancy Foundation in the UK, which was established to provide non-statutory independent regulation of the accountancy profession, continued to contribute to the workings of this body.

Capital Review

In October 2002, as part of a third quantitative impact study, the Basel Committee on Banking Supervision published a technical guidance document outlining the Committee's proposals for a revised capital framework. A number of Irish banks participated in the study, which took place simultaneously throughout the G10, EU and other countries. The data, which were received at the end of the year, are being analyzed within an overall Global, G10 and EU context.

Client Money Rules

A review of comments received from industry representatives in relation to the second consultation paper published in April 2002 has been completed. Comments received from industry representatives are under consideration by the Financial Services Regulator. It is anticipated that the new requirements will be finalized in the coming months.

Codes of Conduct

The Financial Services Regulator, as part of its consumer protection remit, has issued Codes of Conduct to all intermediaries, investment business firms and credit institutions. Following the establishment of the Financial Services Regulator on May 1, 2003, interim codes have been issued to other providers of retail financial products, mainly insurance companies, mortgage intermediaries and moneylenders. A full review of all codes is currently in progress with a view to establishing common requirements for all retail financial service providers.

Developments in the Banking Sector

Banking licences were issued to DePfa ACS Bank and West LB Covered Bond Bank plc; both of these were registered as designated public credit institutions, under the Asset Covered Securities Act, 2001. Registration permits these banks to issue bonds (similar to the German Pfandbrief) backed by pools of mortgages or public credits. Four banking licences were revoked - CNH Capital plc, Lombard & Ulster Banking Limited, Deutsch Bank/DB Ireland plc and CIBC World Markets Ireland Limited, all at the request of the licence holder. At end June 2003, the number of credit institutions supervised by the Financial Services Regulator was fifty three.

The high rate of residential mortgage credit growth, well in excess of overall private sector credit growth, continued to be the main prudential concern. The situation remains under close scrutiny and a series of on-site reviews of residential mortgage lenders has been undertaken. In addition, banks' non-performing assets and provisioning data, as well as their exposure to vulnerable industrial sectors, are being kept under review.

Following consultation with the banking industry, the Bank issued regulations in August and October 2002 to supplement the Asset Covered Securities Act, 2001, which was passed in December 2001.

Supervision of Non-Bank Financial Institutions

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

Responsibility for the supervision of these non-bank financial institutions is derived from various pieces of legislation including the Investment Intermediaries Act, 1995 (as amended by the Central Bank Act, 1997, the Investor Compensation Act, 1998, the Insurance Act, 2000, the Pensions (Amendment) Act, 2002 and the Central Bank and Financial Services Authority of Ireland, Act, 2003), which provides for the authorization and supervision of investment business firms; the Stock Exchange Act, 1995, as amended by the Investor Compensation Act, 1998 which provides for the approval of stock exchanges and the authorization of their member firms and the ongoing supervision of such exchanges and member firms. (The Financial Services Regulator does not have a role in relation to listing requirements or insider dealing requirements for members of the Irish Stock Exchange; these functions are undertaken by the Irish Stock Exchange.) Both these pieces of legislation transpose the obligations of the EU Investment Services Directive.

The 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. It is also responsible for the authorization and ongoing supervision of fund service providers (i.e. managers, administrators and trustee firms).

In July 1998 the European Commission published two proposals to amend Directive 85/611/EEC. These were finally agreed upon in December 2001 and entered into force on February 13, 2002. The amendments take the form of two separate amending Directives commonly called Product Directive and Management Company Directive. These must be transposed into domestic legislation by August 2003 and should result in significant changes for the regulation of funds.

The Bank also issued a new Notice providing for retail investment in unregulated schemes in December 2002.

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

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

Basel II

Capital adequacy rules in the EU, while drawing from the work of the Basel Committee on Banking Supervision, derive from European Directives. In this regard, the practice to date has been to apply solvency rules equally to all banks regardless of their size. This approach is to be followed in the proposed new framework.

With regard to the implementation of Pillar II, the treatment of third country branches remains an open issue. Work is already underway both in Europe, through the Groupe de Contact, and the wider international markets through the Accord Implementation Group to address issues such as the treatment of branches and subsidiaries.

ISRAEL

Developments in the Israeli Economy were affected for the third consecutive year by the unsettled security and political conditions that have slowed down economic growth. The tourist trade has suffered badly and the difficulties encountered by the high tech industries worldwide were reflected in Israel in slower growth and in a sharp contraction in foreign capital investments. The rate of unemployment has reached 10% and the deteriorating economic conditions had their impact on the government`s budget and on the financial markets.

The erosion in tax revenues and additions to the defense budget led to a widening budget deficit and caused a crisis of confidence that was reflected in higher interest rates and in unrest in the securities markets. In an environment of high interest rates maintained by the Bank of Israel, the NIS\$ rate of exchange has declined from its peak in May 2002 and the rate of inflation was brought back to its target range of 1-3% per annum. But the relative stability has not revived the economy. The banks were obliged to make substantial provisions for bad and doubtful debts and their profitability was eroded substantially. Declining prices in both the equity and the bond markets caused significant losses to insurance and other institutional investors.

To prevent further deterioration the government has recently embarked on tough measures of economic policy, including budget cuts, reduction of social benefits and a reform of the pensions sector . The securities markets have welcomed these measures and responded by substantial price increases.

Besides a small bank that went under in April 2002, a more substantial bank encountered difficulties and needed assistance from the Bank of Israel later in the year. One of the causes of this bank`s troubles was the granting of sizable loans to a group of entrepreneurs for the acquisition of companies, a type of loan that was quite popular with the banks in the boom years. To limit the banks` exposure to this type of risk, the Supervisor of Banks has issued some stricter provisions relating to the financing by banks of such acquisitions. The new provisions limit the amounts granted in relation to the bank`s capital and require a closer monitoring of the loans and the security provided, by the board of directors.

The difficulties encountered by some small banks have prompted the Bank of Israel to prepare a proposal for the establishment of a formal system of deposit insurance to replace the current arrangement that authorizes the Bank to guarantee deposits in collapsing banks. The proposal envisages that deposits of up to NIS 1 million will be insured (with some exceptions) and a premium of up to 0.1% will be paid to the insuring entity. The insurer will be a separate statutory body that will receive services from the Bank of Israel. The impact of this change on the public`s confidence in the banking system remains to be seen since under the current arrangement the amount guaranteed was not capped. The proposal has not been yet formally submitted to the government.

The Bank of Israel has also changed its attitude regarding the merger of smaller banks with larger institutions. The Bank reached the conclusion that the contribution of small banks to competition is of less significance than their vulnerability to adverse economic conditions.

Other, less significant, regulatory developments:

- Some amendments to the directive relating to guarantees received by banks from third parties that clarify their duties when the guarantor signs the deed and during the life of the guarantee.

- A directive limiting the fees charged by banks in the case of loan prepayments. The purpose of this directive is to facilitate the transfer of accounts from bank to bank.

-New rules that allow banks to provide to minors (14 years of age) some types of bank cards, subject to certain conditions.

One result of the erosion of stock prices was that the market price of certain permanent investments declined below their book values. The Accounting Standards Board directed publicly quoted companies to write down the value of such investments and allowed reliance on independent valuation in exceptional cases only.

There were no significant changes in the regulation of the securities markets. An important development in the insurance market was the termination of the active participation of Avner in the mandatory motor vehicles insurance market. Avner was a mutually owned company that shared the business with insurance companies and performed some services for the industry as a whole. The transfer of the business as a whole to the insurance companies is expected to increase the competition in the market, although the rates are still controlled by the Insurance Commissioner.

An important reform was approved recently by the Knesset (parliament) in the field of pensions. It was known for quite a number of years that the major pension funds, managed by the Federation of Labor, suffered from substantial actuarial deficits. There were political obstacles to the reform of the system. The implementation of the necessary changes will involve increases in the rate of contributions by both employees and employers, raising of the retirement age to 67 and some deterioration in the calculation of benefits. The government has undertaken to cover the existing deficit and decided to remove the nominees of the Federation of Labor from the management of the funds. Another feature of the reform is that the government will discontinue the issuance of special purpose bonds to the funds that will invest from now on in the capital markets, a change that may provide a significant boost to the markets.

The anti – money laundering provisions of the law enacted in 2000 are now fully implemented by banks and financial institutions, following the conclusion of the process of identification of all registered account holders.

There were no changes in the permissible affiliations of banks and other financial sector firms, but the Governor of the Bank of Israel has reiterated his view that companies managing provident funds (retirement funds), mostly subsidiaries of commercial banks, should be separated from the banks and operated as independent institutions. The implementation of such a reform may have a significant effect on the structure of the financial markets.

Contemplated changes in the Bank of Israel Law that were discussed last year and provoked fierce controversy between the Bank and the government have been shelved for the time being.

ITALY

Basel II

The New Basel Capital Accord will be made effective at national level, and more generally in all the EU countries, by a specific EU Directive. The Directive will apply to all banks and financial institutions within the Union.

In the Basel Committee's third Consultation paper (CP3), Appendix 9 proposed a Simplified Standard approach designed to better meet the needs of small banks.

Italian supervisory authorities have not yet issued instructions on how they intend to treat foreign financial institutions with establishments in Italy, but it is believed that the Bank of Italy will observe the principles set out by the Basel Committee in its August 18, 2003 report, "High-level principles for the cross-border implementation of the New Accord". This publication highlights the work of the Accord Implementation Group in developing a set of principles to facilitate closer, practical cooperation and information exchange among supervisors.

In this paper, Principle 2 refers to the responsibility of a country under Pillar 2 in these terms: "Given the nature of Pillar 2, the responsibility for Pillar 2 assessments of a consolidated banking group must rest with the home country supervisor. However, depending on the organization of the banking group and the importance of activities within the host country, host country supervisors may provide important input into the home country assessment of Pillar 2 for the consolidated banking group. Home country supervisors should seek host country input, where appropriate."

Regulation and Supervision of Banks and Other Nonbank Financial Institutions

During the period under review, a major piece of legislation bearing on banks and other financial institutions has been the reform of company laws, both penal and positive.

The reform of penal laws, under Legislative Decree 61/2002, has rationalized the number of crimes contemplated by "corporate penal law" and at the same time introduced new types of criminal offenses in order to fill gaps in protection long advocated by legal scholars. The reform has also generally reduced the severity of sanctions and broadened the range of offenses in which action is taken upon complaint of the victim.

The reform of positive company laws, with Legislative Decree 6 of January 17, 2003, is characterized chiefly by a broadening of the scope of companies' independent powers in drafting their corporate by-laws, a simplification of company laws, and the regulation of corporate groups under principles of transparency and conciliation. In practice, the reform amounts to a revision of the civil code.

Anti-Money Laundering Developments

In the last year, the Italian banking system continued its cooperation in the battle against money laundering and the financing of international terrorism. The fight against funding for terrorism in particular was conducted by freezing the accounts held by or linked to the persons named in the lists supplied by European Community regulations in this field. Banks also reported to the Italian Foreign Exchange Office, under Article 3 of Law 197/1991, concerning the lists (circulated to the banking system via the Italian Banking Association) of names of persons suspected of links with international terrorism.

In December 2002, the reporting threshold for suspicious transactions was raised from €10,329.14 to €12,500.00. This refers to transactions that must be registered by the database that each banking or financial intermediary must compile under Article 2 of Law 197, for purposes of supplying the anti-laundering authorities with a database on customer accounts and transactions.

Principal Developments in the Italian Banking System

Italian credit intermediaries have grown steadily in size. The average assets of the largest five banking groups rose from €85 billion in 1993 to nearly €200 billion in 2002; for the top three groups alone, the rise was from €96 billion to over €232 billion).

This expansion was due mainly to a strategic choice on the part of Italian banks. Between 1993 and 2002, more than 300 banking mergers and acquisitions were carried out, involving about 10 percent of total system assets. Purchases of majority stakes during these years numbered 167 and involved nearly 40 percent of system assets.

The result was further concentration. The overall asset share of the largest five banking groups rose from 35 percent in 1995 to 55 percent in 2002; that of the top three groups, from 24 to 40 percent. The figure for the top five groups compares with 47 percent in France in 2002, 38 percent in Germany, 56 percent in Britain and 58 percent in Spain.

More recently, there has also been further progress in Italian banks' marketing approach. In 2002, the number of branches increased by 656 to 29,926. The number of financial salesmen employed by the banks rose by 35 percent to over 37,000; those with employee status fell to 14 percent of the total, from 23.2 percent in 2001. Financial salesmen working for securities firms belonging to banking groups number 4,164. At the end of 2002 the number of financial stores exceeded 2,000. Telephone banking intensified; 80 banks now offer both account information and active operation by phone, compared with 59 in 2001, and the number of customers rose from 2.3 to 3.5 million. At the end of 2002, there were 37,400 ATMs and 819,600 POS terminals in Italy, representing growth of 8.8 and 9.6 percent respectively over 2001. Banks permitting transactions by direct on-line link number 445. The number of firms using the service rose from 355,000 to 440,000. Banks offering Internet banking numbered 511, 25 more than at the end of 2001.

Developments in the Payment System

Last year was particularly significant for the payment systems industry in Italy. One major event was the recognition by the antitrust authorities of the importance and the legitimacy of interbank agreements on payment systems. Another was the commencement of the "Europification" of payment systems, heretofore marked by strong domestic features.

On the antitrust side, following thorough revision of the existing agreements, undertaken independently by the Italian Banking Association beginning in November, and given the substantial reduction in the number of interbank fees resulting, the Bank of Italy – the antitrust authority for banking – permitted the retention for five years, in derogation to the ban on restrictive agreements, of those multilateral accords strictly necessary for the orderly, regular working of interbank procedures.

The other area in which the Italian Banking Association was particularly active was the initiation of work towards the Single European Payments Area - SEPA. After the workshop in March in Brussels, which examined the obstacles to automated circulation of payments generated domestically, the European banking industry decided to form the European Payment Council (EPC), whose objective is to create a single European payments area. Italian banks have five representatives (including one from the Italian Banking Association) on the EPC.

The main achievements of the EPC so far have been in the area of credit transfers and direct debit instruments. On credit transfers, the EPC has drafted two conventions. Under the Credeuro Convention, the banks ordering payments undertake to execute cross-border credit transfers within at most three days from the date of acceptance of the order, when the transfer is for less than €12,500, is not urgent, carries the correct international bank coordinates (beneficiary's IBAN and beneficiary bank's BIC) and can be handled in completely automated fashion (STP). The Convention on Interbank Pricing Practices provides that the basic fee option to be offered to customers is the "shared" fee, and that intermediary banks may not reduce the amount of the cross-border credit transfer as a way of collecting commission.

The Italian Banking Association is promoting adherence to both conventions on the part of Italian banks. It is also preparing informational materials for customers and for the training of the bank staff assigned to relations with the public. As to the developments of projects carried on in the SEPA framework, it must be noted that the Euro Banking Association (EBA) has chosen a company owned by the Italian banking system, Società Interbancaria per l'Automazione S.p.A. - SIA, as its technological partner for the realization and operation of STEP 2, which is to be the initial nucleus of the Pan-European Automated Clearing House. STEP 2 was operational on April 28, 2003. At present three Italian banks – members of the 38-bank European pilot group – are participating in STEP 2. The system was opened to all European banks in July 2003.

Another major innovation last year was the launch of the revised version of Italy's new real time gross settlement system, now called New BIREL, by the Bank of Italy with the support of the forum of user banks under the Italian Bankers Association.

Developments Concerning Payment Cards

There was a significant increase in the volume of transactions settled by payment cards in 2002. Like the Italian Bankers Association in the field of payment service agreements, the Convention for the Bancomat brand (CO.GE.BAN.) was engaged during 2002 in working for a positive solution to the investigations undertaken by the Bank of Italy as the competition authority in banking.

In the course of the year, the Convention undertook a series of initiatives to improve services, increase their accessibility and enhance their image. The initiatives included:

- lengthening the operating hours for Bancomat circuit operations, extended to the entire day on Saturday and Sunday and from 5:00 a.m. to 2:00 a.m. on weekdays;
- raising the ceiling on Bancomat cash withdrawals from € 1,500 monthly and € 250 to a daily maximum of € 500, with a limit of € 250 for each single withdrawal;
- institution of a system for monitoring the level of service of ATMs, which will permit, among other things, advance knowledge in real time of the services offered by the bank on each ATM (e.g., withdrawal by credit card, phone card reload, payment for various utilities and services). This will provide highly detailed statistics on the Bancomat service and a picture in real time of the operation of the over 35,000 ATMs that make up the Bancomat circuit, with information that banks and telephone service providers can also make available to customers.

Associazione Progetto Microcircuito (the microchip card association, whose members are more than 450 banks) is also going ahead with its plans for the introduction of chip technology on all bank payment cards. In 2002, the private testing phase was begun, followed by a pilot migration of cards and terminals in four areas (the cities of Alessandria, Lecco, Prato and Taranto).

The nationwide migration to smart cards will begin at the end of 2003 and last until 2006, covering a total of three-and-a-half years.

Other Developments in the Payment Systems Field

Other important payment service developments in 2002 were the successful continuation of interbank corporate banking services and electronic banking for retail customers.

The former (Corporate Banking Interbancario – CBI) is a scheme for payment initiation created for Italian firms, originally promoted by the Italian Bankers Association (in 1995) and now the proprietary system of a specially formed association founded in 2002. More than 400,000 Italian firms are linked to the banks as customers through this channel. The success of recent years has prompted Italian banks to offer new services exploiting this important instrument for enhancing corporate customer loyalty. The new services are now being defined.

As to retail electronic banking, the eCommittee association, also formed at the Italian Bankers Association's initiative, has made available to participating banks the technical specifications for an electronic purse that can contain the main credit and debit cards for Internet payments (a service already available at a good number of banks), those for a mobile payments system, and those for an electronic bill presentment and payment system now under commercial development.

JAPAN

Regulatory Developments

On October 30, 2002, the Financial Services Agency (FSA) announced the "Program for Financial Revival: Revival of the Japanese Economy through Resolving Non-Performing Loan Problems of Major Banks." This Program presents the goals of bringing the non-performing loan issue under control by cutting the ratio of non-performing loans in half at major banks by fiscal 2004 and building a sound banking system that supports restructuring. The Program also indicated a variety of policies including stricter enforcement of asset assessments at major banks, enhancing capital ratios and reinforcing governance. The FSA proceeded to announce a Work Schedule that compiled the schedule for implementing the Program from November 29. The various measures of the Program are presently being implemented based on this Work Schedule.

On March 28, 2003, the FSA compiled the "Action Program concerning Enhancement of Relationship Banking Functions." This Action Program presents the issues that the respective financial institutions and government should tackle during the "Intensive Improvement Period" through fiscal 2004. The pillars of the Action Program are: (1) Measures to revitalize financing for small and medium-sized firms, (2) Measures to secure the soundness and improve the profitability of the respective financial institutions, and (3) The implementation organization for the Action Program.

On January 1, 2003, the "Special Measures Law concerning Promotion of Organizational Restructuring at Financial Institutions" went into force. The primary objective of this law is to promote mergers of regional financial institutions to create a more sound banking system in Japan. The Law contains measures to simplify procedures, measures for increasing capital adequacy ratios that have dropped due to mergers (went into force on April 1) and progress measures regarding the limits for insured deposits.

On April 1, 2003, the Deposit Insurance Law was revised. The Law now prescribes that accounts fulfilling the three requirements of (1) Used for settlement fund transactions, (2) Payment on demand, and (3) No interest are "settlement accounts." These accounts are now guaranteed in full. In addition, measures were put in place to insure all funds in current accounts and interest bearing savings accounts until March 2005.

On May 17, 2003, the FSA issued a business improvement order to Resona Bank due to its capital adequacy ratio falling below 4%, which is the minimum requirement for a sound domestically-operating bank in the settlement for the year ended March 2003. Corresponding to this and based on the Deposit Insurance Law, Resona Bank applied to the Deposit Insurance Corporation on May 30 for public funds totaling 1,960 billion yen. On June 10, FSA determined to recapitalize Resona Bank.

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

On May 23, 2003, a law that partially amends the Securities and Exchange Law was ratified. The new law seeks to establish a system for checking the competence of shareholders holding 20% or more of voting rights in securities firms, investment trust managers and the like. It also seeks to introduce the “securities agent business” system in which agents conduct the buying and selling of negotiable securities upon consignment of such tasks by securities firms and others. This Law will go into effect from April 2004.

On June 11, 2003, the Amendment of the Government Housing Loan Corporation Law went into force. This Law enables the Government Housing Loan Corporation to support securitization of housing loans extended by private financial institutions, stipulates abolishment of the Government Housing Loan Corporation by the end of March 2007 and regulates the establishment of an independent administrative corporation to assume the rights and duties of the Government Housing Loan Corporation.

Market Developments

On January 6, 2003, the Law to Reform the Securities Clearing and Settlement System went into force. This Law establishes measures necessary to prepare a securities market that conducts settlements promptly and reliably. The measures included preparing a new transfer system that doesn’t require physical corporate bonds, government bonds and such, and the preparation of a clearing institution system that enables efficient settlements.

On December 2, 2002, the Sumitomo Mitsui Banking Corporation established the Sumitomo Mitsui Financial Group and became its subsidiary.

On March 1, 2003, Daiwa Bank and Asahi Bank were reorganized and Resona Bank and Saitama Resona Bank were formed.

On March 12, 2003, the “Mizuho Group,” comprised of Mizuho Bank, Mizuho Corporate Bank and others, was reorganized under the holding company, Mizuho Financial Group.

Other Developments

On April 1, 2003, Japan Post was established. This marked the transfer of postal services, postal savings business and postal life insurance business from the Postal Services Agency, a bureau under the umbrella of the Ministry of Public Management, Home Affairs, Posts and Telecommunications to the government-run public corporation, Japan Post.

On May 8, 2003, the Industrial Revitalization Corporation of Japan (IRCJ) was established. The IRCJ will support the revitalization of businesses that are judged as being able to be revitalized. This will be done by coordinating matters from a neutral position between financial institutions serving as the primary funding bank and secondary funding banks of companies, and the purchasing and consolidating of loans and other debts that the secondary banks hold to said firms. The IRCJ will also monitor the execution of agreed revitalization plans.

KOREA

Bancassurance

As of August 2003, banks are authorized to offer bancassurance services. Initially, the scope of permissible activities will be limited to the sales of the products of other insurance companies. A bank may act only as an agent of an insurance company or an independent broker. The government does not yet have a plan to permit banks to act directly as underwriters. If a bank plans to be engaged in underwriting, it can do so either by acquiring an existing insurance company or forming a new one.

The bancassurance business also will be open to securities firms, mutual savings and other financial service providers as long as they have established distribution channels. Insurance companies that intend to offer bancassurance services must form subsidiaries jointly with banks or other financial service providers. The establishment of such subsidiaries was previously very restricted.

Product types available to the market will be introduced sequentially, beginning with savings-type products, followed in time by all insurance products. Services may be offered through the specifically designated sales counters in the lobbies within the offices of the service providers. Outdoor sales or telemarketing are prohibited.

Bancassurance service providers are required to communicate clearly with their customers that they merely act as a sales agent and that insurance companies are the underwriters. Large banks or financial service providers with assets exceeding 2 trillion won are also prohibited from entering into an exclusive arrangement with an insurance company or from generating more than 50% of their total sales volume with the products of a single insurance company.

Comprehensive Plan to Enhance the Soundness of Credit Card Service Companies

The CCSCs are required to lower the ratio of cash advances and card loans (collectively "cash loans") to below 50% of their total credit card receivables (total assets) by the end of 2003 and the ratio of cash loans to below 50% of their total managed assets (total assets plus receivables sold with recourse) by the end of 2004.

To help resolve cardholder delinquencies, the Korea Non-Banking Finance Association (KNFA) will clarify the qualification criteria for extending converted loans and a plan to increase the maturity of these loans up to 5 years.

Accounting Reform Draft to Enhance Corporate Transparency

In August 2002, the government established a task force to review the corporate accounting system and to develop a plan for reform of the system. The first measure of such reform efforts will be to revise the basic format that public companies must use when filing the mandatory business reports. The new system requires more specific and detailed financial disclosure on 1) accounting treatments susceptible to subjective or discretionary valuation or interception, (2) loans and advance payments to related parties and (3) items related to the independence and propriety of outside auditors.

Furthermore, the government announced a plan to enhance the credibility and accuracy of accounting information on initial public offerings (IPOs). The measure includes improvement of audit review processes, increasing sanctions against fraudulent financial accounting, strengthening listing eligibility reviews, activation of the whistle-blower system, and improvement of the due diligence of lead underwriters.

Revised Financial Regulations

After June 30, 2003, the minimum BIS capital adequacy ratio for mutual savings banks was increased from 4% to 5%. The BIS risk weighting of their unsecured small loans will increase from the current 50-to-75% level to as much as 100% by April 2004.

After January 1, 2003, only digital certificates issued by government-authorized institutions were permitted for use in on-line securities trading to enhance the security of on-line trading.

After April 2003, Prompt Corrective Action (PCA) measures for credit card service companies were classified into three distinct stages: management improvement recommendation; management improvement requirement; and management improvement order.

After January 1, 2003, the standard provisions of automobile insurance policies were changed as follows. The maximum death benefit for the insured will increase from 32 million won to 45 million won for those aged 20 to 60 years old, and from 28 million won to 40 million won for all others. Car rental coverage during the interim period when the insured's car is in repair will increase from 80% to 100%.

Basel II

Implementation of Basel II is under serious consideration in Korea. However, official opinions about the timing and methodologies to implement the new capital accord have not yet been announced.

LATVIA

The legislative framework for financial sectors complies with the requirements of EU directives in all material aspects. The Financial and Capital Market Commission's (hereinafter – the Commission) strategy provides for further enhancement of the regulatory framework to keep it in line with international standards and developments in the financial sector.

During the period July 1, 2002 through June 30, 2003 amendments to several laws were approved by the Parliament.

Amendments to the Law on Private Pension Funds (adopted by the Parliament on October 10, 2002) bring investment rules for assets of pension plans in compliance with the principle of free movement of capital and prescribe permissible investments. As of January 1, 2003, assets of pension plans may be invested in securities included in the official list of the Stock Exchange, real estate and deposits in credit institutions registered in Latvia, European Economic Area (EEA) countries, Estonia and Lithuania.

Amendments to the Law on Investment Companies (adopted by the Parliament on October 24, 2002) ensure compliance with provisions of EU Directive 85/611/EEC on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities (UCITS) and EU Directive 2001/108/EC of the European Parliament and of the Council of January 21, 2002 amending Council Directive 85/611/EEC. A range of permissible investments is broadened and investment companies are allowed to establish investment funds with a wider diversity of risk profiles, which makes investment certificates more attractive to potential investors. Rules for admission of investment certificates of foreign investment companies to public circulation in Latvia are also specified.

Amendments to the State-funded Pension Law (adopted by the Parliament on October 31, 2002) grant investment companies the right to, upon authorization by the Commission, manage assets of the state-funded pension scheme. The amendments specify types of permissible assets and diversification rules for investments of funds of the state-funded pension scheme. An investment company shall register a pension plan prospectus with the Commission. Henceforward, upon reaching the retirement age, participants in the state-funded pension scheme will have the option either to transfer the accrued pension capital to supplement the pension capital in Tier 1 pension scheme or to acquire a life insurance policy.

Amendments to the Insurance Contract Law (adopted by the Parliament on October 24, 2002) improve the process of concluding an insurance contract and specify rights and responsibilities of an insurer and an insurance policy holder. Amendments provide that henceforth an insurer, prior to entering into the insurance contract, will be obliged to inform an insurance policy holder of the procedure for out-of-court settlement of complaints and disputes. An insurance contract will also have to specify the time limit for taking a decision to pay or refuse insurance indemnity and the grounds for a refusal to pay insurance indemnity.

Amendments to the Law on Insurance Companies and Their Supervision (adopted by the Parliament on March 27, 2003) implement the "single license" principle with respect to setting up branches of insurance companies licensed in EU and EEA countries. Amendments grant the Commission relevant powers to prevent close links between an insurance company and third parties in cases where such relations might jeopardize the financial stability of the insurance company or hinder the performance of supervisory functions of the Commission. The requirement of prior consent of the Commission to investments exceeding 10% of the insurer's technical provisions is also lifted.

The Commission has elaborated a draft Law on the Financial Instruments Market. The draft law was submitted to the Government on January 30, 2003. It implements several missing EU directive provisions in the area of financial services, the most important among these being the "single license" principle regarding investment firms operating in the EU single market. The draft law also implements the newly adopted Market Abuse Directive.

During the period July 1, 2002 through June 30, 2003 several new regulations as well as some amendments to the previously adopted ones were approved by the Commission.

The Regulations for Obtaining Permits of the Financial and Capital Market Commission Regulating the Operation of Credit Institutions and Credit Unions and for Providing Information (effective as of December 19, 2002) were formulated by taking into account amendments made to the Law on Credit Institutions (previously required formal permission to acquire or increase a qualifying holding in a bank has been substituted by non-objection procedures). In accordance with the said regulations persons acquiring a qualifying holding in a bank will henceforth notify the Commission of their intention to acquire, increase, decrease, or dispose of the qualifying holding. In order that the Commission may ascertain the compliance of supervisory board members, executive board members, the head of a foreign subsidiary of a bank with legislative requirements, the credit institution will have to submit to the Commission notification, an expanded professional biography and copies of identification documents of the supervisory board, executive board members, the head of the foreign subsidiary of the bank.

In order to ensure an efficient procedure for out-of-court settlement of disputes between a credit institution and its customers, the Commission prepared Recommendations for the Formulation of Efficient Procedures for Out-of-court Settlement of Disputes between a Credit Institution and Its Customers regarding Credit Transfers and Electronic Transactions, which set basic principles for a more efficient dispute settlement process than provided by the general procedures for court settlement of disputes. The Ombudsman of the Association of the Latvian Commercial Banks, who reviews complaints of banks' customers regarding credit transfers and electronic transactions, has been operating since January 1, 2003. Decisions taken in settling disputes will be recommendations only, thus the rights of parties involved in a dispute to apply to public authorities or court pursuant to general procedures will not be restricted.

The Board of the Commission approved the Regulations for Calculating Capital Adequacy of Banks and Brokerage Companies (effective as of January 1, 2003), which replaced the Regulations for Calculating Capital Adequacy of Banks and the Regulations for Calculating Capital Adequacy of Brokerage Companies. The Regulations ensure harmonization of the methodology for calculation of capital adequacy and preparation and submission of reports for banks and brokerage firms and are compliant with the requirements of EU Directive 93/6/EEC on Capital Adequacy of Investments Firms and Credit Institutions. The Regulations specify also the amount of the minimum initial capital of brokerage companies depending on the type of authorized intermediary activities.

In order to enhance transparency of activities of banks and to promote market discipline, Regulations on Credit Institutions' Quarterly Reports to the Public (effective as of January 23, 2003) were formulated. The Regulations set the minimum requirements for quarterly disclosures of the information on credit institutions' activities and financial standing. The quarterly reports should be placed on the Internet home page of a credit institution.

Taking into account requirements of EU Directive 91/674/EEC on the Annual Accounts and Consolidated Accounts of Insurance Undertakings and proposals amending EU Directives 78/660/EEC, 83/349/EEC and 91/674/EEC, Regulations on the Preparation of Annual Reports and Consolidated Annual Accounts for Insurance Joint Stock Companies and Mutual Co-operative Insurance Societies (effective as of January 8, 2003) were adopted. Insurers are required to comply with IAS, in particular IAS 39.

The Board of the Commission adopted amendments to the Regulations on the Buyout of Shares (effective as of October 3, 2002), which provide that settlements regarding shares sold through a share buyout proposal should be effected in conformity with the principle 'delivery versus payment'. Such settlement procedures provide greater assurance that the person who has proposed a share buyout will meet the liabilities he/she has pledged to the shareholders who have accepted his/her buyout proposal. Thus, these amendments will promote the protection of rights of minority shareholders in the event of a share buyout.

The legislative process will continue to ensure full implementation of international standards by the date of accession to the EU and further on pursuant to the Financial Services Action Plan.

In market developments, Finland's HEX Group acquired 92.98% of shares of the Riga Stock Exchange (the only stock exchange in Latvia) in August 2002.

BASEL II

As Latvia is a EU candidate country, and, as expected in the near future, also a EU Member State, the Commission is going to implement the respective EU Directive on Capital Adequacy that is being drafted in compliance with Basel II proposals, but incorporating specifics of less complex banking institutions and investment firms. To adapt and develop any necessary systems and processes in conformance with the standards of the new Accord, a task force on capital adequacy was set up by the Commission.

LUXEMBOURG

Law of August 2, 2002 on the Protection of Personal Data

The law of August 2, 2002, which took effect on December 1, 2002 transposes into domestic law Directive 95/46/EC of the European Parliament and Council on the protection of natural persons in respect of the processing of personal data and the free movement of such data.

The purpose of this law is to ensure the protection of personal data of natural and legal persons, who possess the right to be informed that processing of personal data is taking place, to consult the personal data, to request corrections and to object to the processing of data under certain circumstances such as for the purpose of direct marketing.

The law has a very broad scope of application and covers all possible processing situations. The requirements of the text tend in particular to apply to any file which is kept, even manually, by a company in dealings with its customer. The scope of application of the text goes beyond purely information technology applications.

Law of December 20, 2002 on Undertakings for Collective Investment

The Law of December 20, 2002 on Undertakings for Collective Investment (UCIs) was primarily designed to transpose into Luxembourg legislation Directives 2001/107/EC and 2001/108/EC which entered into force on February 13, 2002. These new directives broaden the range of UCIs which may be freely marketed in the Member States of the European Union. They introduce a European passport for UCITS management companies and a simplified prospectus valid in all the Member States.

The legislature has chosen to transpose the two directives through a new law on UCIs rather than amending the law already in force, i.e. the Law of March 30, 1988 on Undertakings for Collective Investment. Although the Law of 2002 will eventually supersede the Law of 1988 it does not abolish the existing legislation with immediate effect. The two laws will coexist until February 2007.

Since the "new" European passport issued by the above amending directives might only be invoked after February 13, 2004, the existing UCITS based on the 1988 law will be able to continue to benefit from the current regime at least during the transitory period. After that, the UCITS may be governed by the new law or, if the grandfathering clauses provided by the applicable directive so permit, may continue to operate under the 1988 law until February 13, 2007 at the latest, the date on which the new law will be fully applicable to them.

Newly created UCITS from the date of entry into force of the new law may be governed by the latter but will not be able to benefit from the European passport before February 13, 2004. If they wish to benefit from the "old" European passport, they should be established under the 1988 law and will only be governed by the new law with effect from February 13, 2004.

Measures to Control Money Laundering and to Fight Terrorism

Luxembourg already has an impressive body of legislative provisions to prevent money laundering. The means of control will be further enhanced by the transposition into the Luxembourg law of Directive 2001/97/EC of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering.

The intensification of cooperation with the authorities following the September 2001 terrorist attacks confirms the determination of Luxembourg to do all in its power to fight the financing of terrorism. For that purpose, a draft law was tabled by the government with a view to approval of the international convention of January 10, 2000 for the prevention of terrorist financing and implementation of the obligations imposed by the decision of the Council of the European Union of June 13, 2002 on the prevention of terrorism. The draft law seeks to clarify the legal situation by making acts of terrorism and the financing of terrorism specific offenses.

Draft Law Amending the Law of April 5, 1993 on the Financial Sector

The aim of this draft law is to amend the Law of April 5, 1993 on the financial sector in particular by broadening the scope of supervision of the supervisory authority of the financial sector to other types of professionals.

Basel II

All banking institutions will be subject to the Capital Adequacy Directive III which will apply to all the credit institutions and investment companies operating in the European Union.

In broad outline, Basel II and CAD III have been drawn up in parallel, although on matters of detail the European Union's provisions must take account of the specific features of the European banking markets with, in particular, the presence of a great many medium-sized banks and the existence of a particularly important clientele of SMBs/SMIs.

Luxembourg will apply the principles of home country supervision on a consolidated basis to branches located in another Member State of the EU.

THE NETHERLANDS

Banking Supervision: Structural Reform

In 2002-2003 the Dutch banking sector has been preparing for the consequences of structural reform in the supervision of the sector. The same authorities will supervise banks and insurers; two authorities remain, for prudential and behavioral supervision, respectively. The new structure will be effective beginning January 2005. Major changes will follow regarding:

Licensing

In progress is a system of partial certificates for commercial banking, investment services or insurance. The sector is still objecting to the proposals, because of overlapping supervisory policies, conflicts of interest between supervisors and cost inefficiencies.

Financial Compensation for Supervision

The Dutch Ministry of Finance is planning to have the sector pay for their supervision. The sector is seeking transparency and influence on budgets in return, e.g. as it is done in the UK by the FSA.

New Liquidity Guidelines

New liquidity guidelines are in place. A sophisticated system of liquidity requirements per banking activity has been designed and implemented. Liquidity positions are calculated for the week and the month ahead.

Investors' Guarantee Scheme

Following the European Directive on Depositors and Investors Guarantee Schemes, a Dutch scheme has been put in place for investors. The scheme is paid for by the investment services providers.

Basel II

The new Capital Adequacy Directive (CAD3) should be effective as of December 31, 2006, implying that data will be gathered following the new requirements as of January 1, 2004. The new rules will be effective for all banks operating in The Netherlands. Regarding the obligations for the supervisor in Pillar 2, the Dutch supervisor intends to follow the High Level Principles (published in August 2003) to respect the judgements of the home supervisor of foreign banks.

The Dutch banks are very surprised that U.S. supervisory authorities intend to apply Basel II only to the largest American banks. This implies a deviation from the purported improvement to the soundness of the global banking system, not only a unlevel playing field, but mainly a missed chance in improving the banks' risk management systems.

NORWAY

Significant Developments for the Financial Sector

Amendments in the Norwegian ownership rules for financial institutions

The Parliament approved new regulations which will replace the existing Norwegian ownership rules. The regulations are based on the provisions in the relevant EEA-directives.

Under the current regime, no one may hold more than 10 percent of the share capital of a Norwegian financial institution. A financial institution may hold another financial institution 100 percent. It has now been decided to abolish these provisions.

Under the new regulations, any person who intends to acquire a "qualified holding" in a financial institution must notify the competent authorities, and get a prior authorization. A "qualified holding" is a holding representing 10 percent or more of the capital or the votes in the institution. Further, persons who already hold a qualified holding must apply in advance before acquiring control of more than 20, 25, 30 or 50 percent of the capital or the votes in the institution. The competent authority may assess the application for three months. In this period, it is obliged to assess whether the acquirer is suitable to own the intended holding.

New regulations on savings banks

In 2002 savings banks gained the opportunity to convert into limited companies or public limited companies. After this law amendment, the savings banks are more free to choose the type of equity capital arrangements that they find most appropriate.

Disclosure Requirements – quoted shares

In 2002 the lowest percentage threshold at which a shareholder must disclose the ownership was lowered from 10 to 5 percent.

Internal audit

In 2002 the Banking, Insurance and Securities Commission issued regulations stipulating requirements for the internal audit in financial services groups.

The Collateral Directive

The Ministry of Finance has in 2003 drafted a law to implement the Collateral Directive (2002/47/EEC).

Market Developments

On the basis of an invitation extended by the Board of Directors in Nordlandsbanken at the end of 2002, Den norske Bank (Norway's leading financial services group) presented an offer to acquire all shares in Nordlandsbanken (a medium-sized bank). The background for Nordlandsbanken's invitation was that last year it had significant financial problems inter alia following losses on loans. The acquisition of Nordlandsbanken was approved by the Ministry of Finance in February 2003.

Gjensidige NOR Sparebank and Gjensidige NOR Spareforsikring were in 2002 converted to public limited companies. All of the shares in both of the companies are owned by a new holding company, Gjensidige NOR ASA. The banking and life-insurance group Gjensidige NOR ASA enjoys strategic cooperation with the non-life insurance group Gjensidige NOR Forsikring and together these two groups comprise the Gjensidige NOR Group (Norway's second largest financial services group).

Den norske Bank (DnB-group) and Gjensidige NOR ASA have agreed on the terms of a merger between the two financial groups. The final consent by supervisory and competition authorities is expected during 2003. If accepted this group will become the by far the largest financial group in Norway.

Finansbanken and Storebrand Bank (two medium-sized banks) were merged in March 2003. The new Storebrand Bank will be a wholly owned subsidiary of the life insurance group Storebrand.

The non-life insurance company Vesta Forsikring, which was a parent company in the Norwegian Vesta Group, which in turn was a part of the Nordea Group, was sold off last year by the Nordea Group to Tryg (a Danish company).

Basel II

Norwegian authorities are not expected to exempt less complex banking institutions from the application of Basel II.

Norwegian authorities are expected to assume only very limited responsibilities under Pillar II of the new capital accord with regard to host country supervision of branches of non-domestic banks (including its supervision of risk management and the operation of credit risk models at such branches).

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 14, 2002, the State Bank of Pakistan issued Prudential Regulations for Microfinance Institutions/Banks (MFIs/MFBs), replacing the Microfinance Bank Rules, 2000 with the objective to ensure that the MFIs/MFBs operate in a safe and prudent manner. These regulations are applicable to operations of MFIs/MFBs including Khushhali Bank.

- On October 15, 2002, the SBP advised banks of a new set of guidelines developed in consultation with the banks and Federation of Pakistan Chambers of Commerce and Industry (FPCCI) to help banks deal with loans in the loss category.

- On December 3, 2002, SBP issued an updated Branch Licensing Policy to the banks for implementation, consolidating all the instructions previously issued relating to branching licensing policy and Automated Teller Machines (ATMs).

- On January 17, 2003, State Bank of Pakistan issued a consolidated and updated version of the instructions to be followed by banks with regard to margin restrictions.

- On February 14, 2003, the SBP issued guidelines to mitigate the risk associated with mobile banking operations of MFBs/DFIs.

- On February 25, 2003, the SBP informed banks of making Credit Information Bureau (CIB) facilities online in collaboration with Pakistan Banks Association.

- In order to resolve the disputes that may arise between borrowers and banks/DFIs, the State Bank formed a committee on March 10, 2003 to ensure early resolution of disputes.

- On March 12, 2003, the SBP issued minimum guidelines to be followed by banks/DFIs to structure and discipline the process of mergers/amalgamations and local incorporation of banks.

- On March 29, 2003, the SBP issued minimum guidelines to banks to be followed while opening/dealing with the accounts of customers to prevent possible use of banking channels for money laundering and transfer of illegal/ill-gotten monies.

- On June 30, 2003, the SBP directed all banks/DFIs to provide information to the Central Board of Revenue on a biannual basis of those accounts where the bank/DFI pays a profit/return in excess of Rs. 10,000 per annum.

Monetary and Credit Policy Measures

- On July 9, 2002, the State Bank amended Prudential Regulations XXVIII and made banks/NBFIs free to decide the rate of return on deposits mobilized under FE 25.

- On July 30, 2002, banks were allowed to provide financing facilities to the general public (individuals) for purchase of consumer durables in order to promote consumer financing in Pakistan.

- To promoted e-commerce and to bring efficiency to the payments system of Pakistan's financial sector, the SBP directed banks on August 5, 2002 to ensure that their systems must be connected online by June 30, 2003.

- On August 27, 2002, the State Bank advised banks about the decisions taken in the Agriculture & Credit Advisory Committee meeting on July 17, 2002 to further enhance the scope of the Agricultural Loan Scheme and to ensure availability of adequate and timely credit to growers/farmers.

- On August 28, 2002, the State Bank directed the banks to eliminate 40 returns to be submitted by them with a view to streamlining the existing reporting requirements of Banks/NBFIs. Now banks/NBFIs are submitting only nine returns to BSD and 19 returns to BPD.

- On September 4, 2002, the State Bank set up a permanent desk for dollar/rupee swaps as a new tool of monetary management.

- Effective from November 18, 2002, the minimum rate of return to be paid by recipients of financing facilities from the State Bank for meeting temporary liquidity shortages and SBP 3-day Repo facilities against Government of Pakistan Market Treasury Bills and Federal/Pakistan Investment Bonds was reduced from 9 percent to 7.5 percent on an annual basis.

- Effective from February 1, 2003, the State Bank reduced the rate of markup for commodity operations of the Government and other agencies from 12% to 9.5%.

- On March 17, 2003, banks/DFIs were advised that all valuations/revaluations of their assets (e.g. their fixed assets) would be carried out through any of the valuers listed on the PBA's approved panel of valuers.

- On March 25, 2003, the State Bank announced minimum capital requirements based on risk-weighted assets. Banks were advised to maintain capital and unencumbered general reserves, the amount of which is not less than 8% of the risk-weighted assets of the banking company both on consolidated as well as on a stand alone basis.

- In order to improve transparency in decision making and to form a judgment on the quality of the Board of Directors of Banks/DFIs, the State Bank, on April 10, 2003 reemphasized that the proceedings of the meetings of the Boards of Banks/DFIs should be recorded in details to reflect all significant deliberations made and decisions taken during the meetings.

- On April 23, 2003, the State Bank advised banks to maintain 5% in their Cash Reserve Account (CRA) and 15% in Special Cash Reserve Account (SPRA) against FE-25 Deposits, after converting into rupees.

- On May 3, 2003, State Bank advised Banks/DFIs to put in place a compliance program to ensure that all relevant laws are complied with in letter and spirit, and thus minimize legal and regulatory risk.

- In order to help banks ensure meticulous compliance with the Cash Reserve Requirement (CRR), the State Bank issued on May 8, 2003 a Master Circular consolidating the existing instructions on the subject.

- On May 9, 2003, the State Bank increased the time period for the process of credit rating of banks/DFIs from four months to six months from the close of the financial year.

- On June 13, 2003, the SBP amended its Housing Finance Credit Policy for banks to further help them develop and market their housing finance products.

- On June 25, 2003, the SBP allowed banks to avail themselves of refinance facilities against their sanctioned limit for 2002-03 until finalization of new limits for 2003-04 or the end of September 2003, whichever is earlier.

Export Finance Policy Measures

- On September 11, 2002, the State Bank made certain relaxations in the Export Finance Scheme.

- Effective from September 16, 2002, the maximum profit to be earned by a financial institution on financial assistance extended under the Scheme for Financing Locally Manufactured Machinery was reduced from 11% to 10% per year and the SBP refinance rate was reduced from 9% to 8%. The maximum profit was further reduced in March 2003 to 7% and the refinance rate was reduced to 5%.

- On November 14, 2002, the State Bank allowed banks and DFIs to participate in asset securitization transactions through special purpose vehicles.

- The refinance rate charged by SBP under the Export Finance Scheme and for export sales under the LMM Scheme were gradually revised downward from 6.5% in July 2002 to 2.0% in June 2003.

PANAMA

Bank Regulatory Developments

The following are the most significant regulations issued by the Superintendency of Banks 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 rating off balance sheet credit and other operations, assigning reserves, establishing risk limits, as well as for concentration of credits and loans to a single party or to related parties; requirements that banks must publish information on such operations, in their periodic audited and non-audited financial statements, in order to allow for an exact risk profile, information related to accounting policies and practices, credit risk management, exposures to credit risk and credit quality.

- Requiring that all banks with a general license must establish in their credit policies the amounts above which approval is required by the Board of Directors, the credit committee or management in the case of credit facilities to realted parties and investments in securities and other documents issued by such related parties.

- As ordered by Law No. 10 of 2002 that established a new license for banks specializing in "micro credits", adopted norms for their operation, such as definition of what is a micro credit, a micro business and a small business; capital requirements; rating of their loan portfolios and requiring a minimum 12% risk weighted capital.

- Modified regulations for rating loan portfolios, establishing a mínimum global provision of one percent, excluding loans fully guaranteed by deposits in the same banks, that do not include deposits held in subsidiaries.

- Regulating electronic banking, including periodic audits of e-bank services, security controls for the verification of the identity and authorizaiton of new customers, the preservation of confidentiality of information, adequacy of physical structure, measures to assure accuracy of transactions, relations with service providers and the prevention of its use for illicit purposes.

The Superintendency of Banks also adopted an internal Code of Ethics for its personnel, and started a new on-line information system that will allow it to have daily information from banks as an important supervision tool as well as for analysis.

As a result, the Superintendency now has available to banks its Global Portfolio Ratings, which serves as a databank for financial analysis in the evaluation of credit requests.

This also allows the Superintendency to publish more frequent and complete banking statistics and analysis, available to the public through its web site. Such statistics are now also transmitted to the Bank for International Settlements.

The Superintendency continued to keep banks updated with respect to OFAC´s Specially Designated Nationals and Blocked Persons (SDN) List.

Money Laundering and Financing of Terrorism

A new chapter was added to the Penal Code establishing “terrorism” as a crime. This will allow the application of the law against money laundering to the financing of terrorism.

As a result of the new law, the previous Financial Analysis Unit has now been renamed “The Financial Analysis Unit for the Prevention of Money Laundering and Financing of Terrorism”.

Financial Crimes

A new law was also passed establishing actions and behavior that constitute a “financial crime”. This will give authorities the tools to pursue such crimes, for which up to now there was no concrete or exact definition. The new law covers such actions as destroying documents to prevent investigations, manipulating accounting data to cover losses or to obtain bank credit, insider information, and other actions in banking and securities transactions.

Securities

Securities legislation was modified to expand the authority of the National Securities Commission to investigate persons conducting securities operations without the required license or authorization. Fines were also increased.

PHILIPPINES

Following are the most significant developments that took place during the period under review:

Organization and Responsibility of Regulatory Authorities

- Reorganization of the Supervision and Examination Sector of the Bangko Sentral ng Pilipinas (BSP) to facilitate the conduct of consolidated supervision of banks and their financial subsidiaries/affiliates in line with Basel Core Principles on Effective Bank Supervision.

Regulation and Supervision of Banks

- Approval of guidelines incorporating market risk in the risk-based capital adequacy framework for universal banks (UBs) and commercial banks (KBs)

- Adoption of policy allowing banks which have no unbooked valuation reserves to exclude loans classified "Loss" in the latest examination by BSP from the non-performing classification, subject to certain conditions.

- Laying out of the guidelines in determining whether a particular business activity is unsafe or unsound and requiring that an analysis of this activity's impact on the bank with respect to its capital position, asset condition, management, earnings posture and liquidity position, among others, be undertaken.

- Adoption of policy allowing excess funds of bank's Foreign Currency Deposit Unit (FCDU) to be lent to the Regular Banking Unit (RBU) for the purpose of funding the latter's net fund outflow on its on-balance sheet foreign exchange transactions, subject to certain conditions.

- Implementation of regulation advising banks, quasi-banks, investment banks and other non-bank financial institutions to seek prior BSP approval for: 1) the issuance of subordinated debt instrument to qualify as Tier 2 capital under Circular No. 280 dated 29 March 2001; and 2) any asset transfer plan to a special purpose vehicle/asset management company.

- Enactment of R.A. No. 9182, otherwise known as "The Special Purpose Vehicle Act" into law on January 10, 2003 and the issuance of its implementing rules and regulations designed to encourage and facilitate private investment in the non-performing assets of banks.

Regulation and Supervision Non-Bank Financial Institutions

- Requiring the members of the board of directors of banks and non-bank financial institutions (NBFI) to participate in at least 50 percent of the meetings of the board. These meetings may be conducted through modern technologies such as teleconferencing and videoconferencing. However, they are required to physically attend at least 25 percent of all board meetings every year.

- Sales contracts receivables of banks and NBFIs can be considered performing assets subject to conditions such as : 1) down-payment or installment payment of at least 20 percent of the agreed selling price has been made; 2) payment of the principal must be in equal installments or in diminishing amounts and with maximum intervals of one year; 3) grace period in the payment of the principal shall not be more than two years; and 4) there is no installment payment in arrear, either on principal or interest. The account shall be automatically classified as "substandard" and considered as non-performing upon the non-payment of any amortization due.

- Adoption of policy requiring banks and NBFIs to publish their Consolidated Statement of Condition side by side with the Statement of Condition of their head office and their branches/other offices.

Regulation for Derivatives Products

- Imposition of the maximum tenor on forward contracts of six (6) months to take advantage of the positive effect of the peso's recovery in the long run.

Anti-Money Laundering Developments

- Amendment of R.A. No. 9160, otherwise known as the Anti-Money Laundering Act of 2001, through the enactment of R.A. No. 9194 on March 7, 2003 which basically modified the definition of covered transaction by reducing the required amount to be reported from ₱4 million to ₱500,000. Also, to ensure compliance with the Act, the BSP was allowed to inquire into or examine any deposit or investment with any banking institution or non-bank financial institution when the examination is made in the course of a periodic or special examination of the BSP.

- Adoption of stricter policy guidelines in the acceptance of second-endorsed checks to ensure that they are not being used as instruments for money laundering or other illegal activities. For this purpose, banks were required to limit the acceptance of second endorsed checks from properly identified clients and only after establishing that the nature of the business of said client justifies, or at least, makes practical the deposit of second endorsed checks.

Mergers and Consolidations and Developments Related to Payments System

Mergers and Consolidation

- During the period under review, the banking system saw six mergers and/or consolidations involving four commercial banks and eight rural banks.

Payments System

- Launching and implementation of the Bangko Sentral's Real Time Gross Settlement System (RTGS), the Philippine Payment System (PhilPaSS). During its initial run, PhilPaSS was used by 39 commercial banks, 26 thrift banks and one non-bank with quasi-banking function with capacity to accommodate the RTGS facility. The development of the PhilPaSS was initiated jointly by the BSP and the Bankers Association of the Philippines (BAP) to improve the efficiency of the existing Multi-transaction Interbank Payments System (MIPS2) by allowing the banks to interface directly with the automated accounting and settlement systems of the BSP.

Other Significant Developments

Fixed Income Exchange

- Approval of the creation of three technical working groups to look into the policy issues surrounding the development of a Fixed Income Exchange (FIE), a market reform initiated by the Bankers Association of the Phiippines (BAP). The working groups shall study: 1) the reserve requirement structure with the view of enhancing its compatibility with an accelerated market development; 2) the possibility of appointing the BSP as a central custodian of banks' holdings of government securities; and 3) the grant of a trust and quasi-banking function for the proposed Philippine Deposit and Trust Company, one of the corporate structures in the FIE.

Bancassurance

- Issuance of guidelines governing banks' sale of the financial products such as insurance products of their allied undertakings or investment house units.

Basel II

- Basel II prescribes complex methodologies for computing capital requirements. The reason is that the computation is intended for the more sophisticated and internationally active banks. In this regard, the Philippines intends to subject its universal and commercial banks to such standards. However, the Philippines also intend to apply the Basel II principles (i.e., among others, to ensure that a bank's risk exposures, not just credit risks, are captured by the capital framework) on its less complex banking institutions such as the thrift and rural banks. This may mean prescribing to such institutions a simpler methodology for weighing risks not covered by Basel I (i.e. operational risk).

- The supervisory review process for non-domestic banks should fall on their home country supervisors. However, to the extent that branches of non-domestic banks have to comply with Pillar I (minimum capital requirement), the BSP would have to validate the methodologies used in arriving at such measure.

POLAND

The condition and performance of the Polish banking sector during the period under review was directly influenced by the economic environment. The GDP growth at the end of 2002 came to 1.3%. An important factor is the clear upward trend which indicates that the worst period of economic slowdown has been overcome. The comparatively good economic results of the first months of 2003 (with GDP growth at 2.5%) indicates that the situation of banks will improve noticeably.

In 2002, the number of commercial banks in Poland went down from 71 to 62 as a result of the following developments:

- The merger of Powszechny Bank Kredytowy SA with Bank Przemysłowo-Handlowy S.A.

- The merger of six co-operative banks and subsequent establishment of Bank Polskiej Spółdzielczości SA.

- The takeover of Dolnośląski Bank Regionalny by Bank Polskiej Spółdzielczości S.A.

- The merger of Pomorsko-Kujawski Bank Regionalny with Gospodarczy Bank Wielkopolski S.A.

Two new banks commenced activity: MHB Bank Polska SA and Bank of Tokyo Mitsubishi S.A.

At the end of 2002, 47 banks controlled by foreign investors accounted for 79% of capital funds and 68% of total assets of financial sector. The banks had taken 62% of deposits from non-financial customers and originated 71% of loans outstanding less provisions.

The three banks directly controlled by the Treasury accounted for 25 % of assets, 21% of loans, 30% of deposits and 15% of capital funds.

The largest investments in the Polish banking sector had been made by German, American, Dutch and Irish investors. The equity held by these investors represented respectively 16.7%, 13%, 6.9 %, and 4.8% of authorized capital of the commercial banks.

The assets of the commercial sector have decreased (down 1%) for the first time since 1993.

The reasons for the decline are:

- New valuation principles introduced at the beginning of the year 2002
- Very low growth of credit action for non-financial sector
- Considerable increase in specific reserves
- Consolidation processes

In 2002, for the first time in 13 years, the non-financial customer deposits fell (by 3.6%). The outflow of deposits was determined by lowering of the interest rates, introduction of interest income taxation and very slow growth of disposable income among the population.

The banks have been strengthening their market position by developing electronic banking services, using such channels as the Internet and mobile phones. Most large banks and an increasing number of smaller ones (including cooperative banks) are offering account access via Internet. Three banks operate own " virtual" retail banks.

The number of banking cards in use reached 17 million. The number of transactions exceeded 123 million in fourth quarter of 2002 (versus 108 million in 4Q 2001).

Cooperative banks have increased their share of total assets of the banking sector (to 5%), capital (4.8% , up 0.2%), credit portfolio (6.5%, up 0.7%) and non-financial sector deposits (6.2%, up 0.6%).

PORTUGAL

Main Developments

The legal framework regulating banking activities has been revised on several fronts. Among the most significant changes is the creation of a new category of credit institution, named "financial credit institution", which will be entitled to perform all operations permitted for banks, with the exception of taking deposits. In addition, the Deposit Guarantee Fund has been given the legal power to take any preventive action that may be needed to restore the soundness of a member institution.

Also during the period under review, regulations concerning mandatory provisions on potential capital losses and non-performing loans were considerably tightened.

Basel II

All banks are at present subject to EU capital adequacy requirements (based on the 1988 Basel Capital Accord) and will be subject to the new requirements that will be based on the New Accord.

ROMANIA

There has been a continued harmonization of Romanian banking legislation with the EU directives.

The provisions of the new Banking Act are in line with those of EU directives on banking and refer principally to the following:

-defining the necessary concepts in order to implement the Community law and to ensure supervision on a consolidated basis;

-creating a legal framework concerning the freedom of establishment and the freedom to provide services of the Member States' credit institutions, making possible the granting of a single license recognized throughout the Community and the application of the principle of home Member State prudential supervision (these provisions will come into force beginning with the accession date);
-establishing the activities that may be carried out by the credit institutions on the basis of mutual recognition, and the conditions under which these provision might be applied to financial institutions;
-laying down the principles determining the competent authorities for the prudential supervision on a consolidated basis;
-introducing provisions on the recognition of contractual netting agreements for different types of operations;
-modifying the requirements regarding the level of capital held by the significant shareholders and establishing the cases when the prior notification to National Bank of Romania is needed;
-increasing the exigency regarding the level of allowed investments in non-financial institutions;
-introducing provisions regarding the cooperation between the National Bank of Romania and the competent authorities from Member States, and regarding the notifying obligations;
-establishing the procedures taking place in case of liquidation of banks as Romanian legal entities which carry out activities in other Member States (these provisions will be applied beginning with the accession date);
-laying down the conditions under which the banks as Romanian legal entities are allowed to establish branches abroad, including within the Member States area;
-improving and completing the provisions regarding the special administration of banks; and
-ensuring an appropriate legal framework allowing the National Bank of Romania to issue regulations regarding internal control.

During the period under review, the following regulations came into force:

-NBR Regulation no. 5/2002 on classification of credits and investments, and the establishment, adjustment and use of the specific credit risk provisions;
- Methodological Norms no. 12/2002 for the application of Regulation no. 5/2002 on classification of credits and investments, and the establishment, adjustment and use of the specific credit risk provisions (introduces an additional classification criterion 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);
-NBR Rules no. 16/2002 on minimum capital requirements of domestic banks and of foreign banks' branches (sets an increased level of the minimum capital and of the own funds than that imposed by the provisions of the Directive 2000/12/EC);
-NBR Rules no.1/2003 amending NBR Rules no. 10/2002 on financial derivative instruments;
-NBR Rules no. 8/2002 on consolidated financial statements of credit institutions;

-NBR Rules no. 11/2002 amending the NBR Rules no. 8/1999 on limitation of the credit risk of banks-includes the financial derivative instruments in the calculation of the solvency ratio; and
- NBR Rules no. 3/2003 amending NBR Rules no. 2/1999 on bank licensing.

As regards the accounting system of banks, in order to apply in the most appropriate manner the Accounting Regulations harmonized with Directive No. 86/635/EEC and the International Accounting Standards, Order no. 188/2003 has been issued by the Minister for Public Finance and NBR Governor. With the same purpose, a commission has been established to analyze and work out problems arising from the application of accounting regulations. The commission includes representatives of credit institutions, audit firms and officials from the Ministry of Public Finance and the NBR.

Through 2003, the commission plans to issue a practical accounting guide which will approach the problems concerning the International Accounting Standards applied to the credit institutions (IAS 21, IAS 30, IAS 32, IAS 37, IAS 39) in order to facilitate their proper application.

In the payment field, there has been the continued implementation of the new inter-bank electronic payment system, a working group being created within the National Bank of Romania, which has been assisted by international financial institutions.

For the time being, there is no RTGS system operating in Romania. Following the finalization of a project partially financed by the PHARE program of the EU Commission, it is expected that an RTGS system will be introduced by the end of the year 2003. Participants in the system will be the National Bank of Romania, banks, the State Treasury, the headquarters of credit cooperatives and other inter-bank clearing houses and settlement account holders (paper-based inter-bank clearing house, Visa, Mastercard, the Bucharest Stock Exchange, the National Company for Clearing, Settlement, Depository of Securities).

In the meantime, the GSRS (government securities registration and settlement system) and an ACH system (Automated Clearing House) are expected to be implemented by the end of 2005.

It is intended that this system will observe the principles set out in the report of the CPSS entitled " Core Principles for Systemically Important Payment Systems" (BIS, January 2001) and all ECB recommendations, standards, rules and provisions in the payment and settlement systems field.

The Romanian legal framework for payment and settlement systems is presently undergoing a review process in order to adjust it to the relevant European directives.

Another change regarding the payment system concerns the fact that starting on July 1, 2003 the funds transfers and the settlement operations in relation with the State Treasury will no longer be carried out by the National Bank of Romania, but by the the National Company for Funds Transfer and Settlement (TansFonD S.A.), as National Bank of Romania's authorized agent.

With regard to the movement of capital, the NBR Regulation no. 3/1997 on the performance of foreign exchange transactions has been amended by two circulars as follows:

-Circular no. 37/2002- abrogates the provisions which prohibited the current foreign exchange transactions denominated in LEI between non-residents, and allows non-residents to participate on the foreign exchange market; it also lays down the liberalization of financial loans and credits granted by residents to non-residents; and
-Circular no. 5/2003 –eliminates administrative barriers in the field of capital movement by abrogating the Norms regarding the circulation of the "order of external foreign currency payment "(DPVE) and "L/C opening request" (CDA), and the Norms regarding the control of the export proceeds and of other transactions with foreign countries.

During the period under review, Law no. 541/2002 was issued regarding savings and loan associations, providing the legal framework needed for the functioning of another type of credit institutions, thus making possible long-term housing financing.

As a consequence, the National Bank of Romania will issue till the end of this year the proper rules regarding the licensing, functioning and prudential supervision of these credit institutions, the regulating process being already in an advanced stage of developing.

Developments with regard to Credit Cooperative Organizations

The National Bank of Romania has continued the regulation process for credit cooperative organizations which have the status of credit institutions.

The regulations regarding the prudential requirements observed by banks have been modified and completed in order to be applied also to credit cooperative organizations.

Thus, during the period under review, the following rules have been issued, harmonized with relevant EU directives:

- NBR Rules no. 13/2002 on minimum capital requirements of credit cooperative organizations and on minimum aggregated capital requirements of credit cooperative networks;
- NBR Rules no. 14/2002 on the own funds of credit cooperative organizations and of credit cooperative networks;
- NBR Rules no. 20 /2002 amending NBR Rules no. 8/1999 regarding limitation of the credit risk of banks;
- NBR Regulation no. 7/2002 amending NBR Regulation no. 5/2002 on classification of credits and investments, and the establishment, adjustment and use of the specific credit risk provisions and Methodological Norms no. 12/2002 for its the application;
- NBR Rules no. 19/2002 regarding changes in situation of credit cooperative organizations;
- NBR Rules no. 7/2002 on large value funds transfer within a credit cooperative network;
- NBR Circular no. 31/2002 amending NBR Regulation no. 1/2002 on large value funds transfer; and

- NBR Circular no. 35/2002 regarding the applying of the rules issued by the National Bank of Romania in the field of payment system to the credit cooperative organizations.

Depositor Protection Arrangements

A draft law has been issued regarding the Banking Deposits Guaranty Fund, which is planed to enter into force at the end of 2003 and which is in compliance with the provisions of the Directive 94/19/EC on deposit guaranty schemes.

Anti-Money Laundering Developments

During the period under review, Law no. 656/2002 was issued on the prevention of money laundering, replacing the former Law no. 21/1999 which regulated this field. The new law improves the legal framework as follows:

-better defines money laundering and suspicious transactions;
-extends and diversifies the entities which are subject to the law;
-strengthens the sanctions to be applied in case of non-compliance with the law;
-sets forth the obligation of the National Office for the Prevention and Control of Money Laundering to take part in the special training programs for representatives of the entities subject to the law, so that they could recognize suspicious transactions which can be linked with money laundering;
-introduces the control obligation in the field of money laundering for the financial control and prudential supervision authorities;
-establishes that the information subject to the bank and professional secrecy is opposable neither to the criminal investigation bodies nor to the judicial instances;

The Draft Emergency Ordinance amending the Law no. 58/1998-The Banking Act stipulates the obligation for banks to provide any information requested by the public prosecutor in pursuing and investigating money laundering, financing of terrorism, illicit traffic of weapons, trafficking in drugs, and organized crime.

Market Developments

The period under review included the following developments:

- the first bank specializing in micro-financing –MIRO Bank S.A.—entered the market;
- the National Bank of Romania authorized the first credit cooperative network;
- the merger of two banks with common shareholders (Raiffeisenbank Romania S.A. with Banca Agricola-Raiffeisen S.A.); and
- the withdrawal of the functioning licenses of three banks with majority private capital (Banca Rom`n[ de Scont S.A., Banca de Inveti\ii =i Dezvoltare S.A., Banca Turco-Rom`n[S.A.).

In November 2002, the privatization of Banc Post was completed with the purchase by the Greek bank EFG Eurobank Ergasias of the shares held by the Authority for Privatization and Management of State Ownership (17% of equity capital).

In addition, the purchase of the main shares of Demirbank Romania S.A. (becoming UniCredit Romania S.A.) and of Banca Comerciala Unirea (becoming Nova Bank S.A.) by foreign investors led to a consolidation of the foreign capital position in the banking market.

Basel II

No banking institution licensed to operate in Romania will remain subject to Basel I or will be exempted from the application of Basel II. While implementing Basel II, the standardized approach will be followed in the first stage.

SINGAPORE

Introduction

The period under review was a challenging one, as the Iraq war, ongoing global terrorist threats and most significantly, the severe acute respiratory syndrome took a toll on the domestic economic growth. Nevertheless, in the face of these challenges, the Monetary Authority of Singapore (MAS) has sustained its efforts to promote a stronger and more dynamic financial industry in Singapore.

On the strategic development front, the Financial Services Working Group, set up by the Economic Review Committee at the beginning of 2002, has identified three promising niche areas for the local financial industry - wealth management, universal processing centers and an Asia Risk Exchange (ARX).

In identifying wealth management, the Working Group singled out alternative assets, such as private equity and hedge funds, as areas for development. For universal processing centers, these aim to consolidate global transactional flows into Singapore. The ARX, on the other hand, strives to integrate Singapore's existing insurance and capital market expertise into a new physical vehicle for the transfer of large and sophisticated risks and to fill a market gap for risk transfer in the Asia Pacific time zone. Both universal processing centers and the ARX are to leverage on Singapore's key strengths in efficiency, technology and infrastructure.

Regulatory Supervision Approach

MAS will continue to adopt the following supervisory approach:

- Shift away from regulator as "gatekeeper" to a greater focus on disclosure;
- Move to more integrated rules and consistent market conduct standards across institutions and sectors;
- Emphasize risk-based approaches, greater levels of transparency and more interactive relationships with market participants; and

- Focus on helping investors to be better equipped to make financial and investment decisions.

To enhance its consultation with industry and public on major policy initiatives, MAS has formalized guidelines in October 2002 governing industry and public consultation and implementation of MAS-administered legislation. These guidelines ensure that industry or public consultation and publication of MAS' responses are standard procedures when significant changes are introduced in the regulatory framework for financial services. This enables market practitioners and the public to provide timely feedback to the MAS in developing sound and responsive regulations for the financial sector.

On a separate note, the Board of Commissioners of Currency, Singapore officially merged with MAS on October 1, 2002. The purpose of the merger is to streamline the institutional structure and also enable MAS to rationalize common functions and bring about efficiency gains, without compromising the overriding objective of managing currency and maintaining confidence in the Singapore dollar.

Banking Developments

The liberalization program of the financial industry to broaden access to domestic wholesale banking and further enhance competition in domestic retail banking continued apace in the period under review. With the award of 8 more Wholesale Banking (WB) licences in May 2003, MAS has completed the major part of the second phase of the banking liberalization program. Over time, all Offshore Banks would be upgraded progressively to WB status.

As part of its anti-money laundering measures against terrorist activities, MAS (Anti-terrorism Measures) Regulations 2002 came into effect on September 30, 2002. The regulations supersede the previous system of implementing United Nations Security Council sanctions by means of directives sent to individual financial institutions. Broadly, the regulations prohibit financial institutions from:

- providing funds to or collecting funds for terrorists;
- dealing with property of terrorists; and
- providing resources and services for the benefit of terrorists.

Other key regulatory changes, which took effect in the period under review, are as follows:

Housing Loans

While the financing limit for residential property purchases remains unchanged at 80% of the purchase price or valuation, whichever is lower, borrowers may, with effect from September 1, 2002, use their CPF savings for up to 10% of the property value as part of the 20% down payment for residential properties. The remaining 10% must be made out of cash from the borrower.

In addition, banks and financial institutions regulated by MAS are allowed to provide loans to HDB flat buyers from January 1, 2003. The cash down payment for these loans, initially at 0% for purchases made on or before December 31, 2003, will increase by 2% a year until it reaches 10% for purchases made from January 1, 2008.

Publication of Accounts
For financial years beginning from or after January 1, 2002, banks are additionally required to disclose in their publications the means by which the complete set of audited financial statements, list of bank directors and subsidiaries can be obtained by the members of the public.

Bridging Loans for the Purchase of Immovable Properties
The criteria for granting of unsecured bridging loans for the purchase of immovable properties were aligned with other unsecured credit facilities, i.e. the borrower must satisfy the minimum annual income of $30,000. The credit limit for such unsecured bridging loans, when aggregated with the borrower's other unsecured credit facilities, shall not exceed 2 times his monthly income effective from January 1, 2003.

Banking Secrecy – Conditions For Outsourcing
MAS outlined conditions for outsourcing arrangements involving the disclosure of customer information between a Singapore bank and a service provider outside Singapore. These conditions cover, among other items, vendor selection criteria, client confidentiality, outsourcing agreements and contingency measures. The conditions will apply with effect from February 19, 2003.

Unsecured Credit Facilities to Individuals
MAS issued updated rules on unsecured credit facilities to individuals. Financial institutions are restricted to granting unsecured credit facilities to individuals with annual income of $30,000 or more, effective April 3, 2003. The maximum loan quantum, in aggregation with other unsecured credit facilities, shall not exceed the borrower's 2-month income, subject to exceptions such as ACU loans to non-residents and expatriates, education loans, home renovation loans, loans to sole-proprietorships and partnerships for business purposes etc.

Car Loans
MAS liberalized lending for car purchases by lifting the restriction on the 70% maximum financing quantum and 7-year maximum loan tenure for car loans. Car loans form a small proportion of financial institutions' total loan portfolio, and the level of non-performing car loans is also low. The lifting of the limits with effect from January 22, 2003 is in line with MAS' shift from a one-size-fits-all supervisory approach to a risk-focused approach.

Outsourcing of Cash and Check-related Transactional Services to Another Bank
From November 20, 2002 banks that are allowed to operate from only one place of business in Singapore, can apply to MAS to outsource their cash and check-related transactional services to another bank in Singapore. This is provided that the outsourced services are not at the same time offered at the premises of the outsourcing bank.

Technical Paper on Credit Stress-Testing
In March 2003, MAS issued a technical paper to help risk managers design and implement a credit stress-testing program and enhance understanding of credit stress-testing.

Guidelines on Sound Risk Management
MAS issued a set of guidelines on sound risk management practices for industry consultation in October 2002. The consultative paper covers the measurement and management of credit, market and liquidity risks, as well as internal controls that will help mitigate operational risks.

The guidelines highlight best practices with emphasis on three key pillars:

- effective board and senior management oversight;
- sound risk management policies and operating procedures; and
- strong risk measurement, monitoring and control capabilities commensurate with the risk taken.

Consultation Paper on Proposed Corporate Governance Framework
In February 2003, MAS issued a consultation paper on a set of proposed guidelines and regulations to enhance the existing corporate governance framework for locally incorporated banks and direct insurers. The paper consists of guidelines on the principles of corporate governance and disclosure, and regulations on corporate governance.

The proposed regulations define clearly what is meant by an independent director and set out the requirements for the composition of the board of directors and board committees, such as the Nominating Committee, Remuneration Committee and Audit Committee. They also require the separation of the roles of Chairman and Chief Executive Officer (CEO)/Principal Officer

Consultation Paper on Cyclical Shareholding Arrangements within Banking Group
Under MAS' anti-commingling policy, banks in Singapore must focus on their core financial business, so as to minimize contagion risk and conflict of interest. The policy includes measures to achieve a clear and more transparent ownership and control structure. In line with this policy, MAS issued a consultation paper on Cyclical Shareholding Arrangements within Banking Group on May 22, 2003.

The paper proposes limiting shareholding stakes held in the bank by affiliated entities of the bank to an aggregate 2% of the bank's share capital. This will restrict cyclical shareholdings (e.g. where A holds shares in B and B holds shares in A) which may mask the sources and extent of control within the banking group, weaken the internal discipline to appraise investments made in affiliated parties, and diminish the influence of minority shareholders and dilute market pressure on the companies in the group.

Consultation Paper on Draft Consumer Protection (Fair Trading) Bill
In February 2003, MAS issued a consultation paper on a draft Consumer Protection (Fair Trading) Bill to gather feedback on applying the draft Bill to transactions involving financial investments and services, as well as on consequent modifications proposed to

certain provisions of the draft Bill. The primary focus of the draft Bill is to protect consumers who lack the expertise or financial resources to guard themselves against unfair trade practices and empower consumers who encounter unfair practice by providing recourse to civil remedies. MAS is considering the feedback received from the consultation exercise.

Consultation Paper on Proposed Principles for Business Continuity Planning
In January 2003, MAS issued a consultation paper on proposed principles for Business Continuity Planning (BCP) to strengthen financial institutions' resilience against widespread disruptions. The guidelines will help financial institutions raise their awareness and preparedness by having in place effective and comprehensive BCP.

Proposed Technology Risk Management Guidelines
In November 2002, MAS issued a set of proposed Technology Risk Management Guidelines. The proposed guidelines aim to

- promote the adoption of robust technology risk management practices by all financial institutions;
- strengthen their security posture against cyber crimes, viruses, worms, hacking exploits and other forms of digital attacks, including potential acts of terrorism and cyber warfare; and
- help financial institutions in recognizing and understanding the dynamism and significance of network, Internet and web vulnerabilities and threats, and the actions they should take to manage these risks and exposures.

A robust technology risk management framework requires financial institutions to implement risk control policies and maintain a security posture that adequately protects their information assets.

Consultation Paper on the proposed features of a deposit insurance scheme in Singapore
In August 2002, MAS released a consultation paper on the proposed features of a deposit insurance scheme in Singapore. The main objectives of the deposit insurance scheme are to provide small depositors protection, and dispel the mistaken perception of an implicit government guarantee on deposits. The proposed scheme will cover all Singapore dollar deposits held by individuals up to a limit of $20,000 and will be backed by a fund targeted to reach 0.3% of insured deposits.

The on-going study will also examine the administrative and legal issues related to the establishment of the deposit insurance scheme. These include the organizational structure of the scheme, depositor payout process, public awareness programs and the deposit insurance legislation. The study is targeted for completion by end 2004 and MAS will consult with the industry and other interested parties on the recommendations.

Developments in the Treasury

Singapore is a global treasury center for both foreign exchange and derivatives activities. Global players continued to consolidate their Asian time zone foreign exchange and derivatives business into Singapore in 2002.

Singapore is the 4th largest foreign exchange center in the world. FX trading remained steady in 2002, with total turnover value of S$43 billion. Derivative trading activity was strong amidst the heightened uncertainties in the global financial market. Trading activity was especially strong in the Eurodollar futures, MSCI Taiwan Index future and Nikkei 225 Stock Index futures. Five new products were launched on SGX-DT in 2002: the Japanese Government Bond futures and options, the MSCI Japan Index futures, Single Stock futures and Middle East Crude Oil futures.

Developments in the Debt Market

The Singapore bond market has grown significantly to provide an important source of longer-term financing for local and foreign corporations, international organizations and governments. The corporate bond market continues to see strong interest from foreign issuers. 2002 was a record year in the volume of issuance and number of issues from foreign entities. Another positive development is the continued growth in the issuance of structured debt and the increase in the diversity of the types of structured products.

Total outstanding corporate debt volume grew by 10% in 2002, from S$80.8 billion in 2001 to S$89.2 billion. In tandem with the global decline in corporate debt issuance and a slow economic environment, the total volume of new corporate debt issuance fell by 48% in Singapore in 2002. However, the total number of corporate debt issues increased from 1,450 in 2001 to 1,769 issues in 2002.

The volume of Singapore dollar (S$) denominated bonds issued by foreign entities grew by a strong 76% and at S$3.2 billion, accounted for 18% of total S$ issuance. Among others, large international issuers, such as triple-A-rated Freddie Mac, tapped the S$ debt market for the first time. Structured products such as credit derivatives, equity-linked notes and asset securitization transactions made up 56% of the S$ denominated market in 2002, up from 47% in 2001. The Singapore debt market has already seen several structured debt products issued in the market this year, including Collateralized Debt Obligations (CDOs).

Developments in the Equities and Derivatives Markets

The implementation of the final phase of the Securities and Futures Act (SFA) and the Financial Advisers Act (FAA) took effect on October 1, 2002. This final phase puts into operation specific parts of the SFA, including Markets, Clearing Facilities, Capital Markets Services License & Representative's License, Accounts, Customer Assets & Audit, Conduct of Business, Disclosure of Interest, and Market Conduct.

The new legislative regime updates the regulatory framework relating to the capital markets to take into account recent developments in globalization, technology and innovation. It further provides a sound and transparent set of rules for market participants, and at the same time the flexibility to accommodate market innovation.

On October 1, 2002, MAS also released Notices and Guidelines to support the implementation of the SFA and the FAA, covering:

- Minimum Entry and Examination Requirements for Representatives
- Cancellation Period for Unit Trusts
- Licence Applications and Payment of Fees
- Criteria for the Grant of a Licence
- Recommendations on Investment Products
- Information to Clients and Product Information Disclosure
- Appointment and Use of Introducers by Financial Advisers
- Reporting of Misconduct of Representatives by Financial Advisers
- Standards of Conduct for Financial Advisers
- Use of the Term “Independent” by Financial Advisers
- Fit and Proper Criteria

Separately, on September 24, 2002, MAS issued subsidiary legislation under the SFA to implement the new risk-based capital (RBC) requirements for holders of Capital Markets Services (CMS) Licenses with effect from October 1, 2002. The regulations introduce a risk-based capital regime for holders to:

- deal in securities or trade in futures contracts as a member of a securities exchange, futures exchange or clearing house; and
- streamline capital requirements for other classes of holders, as well as set out margin requirements for holders providing securities financing. Existing dealers and futures brokers who are members of a securities exchange, futures exchange or clearing house will have a grace period of 12 months to comply with the new financial requirements.

During the year, MAS issued several consultation papers that related to enhancements to the regulatory framework for the Singapore capital markets:

- In July 2002, MAS released a consultation paper on the proposed capital framework for CMS licence holders who are not members of the Singapore Exchange (SGX);
- In August 2002, a consultation paper was issued relating to new guidelines for the offer of retail hedge funds and retail futures and options funds;
- In December 2002, a consultation paper was issued relating to revisions to the property fund guidelines;
- In March 2003, consultation papers were issued on a proposal to issue temporary representative's licence to individuals residing outside Singapore and on proposals relating to the approval of arrangements between foreign companies and locally regulated affiliates under the SFA and FAA; and
- In April 2003, consultation papers were issued on amendments to the SFA and FAA, which included draft versions of the Amendment Bills. These amendments will

improve the operational efficiency of the two Acts, especially with regards to provisions relating to offers of investments.

The SGX has announced its intention to restructure its operations to serve its customers better and focus on being a market-led, fully integrated organization. SGX's new organization will be developed around the exchange's principal customers - institutions, intermediaries, issuers and the retail market so as to serve the various customer segments, remove duplication of operations and better meet customer needs.

From January 22, 2003, SGX introduced separate membership categories for securities trading and clearing. In line with the new RBC framework, the segregation of clearing and trading rights allows members to comply with significantly lower capital requirements commensurate with the risks they take on. The new structure also allows market participants greater flexibility in the way they can structure their businesses and choose how they wish to operate in the equities market.

Both MAS and SGX have supervisory responsibility over SGX's securities and derivatives members. From July 1, 2003, MAS will assume the primary responsibility for on-site inspections of these members in a move to provide a more efficient supervisory regime for SGX member firms by streamlining on-site inspections under a single body. The transfer of the inspection function from SGX to MAS also provides greater clarity in regulatory responsibilities.

SGX will, however, retain other supervisory functions such as oversight of listed companies, granting SGX-access rights to brokers and registration of dealers, market surveillance, and risk management for clearing of securities and derivatives products. It will continue to monitor SGX’s securities and derivatives members’ compliance with SGX’s securities and derivatives business rules and also retain capital and other oversight of brokers and the right to conduct ad-hoc or other on-site inspections or investigations of brokers as warranted.

SGX also made changes to its listing rules which took effect from January 3, 2003 and is in the process of revising SGX-Securities Trading’s (SGX-ST) Rules. Other SGX initiatives to introduce new products and services include:

- In response to growing interest and market demand for stocks from a broader range of industry sectors, SGX and the Australian Stock Exchange Ltd (ASX) doubled the number of stocks available on their co-trading linkage with effect from March 31, 2003. As of June 30, 2003, 99 Singapore stocks and 97 Australian stocks were available for trading through the link.
- SGX has offered open-dated loan tenures under the SGX Securities Lending program from January 15, 2003. In open-dated lending, the securities borrowed can be held for an undefined period, subject to recall by The Central Depository (CDP), the Securities Clearing and Depository division of SGX.
- SGX launched a US$-denominated SGX Middle East Crude Oil (MECO) Futures contract for trading on the SGX Electronic Trading System (SGX ETS) on November 12, 2002, in cooperation with the Tokyo Commodity Exchange (TOCOM). SGX also added six Single Stock Futures (SSF) contracts fro trading on SGX-Derivatives Trading (SGX-DT) on August 15, 2002.

- On May 8, 2003, SGX announced that SGX-DT and Nihon Keizai Shimbun have reached an agreement to give SGX-DT the option to trade the Nikkei Futures and Options on its electronic trading system from 7am to 7pm Singapore time.

Developments in Fund Management

Singapore is one of the major centers for asset management in the Asia-Pacific region. An increasing number of financial institutions use Singapore as their base to conduct their investment activities.

Based on the 2002 MAS asset management survey, total assets under management in Singapore stood at S$343.8 billion at end-2002. This represents an increase of S$36.8 billion, or 12%, over the S$307 billion managed at end-2001. Of the discretionary assets managed in Singapore, 30% of the funds came from Singapore, 25% from Europe and 14% from North America. Compared to end-2001, there was a 5% growth in the amount of funds sourced domestically. The bulk of the discretionary funds were invested in Asia with 18% invested in Singapore and 51% in the rest of Asia Pacific.

There were 32 CPF-Approved Collective Investment Schemes (CIS) managers managing a total of 382 CIS, compared to 319 CIS at end-2001. Total CIS assets increased 35% from S$10.5 billion at end-2001 to S$14.1 billion at end-2002.

Other MAS regulations and guidelines issued on fund management business are as follows:

Guidelines for Retail Hedge Funds and Retail Futures and Options Funds
As part of its review of regulations to facilitate the offer of new investment products for retail investors, MAS issued new Guidelines for Retail Hedge Funds and Retail Futures and Options Funds on December 5, 2002.

The Guidelines for Retail Hedge Funds lower the minimum subscription levels for hedge fund-of-funds (FOHF) and capital protected or guaranteed hedge funds. They also require enhanced disclosures in prospectuses and marketing materials of hedge funds on the unique features of investing in a hedge fund as compared to other types of collective investment schemes, the risks involved and risk controls. These Guidelines also specify different minimum subscription levels for:

a. Single hedge funds, which may be offered with a minimum initial subscription of S$100,000 per investor;
b. FOHF, which may be offered with a minimum initial subscription of S$20,000 per investor; and
c. capital protected and capital guaranteed hedge funds, for which there will be no minimum subscription.

The MAS Guidelines for Retail Futures and Options Funds, on the other hand, cater to schemes whose primary objective is to invest in financial and commodity derivative contracts. As a general rule, futures and options funds should be diversified across instruments and maturity periods.

Revised Property Fund Guidelines
To raise property funds' permitted gearing level, MAS revised its Property Fund Guidelines on March 28, 2003 to give property funds more flexibility in managing their capital structure and to enhance risk disclosure in the prospectuses of such funds. Under the revised guidelines, a property fund can borrow up to 35% (25% previously) of the fund's deposited property. Furthermore, property funds with good credit ratings may borrow more than 35% of their deposited property.

New Regulations on offers of collective investment schemes
On May 23, 2002, MAS issued new regulations on offers of collective investment schemes (CIS) under the omnibus Securities and Futures Act (SFA) and a new Code on CIS. The new regulations are inter alia, aimed at enhancing disclosure requirements of CIS prospectuses and marketing material, and enabling a greater variety of CIS products to be offered to Singapore investors.

Enhancing Disclosure: To raise the standard of prospectus disclosure, prospectuses lodged with MAS will be subject to a minimum two-week holding period and posted on OPERA (Offers and Prospectuses Electronic Repository and Access), a new database launched on the MAS website. MAS may refuse to register a prospectus if it does not satisfy the disclosure requirements or if its registration is not in the public interest. In addition, the checklist for CIS prospectuses has been revised to make it more user-friendly and the advertising regulations have been augmented to prevent false and misleading advertisements.

Greater variety of investment products: Foreign funds that fulfill certain regulatory requirements may be offered directly to the public. The SFA also differentiates between offers of CIS to retail and sophisticated investors. Offers to sophisticated investors will be subject to less stringent requirements.

Trustee requirements: Additionally, the new regulations set out financial and other requirements for trustees of CIS as a further protection for investors.

Code on CIS: The Code sets out best practices on the management, operation and marketing of CIS that fund managers and trustees of CIS are expected to observe.

Financial Sector Tax Incentive Scheme

MAS released the details of the Financial Sector Incentive (FSI) scheme on April 1, 2003. The FSI scheme streamlines the existing tax incentive scheme and encourages the development of high-growth and high value-added financial activities in Singapore.

Broadly, under the FSI Scheme, qualifying activities are categorized as:
Enhanced tier taxed at 5%; or Standard tier taxed at 10%.

Developments in the Insurance Industry

An important event in 2002 was the full implementation of the Financial Advisers Act (FAA) in October. This act provides the framework for a disclosure-based regime, which maintains fair and efficient markets and sets high standards of professional conduct for the distribution of investment products, including life insurance products. This would in turn help investors make well-informed decisions.

Since the implementation of the (FAA), local and foreign companies have expressed interest in setting up operations in Singapore. New business models have also taken shape. Some financial advisers are moving towards fee-based services, though most still rely on commissions to generate their income.

The FAA sets the minimum entry and examination requirements for representatives. Besides being professionally qualified, representatives must also be competent, efficient, and honest, and have integrity and sound financial standing. MAS has issued a set of guidelines to financial advisers to help ensure that they employ fit and proper persons.

The past year also saw significant developments in the general insurance industry's effort in enhancing market discipline and practice standards. After a year of hard work, the General Insurance Association of Singapore (GIA), Singapore Insurance Broker Association, and MAS have jointly transformed the CESGI recommendations into two concrete documents: the Code of Practice which represents the minimum sales and customer service standards, and the Continuous Profession Development requirements detailing the training and competency that front-end operators are expected to achieve.

Through the implementation of the CESGI recommendations, it is envisaged that the general insurance industry would achieve higher standards of service, increased accountability, better transparency, and enhanced customer satisfaction.

As part of the measures to strengthen the protection of policyholders' interests, MAS is rigorously developing two new regulatory frameworks that will be introduced in 2004. Firstly, the risk-based capital framework seeks to build a capital requirement that reflects relevant risks faced by the insurance companies so that capital will serve as an effective buffer to absorb fluctuations in asset and liability values. It will also provide clear information on the financial strength of insurance companies and facilitate early and progressive intervention by MAS. The health insurance regulatory framework, on the other hand, aims to strengthen the prudential and market conduct requirements for health insurers and also help ensure that they are able to meet their obligations.

Singapore's Approach to the Implementation of Basel II

Singapore banks have, in the last few years, been actively gearing up their risk measurement and management infrastructure and capability, not solely for the purpose of Basel II IRB preparation but also to enhance their risk management practices. The principles and rationale of, and the advancement in risk management brought about by, Basel II is in general welcomed by the Singapore banks.

SPAIN

The most significant changes in the Spanish financial regulatory framework during the period under review derived from the Law 44/2002 on Reform Measures of the Financial System that has introduced partial, but sometimes quite important, changes in certain aspects of the legislation of credit institutions, investments and insurance services, with the aim of modernizing and encouraging the development of the Spanish financial industry.

Some of these changes refer to the institutional structure of the markets, like those directed to facilitate the integration of all the clearing and settlement Spanish systems that, until now, have operated in a totally separate way: the clearing and settlement of the Stock Exchanges, the public debt market book-entry system and that of the "AIAF Mercado de Renta Fija" (the official market for non-governmental bonds and other fixed income securities).

Other changes contained in this Law include the following: the regulation of central counterparties in those systems; the legal creation of a new kind of security, the "cedulas territoriales", similar to those in Germany, that will permit credit institutions to efficiently securitize their portfolios of loans and credits to the Government and other official bodies; the increasing scope of the netting to certain financial collateral arrangements covered by master agreements, although the European Directive on this subject has not yet been implemented; a new regulation on the so called "cuotas participativas" of the savings banks (transferable shares without any political right through which these specific institutions, representing nearly half of the volume of the Spanish financial system, will be able to raise capital without issuing it); the regulation of the electronic money institutions according to the European Directive related to them; and the implementation of the European Directive on market abuse.

Apart from the Law 44/2002, there have been important changes in the areas of combating money laundering and the financing of terrorism. The Law 12/2003 has implemented a specific system that will permit a governmental body to block accounts and any kind of financial transactions that could be related to terrorists or to the financing of terrorist groups, without any previous license or intervention of a judge. Another new law implements the second European Directive on money laundering, which increases the scope of the prevention system to any kind of serious criminal offenses and to more professions or activities (auditors, lawyers, accountants, etc.). This last Law has, for the first time in Spain, regulated the issuance of preference shares establishing a favorable fiscal regime as well as the possibility of computing them as regulatory capital.

Other interesting developments that have occurred during the period under review include the reform of the regulation of tender offers of securities to admit some kind of conditional offers, and the enlargement of compulsory offers to certain cases in which, even without exceeding threshold percentages, the changes in the Board reveal that there has been a change in the control of the company.

Basel II

Implementation of Basel II in Spain will occur by means of the transposition of an EU Directive (CAD III) which will be binding for all banks and investment services firms, and which is not expected to include Basel I as an alternative model. With respect to the issue of home/host supervisors' respective roles in applying Pillar II, it is still a very open issue. Its discussion has just commenced both in Basel and at the EU level and the Spanish supervisory authority, Banco de España, is expected to act according to the conclusions reached in those forums.

SWEDEN

Legislative and Regulatory Developments

A new banking law will come into force on July 1, 2004. According to the new law, a bank will be defined as a business that has both payment services via general payment systems and accepts funds that may be called at a short notice.

According to the new rules, it will be possible for credit institutions other than banks (for example mortgage credit institutions and finance companies) to take deposits from the public. It will also be possible for companies that are not credit institutions to take deposits up to 50,000 Swedish kronor (about 5,500 euro). Companies that are not credit market companies will not be covered by the deposit guarantee scheme and will not be supervised by the Financial Supervisory Authority.

The government has also presented a final proposal for a law on covered bonds. The Swedish mortgage credit institutions have for a long time asked for this legislation which in the long run will decrease the costs of funding. The law is proposed to come into force on July 1, 2004. The Swedish framework will be broadly comparable to existing covered bonds legislation in other European countries.

Since July 1, 2002 the EU Regulation on cross-border payments in Euro apply also for 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.

During the year, the Riksbank took further steps to rationalize its cash management activities. The number of storage locations around the country will be reduced from 13 to 4 and the intention is that the cash management activities shall be transferred to private operators.

Market Developments

Both the earnings and the loan losses of the major Swedish banks have stabilized in recent quarters after the gradual deterioration that began at the end of 2000. However, the profitability has decreased by more than a third compared with the level in the late 1990s. The deterioration is mainly explained by the equity price fall and decreased stock market activity in the past two years. The profitability has also been under pressure from large pension allocations

For every year from 1990 to 2000, net interest income decreased as a share of total income, but 2001 and 2002 were characterized by a growth in net interest income and a decrease in other income items. Net interest income now accounts for almost 65 percent of total income while net commission income accounts for around 30 percent.

Loan losses have increased but they are still very low compared to the European average. Some of the large banks have implemented aggressive cost-cutting programs and they have lowered their costs considerably.

Lending to the public from Swedish banks and mortgage credit institutions has increased very fast during the last years. Mortgage lending to households increased by 10 percent in 2002 which mainly can be explained by the low interest rates and a rapid increase in house prices in the large cities. Lending from banks to households increased by 4 percent.

Market Developments

In November 2002, FöreningsSparbanken/Swedbank acquired the small HSB Bank, owned by the co-operative housing organization HSB. As a consequence FöreningsSparbanken will strengthen its position particularly in the Stockholm mortgage market.

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 region.

Swedish banks have a leading position in electronic and Internet banking. The number of customers using the banks' Internet services has increased rapidly since the introduction of these services in 1996. Somewhere between 35 and 40 percent of all Swedes use their banks' Internet services on a regular basis.

Basel II

Since all Swedish banks will follow the EU legislation on capital adequacy it is not expected that less complex banking institutions will be exempted from the application of Basel II. Nor is it expected that the Swedish Financial Supervisory Authority will apply any host country supervision to branches of non-domestic banks.

SWITZERLAND

New Anti-Money Laundering Ordinance of the Swiss Federal Banking Commission

The Swiss Federal Banking Commission (SFBC) has remodeled its 1991/1998 Anti-Money Laundering Guidelines into an Ordinance that came into effect on July 1, 2003. On customer identification and establishing the identity of beneficial owners, the new Ordinance refers to the Swiss Bankers Association's Due-Diligence Agreement.

Under the Ordinance, banks are obliged to take a risk-based approach to anti-money laundering measures. Banks must evaluate the reputational and legal risks involved in their banking activities. They have to categorize these risks and then assign all their customers to the defined risk categories. The banks can then work out their additional information requirements related to those customers in the higher risk categories. By definition, so-called "politically exposed persons" and large cash transactions qualify as "higher risks".

The Ordinance also translates the Financial Action Task Force's (FATF) Special Recommendation VII on wire transfers (originator information on wire transfers) and requires the banks to introduce electronic monitoring systems to facilitate the detection of higher risk transfers.

Banks that have branch offices located outside Switzerland or which control a financial group with non-Swiss group companies are required to manage their legal and reputational risks on a global basis. This may result in some extraterritorial effects of the new Swiss regulation.

Revised Due Diligence Agreement of the Swiss Bankers Association

For the fifth time the 1977 *Agreement of the Swiss Bankers Association on the Swiss banks' code of conduct with regard to the exercise of due diligence* was amended and reedited in 2002. The new version (CDB 03) will enter into force on July 1, 2003. It embodies the basic "know your customer"-standards practiced by Swiss banks for verifying the identity of individuals and legal persons and for establishing the identity of the beneficial owners behind account holders (individuals, shell companies, trusts etc.). This item of self-regulation is equipped with a Supervisory Commission and with a sanction system that can in case of violations by banks pronounce fines of up to 10 million Swiss francs.

The main new elements are connected with the fight against terrorism: dates of birth and the nationality of beneficial owners will be collected on Form A in addition to names and addresses as before. Scrutiny of charities is also to be improved.

The other new element is the procedure of verifying identity when business relations with an individual are opened by correspondence, e.g. over the internet. The new customer has to provide a certified copy of an identification document (passport, ID card, driver's license) at the very beginning, i.e. before the business relationship is established.

This is basically a standard of good banking. Contrary to the Swiss Federal Banking Commission's Money Laundering Ordinance, the Due Diligence Agreement does not call for a risk-based approach.

New SBA Directives on the Independence of Financial Research

In December 2002, the Swiss Bankers Association (SBA) issued new Directives to ensure the independence of financial research. This new piece of self-regulation was ratified by the Swiss Federal Banking Commission (SFBC) in January 2003 as representing a generally binding code of conduct.

The ultimate objective of the Directives is to maintain and enhance the reputation of financial research provided by the Swiss financial services industry - and the reputation of the Swiss financial center as a whole - by sustaining and strengthening investor confidence in the efficient operation of the Swiss capital market.

One important aspect is to reduce and eliminate the possibilities for conflicts of interest in the field of financial analysis. The Directives have three main areas of emphasis. Firstly, they call for "Chinese Walls" to be established between a financial institute's research department and other business areas that are relevant in the given context such as, for example, investment banking, securities trading and the credit department. Secondly, the Directives state that a financial analyst's reward must not be made dependent on the success of one or more specific transactions of the issuing or investment banking department. This measure is designed to prevent incentives that could give rise to biased analysis. Thirdly, financial analysts are not allowed to invest in firms which they themselves assess or in whose assessment they play a leading role.

The Directives generally apply to sell-side as well as to buy-side research, to primary as well as secondary analysis and to equity as well as fixed income research. They are another example of effective self-regulation and stand up favorably to international comparison.

Basel II

The revision of the "Basel Capital Accord" into "Basel II" is currently in progress. The Swiss Bankers Association (SBA) is closely following the work of the Basel Committee on Banking Supervision with the help of its special "Task Force Basel II". At the national level, the implementation of "Basel II" in Switzerland will be prepared by a mixed working group led by the Swiss Federal Banking Commission (SFBC). The SBA, together with the Swiss National Bank (SNB), the Swiss Institute of Certified Accountants and Tax Consultants and the Swiss Association of Independent Securities Dealers will be represented in this group which, at the time of writing, is in the process of being established and will soon become operative.

It is not planned to exempt less complex banking institutions from the application of "Basel II" and permit them to remain subject to "Basel I". As far as host country supervision is concerned, the SFBC has informally signaled that it is going to use a pragmatic approach. The SFBC will, of course, be interested in productive forms of international cooperation between regulatory authorities. With regard to the Internal-Ratings-Based-Approach such a cooperation could specifically mean that the SFBC is generally willing to accept credit risk models at branches of non-domestic banks if these branches use models of their foreign banking institution. However, in order to ensure appropriate Swiss standards for safety and soundness, the SFBC may perhaps demand additional capital charges.

Financial Market Supervision and the "Zimmerli" Group of Experts

At the end of 2001, the Federal Council appointed a panel of experts under the direction of Professor Ulrich Zimmerli to deal with subsequent legislative work in the final report of the financial market supervision panel of experts (Zufferey Report). As an initial measure, the panel of experts recommends "merging" the Swiss Federal Banking Commission and the Federal Office of Private Insurance to a new financial market supervisory authority with its own legal personality. In July 2003 the expert's panel submitted a draft of a federal law as well as a corresponding report to the Federal Department of Finance.

In a subsequent move the panel of experts will comment on enforcement provisions proposed by the Swiss Federal Banking Commission and on the question of upgrading the extensive (prudential) supervision of independent trustees, introducing brokers and exchange dealers. This question requires a more detailed examination. The corresponding work should be completed by the end of 2003 at the earliest.

Project concerning Initial Public Offerings

The Swiss Bankers Association (SBA) is currently working on possible new Directives for new securities issues, especially Initial Public Offerings (IPOs) and Secondary Public Offerings (SPOs). A special Working Group has assessed both the international as well as specifically national situation. The SBA's Board of Directors has mandated the Working Group to draft a text for potential Directives on the allocation of titles within public issues and placements.

As far as content is concerned, principles of transparency for the allocation to private clients and aspects regarding "Friends & Family" programs as well as the allocation to the own (nostro) account of a bank are expected to be some of the important elements in this draft. The Working Group will submit its suggestions to the Board of Directors in due course. In the case of a generally applicable code of conduct, the approval of the Swiss Federal Banking Commission will be needed. The project is another example of the SBA's approach to strengthening efficient and credible self-regulation of the Swiss banking sector.

Switzerland's New Consumer Credit Act

An amended Consumer Credit Act came into force in Switzerland on January 1, 2003. The main features of the amended legislation are:

- an obligatory check of the borrower's credit capacity to be carried out by the lender;
- an obligation on the part of the lender to report the consumer credits granted to a central office;
- an obligation to comply with the maximum rate of interest set by the Federal Council; and
- a right on the part of the borrower to revoke a line of credit.

The new law covers accountholders who have overdraft facilities on their current accounts and accountholders who have overdrawn their accounts with the tacit agreement of the bank involved. The law also covers credit cards and customer cards with credit options, loans - including consumer finance and installment loans - as well as certain leasing agreements. It does not cover overdrafts on current accounts if the overdraft is secured by a security or collateral or if it amounts to less than 500 or more than 80,000 Swiss francs.

TURKEY

Banking Sector Restructuring Program

Progress was achieved in all four main pillars of the Banking Regulation and Supervision Agency's (BRSA) banking sector restructuring program during the period under review. The private banking sector has been further strengthened, efforts are continuing on the resolution of the Savings Deposits Insurance Fund (SDIF) banks, privatization of the state banks is progressing, and the regulatory and supervisory framework is being strengthened.

Financial restructuring has been completed among the state banks. The total resources transferred to the state banks amounted to TL 28.7 quadrillion. As a result, there have been significant improvements in the capital structure of state banks. Operational restructuring efforts for state banks have continued, with the ultimate aim of privatizing these banks.

Efforts on resolution of banks under the SDIF are continuing. Within the period of 1997-2002, 20 banks were transferred to the SDIF. Of 20 SDIF banks, 12 were resolved through merger, while the sale of five banks to foreign and domestic investors were completed. The main remaining issues for SDIF are the sale of Pamukbank, which is one of two banks under its management, and the disposal of assets held by the SDIF Collection Department. The BRSA announced a strategy for disposal of assets held by the SDIF on September 20, 2003 in line with international best practices.

Private Bank Capital Strengthening Program

Strengthening the capital structure of private banks is an important component of the banking restructuring program, with the goal of helping the banks reach internationally accepted minimum capital levels.

The Act on Restructuring of the Debts to the Financial Sector and Amendments to be Made to Some Laws, No.4743, went into effect on January 31, 2002 and established the legal framework for capital strengthening as follows:

- the Bank recapitalization process was structured;
- the İstanbul Approach for resolution of NPL's in the banking sector was started; and
- the legal framework for establishment of asset management companies was adopted.

Twenty-five privately owned commercial banks under the scope of the Program went through a three-stage audit, and standard reports were prepared showing the real financial status of the banks in question as of December 31, 2001. Cash capital increases, corrections of provisions for non–performing loans, and positive changes in the market risk and valuation of securities were taken into account during the evaluations. As a result, the capital adequacy ratio of the 25 banks covered by the program was calculated as 14.8%, compared to the pre-inflation adjusted level of 14.2 %. Banks included in the program had to announce high amounts of losses due to inflation accounting.

The capital needs of the 25 banks within the scope of the recapitalization program was determined as TL 1.3 quadrillion ($866 million) during the evaluation phase. Following this, discussions were carried out with the banks and a TL 1.1-quadrillion ($720 million) capital need was covered as a result of the measures taken by the banks and other positive developments. The remaining capital needs was covered by the banks and the SDIF.

In line with the program, important developments were achieved in strengthening the capital base of private banks with their own resources and restriction of their market risks. Within the scope of restoring soundness in the private banking system, mergers and acquisitions of banks and their subsidiaries have been encouraged, while important improvements have also been realized in establishing internal control and risk management systems within the banking system.

Financial Restructuring Program: "İstanbul Approach"

Under Law No.4743, the legal framework for voluntary restructuring of the debts to the financial sector (Financial Restructuring Program) was adopted. This program is aimed at helping private sector firms continue to operate and regain solvency through restructuring of the banks' receivables or assigning a new redemption plan or through providing additional finance to debtors if necessary in accordance with the Financial Restructuring Framework Agreements.

Regulation on General Conditions for the Approval and Implementation of Financial Restructuring Framework Agreements, published on April 11, 2002, established the provisions to be set aside for loans which have been taken under the scope of financial restructuring framework and for which financial restructuring contracts have been signed with debtors, and the principles and procedures for classification of these loans.

The Financial Restructuring Framework Agreement issued by the Banks Association of Turkey was approved by the BRSA on June 4, 2002. It was signed by 25 banks, 17 financial institutions, Emlak Bankası under the liquidation process, and the SDIF.

Within the framework of Financial Restructuring Framework Agreement, companies are basically separated into two different groups. The criteria for the large-scale companies in the first group have been determined as follows: number of registered employees of the company must be over 100, annual export volume of the company must be over USD 15 million, annual turnover thereof must be over TL 25 trillion and audited balance sheet size thereof must be over TL 15 trillion. Companies out of this classification are assessed as medium and small-scale companies.

Fifty-two small-scale and a total of 192 large-scale companies belonging to 30 groups have been taken under the scope of restructuring as of April 2003. The total amount of debt under the scope of restructuring was $5.7 billion.

There were 141 signed restructuring agreements as of April 2003. The total amount of signed contracts has reached $3.5 billion. Of this amount, $298 million was accounted for by 31 small-scale companies and $3.5 billion by 110 large-scale companies.

Establishment of Asset Management Companies

Within the framework of the Law No. 4743, establishment of Asset Management Companies (AMC) was encouraged by providing some tax facilities in order to resolve NPL's and mobilize bank assets. According to the law, it is possible for the SDIF to participate in AMCs with a maximum state of 20 %. With the "Regulation on Establishment and Operations of Asset Management Companies" the legal infrastructure for asset management companies has been established.

Regulation on Banks' Establishment and Operations

The Regulation on Amendments to be made to the Regulation on Banks' Establishment and Operations was published on July 9, 2002. It addresses the need to evaluate the structures of off-shore banking activities and their connections to the parent company.

Accounting Practices

Regulation on Accounting Practices was published on June 21, 2002. It sets out the principles and procedures for prevention of non-recorded transactions, transparency and uniformity in banks' accounts and records, sound and reliable accounting of activities in accord with their essential characteristics, timely and accurate preparation of financial statements, independent auditing, and reporting and publication of these statements. The regulation became effective on July 1, 2002 to bring banks' 2002 year-end balance sheets into compliance with the International Accounting Standards (IAS).

Change in the Rate of Premiums Collected by SDIF

The rates concerning the premiums to be collected by the Savings Deposit Insurance Fund and principles and procedures on premium collection were re-determined by the Banking Regulation and Supervision Agency, effective as of January 1, 2003. Under this framework, the two-tiered premium system applied as 25 basis points for the banks with capital adequacy ratios of 8% and above and 26 basis points for banks with ratios below 8% has been abrogated.

The new regulation rearranges the criteria to be taken as basis for developing a new risk based system and determines the basic premium rate as 12.5 basis points on the savings deposits made in Turkish Lira by natural persons and the foreign exchange deposit accounts and gold deposit accounts having the nature of savings accounts opened by natural persons in Turkish branches of banks at a quarterly periods. The total premium amount will be determined by takinge into account additional factors, such as the capital adequacy standard ratio and the foreign exchange net position/own funds standard ratio.

Law on Consumer Protection

Law No 4822 on Amendments to Be Made to Law No 4077 on Protection of Consumer Rights was published in the Official Gazette on March 14, 2003. With this Law, certain amendments are brought forth in compliance with EU Legislation on consumer protection. The major provisions are as follows:

1. Unfair terms in contracts to be made between banks and credit customers shall not be included.
2. Certain requirements, which are to apply to contract forms with the purpose of making contracts more understandable for customers shall be adopted.
3. Credit card consumers shall be informed of any increase in the annual interest rate.
4. Default interest rates shall be limited to 50% of interest rate of contract.
5. The grantor of credit shall be jointly liable with supplier of goods or services having a pre-existing agreement under which credit is made available exclusively by that grantor of credit to customers of that supplier for the acquisition of goods or services from that supplier.
6. Terms in credit contracts against the consumers shall be terminated.

Reforms of the Bankruptcy Act

The Ministry of Justice has prepared a package of comprehensive reforms of the Bankruptcy Act. These reforms are aimed at creating an effective bankruptcy system that will provide appropriate incentives for voluntary workouts. The Ministry of Justice has since reviewed the comments received on the package, and the Government submitted the package to Parliament on March 25, 2003.

Market Developments

Excluding the Central Bank, the number of banks operating in Turkey decreased from 57 to 53 during the period under review; 39 of which are commercial banks and 14 development and investment banks.

This decline in the number of banks resulted mainly from the resolution of banks in the Savings Deposit Insurance Fund through mergers, sales and liquidations.

Developments in the SDIF bank group included the following:

- Toprakbank AŞ was transferred to Bayındırbank AŞ, which is one of two banks under SDIF.
- Milli Aydın Bankası TAŞ was transferred to Denizbank AŞ, which is a private commercial bank.
- The decision concerning the liquidation of Türk Ticaret Bankası AŞ was registered and liquidation process has still been continuing.
- The management of Pamukbank TAŞ was transferred to the SDIF.

In addition, Fibabank AŞ was taken over by Finans Bank AŞ. The number of bank branches declined from 6,377 to 6.130 in the same period.

Basel II

With regard to implementation of Basel II in Turkey, the most important matters relate to the development of rating systems, the need for collecting five to ten years of data for the calculation of credit risk, and monitoring and assessing operational risk. Turkey is expected to follow the calendar that has been announced by BIS. However, Turkey's regulatory authorities may allow banks a transitional period to meet capital requirements. During this transitional period, Turkey's regulatory authorities may ask the banks to remain subject to Basel I.

UNITED KINGDOM

Introduction

UK banks faired well during the year, with volume growth remaining strong on the back of continued consumer optimism and spending, as interest rates in the UK have continued to fall. Borrowers took advantage of historically low rates and competitive offerings from banks to re-mortgage their homes or to purchase buy-to-let property. Mortgage volumes grew by 13% in the year to June 2003. Lending margins generally held up as borrowers switched to credit card borrowing from other forms of unsecured finance and revenue growth exceeded the increase in costs.

Regulatory developments

Risk based supervision

During 2003 the Financial Services Authority (FSA) completed its "ARROW" prudential reviews of all the banks it supervises in the UK. These reviews are based on the FSA's view that it is not its task to prevent every single bank failure or investor loss but to deploy its inevitably limited resources to ensure that it meets its four statutory objectives. These are to:

- Maintain confidence in the UK financial system;
- Promote public understanding of the financial system;
- Secure the right degree of protection for consumers;
- Help to reduce financial crime.

The ARROW review process comprises a desk based review augmented where necessary by on-site visits with senior management.

The review starts off with a categorization of the bank according to 40 risk elements, grouped in two broad categories, *Business Risk* and *Control Risk*.

Business risks are grouped into the following categories:

- Strategy
- Market, credit, operational and insurance underwriting
- Financial soundness
- Nature of customers and/or services

Control risks are grouped into the following categories:

- Treatment of customers
- Organization
- Internal systems and controls
- Board, management and staff
- Business and compliance culture

When these risks have been identified they are assessed in terms of seven Risks to Objectives groups, as follows:

- Financial failure
- Misconduct and/or mismanagement
- Consumer understanding
- Incidence of fraud/dishonesty

- Incidence of market abuse
- Incidence of money laundering
- Market quality

As a result of this analysis a bank is allocated to one of four risk based impact bands, High, Medium High, Medium Low and Low. A bank's banding will determine the subsequent intensity and type of supervisory relationship between it and the FSA. Where necessary, a risk mitigation program based on the FSA review is agreed upon with the bank.

Central to the FSA's expectation is the concept of senior management responsibility – that is, it is the chief executive, fellow board members and other senior officers of the bank who bear the responsibility for ensuring that regulatory requirements are complied with.

While for some banks operating in the UK the FSA's approach is novel, most major banks are already operating in accordance with such a risk based approach, which represents existing industry good practice.

Prudential capital

During 2003, dialogue between the industry and regulator has continued on the contents of the Integrated Prudential Source Book (PSB). The PSB details the FSA's approach to the assessment of the adequacy of a regulated firm's capital according to a number of different risk categories - including credit, operational, market, group and insurance risks. The PSB will apply irrespective of the sub-sector of the financial services industry to which a firm belongs. Among other things, the PSB will implement Basel II and the consequent EU Risk Based Capital Directive into UK regulatory practice by the end of 2006, although some elements of the different risk based models, relating among other things to systems and controls, will be introduced during 2004.

Tier 1 Capital

In May 2003 the FSA announced that it would no longer permit structured instruments to be included in the non-innovative portion of Tier 1 capital. It subsequently confirmed that at least 50% of Tier 1 should be in the form of ordinary shares and retained earnings and that all non-innovative Tier 1 should be met by share capital (including preference shares) and retained earnings as defined under the Companies Act.

In order for a capital instrument to be considered as eligible for Tier 1 or Upper Tier 2 treatment, the capital instrument concerned must be loss absorbent on a going concern basis and permanently available for this purpose. Applications to the FSA for approval of capital instruments for innovative Tier 1 or Upper Tier 2 capital treatment must now be supported by a legal opinion stating that:

- A winding up or administration petition based only on the grounds that the firm was unable to pay its obligations under the capital instrument concerned would be dismissed.
- Company directors would not be at risk of wrongful trading if they continue while liabilities exceed assets.

Polarization

Over the last year, the retail financial services sector has been put firmly under the regulatory microscope through a series of high profile reviews - namely, the Polarization and Sandler reviews - as the UK government and the FSA come to grips with the damaging effects that numerous consumer miss-selling scandals and spiralling costs of regulation have had on the retail savings market. This has also come at a time when the industry is experiencing the longest sustained fall in the stock market, a continuing crisis of consumer confidence and an increasing concern that many people are not saving enough for their retirements. It is well documented in industry circles that the UK savings gap stands at an estimated £27 billion and is set to grow.

Having concluded that the current polarization regime no longer delivers sufficient consumer benefits to justify its anti-competitive effects, FSA is now pushing ahead with reforms to completely overhaul the retail savings market. Polarization, which prevents financial advisers from advising on the products of more than one provider, is to be abolished, and replaced by a regime designed to open consumer access to a wider variety of distribution channels.

This abolition of polarization will undoubtedly have a dramatic effect on the nature and structure of the financial services industry. Simplified products, streamlined sales processes and the application of mass market retailing techniques, coupled with retail financial service providers' better use of technology to interact with their customers, will redefine the provider/customer relationship.

As reform of the retail savings market is still very much a live issue, with final decisions still to be made in significant areas, it is difficult to predict the eventual shape of the industry. What does seem definite is that the relationship between retail providers and their customers will be very different from the one that exists now.

Mortgage Regulation

The FSA is developing a new regime to regulate the sale of mortgages as a result of the UK Government's response to the fast-changing mortgage market for residential buyers in the UK. Of particular interest to banks is moderating the impact of mortgage regulation on small business proprietors who choose to secure their borrowings by a first mortgage on their homes.

General Insurance Regulation

Banks distribute about a third of all general insurance products and the impact of implementing the EU Insurance Mediation Directive in the UK could have significant impacts on the shape of the overall market and the cost of distribution for banks. The FSA is seeking a proportionate approach to what are low risk commodity products in a keenly competitive market, which the banking industry supports.

Money Laundering

The FSA has made it clear that although it does not require all firms to conduct a current customer review of all customer accounts (CCR), any firm that was not confident that it knew its customers' identities was running both a legal and regulatory risk. Firms therefore needed to assess what action they needed to take to identify existing customers, including pre-1994 customers, in the light of the individual circumstances of the firm. The FSA envisaged that some firms would conclude that it was necessary to undertake a full retrospective customer review. It reminded firms that they expected them to have adequate anti-money laundering systems and controls in place, covering identification (including identification of existing customers) as well as other key controls.

The Treasury, the National Criminal Intelligence Service (NCIS) and the FSA launched a publicity campaign targeted at retail customers, to explain why banks in the UK are increasingly asking them for evidence of identity before they open bank accounts.

Discussions continue between trade associations and the Home Office, NCIS and other public authorities on issues arising from implementation of the Proceeds of Crime Act. In addition the Home Office announced in June that it was establishing a high level Task Force to take forward the recommendations of a recent review of the Suspicious Activity Reporting regime, in which the banks will participate fully.

Tax

Taxation of UK branches of foreign banks

As foreseen in last year's report, the Finance Act 2003 has introduced new rules for calculating the profits of UK branches of foreign banks, with effect from January 1, 2003. In particular the new legislation replaces the previously favorable rules for allocating capital to such branches. The new basis of allocation is on a thin capitalization basis by reference to the capital that would be required by an independent subsidiary that is subject to UK banking regulation. The new basis covers both Tier 1 and Tier 2 capital. In certain circumstances the Inland Revenue is willing to consider top down allocations of the bank's total capital.

In practice there will be a considerable amount of negotiation needed on a case by case basis, as it is virtually impossible to find a comparable, UK regulated bank with the same business and circumstances.

Implementation of the Savings Tax Directive

Agreement by European Finance Ministers on the detail of a Savings Tax Directive was announced in July 2003. Information about savings interest paid to individual residents of the other EU Member States will commence on January 1, 2005, subject to agreement with key third countries, particularly Switzerland, which will adopt equivalent measures from the same date.

Twelve of the other EU Member States will provide information to the UK on a reciprocal basis. Three of the Member States (Belgium, Austria and Luxembourg) will deduct withholding tax rather than exchange information for an extended transitional period. The initial the rate of withholding tax is 15 % but it will increase to 35%. Jersey, Guernsey, Isle of Man, Switzerland, Monaco, Liechtenstein and various dependent territories have indicated that they will opt for a withholding tax during the same transitional period.

All EU Member States are required to implement the necessary national legislation by January 1, 2004. The UK Inland Revenue is probably more advanced than other member States in consulting about national legislation.

Basel II

Basel II will be implemented in the UK through the FSA Handbook, based in turn on the EU Regulatory Capital Directive, which is currently being drafted. This Directive is expected to complete the political process by the end of 2005. No further legislation will be required in the UK to implement the Regulatory Capital Directive.

The FSA is already working with industry to plan implementation methodology, in particular for the Internal Ratings Based (IRB) approach to credit risk and the Advanced Measurement Approaches (AMA) to operational risk. The proposals cover the qualifying criteria for IRB (what systems and controls a bank must have), validation (use of external models and data) and technical clarification (definition of default/approach to stress testing).

The FSA has reported that almost 40 of the banks its regulates expect to be using an IRB by 2007 reflecting the already high degree of sophistication of risk management practice in UK banks and the capital benefit they expect it to deliver.

Less complex banking institutions are not expected to be exempted from Basel II.

The expectation is that Pillar 2 supervisory review will be undertaken by the host state with any input from the host state coming as a result of home/host state regulators' agreement.

UNITED STATES

Introduction

Congress turned its attention to the proposed New Basel Capital Accord in hearings held in early and mid-2003, as the debate among policymakers in Washington intensified regarding how Basel II should be implemented in the United States. Because of the complexity of the proposed new international capital rules, the federal bank and thrift regulatory agencies indicated that they only plan to implement Basel II on a limited basis. In another significant development, Treasury Secretary John W. Snow unveiled a Bush Administration proposal in September 2003 for Treasury to assume oversight of Fannie Mae and Freddie Mac, the government-sponsored enterprises that are the largest players in the U.S. mortgage lending industry. The move followed an accounting scandal at Freddie Mac that led to the ouster of its CEO. The period under review also witnessed the historic $1.4 billion "global settlement" of enforcement actions against ten of the largest investment banking firms in connection with conflicts of interest between research and investment banking activities. And in further fallout from the collapse of Enron Corporation, American banking giants Citigroup and J.P. Morgan Chase agreed in July 2003 to pay $120 million and $135 million, respectively, to settle SEC charges in connection with their structured finance transactions with Enron. Meanwhile, with the passing of the first anniversary of enactment of the Sarbanes-Oxley Act, Congress held hearings in September to review implementation of the corporate governance reforms enacted in July 2002. Responding to concerns raised about the extraterritorial application of the prohibition on loans to executive officers and directors, the SEC agreed on September 11th to propose a rule that would exempt international banks from the insider lending prohibition under Section 402 of the Act.

In other key developments during the period under review, financial services firms continued their efforts to meet new customer identification and other requirements under the anti-money laundering provisions of the USA Patriot Act, as the Treasury Department worked to fully implement the Act, which was signed into law almost two years ago in the immediate aftermath of the September 11th terrorist attacks. Meanwhile, Congress continued to consider regulatory relief legislation, including reform of asset pledge/capital equivalency deposit (CED) requirements applied to federally-licensed branches and agencies of international banks. At the state level, New York finalized a major reduction of its asset pledge requirement in December 2002, marking the successful conclusion of a multi-year effort by the Institute of International Bankers and its member institutions. In the tax area, it appeared unlikely that the 108th Congress would enact previously proposed changes to the “earnings stripping” interest disallowance rule that, if adopted, would have a severe adverse impact on U.S. branches and subsidiaries of many international banks, including their securities affiliates.

Basel II

On April 29, 2003, the Basel Committee on Banking Supervision issued its third Consultative Paper (CP-3) on the proposed New Basel Capital Accord, with the goal of completing the new accord by the fourth quarter of 2003 and having it implemented by member countries by the end of 2006. In the United States, an Advance Notice of Proposed Rulemaking (ANPR) was issued by the four federal bank and thrift regulatory agencies on July 11th. U.S. supervisory authorities intend to use only the most sophisticated approaches of Basel II, which will be required for only about the 10 largest U.S. banks (another 10 U.S. banks are expected to adopt them on a voluntary basis).

Publication of the ANPR followed hearings on Basel II in the House of Representatives in February and again during June in both the House and the Senate. Following the hearings, which included testimony by top banking regulators, the House Financial Institutions Subcommittee approved legislation that would create a Financial Policy Committee responsible for unifying the U.S. position on Basel II. During the “markup” of the bill, some members of the House panel also questioned the wisdom of requiring a mandatory capital charge for operational risk under Pillar 1 of the new accord.

In a comment letter to the Basel Committee on CP3 submitted on July 31, 2003, the Institute urged the Committee to articulate clear international standards for cross-border implementation of Basel II to ensure the primacy of the home country supervisor’s role in supervising the capital adequacy of internationally active banking institutions under the new accord. The Institute argued that host country standards requiring capital in excess of Basel II minimum requirements – such as U.S. capital standards under the Gramm-Leach-Bliley Act – present an especially compelling case for cross-border consultation and appropriate deference to home country supervisors.

In a speech before the Institute on June 10, 2003, Roger W. Ferguson, Jr., Vice Chairman of the Federal Reserve Board, described the Federal Reserve's intentions regarding its role as host country supervisor vis-à-vis the capital adequacy of international banks. For international banks that operate in the United States through branches and agencies, Vice Chairman Ferguson indicated that the Federal Reserve Board expects to accept whichever of the Basel II approaches the international bank adopts under home country standards, including for purposes of determining whether an international bank meets the "well-capitalized" criteria to qualify as a financial holding company (FHC) under the Gramm-Leach-Bliley Act.

The Institute's comment letter also addressed Pillar 3 disclosure requirements under Basel II as well as the Committee's proposed implementation schedule. With regard to Pillar 3, the Institute encouraged the Basel Committee to reconsider in particular the detailed credit risk disclosure requirements set forth in CP3. The Institute's letter also expressed the view of many member institutions that the Committee's implementation schedule for Basel II is overly ambitious, particularly in connection with the operational risk capital charge calculation and the need to develop and adequately test operational risk management systems.

Regulatory Oversight of Fannie Mae, Freddie Mac

In the wake of an accounting scandal at Freddie Mac that led to the ouster of its CEO, the Bush Administration proposed in September to transfer to the Treasury Department regulatory oversight of Fannie Mae and Freddie Mac – the government-sponsored enterprises (GSEs) that are the largest players in the U.S. mortgage lending industry. Regulatory authority over Freddie and Fannie currently rests with the Office of Federal Housing Enterprise Oversight. The two publicly-traded GSEs buy mortgages from lenders and package them into securities for sale to investors. Following Congressional testimony on September 10th by Treasury Secretary Snow outlining the Administration's proposal, House Financial Services Committee Chairman Michael G. Oxley and Senate Banking Committee Chairman Richard Shelby announced plans to draft legislation based on the principles put forward by Secretary Snow.

Global Settlement

On April 28, 2003, Securities and Exchange Commission Chairman William H. Donaldson, New York Attorney General Eliot Spitzer and other officials announced a $1.4 billion "global settlement" with ten of the largest investment banking firms, finalizing enforcement actions that had been brought against the firms in connection with conflicts of interest between their research and investment banking activities. Three of the ten firms were charged with issuing fraudulent research reports in violation of SEC rules and various state statutes.

In addition to the monetary payments, the global settlement requires the firms, among other things, to separate their research and investment banking departments and make independent research available to investors. The ten firms also entered into a collective voluntary agreement to restrict allocations of securities in "hot" initial public offerings (IPOs) to company executive officers and directors – a practice known as "spinning." In announcing the settlement, regulators said it was an attempt to restore investor confidence in the integrity of the marketplace.

Enron Settlements

In another significant settlement case, the SEC announced on July 28, 2003 that Citigroup agreed to pay $120 million and J.P. Morgan Chase agreed to pay $135 million to settle charges that they helped Enron defraud investors through complex structured finance transactions. (The Citigroup charges also involved transactions with Dynegy Inc.) In addition, the two banks each agreed to pay $25 million to New York State and New York City. The SEC charged that the complexity of the deals had no business purpose other than masking the fact that the transactions were, in essence, loans. As such, the structured finance transactions helped Enron defraud investors by, among other things, inflating reported cash flow from operations and underreporting debt. The SEC indicated that it will closely scrutinize structured finance transactions that do not appear to have a business purpose other than to manipulate reported results.

Sarbanes-Oxley

Public companies were confronted during the period under review with the challenge of adjusting to the new requirements of the Sarbanes-Oxley Act, the sweeping legislation enacted in July 2002 to overhaul accounting, auditing and corporate governance practices. One of the major provisions of the Act was the creation of a new Public Company Accounting Oversight Board (PCAOB), and on May 31, 2003, the SEC announced the approval of William J. McDonough, then President of the Federal Reserve Bank of New York, to serve as Chairman of the Oversight Board.

The extraterritorial aspects of Sarbanes-Oxley, including the PCAOB's reach to register foreign accountants abroad as well as the prohibition on loans to executive officers and directors under Section 402 of the Act, continued to draw criticism from governmental authorities outside the U.S. Section 402 regulates loans by U.S.-listed international banks to their executive officers and directors (i.e., including head office loans to head office executive officers and directors). Among its other practical implications, Section 402 potentially interferes with the ability of international banks to make available to executive officers and directors discounts that they may offer to bank employees for mortgage and other loans.

During the period under review, the Institute continued to urge the SEC to act on the Institute's proposed exemption for international banks from the insider lending prohibition under Section 402. The Institute's proposal was submitted to the SEC on August 16, 2002 and the Commission's senior staff subsequently acknowledged publicly that Section 402 does not treat international banks comparably to FDIC-insured U.S. banks, which were granted an exemption under the Act from Section 402. In meetings with the Institute in June 2003, SEC staff indicated that they were in the advanced stages of considering the Institute's proposal, as one of the first discretionary items the SEC was considering after the mandatory rulemaking procedures under the Act. On September 11th, the SEC proposed an exemption for international banks that adopted the basic framework suggested by the Institute. The SEC set an October 17th deadline for comments on its proposed rule.

USA Patriot Act

The Treasury Department continued the process of implementing the anti-money laundering provisions of the USA Patriot Act. Under rules issued pursuant to Section 326 of the

Act, for example, financial institutions are required to have in place by October 1, 2003 Customer Identification Programs (CIPs). In an unusual move, Treasury reopened the rulemaking process regarding Section 326 to consider whether it should reverse its earlier decision not to require banks to keep copies of identifying documents on file. Treasury was expected to settle the issue by the October 1st deadline. At the same time, Treasury had yet to issue final regulations implementing the Section 312 due diligence and enhanced due diligence requirements on U.S. financial institutions that maintain correspondent accounts (including accounts established before passage of the USA Patriot Act) for non-U.S. respondents.

Treasury's proposed regulations under Section 312 created a regulatory exception suggested by the Institute that would exempt offshore branches of non-U.S. banks that are from countries that the Federal Reserve had determined provide comprehensive consolidated supervision ("CCS"). Since that time, the Institute has actively urged Treasury to expand the scope of this exception to apply to offshore booking locations of non-U.S. banks from countries that are members of FATF. The Institute also suggested that the FATF and CCS exceptions should apply if the offshore-licensed entity is a subsidiary of the non-U.S. bank or the non-U.S. bank itself.

In a letter to then Treasury Secretary O'Neill dated November 22, 2002, the Institute expressed concern that without expansion of the CCS exemption to cover banks in other countries that are meeting their responsibilities to prevent money laundering, particularly those FATF member-countries for which the Federal Reserve had not yet had reason to make a CCS determination (Denmark, Iceland, New Zealand, Norway, Singapore and Sweden), serious harm could be done to their world-wide competitive position by being unnecessarily placed in the pejorative category of banks that require enhanced due diligence before they may be considered to be eligible counterparties.

Reforming Asset Pledge/Capital Equivalency Deposit Requirements

Following up on its June 2002 draft proposal, the New York State Banking Department finalized major revisions to its asset pledge requirement in December 2002. The revisions were consistent with the policy recommendations made by the Institute over the past several years and have resulted in a substantial reduction (eventually by as much as 80%) of the $35 billion of collateral that had been pledged under the old requirements by New York-licensed branches and agencies of international banks.

During the period under review, the Institute also continued its efforts in support of the Comptroller of the Currency's amendment that would eliminate the mandatory 5% asset pledge/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 regulatory relief legislation (H.R. 1375) that was reintroduced in the House of Representatives in early 2003. The bill cleared the House Financial Services Committee on May 20th but had not reached the floor of the House prior to the Congressional summer recess. Companion legislation in the Senate had also not yet been introduced prior to the recess.

The Institute continued its strong support for reform of the CED requirement but also expressed concerns about the inclusion of a "state floor" provision that would limit the Comptroller's discretionary authority by barring the Comptroller from setting a CED requirement for a federal branch or agency in a specific state that is lower than the comparable state asset pledge requirement.

In letters to Chairman Oxley of the House Financial Services Committee, Chairman Shelby of the Senate Banking Committee and to Treasury and Federal Reserve officials, the Institute argued that the state floor provision in Section 107 of the House bill amounts to a "reverse preemption" that would result in the potentially anomalous situation of an international bank with federal branches in multiple states meeting different CED requirements based on the individual state requirements. The Institute further argued that limiting the Comptroller's authority in this manner is unnecessary and cannot be justified on the basis of safety and soundness considerations.

The Institute has also continued to point out that the current flat-rate 5% CED requirement raises significant national treatment issues because U.S. headquartered banks are not subject to such a standard in their overseas activities.

Deposit Insurance Reform

The fate of deposit insurance reform legislation continued to hang in the balance during the period under review, as lawmakers disagreed over an increase in the current coverage level of $100,000 per account. The House approved a bill in early April 2003 that included a 30% increase in insurance coverage to $130,000 per account, but there is strong disagreement in the Senate about any increase, making it unclear whether legislation will be enacted by the end of 2003. Other aspects of the reform efforts deal with the premiums charged by the Federal Deposit Insurance Corporation and merging the bank and thrift funds.

Tax Matters

Overview

Tax issues were high on the agenda of Washington policymakers, both in the Administration and in Congress during the past year. President Bush signed into law the third major tax cutting bill of his Administration, the Jobs and Growth Tax Reconciliation Act of 2003, on May 28, 2003. This package contained numerous tax code changes, most notably lowering the individual tax rate on dividends and capital gains.

U.S. government tax writers have also begun to focus on a potentially broad rewrite of U.S. international tax rules. Spurred by the U.S. loss in the World Trade Organization (WTO) dispute over the Foreign Sales Corporation (FSC) / Extraterritorial Income Exclusion (ETI) and the threat of more than $4 billion in European Union trade sanctions, the U.S. government appears poised to repeal the ETI regime. The Bush Administration proposed, in its Fiscal-Year 2004 Budget, numerous international tax law changes to accompany ETI repeal (including an extensive overhaul of the section 163(j) earnings stripping provision).

The Administration backed changes include: repealing the foreign base company sales and services rules of Subpart F; adopting a worldwide interest allocation formula for foreign tax credit purposes; and extending the foreign tax credit carryover period from 5 to 10 years. Congressional tax writers are considering these suggestions – indeed, legislation introduced by Chairman Thomas of the House Ways and Means Committee includes many of these recommendations – but there is also considerable Congressional support to adopt some sort of incentive for domestic manufacturing activities. Congressional completion of an ETI replacement bill is unlikely to occur before the end of the 2003 calendar year.

Earnings Stripping

After intensive lobbying by the Institute and others during the period under review, it appeared unlikely that the 108th Congress would enact previously proposed changes to the "earnings stripping" interest disallowance rule that, if adopted, would have a severe adverse impact on U.S. branches and subsidiaries of many international banks, including their securities affiliates.

On July 25, 2003, Ways and Means Committee Chairman Thomas introduced a new tax bill that focuses on international provisions, and on July 28th, Senator Orrin Hatch introduced a similar bill in the Senate Finance Committee. Neither bill (nor alternative bills that were also introduced) included the earlier, troublesome proposal – which had been favored by Chairman Thomas and the Treasury Department – to add a new "worldwide limitation" to the existing "earnings stripping" rule.

The proposed change under the earlier proposal would compare the leverage ratio of the U.S. operations of a foreign-owned multinational group to the leverage ratio of the worldwide group, and would disallow the *gross* amount of interest paid by the U.S. operations to, or guaranteed by, the parent or its non-U.S. affiliates to the extent attributable to the "excess" leverage of the U.S. operations over the leverage of the worldwide group.

In response to concerns raised by the Institute and others, the Treasury Department in February 2003 modified the original proposal so as to add a safe harbor setting forth specific debt-to-asset ratios for different categories of assets. However, the Treasury's proposed safe harbor debt ratios were much lower than prevailing debt ratios in the financial industry (both in the U.S. and abroad, the financial industry is much more highly leveraged than the proposed ratios). As a result, major financial institutions are unlikely to be helped by the Treasury's proposed safe harbor.

While the other international tax bills introduced in Congress generally would not seek to tighten the "earnings stripping" rule, Chairman Thomas' new bill proposed the following with respect to the rule:

- There would be no worldwide limitation requiring that the leverage of the U.S. operations conform to that of the worldwide group.

- The existing law's "adjusted taxable income limitation" (which, in general, limits the deduction for interest paid to, or guaranteed by, foreign affiliates if and to the extent the U.S. group's net interest expense exceeds 50% of tax EBITDA) would be revised in the following respects:

(a) The limitation would be reduced from 50% to 35% next year and to 25% thereafter. However, the 50% limitation would continue to apply to the extent that third-party borrowings are guaranteed by foreign affiliates. Also, the limitation would continue to apply only if and to the extent that the U.S. group has net interest expense.

(b) The 1.5:1 debt-to-equity safe harbor would be eliminated, and would not be replaced with alternative safe harbor ratios (such as those proposed by Treasury).

(c) Disallowed interest expense could be carried forward for 10 years.

(d) There would be no "excess limitation" carryforward.

Chairman Thomas' revised "earnings stripping" proposal reflected the position that he expressed when the Institute met with him and his staff in May, and this proposal elicited the Institute's support. At the meeting, Chairman Thomas and his staff indicated that in formulating this revised proposal, they accepted the Institute's fundamental contention that financial institutions operate on a different business model than industrial companies and that neither the worldwide limitation nor Treasury's proposed safe harbors were appropriate for financial firms.

Senator Hatch's bill actually proposes to relax the application of the "earnings stripping" rule to borrowings from third parties that are guaranteed by foreign affiliates, by excluding interest paid on such loans from the "earnings stripping" rule if the taxpayer establishes that it could have borrowed the same amount of debt from an unrelated lender on substantially similar terms without a guarantee. Another bill that was being prepared by Senators Grassley and Baucus was expected to contain a harsher "earnings stripping" rule that would be applicable only to "inverted" companies (*i.e.*, certain U.S. companies that migrate the group's holding company to a non-U.S. jurisdiction).

Treasury Department tax policy officials are still understood to favor, at least as a conceptual matter, a worldwide limitation with safe harbor ratios. In addition, there could be pressure to include "revenue raiser" provisions in future tax legislation to narrow projected deficits, which could induce Congress to entertain further changes to the "earnings stripping" rule.